POWER EFFICIENCY CORP
Form 424B3
May 19, 2010

Pursuant to Rule 424(b)(3)
Registration No. 333-150556

DATED MAY 17, 2010

PROSPECTUS
POWER EFFICIENCY CORPORATION
58,071,092 SHARES OF COMMON STOCK

This prospectus relates to 58,071,092 shares of our common stock that may be sold from time to time by the Selling Stockholders listed under the caption "Selling Stockholders". We will not receive any of the proceeds from the sale of the common stock sold. The Selling Stockholders may sell those shares from time to time in the public securities market. The Selling Stockholders may determine the prices at which they will sell the common stock, which prices may be at market prices prevailing at the time of such sale or some other price. See "Plan of Distribution".

Our common stock is traded on the National Association of Securities Dealers Over The Counter Bulletin Board (the "OTC Bulletin Board") under the symbol "PEFF." On April 27, 2010, the closing bid price of our common stock as reported on the OTC Bulletin Board was $0.26.

THE SHARES OF COMMON STOCK OFFERED HEREBY INVOLVE A HIGH DEGREE OF RISK. IT IS LIKELY THAT THE COMMON STOCK WILL BE SUBJECT TO "PENNY STOCK" RULES, WHICH GENERALLY REQUIRE THAT A BROKER OR DEALER APPROVE A PERSON'S ACCOUNT FOR TRANSACTIONS IN PENNY STOCK AND THE BROKER OR DEALER RECEIVE FROM THE INVESTOR A WRITTEN AGREEMENT TO THE TRANSACTIONS SETTING FORTH THE IDENTITY AND QUANTITY OF THE PENNY STOCKS TO BE PURCHASED BEFORE A TRADE INVOLVING A PENNY STOCK IS EXECUTED. SEE "RISK FACTORS" BEGINNING ON PAGE 5.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this Prospectus is May 17, 2010

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ABOUT THIS PROSPECTUS

This prospectus is part of a post-effective amendment to a registration statement we have filed with the SEC. Under this registration process, the selling stockholders referred to in this prospectus may offer and sell from time to time up to 24,702,117 currently outstanding shares of our common stock, 7,890,000 shares of our common stock issuable upon the conversion of the Company's Series B Preferred Stock, 17,927,997 shares of our common stock issuable upon the exercise of warrants outstanding at an weighted average exercise price of $0.47 per share and held by the selling stockholders as of the date of this prospectus and 7,550,978 shares of our common stock issuable upon the exercise of options and warrants issued to employees, consultants, vendors and noteholders.

This prospectus does not cover the issuance of any shares of common stock by us, and we will not receive any of the proceeds from any sale of shares by the selling stockholders. We have agreed to pay all expenses incurred in connection with the registration of the shares of common stock covered by this registration statement.

Information about the selling stockholders may change over time. Any changed information given to us by the selling stockholders will be set forth in a prospectus supplement if and when necessary. Further, in some cases, the selling stockholders will also be required to provide a prospectus supplement containing specific information about the terms on which they are offering and selling our common stock. If a prospectus supplement is provided and the description of the offering in the prospectus supplement varies from the information in this prospectus, you should rely on the information in the prospectus supplement.

PROSPECTUS SUMMARY

This section highlights selected information only and may not contain all of the information that may be important to you. Please read this entire prospectus before making your investment decision. This summary, including the summary financial information, is qualified in its entirety by the more detailed information appearing elsewhere in this prospectus. Throughout this prospectus, when we refer to "Power Efficiency" or the "Company" or when we speak of ourselves generally, we are referring to Power Efficiency Corporation unless the context indicates otherwise or as otherwise noted.

THE OFFERINGS

On January 21, 2008, Power Efficiency Corporation issued an aggregate of 140,000 units, each unit consisting of one share of the Company's Series B Preferred Stock, par value $.001 per share, and a warrant to purchase 50 shares of the Company's common stock, receiving aggregate consideration of $7,000,000, which included $5,150,000 of cash and the cancellation of $1,850,000 of debt. The Series B Preferred Stock and warrants issued in the offering are convertible or exercisable, as applicable, into an aggregate of up to 18,360,000 shares of the Company's common stock, of which 13,885,000 shares are being registered on this registration statement.

Each share of Series B Preferred Stock is initially convertible into 100 shares of the Company's common stock, subject to adjustment under certain circumstances. The Series B Preferred Stock is convertible at the option of the holder at any time. The Series B Preferred Stock is also subject to mandatory conversion in the event the average closing price of the Company's common stock for any ten day period equals or exceeds $1.00 per share, such conversion to be effective on the trading day immediately following such ten day period. The Series B Preferred Stock has an 8% dividend, payable annually in cash or stock, at the discretion of the Company's Board of Directors. Each warrant is exercisable for up to 50 shares of common stock at an exercise price of $0.60 per share and expires five years from the date of issuance.

On November 30, 2006, January 19, 2007, March 2, 2007, March 7, 2007, March 30, 2007 and March 31, 2007, the Company issued and sold an aggregate of 14,116,680 shares of its common stock, $2,000,000 in promissory notes and 9,558,340 common stock purchase warrants in a private offering of equity and debt for an aggregate of $6,235,000 in cash, cancellation of indebtedness and in lieu of compensation owed to certain employees, officers and directors of the Company. The per share purchase price of the common stock was $0.30. The warrants have a per share exercise price of $0.40 and expire five years from the date of issuance. The $6,235,000 investment consisted of $400,000 from the cancellation of indebtedness, approximately $50,000 in lieu of compensation owed to certain employees, officers and directors of the Company, and approximately $5,785,000 in new cash. Of the aggregate 23,675,020 shares of issued Company common stock and shares of common stock issuable upon the exercise of warrants, 20,686,422 shares are being registered on this registration statement.

In June, July and August of 2005, we conducted a private offering of our common stock and warrants. We offered up to 50 units, at $50,000 each, to individuals or entities who qualified as "accredited investors" as defined in Rule 501 of Regulation D promulgated under the Securities Act. Each such unit consisted of (a) 250,000 shares of common stock and (b) a warrant to purchase prior to the fifth (5th) anniversary following the closing 125,000 shares of common stock, at an exercise price of $0.40. The placement closed on August 31, 2005 with the Company receiving gross proceeds of $2,900,000, and resulted in an aggregate of 24,350,001 shares of Company common stock being issued or reserved for issuance upon the exercise of warrants, of which 15,696,591 shares are being registered on this registration statement.

The Company is also registering an aggregate of 7,803,079 shares of Company common stock issuable upon the issuance of warrants and non-qualified options issued to employees, consultants and vendors on this registration statement.

THE COMPANY

Our Business

Power Efficiency produces products that reduce energy costs in specific commercial applications, utilizing patented improvements upon motor controller technologies developed by National Aeronautics Space Administration (“NASA”), as well as technologies based solely on the Company’s inventions. The Company has branded these collective patented and patent pending technologies as E-SAVE Technology® and has a trademark on this name. Our products are solid-state motor controllers which reduce the amount of power consumed by alternating current (AC) induction motors operating at constant speeds and under variable loads. Our products were previously marketed as the Performance Controller and the Power Genius, but have recently been re-branded as Motor Efficiency Controllers (“MEC”). The MEC reduces energy consumption on electrical equipment by electronically sensing and controlling the amount of energy the motor consumes on certain applications. The energy savings can range up to 35%, while the life of the motor is extended because of both the reduced motor operating temperatures and the reduced mechanical stress provided by its “soft start” technology. The efficiency of the MEC has been tested by Excel Energy, Nevada Power Company and other utilities, and independent third parties, with positive results.

We market our products directly under the brand name MEC, and through other companies under names such as Power Commander® and EcoStar®. Customers include large elevator and escalator manufacturers such as Otis Elevator Co. (a subsidiary of United Technologies, Inc.) and KONE Inc, as well as many industrial companies in plastics, mining, manufacturing and other industries

There are over one billion AC motors in operation in the U.S. alone. Alternating current induction motors are commonly found in industrial and commercial facilities throughout the world. Customers for the MEC are typically in a high electricity cost environment, may have local utility or governmental incentives to save energy, have energy usage as a significant operating cost, use constant speed induction motors that are lightly or cyclically loaded, and have motors that run continuously or have frequent on/off cycles. This customer base represents a market which includes target sectors such as elevators, escalators, granulators, crushers, grinders, conveyors and other industrial applications.

We are focused on creating distribution channels to take advantage of opportunities given the current conditions in the energy market and how our product meets these needs. Management believes this multi-channel distribution strategy, if successful, will allow Power Efficiency to achieve sustainable revenue growth.

Highlights

Demonstrated Energy Savings - Over 1,000 units have been installed at facilities throughout the U.S. [update] The products have demonstrated the ability to reduce the energy consumption of AC induction motors, by up to 35% in appropriate applications.

Extensive Engineering - Our products incorporate trade secret and engineering know-how, which we believe enables them to operate effectively over a broad range of conditions.

Large Potential Market - A study for the United States Department of Energy estimates that motor driven systems consume 64% of all the electricity used in the U.S. manufacturing sector alone. Based on our own in-house testing, our product can save up to 35% of the energy consumed by electric AC induction motors in lightly loaded applications. These applications include most motors that work at constant speed but are variably loaded, such as the AC motors found on many elevators, escalators, granulators, saw mills, stamping presses and other manufacturing equipment. The U.S. Department of Energy studies have found that nearly half the motors in the manufacturing sector are operating in a lightly loaded condition.

Proprietary Technology – Our products incorporate patented and patent-pending technologies and other trade secrets. We have on approved patent and three patents pending.

New Products - We have developed and received certifications for digital versions of our products from 22 to 380 amps from Underwriter Laboratories, Inc. (“UL”), Conformity European (“CE”), and the Canadian Standards Association (“CSA”). We have also developed a product for small motors such as those found in residential and light commercial equipment and appliances.

Limited Competition - We are not aware of any products on the market today that have been certified by CE, CSA, and UL, and offer the same energy-saving and soft start characteristics as our products, and we have proven to save energy in independent tests.

International Distribution - International markets, such as those in Europe and Asia, often have higher prices for electricity than in the U.S. Therefore, we believe international markets provide a significant opportunity in the future.

A detailed description of our business strategy is provided under the heading “Business” below.

Our headquarters is located at 3960 Howard Hughes Parkway, Suite 460, Las Vegas, NV 89169, and our telephone number is 702-697-0377.

Selling Stockholders

The shares of common stock covered by this prospectus that are being offered by the selling stockholders consist of up to 58,071,092 shares issued or to be issued (the "Securities") to the selling stockholders within 60 days of the date hereof. The full name, address and control persons of the selling stockholders are set forth beginning on page 36 of this prospectus.

RISK FACTORS

An investment in the Company's common stock involves a high degree of risk. You should carefully consider the risks below, together with the other information contained in this prospectus, before you decide to purchase the shares offered hereby. If any of the following risks occur, our business, results of operations and financial condition could be harmed, the trading price of our common stock could decline, and you could lose all or part of your investment. The risks and uncertainties described below are intended to be the material risks that are specific to us and to our industry. New risk factors emerge from time to time and it is not possible for us to predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause future actual results to differ materially from those contained in any historical or forward-looking statements.

RISKS RELATED TO OUR BUSINESS

Unless We Achieve Profitability and Related Positive Cash Flow, We May Not Be Able To Continue Operations, And Our Auditors Have Questioned Our Ability To Continue As A "Going Concern".

The Company has suffered recurring losses from operations, and experienced a deficiency of cash of approximately $3,000,000 and $3,100,000 from operations for the years ended December 31, 2009 and 2008, respectively. For the years ended December 31, 2009 and December 31, 2008, we had net losses of $4,168,708 and $3,948,204, respectively. In our Auditors' Report dated March 31, 2010 on our December 31, 2009 financial statements included in this report, our auditors have stated that these factors raise substantial doubt about our ability to continue as a "going concern". Our financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amount of liabilities that might be necessary should we be unable to continue in existence. The Company's continuation as a "going concern" is dependent upon achieving profitable operations and related positive cash flow and satisfying our immediate cash needs by external financing until we are profitable. Our plans to achieve profitability include developing new products, obtaining new customers and increasing sales to existing customers. We are seeking to raise additional capital through equity issuance, debt financing and other types of financing, but we cannot guarantee that sufficient capital will be raised.

We Have A Limited Operating History, Have Experienced Recurring Losses And Have Limited Revenue.

To date, and due principally to a lack of working capital, our operations have been limited in scale. Although we have an arrangement with an outsourced production facility to manufacture our products, have established relationships with suppliers, and have received contracts for our products, we may experience difficulties in production scale-up, product distribution, and obtaining and maintaining working capital until such time as our operations have been scaled-up to acceptable commercial levels. We have not had a profitable quarter in the past three years and we cannot guarantee we will ever operate profitably. In addition, we have limited revenue. For the year ended December 31, 2009, our total revenues were $283,990, and for the year ended December 31, 2008, our total revenues were $480,513.

We Do Not Have A Bank Line Of Credit.

At the present time, we do not have a bank line of credit, which further restricts our financial flexibility.

We Will Require Additional Funds To Meet Our Cash Operating Expenses And Achieve Our Current Business Strategy.

The Company continues to have limited working capital and will be dependent upon additional financing to meet capital needs and repay outstanding debt. We cannot guarantee additional financing will be available on acceptable terms, if at all. We also need additional financing to raise the capital required to fully implement our business plan. Our current operating expense level is approximately $250,000 to $300,000 per month. Management is seeking to raise additional capital through equity issuance, debt financing or other types of financing. However, there are no assurances that sufficient capital will be raised.

When our operations require additional financing, if we are unable to obtain it on reasonable terms, we would be forced to restructure, file for bankruptcy or cease operations, any of which could cause you to lose all or part of your investment in us.

Our Management Group Owns Or Controls A Significant Number Of The Outstanding Shares Of Our Common Stock And Will Continue To Have Significant Ownership Of Our Voting Securities For The Foreseeable Future.

As of the date of this report, management controls approximately twenty-one percent (21%) of our issued and outstanding Common Stock and voting equivalents. Additionally, Summit Energy Ventures, LLC ("Summit") owns eleven percent (11%) of our common stock and voting equivalents, which is included in the above number. Summit is controlled by Steven Strasser, our Chairman and CEO, and he has the right to vote all shares owned by Summit. BJ Lackland, our CFO, owns a minority equity interest in Summit. As a result, these persons will have the ability, acting as a group, to greatly influence our affairs and business, including the election of directors and, subject to certain limitations, approval or preclusion of fundamental corporate transactions. This concentration of ownership of our common stock may:

- delay or prevent a change in the control;
- impede a merger, consolidation, takeover, or other transaction involving the Company; or
- discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of the Company.

The relationships between Summit and our executive officers are discussed in more detail under "Certain Relationships And Related Party Transactions" herein.

Our Business Depends Upon The Maintenance Of Our Proprietary Technology, And We Rely, In Part, On Contractual Provisions To Protect Our Trade Secrets And Proprietary Knowledge.

The Company depends upon its proprietary technology, relying principally upon trade secret and patent law to protect this technology. The Company also regularly enters into confidentiality agreements with key employees, customers, potential customers, and vendors and limits access to and distribution of trade secrets and other proprietary information. However, these measures may not be adequate to prevent misappropriation of our technology. Additionally, our competitors may independently develop technologies substantially equivalent or superior to our technology. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States. We also are subject to the risk of adverse claims and litigation alleging infringement of intellectual property rights of others.

Confidentiality agreements to which we are party may be breached, and we may not have adequate remedies for any breach. Our trade secrets may also be known without breach of such agreements or may be independently developed by competitors. Our inability to maintain the proprietary nature of our technology and processes could allow our competitors to limit or eliminate any competitive advantages we may have.

We Are Dependent On Third-Party Suppliers.

Although we believe most of the key components required for the production of our products are currently available in sufficient production quantities from multiple sources, they may not remain so readily available. It is possible that other components required in the future may necessitate custom fabrication in accordance with specifications developed or to be developed by us. Also, in the event that we, or our contract manufacturer, as applicable, are unable to develop or acquire components in a timely fashion, our ability to achieve production yields, revenues and net income can be expected to be adversely affected. Additionally, we are dependent on Sanmina-Sci to manufacture our higher volume products. While we believe we would be successful in finding alternative manufacturers should this manufacturer not be available to manufacture our product, it could take substantial time and effort to locate such alternatives and, depending on the timing of the loss of Sanmina-Sci, could result in disruption in delivery schedules and harm to our clients, our reputation and future prospects.

We Are Developing And Commercializing New Energy Saving Technologies And Products Which Will Involve Uncertainty And Risks Related To Product Development And Market Acceptance.

Our success is dependent, to a large degree, upon our ability to fully develop and commercialize our technology and gain industry acceptance of our products based upon our technology and its perceived competitive advantages. Accordingly, our prospects must be considered in light of the risks, expenses and difficulties frequently encountered in connection with the establishment of a new business in a highly competitive industry, characterized by frequent new product introductions. We anticipate that we will incur substantial expense in connection with the development and testing of our proposed products and expect these expenses to result in continuing and significant losses until such time, if ever, that we are able to achieve adequate levels of sales or license revenues.

We Have Limited Experience in Direct Sales.

Our products have been distributed primarily through OEMs. We have recently begun pursuing an expanded distribution strategy designed to reduce our reliance on OEMs. Pursuant to this strategy, we are increasing our direct sales efforts into new markets. Our future growth and profitability will depend upon the successful development of business relationships with additional OEMs, growth in direct sales, and sales through select resellers and reps to penetrate the market with our products.

We Currently Depend On A Small Number Of Customers And Expect To Continue To Do So.

The Company currently does business with approximately 20 customers. Of this number, four customers accounted for approximately 71% of our gross revenues in 2009. We are, and may continue to be, dependent upon a small number of customers. Accordingly, the loss of one or more of these customers is likely to have a material adverse effect on our business.

Most Of Our Current And Potential Competitors Have Greater Name Recognition, Financial, Technical And Marketing Resources, And More Extensive Customer Bases And Industry Relationships Than We Do, All Of Which Could Be Leveraged To Gain Market Share To Our Detriment, Particularly In An Environment Of Rapid Technological Change.

We compete against a number of companies in the electric motor energy savings market, many of which have longer operating histories, established markets and far greater financial, advertising, research and development, manufacturing, marketing, personnel and other resources than we currently have or may reasonably expect to have in the foreseeable future. This competition may have an adverse effect on our ability to expand our operations or operate profitably. The motor control industry is also highly competitive and characterized by rapid technological change. Our future performance will depend in large part upon our ability to become and remain competitive and to develop, manufacture and market acceptable products in these markets. Competitive pressures may necessitate price reductions, which can adversely affect revenues and profits. If we are not competitive in our ongoing research and development efforts, our products may become obsolete, or be priced above competitive levels. However, management believes, based upon their performance and price, our products are attractive to customers. We cannot guarantee that competitors will not introduce comparable or technologically superior products, which are priced more favorably than our products.

Changes In Retail Energy Prices Could Affect Our Business.

We have found that a customer’s decision to purchase an MEC (or similar product) is primarily driven by the payback on the investment resulting from the increased energy savings. Although management believes that current retail energy prices support an attractive return on investment for our products, the future retail price of electrical energy may not remain at such levels, and price fluctuations reducing energy expense could adversely affect product demand.

Loss Of Key Personnel Could Have Significant Adverse Consequences.

We currently depend on the services of Steve Strasser, and BJ Lackland, our Chief Executive Officer and Chief Financial Officer, respectively. The loss of the services of either of these persons could have an adverse effect on our business. As discussed under “Management”, we have entered into long-term employment contracts with Messrs. Strasser and Lackland, but such contracts do not guarantee they will remain with us.

We Do Not Have “Key Man” Life Insurance.

The Company presently does not have any key man life insurance policies. As soon as practicable following the commencement of profitable operations (which may never occur), we intend to purchase key man life insurance on the life of our principal executive officer, Steven Strasser. Upon purchase of such insurance, we intend to pay the premiums and be the sole beneficiary. The lack of such insurance may have a material adverse effect upon our business.

Delaware Law Limits The Liability Of Our Directors.

Pursuant to our Certificate of Incorporation, the Company’s directors are not liable to us or our stockholders for monetary damages for breach of fiduciary duty, except for liability in connection with a breach of the duty of loyalty, for acts or omissions not in good faith or which involved intentional misconduct or a knowing violation of law for dividend payments or stock repurchases illegal under Delaware law or any transaction in which a director has derived an improper personal benefit.

Potential Product Liability Claims May Not Be Fully Covered By Insurance.

The Company may be subject to potential product liability claims that could, in the absence of sufficient insurance coverage, have a material adverse impact on us. Presently, we have general liability coverage that includes product liability up to $2,000,000 and umbrella liability up to $4,000,000. Any large product liability suits occurring early in our growth may significantly and adversely affect our ability to expand the market for our products.

RISKS RELATED TO OUR COMMON STOCK AND CAPITAL STRUCTURE

Trading In Our Common Stock Over The Last 12 Months Has Been Limited, So Investors May Not Be Able To Sell As Many Of Their Shares As They Want At Prevailing Prices.

Prices of our common stock are quoted on the OTC Bulletin Board. Approximately 26,000 shares were traded on an average daily trading basis for the 12 months ended December 31, 2009. If limited trading in our common stock continues, it may be difficult for shareholders to sell their shares. Also, the sale of a large block of our common stock could depress the market price to a greater degree than a company that typically has a higher volume of trading of its securities.

The Limited Public Trading Market May Cause Volatility In Our Stock Price.

The Company’s common stock is currently quoted on a limited basis on the OTC Bulletin Board under the symbol “PEFF”. The quotation of our common stock on the OTC Bulletin Board does not assure that a meaningful, consistent and liquid trading market exists at all times, and in recent years such market has experienced extreme price and volume fluctuations that have particularly affected the market prices of many smaller companies like us. Our common stock is thus subject to this volatility. Sales of substantial amounts of our common stock, or the perception that such sales might occur, could adversely affect prevailing market prices of our common stock.

An Active And Visible Trading Market For Our Common Stock May Not Develop.

The market for our common stock may become inactive in the future. In the absence of an active trading market:

- Investors may have difficulty buying and selling or obtaining market quotations;
- Market visibility for our common stock may be limited; and

- A lack of visibility for our common stock may have a depressive effect on the market price for our common stock.

The OTC Bulletin Board is an inter-dealer, over-the-counter market that provides significantly less liquidity than NASDAQ, and quotes for stocks included on the OTC Bulletin Board are not listed in the financial sections of newspapers, as are those for the NASDAQ Stock Market. The trading price of the common stock is expected to be subject to significant fluctuations in response to variations in quarterly operating results, changes in analysts' earnings estimates, announcements of innovations by the Company or its competitors, general conditions in the industry in which we operate and other factors. These fluctuations, as well as general economic and market conditions, may have a material or adverse effect on the market price of our common stock.

Penny Stock Regulations May Impose Certain Restrictions On Marketability Of Our Securities.

The SEC has adopted regulations which generally define a "penny stock" to be any equity security that has a market price of less than $5.00 per share or an exercise price of less than $5.00 per share, subject to certain exceptions. As a result, our common stock is subject to rules that impose additional requirements on broker-dealers who sell such securities to persons other than established customers and accredited investors (generally those with net worth in excess of $1,000,000 or annual income exceeding $200,000, or $300,000 together with their spouse). For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of such securities and have received the purchaser's written consent to the transaction prior to the purchase. Additionally, for any transaction involving a penny stock, unless exempt, the rules require the delivery, prior to the transaction, of a risk disclosure document relating to the penny stock market. The broker-dealer must also disclose the commission payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. Consequently, the "penny stock" rules may restrict the ability of broker-dealers to sell the Company's securities and may affect the ability of investors to sell the Company's securities in the secondary market and the price at which such purchasers can sell any such securities.

Stockholders should be aware that, according to the Commission, the market for penny stocks has suffered in recent years from patterns of fraud and abuse. Such patterns include:

- Control of the market for the security by one or a few broker-dealers that are often related to the promoter or issuer;
- Manipulation of prices through prearranged matching of purchases and sales and false and misleading press releases;
- "Boiler room" practices involving high pressure sales tactics and unrealistic price projections by inexperienced sales persons;
- Excessive and undisclosed bid-ask differentials and markups by selling broker-dealers; and
- The wholesale dumping of the same securities by promoters and broker-dealers after prices have been manipulated to a desired level, along with the inevitable collapse of those prices with consequent investor losses.

The Company's management is aware of the abuses that have occurred historically in the penny stock market.

We May Never Pay Cash Dividends On Our Common Stock.

We have not paid or declared any dividends on our common stock and do not anticipate paying or declaring any cash dividends on our common stock in the foreseeable future.

Sales Of Common Stock Under Rule 144 May Adversely Affect The Market Price Of Our Common Stock.

Possible Resales under Rule 144. Of the 45,077,984 shares of the Company's common stock outstanding on the date of this report, 33,547,157 shares are freely trading in the market place (the "Free Trading Shares"). The Free Trading Shares are comprised mostly of shares (1) originally issued in private offerings of common stock from June through March 2007, that were later registered in the Company's S-1 Registration Statement (the "Registration Statement"), declared effective on October 10, 2008 and (2) shares originally issued in transactions exempt from registration under the Securities Act.

The remaining 11,530,827 shares of our common stock outstanding are restricted securities as defined in Rule 144 and under certain circumstances may be resold without registration pursuant to Rule 144. These shares include the 9,968,910 shares held by Summit and Steven Strasser in the aggregate, and 1,561,917 shares held by directors and insiders.

In addition, the Company had approximately 31,447,563 common stock purchase warrants outstanding and approximately 16,197,396 common stock options outstanding as of the date of this report, including the warrants issued in connection with the private offer and sale of preferred stock units in 2008 and 2009 (See Note 15 to the Financial Statements). The shares issuable on exercise of the options and warrants may, under certain circumstances, be available for public sale in the open market under the Registration Statement or pursuant to Rule 144, subject to certain limitations.

In general, pursuant to Rule 144, after satisfying a six month holding period: (i) affiliated stockholder (or stockholders whose shares are aggregated) may, under certain circumstances, sell within any three month period a number of securities which does not exceed the greater of 1% of the then outstanding shares of common stock or the average weekly trading volume of the class during the four calendar weeks prior to such sale and (ii) non-affiliated stockholders may sell without such limitations, provided we are current in our public reporting obligations. Rule 144 also permits the sale of securities by non-affiliates that have satisfied a one year holding period without any limitation or restriction. Any substantial sale of the common stock pursuant to Rule 144 may have an adverse effect on the market price of the Company's shares.

Exercise Of Outstanding Options And Warrants Will Dilute Ownership Of Outstanding Shares.

As of the date of this report, the Company has reserved 71,429 shares of common stock for issuance upon exercise of stock options or similar awards which may be granted pursuant to the 1994 Plan, of which no options are outstanding. Furthermore, we have reserved 25,000,000 shares of our common stock for issuance upon exercise of stock options or similar awards which may be granted pursuant to the 2000 Plan, of which options to purchase an aggregate of 16,197,396 shares are outstanding. The outstanding options under the 2000 Plan have a weighted average exercise price of $0.35. As of the date of this report, we have issued warrants exercisable for 31,447,563 shares of common stock to financial consultants, investors, former employees and other business partners, having a weighted average exercise price of $0.43 and expiring on various dates from February 2010 to February 2015. Exercise of these options and warrants in the future will reduce the percentage of common stock held by the public stockholders. Furthermore, the terms on which we could obtain additional capital during the life of the options and warrants may be adversely affected, and it should be expected that the holders of the options and warrants would exercise them at a time when we would be able to obtain equity capital on terms more favorable than those provided for by such options and warrants.

Our Issuance Of "Blank Check" Preferred Stock Could Adversely Affect Our Common Stockholders.

The Company's Certificate of Incorporation authorizes the issuance of "blank check" preferred stock with such designations, rights and preferences as may be determined from time to time by the board of directors. Accordingly, our Board of Directors is empowered, without stockholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the relative voting power or other rights of the holders of our common stock. In the event of issuance, the preferred stock could be used as a method of discouraging, delaying or preventing a change in control of the Company, which could have the effect of discouraging bids for the Company and thereby prevent stockholders from receiving the maximum value for their shares. From August 12, 2009, through February 24, 2010, the Company sold 23,375 shares if its Series C preferred stock and 34,625 shares of its Series C-1 preferred stock in private offerings of units (See Note 15 to the Financial Statements).

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus, including the sections entitled "Prospectus Summary," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business," contains forward-looking statements. These statements relate to future events, our future financial performance, growth of our target market and related worldwide markets, future demand for our products, retail electrical energy demand and prices and similar expectations. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. You can identify forward-looking statements by terminology such as "may," "will," "should," "expects," "intends," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "continues" or the negative of these terms or other comparable terminology. These risks and other factors include those listed under "Risk Factors" and elsewhere in this prospectus. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on any forward-looking statements as they reflect our management's view only as of the date of this prospectus. We will not update any forward-looking statements to reflect events or circumstances that occur after the date on which such statement is made.

This prospectus contains statistical data that we obtained from industry sources. These sources generally indicate that they have obtained their information from sources believed to be reliable, but do not guarantee the accuracy or completeness of the information. Although we believe that the industry sources are reliable, we have not independently verified their data.

USE OF PROCEEDS

We will not receive any of the proceeds from the sale of the shares of common stock by the Selling Stockholders. If and when the warrants held by Selling Stockholders are exercised, we will receive the proceeds from the exercise of those warrants. If all of these warrants are exercised in full, we will receive approximately $10,000,000, which we intend to use for working capital and other general corporate purposes.

We anticipate we will need at least $250,000 to $300,000 per month to continue our current operations, not including non-cash expenses and payments to certain creditors, including accrued expenses. As discussed in "Risk Factors" above, we will need to make payments toward accrued liabilities out of our cash flow for the foreseeable future. Overall, our satisfaction of our cash requirements depends on our ability to raise money from external financing sources and to generate future sales.

PRICE RANGE OF COMMON STOCK

The Company’s common stock is thinly traded on the National Association of Securities Dealers’ Over the Counter Bulletin Board (“OTCBB”) under the symbol “PEFF”.

The following table sets forth the high and low bid information for periods in the three month period ended March 31, 2010 and the two twelve month periods ended December 31, 2009 and December 31, 2008.

Three months Ended March 31, 2010	High	Low
January 1, 2010 — March 31, 2010	$ 0.32	$ 0.20
Twelve months Ended December 31, 2009	High	Low
October 1, 2009 — December 31, 2009	$ 0.45	$ 0.20
July 1, 2009 — September 30, 2009	0.25	0.11
April 1, 2009 — June 30, 2009	0.30	0.12
January 1, 2009 — March 31, 2009	0.30	0.08
Twelve months Ended December 31, 2008	High	Low
October 1, 2008 — December 31, 2008	$ 0.25	$ 0.08
July 1, 2008 — September 30, 2008	0.32	0.19
April 1, 2008 — June 30, 2008	0.39	0.26
January 1, 2008 — March 31, 2008	0.55	0.26

As of April 27, 2010 there were 168 stockholders of record of the Company’s common stock.

DIVIDEND POLICY

We have never declared or paid cash dividends on our capital stock and have no present intention of paying cash dividends in the foreseeable future. Payment of future dividends, if any, will be at the discretion of our Board of Directors and will depend on our financial condition, results of operations, capital requirements and such other factors as the Board of Directors deems relevant. It is the intention and present policy of our board to retain all earnings to provide for our future growth.

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

The following discussion should be read in conjunction with our financial statements and the related notes included elsewhere in this prospectus. In addition to historical information, this discussion includes forward-looking information that involves risks and assumptions which could cause actual results to differ materially from management's expectations. See "Special Note Regarding Forward-Looking Statements" on page 10 of this prospectus.

OVERVIEW

The Company generates revenues from a single business segment: the design, development, marketing and sale of proprietary energy efficiency technologies and products for electric motors. The Company's products, called Motor Efficiency Controllers ("MEC"), save up to 35 percent of the electricity used by a motor in appropriate applications. The Company's patented technology platform, called E-Save Technology®, saves energy when a constant speed alternating current induction motor is operating in a lightly loaded condition. Target applications for the Company's three-phase MECs include escalators, MG set elevators, grinders, crushers, saws, stamping presses, and many other types of industrial equipment. The Company has also developed a single-phase MEC targeted at smaller motors, such as those found in clothes washers, dryers, and other appliances and light commercial equipment. The Company has one existing patent and three patents pending on E-Save Technology®.

Analog Three-phase MEC

The Company began generating revenues from sales of its patented analog three-phase MEC line of motor controllers in the late 1990's. The Company sold this product through the second quarter of 2009.

Digital Three-phase MEC

In 2005, the Company began development of a digital version of its three-phase MEC so that the product would be capable of high volume sales through existing distribution channels for motor controls. The digital version is much smaller in size and easier to install than the analog product, is driven by a powerful microprocessor and digital signal processor. The digital MEC is a complete motor control device, meaning is can start, stop, soft start and protect a motor, and is therefore capable of replacing standard motor starters and soft starts that do not save energy. The product can be installed by OEMs at their factories or it can be retrofitted on to existing equipment.

In 2008, the Company launched limited sales of the digital three-phase MEC and initiated testing if the digital product by several OEMs, primarily in the elevator/escalator industry. In the summer of 2009, the Company announced its first OEM agreements and that it had received Underwriters' Laboratories ("UL") certification on a full line of the Company's digital three-phase products. UL certification enables the Company to sell its digital three-phase products to industrial markets. The Company is developing a network of independent sales representatives to penetrate the industrial markets.

Digital Single-phase MEC

In 2006, the Company began development on its digital single-phase product. The digital single phase MEC is targeted at appliances, such as clothes washers and dryers. The Company has one patent pending on its digital single-phase MEC.

Capitalization

As of December 31, 2009, the Company had total stockholders' equity of $801,642 primarily due to (i) the Company's sale of 30,250 shares of Series C and Series C-1 Convertible Preferred Stock in a private offering in December of 2009, (ii) the Company's sale of 140,000 shares of Series B Convertible Preferred Stock in a private offering from October of 2007 through January of 2008, (iii) the Company's sale of 12,950,016 shares of common stock in a private stock offering from November of 2006 through March of 2007, (iv) the Company's sale of 14,500,000 shares of common stock in a private stock offering in July and August of 2005, (v) the Company's sale of 2,346,233 shares of Series A-1 Convertible Preferred stock to Summit Energy Ventures, LLC in June of 2002 and (vi) the conversion of notes payable of approximately $1,047,000 into 982,504 shares of Series A-1 Convertible Preferred Stock in October of 2003. All of the Company's Series A-1 Convertible Preferred Stock was converted into the Company's common stock in 2005.

Because of the nature of our business, the Company makes significant investments in research and development for new products and enhancements to existing products. Historically, the Company has funded its research and development efforts through cash flow primarily generated from debt and equity financings. Management anticipates that future expenditures in research and development will continue at current levels.

The Company's results of operations for the year ended December 31, 2009 were marked by a significant decrease in revenues and an increase in losses from operations that are more fully discussed in the following section "Results of Operations for the Years Ended December 31, 2009 and 2008". Sales cycles for our products are generally lengthy and can range from less than a month to well over one year, depending on customer profile. Larger OEM deals and sales to larger end users generally take a longer period of time, whereas sales through channel partners may be closed within a few weeks. Because of the complexity of this sales process, a number of factors that are beyond the control of the Company can delay the closing of transactions.

RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

The following table sets forth certain line items in our condensed statement of operations as a percentage of total revenues for the periods indicated:

	Year Ended December 31, 2009	Year Ended December 31, 2008
Revenues	100.0%	100.0%
Cost of revenues	78.8	82.8
Gross profit	21.2	17.2
Costs and expenses:		
Selling, general and administrative	933.0	631.1
Research and development	335.6	211.5
Depreciation and amortization	23.4	15.5
Total expenses	1,292.1	858.1
Loss from operations	(1,270.9)	(840.9)
Other income	(175.6)	21.8
Provision for taxes	(21.4)	(2.6)
Net loss	(1,467.9)	(821.7)
Dividends paid or payable on Series B, Series C and Series C-1 Preferred Stock	447.5	113.6
Net loss attributable to common shareholders	(1,915.5)	(935.3)

REVENUES

Revenues for the year ended December 31, 2009, were approximately $284,000 compared to approximately $481,000 for the year ended December 31, 2008, a decrease of $197,000 or 41%. This decrease is mainly attributable to a decrease in sales in the elevator and escalator market during the year ended December 31, 2009. Specifically, escalator manufacturer and service provider sales fell to approximately $183,000 for the year ended December 31, 2009, from $363,000 for the year ended December 31, 2008. Sales of the analog product to one escalator manufacturer and service provider, which is one of the Company's largest customers, slowed very significantly during this period in anticipation of release of their private label version of our digital product. The digital product has been tested and approved for use on a retrofit and OEM basis by this customer, and a supply agreement was signed during the second quarter of 2009, and the customer's private label version of our digital product was launched at the end of the second quarter of 2009. The digital product offers greater features and functionality compared to the analog product, making it more attractive as an OEM product. Furthermore, industrial sales fell to approximately $78,000 for the year ended December 31, 2009, from approximately $118,000 for the year ended December 31, 2008. Sales of the Company's single-phase product, which is for use on small appliances, totaled approximately $23,000 for the year ended December 31, 2009. There were no comparable sales of the single-phase product in 2008. For the year ended December 31, 2009, industrial and other sales, of which all but one sale consisted of digital units, were approximately 27% of total revenues, escalator and elevator sales, which consisted of a mix of digital units and analog units, were approximately 65% of total revenues, and sales of our single-phase product were approximately 8% of total revenues. For the year ended December 31, 2008, industrial and other sales, which consisted of a mix of digital units and analog units, were approximately 21% of total revenues, and escalator and elevator sales, which consisted mostly of analog units, were approximately 79% of total revenues.

COST OF REVENUES

Cost of revenues for the year ended December 31, 2009 were approximately $224,000 compared to approximately $398,000 for the year ended December 31, 2008, a decrease of $174,000, or 44%. This decrease is mainly attributable to a decrease in sales in both the elevator and escalator and the industrial markets during the year ended December 31, 2009. Also, the Company recorded an inventory obsolescence charge of approximately $41,000 during the year ended December 31, 2008 and no comparable charge was recorded during the year ended December 31, 2009. As a percentage of sales, total cost of revenues decreased to approximately 79% for the year ended December 31, 2009, compared to approximately 82% for the year ended December 31, 2008. The decrease in the costs as a percentage of sales was primarily due to the Company increasing its prices on certain units, which resulted in higher margins during the year ended December 31, 2009, and an increase in the sale of digital units, which have higher average margins than analog units, as well as no inventory obsolescence charges during 2009.

GROSS PROFIT

Gross profit for the year ended December 31, 2009 was approximately $60,000 compared to approximately $83,000 for the year ended December 31, 2008, resulting in a decrease of $23,000 or 28%. This decrease is mainly attributable to a decrease in sales in both the elevator and escalator and the industrial markets during the year ended December 31, 2009, partially offset by the inventory obsolescence charge recorded by the Company during the year ended December 31, 2008, as described above. As a percentage of revenue, gross profit increased to approximately 21% for the year ended December 31, 2009, compared to approximately 17% for the year ended December 31, 2008.

OPERATING EXPENSES

Selling, General and Administrative Expenses

Selling, general and administrative expenses were approximately $2,650,000 for the year ended December 31, 2009, compared to approximately $3,033,000 for the year ended December 31, 2008, a decrease of $383,000 or 13%. The decrease in selling, general and administrative expenses compared to the prior year was primarily due to a decrease in travel expenses, consulting fees, and a decrease in stock based compensation costs related to FASB ASC 718 (SFAS 123(R)). These decreases were partially offset by increases in legal and professional fees, related to the Company's patent attorneys and litigation (see Item 3 – Legal Proceedings), and a change in the Company's independent registered accounting firm.

Research and Development Expenses

Research and development expenses were $953,000 for the year ended December 31, 2009 compared to approximately $1,016,000 for the year ended December 31, 2008, a decrease of $63,000 or 6%. This decrease is mainly attributable to a decrease in the Company's product development and certification costs related to the Company's digital controller for both its single-phase and three-phase products during the year ended December 31, 2009.

Change in Fair Value of Warrant Liability

Warrants issued in connection with a private offering of the Company's common stock completed on July 8, 2005 and August 31, 2005 are being accounted for as liabilities in accordance with FASB ASC 820-10, Fair Value Measurements and Disclosures (Prior authoritative literature: FASB EITF 07-5, Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock ("EITF 07-5"), issued January 2009), based on an analysis of the terms and conditions of the warrant agreements.

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As a result, the fair value of these warrants (five year warrants to purchase up to 5,696,591 shares of the Company's common stock at an exercise price of $0.44 per share), amounting to $381,856 as of January 1, 2009, was reclassified from equity and reflected as a liability. The fair value of these warrants amounted to $828,827 as of December 31, 2009. The $514,089 increase in the fair value of these warrants during 2009 has been reflected as a non-operating loss in the Statement of Operations for 2009. The warrants are being valued at each reporting period using the Black-Scholes pricing model to determine the fair market value per share. We will continue to mark the warrants to market value each quarter-end until they expire.

Financial Condition, Liquidity, and Capital Resources: For the Year Ended December 31, 2009

The Company has suffered recurring losses from operations, and experienced a deficiency of cash of approximately $3,000,000 and $3,100,000 from operations for the years ended December 31, 2009 and 2008, respectively. For the years ended December 31, 2009 and December 31, 2008, we had net losses of $4,168,708 and $3,948,204, respectively. In our Auditors' Report dated March 31, 2010 on our December 31, 2009 financial statements included in this report, our auditors have stated that these factors raise substantial doubt about our ability to continue as a "going concern". Our financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amount of liabilities that might be necessary should we be unable to continue in existence.

The Company's continuation as a "going concern" is dependent upon achieving profitable operations and related positive cash flow and satisfying our immediate cash needs by external financing until we are profitable. Our plans to achieve profitability include developing new products, obtaining new customers and increasing sales to existing customers. We are seeking to raise additional capital through equity issuance, debt financing and other types of financing, but we cannot guarantee that sufficient capital will be raised.

On March 30, 2010, the Company issued unsecured notes payable to Steven Strasser, the Company's CEO, totaling $125,000. The notes bear interest at 5%, payable upon maturity. The notes mature two months after issuance.

Since inception, the Company has financed its operations primarily through the sale of its securities. In 2009, the Company received a total of approximately $1,210,000 in gross proceeds from a private placement of its Series C and Series C-1 preferred stock and warrants to purchase common stock. In 2008 and 2007, the Company received a total of approximately $8,025,000 in gross proceeds from a private placement of its Series B preferred stock, common stock and warrants to purchase common stock, as to which the Company was required to file a registration statement on Form SB-2 or other relevant registration statement. Of this amount, $1,850,000 was converted from existing debt securities. Also in 2007, the Company grossed approximately $680,000 in cash from the exercise of warrants. As of December 31, 2009 the Company has received a total of approximately $21,515,000 from public and private offerings of its equity securities, received $300,000 from a bridge note with a shareholder (which was converted into 3,000,000 shares of common stock and 1,500,000 warrants with an additional investment of $300,000 on July 8, 2005), received approximately $445,386 under a bank line of credit (which was repaid during 2002), and received $1,000,000 under a line of credit with a shareholder (which was converted to Series A-1 Preferred Convertible shares during 2003). In October 2004 and February 2005, the Company received $1,589,806 in debt financing through a debt offering arranged by a placement agent, Pali Capital. Of this total, $300,000 plus accrued interest was converted from borrowings with the same shareholder as referenced above. In April 2006, the Company received $1,000,000 in debt financing from EMTUCK , LLC, in which the managing member is a management company wholly owned and controlled by Steven Strasser, the Company's CEO. In May 2006, the Company received an additional $500,000 in debt financing from EMTUCK. In November 2006, the Company received $2,000,000 in debt financing. Of this amount, $1,450,000 was converted from borrowings from prior investors. This $2,000,000 note was paid off in full in October of 2007. As of December 31, 2009 the Company had cash of $247,564 and has no outstanding debt securities.

Net cash used for operating activities for the year ended December 31, 2009 was $3,002,386 which primarily consisted of: a net loss of $4,168,708; less bad debt expense of $8,149, depreciation and amortization of $66,589, loss on the disposal of fixed assets of $3,097, warrants and options issued in connection services from vendors, and to employees and consultants of $405,143, change in fair value of warrant liability of $514,089, deferred tax provision of $49,946, decreases in prepaid expenses and other current assets of $10,728, and deposits of $11,292, increases in accounts receivable of $30,133 and inventory of $35,233. In addition, these amounts were partially offset by decreases in deferred rent of $3,750, and increases in accounts payable and accrued expenses of $166,405.

Net cash used for operating activities for the year ended December 31, 2008 was $3,102,847 which primarily consisted of: a net loss of $3,948,204; less bad debt expense of $7,770, inventory obsolescence expense of $40,758, depreciation and amortization of $74,539, warrants and options issued in connection with services from vendors, and to employees and consultants of $765,504, common stock issued for consulting services of $7,960, decreases in accounts receivable of $57,323 and deposits of $84,057, increases in inventory of $155,016 and prepaid expenses of $5,869. In addition, these amounts were partially offset by decreases in accounts payable and accrued expenses of $30,669 and customer deposits of $1,605, and increases in deferred rent of $605.

Net cash used in investing activities for fiscal year 2009 was $32,882, compared to $132,364 in fiscal year 2008. The amount for 2009 consisted of the purchase of fixed assets of $9,601, costs related to patent applications of $24,174, and proceeds from the sale of fixed assets of $893. The amount for 2008 consisted of the purchase of fixed assets of $104,857, and costs related to patent applications of $27,507.

Net cash provided by financing activities for fiscal year 2009 was $1,182,819. The entire amount consisted of the net proceeds from the issuance of equity securities.

Net cash provided by financing activities for fiscal year 2008 was $248,846. The entire amount consisted of the net proceeds from the issuance of equity securities.

The Company expects to increase its operating expenses, particularly in research and development and selling, general and administrative expenses, for the foreseeable future in order to execute its business strategy. As a result, the Company anticipates that operating expenses will constitute a material use of any cash resources.

Cash Requirements and Need for Additional Funds

The Company anticipates a substantial need for cash to fund its working capital requirements. It is the opinion of management that approximately $2.5 - 3 million will be required to cover operating expenses, including, but not limited to, marketing, sales, research and operations during the next twelve months. If the Company is unable to obtain funding on reasonable terms or finance its needs through current operations, the Company will be forced to restructure, file for bankruptcy or cease operations.

Notable changes to expenses are expected to include an increase in the Company’s sales personnel and efforts, and developing more advanced versions of the Company’s technology and products.

Critical Accounting Policies and Estimates

Management’s discussion and analysis of Power Efficiency Corporation’s financial condition and results of operations are based upon the condensed financial statements contained in this Annual Report on Form 10-K, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. On an on-going basis, management evaluates estimates, including those related to the valuation of inventory and the allowance for uncollectible accounts receivable. We base our estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed financial statements.

Inventories

Inventories are valued at the lower of cost (first-in, first-out) or market. The Company reviews inventory for impairments to net realizable value whenever circumstances arise. Such circumstances may include, but are not limited to, the discontinuation of a product line or re-engineering certain components making certain parts obsolete. Management has determined a reserve for inventory obsolescence is not necessary at December 31, 2009 or 2008.

Accounts Receivable

The Company carries its accounts receivable at cost less an allowance for doubtful accounts and returns. On a periodic basis, the Company evaluates its accounts receivable and establishes an allowance for doubtful accounts, based on a history of past write-offs and collections and current credit conditions. Change in customer liquidity or financial condition could affect the collectability of that account, resulting in the adjustment upward or downward in the provision for bad debts, with a corresponding impact to our results of operations.

Fair Value Measurements:

FASB ASC 820-10 (SFAS No. 157) emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, FASB ASC 820-10 (SFAS No. 157) establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy). The Company has applied FASB ASC 820-10 (SFAS 157) to measure the amount of the liability related to its derivative instruments at fair value and to determine fair value for purposes of testing goodwill for impairment.

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, which is typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Revenue Recognition

Revenue from product sales is recognized at the time of shipment, when all services are complete. Returns and other sales adjustments (warranty accruals, discounts and shipping credits) are provided for in the same period the related sales are recorded.

Accounting for Stock Based Compensation

The Company accounts for employee stock options as compensation expense, in accordance with FASB ASC 718 (SFAS 123(R)). FASB ASC 718 (SFAS 123(R)) requires companies to expense the value of employee stock options and similar awards, and applies to all outstanding and vested stock-based awards.

In computing the impact, the fair value of each option is estimated on the date of grant based on the Black-Scholes options-pricing model utilizing certain assumptions for a risk free interest rate; volatility; and expected remaining lives of the awards. The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if factors change and the Company uses different assumptions, the Company's stock-based compensation expense could be materially different in the future. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. In estimating the Company's forfeiture rate, the Company analyzed its historical forfeiture rate, the remaining lives of unvested options, and the amount of vested options as a percentage of total options outstanding. If the Company's actual forfeiture rate is materially different from its estimate, or if the Company reevaluates the forfeiture rate in the future, the stock-based compensation expense could be significantly different from what we have recorded in the current period. The impact of applying FASB ASC 718 (SFAS 123(R)) approximated $405,000 and $766,000 in additional compensation expense during the periods ended December 31, 2009 and 2008, respectively. Such amounts are included in research and development expenses and selling, general and administrative expense on the statement of operations.

Product Warranties

The Company typically warrants its products for two years. Estimated product warranty expenses are accrued in cost of sales at the time the related sale is recognized. Estimates of warranty expenses are based primarily on historical warranty claim experience. Warranty expenses include accruals for basic warranties for products sold. While management believes our estimates are reasonable, an increase or decrease in submitted warranty claims could affect warranty expense and the related current and future liability.

Provision for Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes pursuant to FASB ASC 740 Accounting for Income Taxes (Prior authoritative literature FASB SFAS No. 109, Accounting for Income Taxes ("SFAS 109")), which requires the recognition of deferred tax assets and liabilities for both the expected future tax impact of differences between the financial statement and tax basis of assets and liabilities, and for the expected future tax benefit to be derived from tax loss and tax credit carryforwards. FASB ASC 740 (SFAS 109) additionally requires the establishment of a valuation allowance to reflect the likelihood of realization of deferred tax assets. We have reported net operating losses for consecutive years, and do not have projected taxable income in the near future. This significant evidence causes our management to believe a full valuation allowance should be recorded against the deferred tax assets.

FASB ASC 740-10-25-10 Definition of Settlement in FASB Interpretation No. 48 (Prior authoritative literature FIN 48-1 Definition of Settlement in FASB Interpretation No. 48 ("FIN 48-1") issued May 2007) provides guidance on how to determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FASB ASC 740-10-25-10 (FIN 48-1) is effective retroactively to January 1, 2007. Under FASB ASC 740 (FIN 48), the impact of an uncertain tax position taken or expected to be taken on an income tax return must be recognized in the financial statements at the amount that is more likely than not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized in the financial statements unless it is more likely than not of being sustained. The implementation of FASB ASC 740 (FIN 48) and FASB ASC 740-10-25-10 (FIN 48-1) did not have a material impact on the Company's financial position, results of operations or cash flows.

Goodwill

FASB ASC 350, Goodwill and Other Intangible Assets (Prior authoritative literature: FASB SFAS No. 142, Goodwill and Other Intangible Assets ("SFAS 142")) requires that goodwill shall not be amortized. At a minimum, goodwill is tested for impairment, on an annual basis by the Company, or when certain events indicate a possible impairment, utilizing a two-step test, as described in FASB ASC 350 (SFAS 142).

The Company's most recent impairment analysis was performed on December 31, 2009, on the Company's single reporting unit. Using the Company's market capitalization (based on Level 1 inputs), management determined that the estimated fair market value substantially exceeded the company's book value. As of December 31, 2009, the Company's market capitalization was $13,896,024, and the Company's book value was $801,642. As of December 31, 2008, the Company's market capitalization was $8,651,088, and the Company's book value was $4,046,747. Based on this, no impairment exists as of December 31, 2009 and 2008. Circumstances may arise in which the Company will perform an impairment test in addition to its annual tests. A significant impairment could have a material adverse affect on our financial condition and results of operations.

New Accounting Pronouncements:

In October 2009, the Financial Accounting Standards Board issued Accounting Standards Update 2009-13, “Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements, a consensus of the FASB Emerging Issues Task Force (“ASU 2009-13”). ASU 2009-13 amends existing accounting guidance for separating consideration in multiple-deliverable arrangements. ASU 2009-13 establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third-party evidence if vendor-specific evidence is not available, or estimated selling price if neither vendor-specific evidence nor third-party evidence is available. ASU 2009-13 eliminates residual method of allocation and requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the “relative selling price method.” The relative selling price method allocates any discount in the arrangement proportionately to each deliverable on the basis of each deliverable’s selling price. ASU 2009-13 requires that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a stand-alone basis. ASU 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with earlier adoption permitted. We do not believe the adoption of ASU 2009-13 will have any material impact on our financial statements.

In January 2010, the FASB issued accounting standards update (ASU) No. 2010-06, Fair Value Measurements and Disclosures (Topic 820)—Improving Disclosures about Fair Value Measurements (ASU No. 2010-06). ASU No. 2010-06 requires: (1) fair value disclosures of assets and liabilities by class; (2) disclosures about significant transfers in and out of Levels 1 and 2 on the fair value hierarchy, in addition to Level 3; (3) purchases, sales, issuances and settlements be disclosed on gross basis on the reconciliation of beginning and ending balances of Level 3 assets and liabilities; and (4) disclosures about valuation methods and inputs used to measure the fair value of Level 2 assets and liabilities. ASU No. 2010-06 becomes effective for the first financial reporting period beginning after December 15, 2009, except for disclosures about purchases, sales, issuances and settlements of Level 3 assets and liabilities which will be effective for fiscal years beginning after December 15, 2010. We are currently assessing what impact, if any, ASU No. 2010-06 will have on our fair value disclosures; however, we do not believe the adoption of the guidance provided in this codification update to have a material impact on our financial statements.

BUSINESS

General Background

We design, develop and market energy efficiency technologies and products for electric motors. Until recently these products were called the "Power Genius™". We recently re-branded the product as the "MEC". Our new digital technology is called " E-SAVE Technology ™". Our products reduce the amount of power consumed by lightly loaded alternating current induction motors that operate at a constant speed. Utilizing patented improvements upon NASA-developed motor diagnostic technologies, our products provide energy cost savings to the user of as much as 35%. We market our products directly under the brand name MEC, and through other companies under names such as Power Commander® and EcoStart™. These companies include the leading elevator/escalator manufacturers in the world, such as Otis Elevator Co (a division of United Technologies) and KONE, Inc.

Description of Business

(a) Business Development

Formation

Power Efficiency Corporation was incorporated in Delaware on October 19, 1994. From inception through 1997, the Company was a development stage entity that was engaged in the design, development, marketing and sale of proprietary solid state electrical components designed to reduce energy consumption in alternating current induction motors. Alternating current induction motors are commonly found in industrial and commercial facilities throughout the world.

(b) Business of the Company

The Company's Principal Products and Technology

In the late 1990s the Company commenced the sale of its initial product, which was based on analog technology and reduces energy consumption in alternating current induction motors in certain applications. This product has been known by several names, including the Power Commander® and Power Genius. In 2005 the Company began development of a digital product that would overcome many of the commercial limitations of the analog product. In 2008, limited models of the first-generation of the digital product were launched. In mid-2009 the Company launched a line of products up to 300 horsepower that had certification from Underwriters Laboratories ("UL") and its second-generation digital circuitry was launched. Going forward, the Company has chosen to call its products Motor Efficiency Controllers ("MEC").

The Company has developed patented and patent-pending technologies for effectively controlling the energy usage of an electric motor. The Company's first United States Patent was granted in 1998. Over the past four years the Company has undertaken extensive study and computer modeling of motors and their energy use, and has developed digital technologies for its controllers. In the process, the Company has discovered what it believes are significant innovations and has completed numerous patent filings around these new inventions. The Company has branded these collective patented and patent pending technologies as E-SAVE Technology® and has a registered trademark on this name.

The Company has developed technologies and products for use on three-phase and single-phase motors. Three-phase power and motors are generally found in industrial and commercial buildings for larger applications than single-phase power and motors.

The Company's marketing efforts initially focused on the three-phase version but it is also now marketing the single-phase product. The Company's digital Three-Phase MEC is designed to have the following functionality:

1. Start a motor
2. Provide a soft start for the motor, bringing it gradually from rest to full speed
3. Provide various motor protection capabilities, such as sensing current overload, phase loss, under- and over-voltage, and more.
4. Save energy when the motor is at full speed but is less than fully loaded

The Company's digital Single-Phase MEC is designed to have the following functionality:

1. Start a motor
2. Provide a soft start for the motor, bringing it gradually from rest to full speed
3. Save energy when the motor is at full speed but is less than fully loaded

Three-Phase and Single-Phase MECs are unique particularly because of their energy savings capabilities. The product reduces energy consumption by electric motors by electronically sensing and controlling the amount of energy the motor consumes. A motor with an MEC installed only uses the energy it needs to perform its work task, thereby increasing its efficiency. The result is a reduction of energy consumption typically ranging from 15% - 35% in applications that do not always run at peak load levels. The amount of energy savings depends on a variety of factors, including the load on the motor and the motor's characteristics.

The Company's management believes its Motor Efficiency Controllers offer certain advantages over competing products for the following reasons:

- Motor and Equipment Life: The MEC extends motor life by reducing the stress and strain on the motor and surrounding equipment, and reduces the amperage to the motor, which results in cooler running.
- Successful Utility and Customer Tests: The MEC has been successfully tested by numerous electric utilities and customers. For example, Paragon Consulting Services, a contractor for Nevada Power Company, the electric utility for southern Nevada, performed 8 field tests on escalators and one on an elevator in major Las Vegas casinos. The tests resulted in average energy savings of over 30% on the escalators and 20% on the elevator.

- Utility Incentive Financing: The three-phase product has qualified for rebate incentive financing, most frequently called “rebates”, from many electric utilities. This financing is generally paid to the end user of the MEC as an incentive to invest in energy saving products. As such, this financing effectively decreases the cost of the Company’s MEC for end users. The utilities that have approved the Company’s products for incentive financing include: NV Energy (formerly Nevada Power Company and Sierra Pacific Power Company), the Los Angeles Department of Water and Power, Southern California Edison, Sacramento Municipal Utility District, Anaheim Utilities, the New York Power Authority, Excel Energy and San Diego Gas and Electric.

- Acceptance by Original Equipment Manufacturers: The Company's products have been approved and installed by numerous original equipment manufacturers ("OEMs") in the escalator and granulator industries.

Three-Phase MEC

The Company initially focused its marketing efforts for the Three-Phase MEC in the elevator and escalator industry, although the Company is also actively marketing this product to industrial markets, such as recycling, mining, plastics, and manufacturing. Industries that operate equipment such as conveyor systems, crushing equipment, stamping presses, granulators, grinders, shredders and other motor driven equipment with varying loads, are believed to be viable target markets for the Three-Phase MEC. The Company is seeking to target markets with appropriate applications and market access, using direct sales, OEMs, distributors and independent representatives to address these markets.

Single-Phase Product

Like the Company's three-phase product described above, the Company's single-phase product reduces energy consumption in electric motors by sensing and controlling the amount of energy the motor consumes. Many motors commonly used in home appliances and other consumer goods are single-phase AC motors. Since the single-phase product is much smaller, has a much lower price point, and can be incorporated directly into a broad variety of applications, the Company believes it is a product most suitable for installation at the OEM level.

Product Development

The Company has devoted significant time and resources in the past several years toward developing "digital" versions of its three-phase and single-phase products. Through this process, the Company has transformed its technology so that its key technological breakthroughs are primarily incorporated in algorithms and software on a microchip. The Company believes the digital versions of its products have several distinct advantages over the older analog versions, including:

- Motor starter and motor protection capabilities similar to standard solid state starters sold by large motor control companies. The analog product could not start a motor and provided no motor protection, so the customer had to purchase these items at additional costs for components and installation. The digital MEC instead incorporates all these functions and therefore replaces a standard solid state motor control.
- Increased ease of installation and reduced technical support requirements. For example, instead of approximated and manual adjustments during installation, which can require technical support from the Company, the digitized unit will allow more simplified and precise adjustments by customers and third party installers.
- Reduced product size, which is important for many installations.
- Input-output communications capabilities, so the device can communicate with external control systems.
- Increased functionality. The Company expects to be able to add new functionality to the products. These new functions may include such things as:

- Recording and reporting of actual energy savings;
- Prediction of maintenance problems by reading and reporting on changes in the motor's operating characteristics; and
- More secure intellectual property protection through the use of secured chips and software.

Marketing and Sales

The Company’s marketing efforts have historically been concentrated in the elevator and escalator industry, primarily to OEMs of elevator and escalator equipment and end users that own this equipment. With UL approval in mid-2009, the Company has targeted more heavily industrial markets, such as mining aggregates and plastics. End users of the Company’s products include retail chains, hotels, airports, transit systems, and mining, plastics and manufacturing companies.

The Company sells products into the elevator and escalator market primarily to and through large OEM resellers. The elevator and escalator market is dominated by four global companies, Otis Elevator, Schindler, ThyssenKrupp and KONE. Collectively these companies are believed to have over 80% of the world market for new equipment and service contracts. The Company has formal supply agreements for North America with ThyssenKrupp and KONE. The Company also sells to and completes projects with Otis Elevator and Schindler.

The Company is focused on penetrating industrial markets through independent representatives and distributors who will in turn sell to OEMs of industrial equipment and end users. The Company significantly increased these industrial market activities in late 2009 after receiving UL certification, since this certification is required by many industrial concerns.

The Company's longer term goal is to be a high value supplier of technologies, with numerous OEMs and other resellers engaged with high volume sales and/or licensing agreements.

Manufacturing and Distribution

The Company's products are manufactured internally and by a multi-billion dollar global contract manufacturer, Sanmina SCI ("Sanmina"). The Company's strategy is to manufacture internally products that sell at lower volumes, such as MECs for very large motors, and to outsource the manufacturing of higher volume products, such as smaller units and circuit boards. The Company believes this strategy allows for high quality production, cost efficiencies, and the capability to rapidly increase production volumes. Management believes this strategy has the ability to meet the Company's production needs and the Company would be successful in finding alternative manufacturers should Sanmina not be available to manufacture our product.

Competition

Power Efficiency believes the principal competitive factors in the Company's markets include innovative product development, return on investment from energy savings, product quality, product performance, utility rebate acceptance, established customer relationships, name recognition, distribution and price.

Three-Phase Competition. The Company's Three-Phase MEC's principal capabilities include being a motor starter, providing a soft start and protection for the motor, and reducing the motor's electricity consumption once the motor is at full speed. The Company believes its products are unique primarily because of the last capability – energy savings.

The first capabilities - starting, soft starting and protecting a motor - are commonly found in existing motor control products. There are billions of dollars of motor starters and soft starts sold every year. These products are typically manufactured and marketed by large motor control companies, many of which have longer operating histories, established markets and far greater financial, advertising, research and development, manufacturing, marketing, personnel and other resources than the Company currently has or may reasonably be expected to have in the foreseeable future. This competition may have an adverse effect on the ability of the Company to commence and expand its operations or operate in a profitable manner.

There are also several small companies that reportedly make products that combine motor starting, soft starting and energy savings. The Company is unaware of any large company that makes a product of this nature. Although the Company has not completed any formal market study, the Company believes its Three-Phase MEC has the following competitive advantages over other products:

- It combines soft start features with energy savings features in a single integrated unit that is CSA, UL and CE certified and has achieved energy savings levels of up to 15% to 35% in independent, third party testing;

- Its circuitry is proprietary, protected by one patent. Three additional patent filings on new innovations are pending approval of the U.S. Patent and Trademark Office;
- It has been tested extensively by utilities with documented energy savings and approval for incentive financing rebates;

- It is accepted by OEMs in the escalator and granulator industries.

Single-Phase Competition. There have been several companies that have, with different technologies, attempted to exploit this market due to the enormous opportunity in single-phase motor applications. These products include among others, “Green Plug” (voltage clamping), “Power Planner” (digital microchip) and “Econelectric” (power factor control). The Company has made numerous innovations in the past three years that it believes overcome many of the problems with these and the Company’s earlier designs. The Company has filed for a patent on these innovations and has reduced the product in size and cost to the point it can be sold to OEMs of applicable appliances and other equipment driven by single-phase AC motors.

Premium Efficiency Motors. Motors are rated by their efficiency at full load. However, when motors, including “premium efficiency motors” are lightly loaded, they become very inefficient. Management believes that the energy savings gain attributable to premium efficiency motors is materially lower than that of its MEC on underloaded motor applications. Furthermore, the Company’s products are able to save energy on underloaded premium efficiency motors, so that such motors and the Company’s technology are not mutually exclusive.

Source of Supply and Availability of Raw Materials

The MEC has been designed to use standard, off-the-shelf, easily acquired components, except for the custom made circuit boards. Such off-the-shelf components are basic items readily available worldwide at competitive prices. They come in standard and miniature versions and offer the Company latitude in product design and production. Although the Company believes most of the key components required for the production of its products are currently available in sufficient production quantities from multiple sources, there can be no assurance they will remain so readily available or at comparable prices.

Customers

The Company currently does business with approximately 20 customers. Of this number, four customers presently account for approximately 71% of the Company’s gross revenues. These customers and their respective gross revenue percentages are KONE – 49%; IXYS – 8%; Otis – 7%; and Global PET – 7%. The Company is, and may continue to be, dependent upon a limited number of customers. Accordingly, the loss of one or more of these customers may have a material adverse effect upon the Company’s business.

Patents and Proprietary Rights

The Company currently relies on a combination of trade secrets, non-disclosure agreements and patent protection to establish and protect its proprietary rights in its products. There can be no assurance these mechanisms will provide the Company with any competitive advantages. Furthermore, there can be no assurance others will not independently develop similar technologies, duplicate or “reverse engineer” the proprietary aspects of the Company’s technology.

The Company has one U.S. patent issued with respect to its products. The “Balanced and Synchronized Phase Detector for an AC Induction Motor Controller,” No. 5,821,726, was issued on October 13, 1998 and expires in 2017. This patent covers improvements to the technology under the NASA License Agreement (described below), which were developed by the Company. Management believes this patent protects the Company’s intellectual property position beyond the expiration of the NASA License Agreement.

The Company has filed three utility patents on new inventions associated with the development of its digital products. The Company is continually making improvements to its products and technologies, and anticipates making additional patent filings on new inventions when warranted.

The Company has obtained U.S. Trademark registration of the E-Save Technology® mark.

NASA License Agreement

The Company had been the exclusive United States licensee of certain power factor controller technology owned by the United States of America, as represented by NASA. This license agreement covered the United States and its territories and possessions and did not require the Company to pay royalties to NASA in connection with the Company's sale of products employing technology utilizing the licensed patents. The Company's rights under the license agreement were non-transferable and were not to be sublicensed without NASA's consent. The license agreement terminated on December 16, 2002 upon expiration of all of the licensed patents.

The Company believes its products and other proprietary rights do not infringe any proprietary rights possessed by third parties. There can be no assurance, however, that third parties will not assert infringement claims in the future, the defense costs of which could be substantial.

Government Regulation

The Company is not required to be certified by any government agencies. However, most of the Company's products are manufactured to comply with specific codes that meet industry accepted safety standards. Presently, many of the Company's products are certified to comply with UL 508 Industrial Control Equipment and the Company has also received certification meeting CSA (Canadian Standards Association) B44.1/ASME-17.5 Elevator and Escalator Electrical Equipment for many of the Company's products. Many of the Company's products are also CE marked. The Department of Commerce does not require the Company's technology to be certified for export. The Company's industrial code is 421610 and the SIC code is 5063.

Deregulation of Electrical Energy

Sales of the Company's product are not dependent on deregulation of the electrical energy market as the Company's product can be sold in regulated and deregulated markets.

Research and Development

The Company intends to continue its research and development effort to introduce new products based on its energy saving technology. Towards this end, the Company spent $953,004 and $1,016,158 in fiscal years 2009 and 2008, respectively, on research and development activities, virtually none of which was borne by customers. A major focus of the Company's foreseeable research and development activities will be on completing additional features and refinements to the three-phase and single phase products. The Company also anticipates the possibility of working with OEMs that make or purchase motor control equipment, in order to develop products with features or specifications they require.

Effect of Environmental Regulations

The Company is not aware of any federal, state, or local provisions regulating the discharge of materials into the environment or otherwise relating to the protection of the environment with which compliance by the Company has had, or is expected to have, a material effect upon the capital expenditures, earnings, or competitive position of the Company.

Employees

At the date of this document, the Company employs fourteen people. Of this number, two are engaged in accounting and finance, three in operations and general management, three in sales and marketing, and six in product research and development, engineering and manufacturing. At such time as business conditions dictate, the Company may hire additional personnel for, among other things, increased engineering, marketing and sales. The Company has no collective bargaining agreements and considers its relationship with its employees to be good. The Company utilizes consultants in the areas of marketing, product and technology development and finance on a regular basis.

(c) Reports to Security Holders

The Company is a smaller reporting company, and as such files Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q under the scaled disclosure requirements and Current Reports on Form 8-K on a regular basis with the

SEC.

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The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at http://www.sec.gov.

Description of Property

The Company's corporate office space is located at 3960 Howard Hughes Pkwy, Suite 460, Las Vegas, Nevada 89169. The office lease calls for rent of $11,292 per month, plus annual increases equal to 3%, through the end of the lease term in February 2011.

The Company leases office space at 6380 South Valley View Blvd., Suite 412, Las Vegas, Nevada 89118. The lease calls for rent of $1,995 plus common area maintenance charges, per month, through the end of the lease term in August 2010. This space is used primarily for research and development.

The Company leases office space at 6380 South Valley View Blvd., Suite 402, Las Vegas, Nevada 89118. The lease calls for rent of $1,605 plus common area maintenance charges, per month, through the end of the lease term in August 2010. This space is used primarily for manufacturing and warehousing.

Legal Proceedings

None.

MANAGEMENT

INFORMATION ABOUT THE COMPANY'S EXECUTIVE OFFICERS AND DIRECTORS

The following table lists the current executive officers and directors and, in the case of directors, their length of service on the board. Each director is elected to hold office for a term expiring at the first annual meeting of stockholders held following such director's election and until his successor has been elected and qualified, or until his prior resignation or removal. All of the Company's current directors were either appointed by the plurality of votes cast by the holders of our common stock present, or represented, at the 2009 Annual Meeting of the Stockholders in July 2009, or elected by the board. On March 29, 2010, Gregory Curhan resigned from the Board of Directors. Mr. Curhan’s resignation is not as a result of any disagreement with the Company on any matter relating to the Company’s operations, policies or practices.

Name	Age	Director Since	Position
Steven Z. Strasser	61	2002	C Chairman, Chief Executive Officer
John (BJ) Lackland	39	2002	Di Director, Chief Financial Officer, and Secretary
George Boyadjieff	71	2006	Di Director, Senior Technical Advisor
Douglas M. Dunn	67	2006	Di Director
Richard Morgan	64	2007	Di Director
Gary Rado	70	2005	Di Director
Kenneth Dickey	68	2009	Di Director, Consultant

Director Independence

Pursuant to SEC rules, a majority of our Board of Directors is comprised of independent directors, as defined under Section 121(A) of the New York Stock Exchange Constitution and Rules. Messrs. Boyadjieff, Dickey, Dunn, Morgan and Rado are independent directors. Our audit committee is comprised of Messrs. Dunn, Morgan and Rado; and our compensation committee is comprised of Messrs. Boyadjieff, Dickey and Rado, all of whom are independent directors.

Steven Strasser – Chairman and Chief Executive Officer. Prior to becoming the Company’s CEO in October 2004, Mr. Strasser was the Managing Director, founder and majority owner of Summit Energy Ventures LLC, currently the largest stockholder in Power Efficiency Corporation. Summit is a private equity firm focused on investments in companies with energy efficiency technologies. At Summit, Mr. Strasser spent four years, from 2001 through 2005, evaluating and investing in energy technology companies and serving on the boards of portfolio companies. Mr. Strasser has been a director since August 2002.

From 1984 through 2000, Mr. Strasser was the founder and CEO of Northwest Power Enterprises. Over its seventeen-year history, Northwest Power Enterprises and its predecessor companies were involved in multiple aspects of the energy development business. Mr. Strasser received law degrees from McGill University, Montreal, Canada and the University of Washington, Seattle, Washington.

John (BJ) Lackland – Director, Chief Financial Officer, and Secretary. Mr. Lackland became the Company’s CFO in October 2004. Mr. Lackland has been the Vice President and Director Summit Energy Ventures since 2001, a private equity firm that is the largest stockholder in Power Efficiency Corporation. Summit focuses on investments in companies with energy efficiency technologies. At Summit, Mr. Lackland evaluated and invested in energy technology companies and served on the boards of portfolio companies. Prior to joining Summit, Mr. Lackland was the Director of Strategic Relations at Encompass Globalization, where he was in charge of strategic alliances and mergers and acquisitions. Prior to Encompass, he was the Director of Strategic Planning and Corporate Development at an Internet business development consulting company, where he was in charge of strategic planning and investor relations. Mr. Lackland has been an independent consultant to Fortune 1,000 companies and startups. Mr. Lackland also worked at The National Bureau of Asian Research, an internationally acclaimed research company focusing on U.S. policy toward Asia, where he led economic and political research projects for Microsoft, Dell, Compaq and U.S. government agencies. Mr. Lackland has been a director since August 2002.

Mr. Lackland earned an M.B.A. from the University of Washington Business School, an M.A. in International Studies (Asian Studies) from the University of Washington's Jackson School of International Studies, and a B.A. in Politics, Philosophy and Economics from Claremont McKenna College.

George Boyadjieff — Director and Senior Technical Advisor. Mr. Boyadjieff has been a director of the Company since May 2006, and Senior Technical Advisor of the Company since April 2005. Mr. Boyadjieff is the retired CEO of the former Varco International, a New York Stock Exchange traded oil service company with over $1.3 billion in annual revenues at the time of Mr. Boyadjieff's retirement. Varco has recently merged with National Oil Well to become National Oil Well Varco (NOV). Mr. Boyadjieff joined Varco in 1969 as Chief Engineer and was appointed CEO in 1991. Currently Mr. Boyadjieff is a director of Southwall Technologies, a Silicon Valley hi-tech firm. Mr. Boyadjieff joined Southwall in December 2004.

Mr. Boyadjieff holds over 50 US patents related to oil and gas well drilling equipment. Mr. Boyadjieff holds BS and MS degrees in Mechanical Engineering from the University of California at Berkeley and is a graduate of the University of California at Irvine executive program.

Dr. Douglas Dunn — Dr. Dunn has had an extensive career in research, business and academic leadership. Dr. Dunn served as dean of Carnegie Mellon University's Graduate School of Industrial Administration (now the Tepper School of Business) from July 1996 through June 2002, after which he retired. He began his career at AT&T Bell Laboratories, and his corporate experienced culminated in senior positions as a corporate officer leading Federal Regulatory Matters, Regional Government Affairs, and Visual Communications and Multimedia Strategy for AT&T. Dr. Dunn is a board member of Universal Stainless & Alloy Products, Inc. (NasdaqNM: USAP). He holds a Ph.D. in business from the University of Michigan, an MS in industrial management and a BS in physics from the Georgia Institute of Technology.

Richard Morgan – Mr. Morgan is currently Of Counsel to the law firm of Lionel, Sawyer & Collins, and is the Dean Emeritus and a former Professor of Law at the William S. Boyd School of Law at the University of Nevada, Las Vegas, a position he held from September 1, 1997 through June 30, 2007. Mr. Morgan is an experienced legal educator, having served as dean at both the Arizona State University College of Law and the University of Wyoming College of Law. Mr. Morgan earned his B.A. in Political Science at the University of California, Berkeley in 1967. In 1971 he received his J.D. from UCLA, where he was an editor of the UCLA Law Review. He practiced with the Los Angeles law firm of Nossaman, Krueger & Marsh in the corporate/securities areas from 1971 to 1980. He was a professor at the Arizona State University College of Law from 1980 to 1987 and served as associate dean from 1983 to 1987. He was dean at the University of Wyoming College of Law from 1987 to 1990 and returned to the Arizona State University College of Law in 1990, where he served as dean and professor of law until 1997.

Gary Rado – Mr. Rado retired in 2002 after being the President of Casio Inc. USA for 3 years. He joined Casio in 1996 as an EVP to spearhead the move into the digital camera business. Before joining Casio, Mr. Rado was with Texas Instruments Inc. for 21 years. He was the Division Manager of the Consumer Products Division Worldwide and ran the division for 7 years, including two years while based in Europe. This division was responsible for home computer, calculator, and educational products. Mr. Rado earned a Bachelors of Science in Business Administration from Concord College in 1963.

Kenneth Dickey– Mr. Dickey is the co-founder of The Institute of Strategic Mapping, and has spent his extensive career learning how superior results can be achieved from very average businesses and how to translate this winning process into an understandable, reusable format. Mr. Dickey has been retired since February 2002. From October 1999 to February 2002, Mr. Dickey was Vice President Sales-Marketing for Safetronics, where he developed sales and marketing strategies, completed Safetronic's acquisition of Fincor Electric, a manufacturer of variable frequency drives, and ran that business unit. Prior to this, Mr. Dickey was the President/CEO of Cleveland Motion Control, Dynact Inc., and Motion Science, Inc., from February 1997 to October 1999. Prior to this, Mr. Dickey served as Senior Vice-President Sales for Reliance Electric/Rockwell Automation from 1994 thru 1996. His responsibilities included Sales/Marketing with 76 sales offices (located in the Americas), which generated more than $900 million in revenue. He also spent 9 years as the Operating General Manager of the Industrial Motor Division at Reliance Electric from 1986 to 1994. Mr. Dickey earned his Bachelor of Science degree in Finance from the University of Akron and an Executive MBA from Case-Western Reserve University.

On March 29, 2010, Gregory Curhan resigned from the Board of Directors. Mr. Curhan's resignation is not as a result of any disagreement with the Company on any matter relating to the Company's operations, policies or practices.

Board of Directors and Committees of the Board

Our business affairs are conducted under the direction of our board of directors. The role of our board of directors is to effectively govern our affairs for the benefit of our stockholders and, to the extent appropriate under governing law, of other constituencies, which include our employees, customers, suppliers and creditors. Our board strives to ensure the success and continuity of our business through the selection of a qualified management team. It is also responsible for ensuring that our activities are conducted in a responsible ethical manner. Our board of directors has two standing committees – an audit committee and a compensation committee.

Our board of directors met eight times in 2009.

We do not have a policy that requires directors to attend our annual meetings of stockholders. All but one of the directors attended the 2009 Meeting of Stockholders on July 16, 2009.

Audit Committee

Douglas Dunn, Richard Morgan and Gary Rado currently serve on our audit committee. Messrs. Dunn, Morgan and Rado are each independent directors as required by Section 301 of the Sarbanes-Oxley Act of 2002, Rule 10A(3)(b)(1) of the Securities Exchange Act of 1934 and Section 121(A) of the New York Stock Exchange Constitution and Rules. Raymond Skiptunis served as the Chairman of our audit committee from January 1 through April 20, 2009. Dr. Dunn, the current Chairman of our audit committee, qualifies as a financial expert. Our audit committee, among other things:

- selects the independent auditors, considering independence and effectiveness;
- receives the written disclosures and the letter from the independent accountant required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant's communications with the audit committee concerning independence, and has discussed with the independent accountant the independent accountant's independence;
- discusses the scope and results of the audit with the independent auditors and reviews with management and the independent auditors our interim and year-end operating results;
- discusses with the independent accountant the matters required to be discussed by Statement on Auditing Standards No. 114 (Communications with Audit Committees);
- considers the adequacy of our internal accounting controls and audit procedures;
- reviews and approves all audit and non-audit services to be performed by the independent auditors; and
- administers the whistleblower policy.

The audit committee has the sole and direct responsibility for appointing, evaluating and retaining our independent auditors and for overseeing their work.

Compensation Committee

Kenneth Dickey, Gary Rado and George Boyadjieff currently serve on our compensation committee. Messrs. Dickey, Rado and Boyadjieff are independent directors as required by SEC Rules and as defined in Section 121(A) of the American Stock Exchange Constitution and Rules. Mr. Dickey serves as the Chairman of our compensation committee. Our compensation committee, among other things:

- recommends to the board of directors the compensation level of the executive officers;
- reviews and makes recommendations to our board of directors with respect to our equity incentive plans;
- establishes and reviews general policies relating to compensation and benefits of our employees.

Committee Interlocks and Insider Participation

None of our executive officers currently serve as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving on our board of directors or compensation committee.

CODE OF ETHICS

The Company has not adopted a code of ethics. The Company has been focused on developing technology, generating sales and raising capital to support operations and consequently has not focused on adopting a code of ethics. In early 2006, the Company developed and implemented an official Employee Manual that requires ethical behavior from its employees, and defines the consequences of unethical behavior by its employees.

Executive Compensation

The following table summarizes compensation information for the last two fiscal years for (i) Mr. Steven Z. Strasser, our Principal Executive Officer and (ii) John (BJ) Lackland, our Principal Financial Officer, who were serving as executive officers at the end of the fiscal year and who we refer to collectively, the Named Executive Officers.

SUMMARY COMPENSATION TABLE

Name and principal position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Steven Z. Strasser(1)	2009	$ 304,730	-	-	-	-	-	-	$ 304,730
Chairman and Chief Executive Officer	2008	$ 311,208	-	-	-	-	-	-	$ 311,208