POWER EFFICIENCY CORP
Form 10KSB/A
September 09, 2002

Securities and Exchange Commission
Washington, D.C. 20549
FORM 10-KSB/A
Amendment No. 2 to Form 10-KSB

[X] Annual report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2001

[ ] Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ____________________ to __________________

Commission File Number: 000-31805

Power Efficiency Corporation
(Name of Small Business Issuer in its Charter)

Delaware	22-3337365
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

4220 Varsity Drive, Suite E Ann Arbor, Michigan	48108
(Address of Principal Executive Offices)	(Zip Code)

(734) 975-9111
(Issuer's Telephone Number, Including Area Code)

Securities Registered under Section 12(g) of the Exchange Act:

Common Stock, $.001 Par Value
(Title of Class)

Check whether the registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No _____

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. (X)

The issuer's revenues for the year ended December 31, 2001, were $633,563.

As of February 8, 2002, the aggregate market value of the common stock held by non-affiliates of the issuer was approximately $10,015,844. This amount is based on the average of the bid and asked price of $4.00 per share for the registrant's stock as of such date.

As of February 8, 2002, the issuer had outstanding 6,523,120 shares of common stock.

Transitional Small Business Disclosure Format (check one) : Yes _____ No X

AMENDMENT TO FORM 10-KSB

This Amendment No. 2 to the Registrant's Form 10-KSB for the fiscal year ended December 31, 2001 (the "Amendment") is filed to amend the information contained in certain Items listed in that report.

FORWARD-LOOKING STATEMENTS

This report and the documents incorporated into this report contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), including, but not limited to, statements relating to the Registrant's business objectives and strategy. Such forward-looking statements are based on current expectations, management beliefs, certain assumptions made by the Registrant's management, and estimates and projections about the Registrant's industry. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," "forecasts," "is likely," "predicts," "projects," "judgment," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict with respect to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may differ materially from those expressed, forecasted, or contemplated by any such forward-looking statements. The PSLRA does not apply to initial public offerings.

Factors that could cause actual events or results to differ materially include, but are not limited to, the following: continued market acceptance of the Registrant's line of Power Commander(R) products; the Registrant's ability to expand and/or modify its line of Power Commander(R) products on an ongoing basis; general demand for the Registrant's products, intense competition from other developers, manufacturers and/or marketers of energy reduction and/or power saving products; the Registrant's negative net tangible book value; delays or errors in the Registrant's ability to meet customer demand and deliver Power Commander(R) products on a timely basis; the Registrant's lack of working capital; the Registrant's need to relocate and/or upgrade its facilities; changes in laws and regulations affecting the Registrant and/or its products; the impact of technological advances and issues; the outcomes of pending and future litigation and contingencies; trends in energy use and consumer behavior; changes in the local and national economies; local and global uncertainties created by the terrorist acts of September 11 and the current war against terrorism; and other risks inherent in and associated with doing business in an engineering and technology intensive industry. See "Management's Discussion and Analysis or Plan of Operation." Given these uncertainties, investors are cautioned not to place undue reliance on any such forward-looking statements.

Unless required by law, the Registrant undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. However, readers should carefully review the risk factors set forth in other reports or documents that the Registrant files from time to time with the Securities and Exchange Commission (the "SEC"), particularly Annual Reports on Form 10-KSB, Quarterly Reports on Form 10-QSB and any Current Reports on Form 8-K.

GLOSSARY OF TERMS

Set forth below are technical terms used in the discussion in this document and explanations of the meanings of those terms.

Alternating Current (AC)	A type of electrical current, the direction of which is reversed at regular intervals or cycles; in the U.S. the standard is 120 reversals or 60 cycles per second; typically abbreviated as AC.
Ampere (amp)	A unit of measure for an electrical current; the amount of current that flows in a circuit; abbreviated as amp.
Apparent Power (KVA)	The product of volts times amperes in an electric current.
Audit (Energy)	The process of determining energy consumption, by various techniques, of a building or facility.
Current (Electrical)	The flow of electrical energy (electricity) in a conductor, measured in amperes.
Cycle	In an alternating current, the current goes from zero potential (or voltage) to a maximum in one direction, back to zero, and then to a maximum potential (or voltage) in the other direction. The number of complete cycles per second determines the current frequency; in the U.S. the standard for alternating current is 60 cycles.
Efficiency	Efficiency is the ratio of work (or energy) output to work (or energy) input, and cannot exceed 100 percent.
Energy	The capability of doing work.
Hertz	A measure of the number of cycles or wavelengths of electrical energy per second; U.S. electricity supply has a standard frequency of 60 hertz.
Horsepower (HP)	A unit for measuring the power of motors or the rate of doing work. One horsepower equals 33,000 foot-pounds of work per minute or 746 watts.
Induction	The production of an electric current in a conductor by the variation of a magnetic field in its vicinity.
Induction Motor	The simplest and most rugged electric motor, it consists of a wound starter and a rotor assembly. The AC induction motor is so named because the electric current flowing in its secondary member (the rotor) is induced by the

	alternating current flowing in its primary member (starter). The power supply is connected only to the starter. The combined electromagnetic efforts of the two currents produce the force to create rotation.
Inrush Current	The current that flows at the instant of connection of a motor to the power source. Usually expressed as a multiple of motor full-load current.

Kilowatt (kW)	A standard unit of electrical power equal to one thousand watts.
Load	The demand on an energy producing system. The energy consumption or requirement of a piece or group of equipment.
Losses (Energy)	A general term applied to the energy that is converted to a form that cannot be effectively used (lost) during the operation of an energy producing, conducting, or consuming system.
Motor	A machine supplied with external energy that is converted into force and/or motion.
Motor Speed	The number of revolutions that the motor turns in a given time period (i.e. revolutions per minute, or rpm).
Power	The rate at which work is done, typically measured in Watts or horsepower.
Power Factor	The ratio of watts to volt-amperes of an AC electric circuit.
Soft-start	Soft-start is the regulation of the supply voltage from an initial low value to full voltage during the starting process.
Staring Torque	The torque produced by a motor at rest when power is applied. For an AC machine, this is the locked-rotor torque.
Three-phase Current	Alternating current in which three separate pulses are present, identical in frequency and voltage, but separated 120 degrees in phase.
Torque (Motor)	The rotating force provided by a motor. The units of torque may be expressed as pound-foot, pound-inch (English system), or newton-meter (metric system).
Torque (Starting)	This torque is what is available to initially get the load moving and begin its acceleration.
Total Harmonic Distortion	The measure of closeness in shape between a

	waveform and its fundamental component.
Transformer	An electromagnetic device that changes the voltage of alternating current electricity; it consists of an induction coil having a primary and secondary winding and a closed iron core.
Voltage	The amount of electromotive force, measured in volts, that exists between two points.
Watt	The amount of power required to maintain a current of one ampere at a pressure of one volt when the two are in phase with each other. One horsepower is equal to 746 watts.
Wattmeter	A device for measuring power consumption.

PART I

Item 1. Description of Business

(a) Business Development

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

Recent Acquisition/Private Placement. On August 7, 2000, the Registrant executed an Asset Purchase Agreement (the "Asset Agreement") with Performance Control, L.L.C., a Michigan limited liability company and formerly the largest distributor of the Registrant's products ("Percon"). Percon was formed on February 15, 1996. Pursuant to the terms and conditions of the Asset Agreement, the Registrant acquired Percon's (i) contracts; (ii) inventory; (iii) state and municipal permits, certificates, registrations, licenses and authorizations; (iv) intellectual property, including the name "Performance Control"; (v) goodwill; (vi) accounts receivable; (vii) prepaid expenses; (viii) furniture, fixtures and equipment; (ix) customer lists; and (x) Internet web site located at www.performancecontrol.com (collectively the "Assets") in consideration for an aggregate of 1,112,245 newly issued shares of the Registrant's common stock, $.001 par value per share. The Registrant also assumed $438,888 of Percon's liabilities. After the purchase was completed, Percon amended its Articles of Organization and changed its name to Percon, LLC. As of the date of this filing, Percon had no operations and its sole asset was the Registrant's stock received pursuant to the Asset Agreement.

The closing of the Registrant's purchase of the Assets was conditioned upon the sale of a minimum of 12 units in the Registrant's May 16, 2000 private offering of a minimum of 12 ($300,000) units and a maximum of 40 ($1,000,000) units pursuant to the provisions of Rule 506 of Regulation D under the Securities Act of 1933, as amended (the "Securities Act"). Each unit consisted of 25,000 shares of the Registrant's common stock, $.001 par value per share, offered at $1.00 per share; and a five year warrant to purchase 25,000 additional shares of the Registrant's common stock at an exercise price of $3.00

per share during the first year, $4.00 per share during the second year and $5.00 per share during the third year. For additional information regarding the Registrant's May 16, 2000 private offering, see Part II, Item 5, "Recent Sales of Unregistered Securities."

Stockholders' Agreement. As part of the transaction with Percon, the Registrant, Nicholas Anderson and Anthony Caputo, the Registrant's two principal stockholders, and Percon, Philip Elkus and Stephen L. Shulman, Percon's two principal members, entered into a Stockholders' Agreement dated August 7, 2000 (the "Stockholders' Agreement"). The Stockholders' Agreement establishes two groups of stockholders: Messrs. Anderson and Caputo, on the one hand (the "Founders"), and Percon and Messrs. Elkus and Shulman, on the other hand (the "Percon Group").

The Stockholders' Agreement establishes two directors nominated by the Founders (the "Founders Directors") and one director nominated by the Percon Group (the "Percon Director"). The Stockholders' Agreement requires each stockholder group to elect the director nominee(s) of the other stockholder group and also provides certain rights of first refusal for one stockholder group to purchase the shares held by the other stockholder group before such shares may be sold to third parties.

There are certain actions of the Registrant that, under the Stockholders' Agreement, require supermajority approval. These actions include:

- o The purchase of any business or assets other than in the ordinary course of the Registrant's business;
- o Any sale, lease, assignment, transfer or disposition of all or substantially all of the Registrant's assets;
- o Any modification of the Certificate of Incorporation or By-laws; and
- o An initial public offering of the securities of the Registrant.

The Stockholders' Agreement terminates on the date of the first to occur of the following events: (i) the closing of the sale by one or more of the stockholders pursuant to one or more offerings registered under the Securities Act to any person or group of persons who are not, and who do not become, at the time of sale, parties to the Stockholders' Agreement of a number of shares equal to at least 50% of the maximum total number of shares beneficially owned by all of the stockholders at any time; (ii) bankruptcy, receivership, or dissolution of the Registrant; (iii) the voluntary agreement of all the parties who are then bound by the terms of the Stockholders' Agreement; (iv) the acquisition of all the shares by one of the stockholders; or (v) five years from the date of the Stockholders' Agreement.

(b) Business of the Registrant

The Registrant's Principal Products

Commencing in 1995, the Registrant commenced the sale of the Power Commander(R), its principal and proprietary product that reduces energy consumption in alternating current induction motors in industrial applications. In addition, the Power Commander(R) extends motor life, minimizes maintenance, results in cooler running, reduces stress and strain on the motor, and reduces stress and strain on accompanying electrical and mechanical systems. Technology and circuitry included in the Registrant's Power Commander(R) is the subject of a United States Patent granted in 1998. The Registrant offers the Power Commander(R) in two versions, each of which is a distinctly different product, marketed and sold to different audiences and having different applications. These two products are:

- the Three-Phase Power Commander(R) used in industrial and commercial applications; and

- the Single-Phase Power Commander(R) used in consumer applications such as home appliances and the like.

The Registrant's motor starter product is designed to soft start a motor, save energy, and protect and conserve the motor. It also has the capacity to act as a remote-switching device.

The Registrant offers the Power Commander(R) in a Three-Phase version and a Single-Phase version. The Registrant's marketing efforts have been initially focused on the Three-Phase Power Commander(R). Both versions of the Power Commander(R) reduce energy consumption on electrical equipment by electronically sensing and controlling the amount of energy the motor consumes. The motor with a Power Commander(R) installed only uses the energy it needs to perform its work task, thereby increasing its efficiency. The end result is a reduction of energy consumption of up to 15% to 35% in those applications which do not always run at peak load levels.

The Registrant's management believes that the Power Commander(R) line offers certain advantages over competing products for the following reasons:

- The Power Commander(R) is the result of field and laboratory engineering refinements undertaken since 1994. These refinements enable the Power Commander(R) to offer a control system which measures and monitors key motor operating conditions and adapts motor operating parameters during rapid changes in motor load, all without excessive vibration, synchronization problems or other material adverse effects to the motor or surrounding electrical and mechanical systems.

- Energy savings and motor efficiencies were verified through tests of the Power Commander(R) performed by three independent laboratories. Oak Ridge National Laboratory tested the Power Commander(R) and concluded that "significant energy savings due to lower electrical power demand can clearly be obtained in medium-sized and especially large-sized motor applications where the motor is frequently operating with no load." Oak Ridge's conclusions were based on tests that examined energy savings, motor temperature, and soft start impact.

- Another independent laboratory at Oregon State University determined that the Power Commander(R) converted electrical energy into mechanical energy at a more efficient rate than a motor without the unit. The test compared energy consumption and torque on a 15HP motor with and without the unit installed.

- Finally, Medsker Electric, Inc., an independent electric motor repair and test laboratory, performed a series of inrush current and energy savings tests on the Power Commander(R). The tests compared the Registrant's product to the products of three competitors. In its conclusions, Medsker stated that the Registrant's Power Commander(R) "exhibited twice the energy savings of the next nearest competitor." In addition, Medsker concluded that the Power Commander(R) "exhibited the best soft-start performance, reducing the motor inrush current by 71%." Finally, Medsker concluded that the Power Commander(R) "was the simplest to install and test, and was the best performer in terms of energy savings and inrush current reduction."

- In addition to the tests performed by independent laboratories, the Power Commander(R) was subjected to a performance case study by one of the Registrant's customers, Otis Elevator Company. In the Otis Elevator case study, the Power Commander(R) resulted in reduced energy consumption and lower operating temperatures. The case study examined the effects and energy savings obtained with a Power Commander(R) installed on a 10 horsepower AC induction motor operating a single width, single level escalator.

Three-Phase Power Commander(R). The initial market for the Three-Phase Power Commander(R) is the elevator and escalator industry, although the Registrant is marketing this product to other industries such as the plastics manufacturing, petroleum and automotive industries. Domestic sales in the elevator and escalator market were $6.5 billion in 2000. Based upon trade journals (e.g. Elevator World Source Book 2001-2002), there are approximately 699,725 elevators and 36,400 escalators currently in operation in North America alone. Additionally, approximately 24,725 new elevators and 1,400 new escalators, respectively, are installed annually in the domestic market. Each existing installation is a potential candidate for the retrofit of the Three-Phase Power Commander(R) and each new installation is a potential candidate for initial installation.

Various other markets such as conveyor systems, machine tools, mining equipment, crude oil pumps, weaving machines, etc., are believed to be viable target markets for the Three-Phase Power Commander(R) and the Registrant is seeking to build an Original Equipment Manufacturer ("OEM") and distributor base to address these markets.

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Single-Phase Power Commander(R). Like the Registrant's Three-Phase Power Commander(R) described above, the Registrant's Single-Phase Power Commander(R) reduces energy consumption in electrical equipment by sensing and controlling the amount of energy the motor consumes. Most motors commonly used in home appliances and other consumer goods are Single-Phase motors.

Since the Single-Phase Power Commander(R) is usable in a broad variety of contexts and can be installed when the motor is assembled with little effort or expense, it is a product suitable for installation at the OEM level or large volume sales and installation. Consequently, the Registrant's marketing plan for the Single-Phase Power Commander(R) is to identify the major OEMs that can best utilize the Single-Phase Power Commander(R).

Registrant's Motor Starter Product. The Registrant's motor starter product is designed to soft start a motor, which saves energy and protects the motor, and has the capacity to act as a remote-switching device. The motor starter product is still under development and management expects to complete the development and release of this product in fiscal 2002.

Research and Development

The Registrant intends to continue its research and development effort to introduce new products based on the Power Commander(R) solid-state technology. Towards this end, the Registrant spent $242,243 in fiscal 2001 and $120,429 in fiscal 2000 on research and development activities, virtually none of which was borne by customers. In addition, and for the foreseeable future, the Registrant intends to limit its research and development activities to secondary products for Three-Phase industrial and commercial AC induction motors. Two of these products are (i) a soft starting motor starter (without energy saving features) to compete with existing transformer and other electro-mechanical type motor starters; and (ii) a high voltage energy saving motor controller for motors ranging in sizes from 2000 to 6000 volts.

Marketing and Sales

The Registrant's marketing efforts for the Power Commander(R) have been concentrated in several industries in which the Registrant's principal stockholders have significant experience. These areas include the elevator and escalator industry; national electrical supply houses; large real estate property management companies; the oilfield supply industry; and to a lesser extent, public transportation systems. From inception through December 31, 2001, a total of 3,951 of the Registrant's motor controllers were sold to more than 120 of the OEM's customers located throughout the United States and Asia under the following brands: Performance Controller(TM), Power Commander(R), Energy Master, Current Control, and Ecostart. Customer industry profiles include retail outlets, public transportation, hotels, manufacturers and federal government facilities. This unit total includes sales made by Percon's OEM's and distributors prior to selling its assets to the Registrant.

As the Registrant's operations are scaled up and revenues from the sale of the Power Commander(R) grow, the Registrant intends to simultaneously (i) market the Power Commander(R) through OEMs to other compatible industries such as conveyor and line production systems, machine tools and other industrial applications, and (ii) develop and market its motor starter product line.

The Registrant is a party to four material contracts for the sale of Power Commander(R) products. The first contract is an annual contract with Montgomery KONE, Inc., the world leader in escalator sales. The contract was executed on December 1, 1998, and was renewed on August 21, 2001, extending the contract until December 1, 2002. It is a requirements contract and covers the sale of motor controllers manufactured under the brand name Ecostart. The Ecostart brand name is exclusive to KONE and also contains a safety circuit designed specially for KONE.

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The second contract is a contract for the sale of Performance Controller(TM) brand products to the Defense Logistics Agency of the federal government of the United States of America. The original contract was executed on January 12, 2000, and expired on January 11, 2002. An extension of the contract has been negotiated and the Registrant is awaiting final confirmation of the terms. It is a requirements contract that enables the Defense Logistics Agency to purchase up to $398,000 worth of products annually without having to utilize the government bidding procedures.

The third contract is an open purchase order from Otis Elevator Company for the sale of Performance Controller(TM) brand devices developed for elevators. The purchase order was executed on August 8, 2000, and expires on October 31, 2002. The open purchase order is for purchases up to $100,000, and is expected to be renegotiated upon reaching the purchase limit.

The fourth contract is with Millar Elevator Corporation, the service arm of Schindler Elevator Corporation. The contract was executed on August 17, 2000, whereby Millar agreed to purchase Power Commander(R) motor controllers under the brand name "Current Control." The contract was renewed on October 5, 2001, extending the contract until September 1, 2002.

Manufacturing

The Registrant has an arrangement with a leading manufacturer in the electronics industry, Q.C. Corporation d/b/a System Controls. System Controls manufactures units for the Registrant on an as-needed basis. Under the arrangement, the Registrant issues a purchase order to System Controls that outlines, among other things, the number of units to be manufactured and the price per unit. System Controls is under no obligation to accept the order and the Registrant is under no obligation to use System Controls for its manufacturing needs.

The Registrant leases space in Ann Arbor, Michigan, where it performs activities such as component assembly, quality assurance, quality control and packaging. Management believes the arrangement between the Registrant and System Controls has been mutually beneficial to both and expects that the relationship will continue. System Controls' production capacity is approximately 1,000 units per month. The Registrant believes, however, that leasing new or additional space to increase the manufacturing capacity in the Detroit area can be done cost-effectively, as production of the Registrant's product does not require expensive, capital-intensive equipment.

The Registrant is in the final pre-production testing of electronic modules incorporating the latest gating switches. Switching to these modules would replace other more costly components used in the manufacture of the Power Commander(R) and would also eliminate several labor intensive assembly steps. Total per unit cost savings (component cost savings and labor cost savings) are estimated to be approximately 30% compared to current production methods.

Product cost-reduction efforts are, and will remain, a focal point of the Registrant. One key element of the program includes an aggressive manufacturing and engineering effort to reduce production cycle times as well as material and processing costs. A second element of the program is to out-source production operations. Management believes the assembly of printed circuit boards by outside suppliers, with automated assembly and test equipment, should reduce costs and ensure quality. As the product volumes increase, the Registrant expects to recognize favorable purchasing economies, increased labor efficiencies and improved overhead absorption. Also, the Registrant is evaluating offshore manufacturing in order to help reduce production costs.

Source of Supply and Availability of Raw Materials

The Power Commander(R) motor controller and the Registrant's motor starter product have both been designed to use standard, off-the-shelf, easily acquired components. Such components are basic items that are readily available worldwide at competitive prices. They come in standard and miniature versions and offer the Registrant large latitude in product design. Both the Power Commander(R) motor controller and the motor starter use a combination of components. Although the Registrant believes that 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 that they will remain so readily available.

Competition

The principal competitive factors in the Registrant's markets include innovative product design, product quality, product performance, utility rebate acceptance, established customer relationships, name recognition, distribution and price.

The Registrant competes against a number of 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 Registrant 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 Registrant to commence and expand its operations or operate in a profitable manner.

Motor Starter Competition. The Registrant believes that expected competition in the motor starter market will be more intense than that for the Power Commander(R) because:

- The potential market for the Registrant's motor starter product is much larger than that for motor controllers in general and the Power Commander(R) in particular;
- Competitors in the motor starter field are more numerous and generally much larger compared to competitors in the motor controller field; and
- The motor starter is a staple product type and is currently being sold by nearly all companies in the electrical component business.

Three-Phase Competition. Although the Registrant has not conducted any formal market study, the Registrant believes its Three-Phase Power Commander(R) has the following competitive advantages:

- The Power Commander(R) is the only device management is aware of that combines soft start features with energy savings features in a single integrated unit that achieves energy savings levels of up to 15% to 35%;
- The Power Commander(R) analog circuitry is proprietary and protected by a patent; and
- Energy saving motor controllers claimed to be competitive with the Power Commander(R) (i.e., Fairford, Power Boss and Power Planner) utilize technologies inferior to the Registrant's technology because:
- Their products achieve lower levels of energy savings in comparable applications compared to the Power Commander(R) (see Part I, Item 1 "Description of Business," pages 6-7 for a description of the independent tests performed on the Registrant's products); and
- Their digital design produces extensive harmonic distortion.

Insofar as high efficiency motor replacement is concerned, management believes that the energy savings gain attributable to high efficiency motors is materially lower than that of the Power Commander(R). In addition, the in-rush amperage needed to start an energy efficient motor is many times higher than that needed to start a conventional motor. This factor is made worse because the purchase of a new motor does not provide a soft starting capability without the purchase of a separate soft start device.

Single-Phase Competition. Because of the enormous opportunity in single-phase motor applications, there have been several companies that have, with different technologies, tried to exploit this market. The "Green Plug" (voltage clamping), "Power Planner" (digital microchip) and "Econelectric" (power factor control) are products that have created industry awareness. To the best of Registrant's belief, however, none of these products have remained on the market.

Patents and Proprietary Rights

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

Apart from its rights under the NASA License Agreement, which is described below, the Registrant 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, which were developed by the Registrant. Management believes this patent protects the Registrant's intellectual property position beyond the expiration of the NASA License Agreement because:

- o the circuitry covered by the Registrant's patent more effectively reduces the motor vibration; and

- o the circuitry eliminates most of the balance and synchronization problems that are created by other energy saving motor controllers, including those that would eventually use the licensed NASA technology upon the expiration of the underlying NASA patents.

The Registrant has additional proprietary technology being assessed for patent filing.

NASA License Agreement. The Registrant is 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 covers the USA and its territories and possessions and does not require the Registrant to pay royalties to NASA in connection with the Registrant's sale of products employing technology utilizing the licensed patents. The Registrant's rights under the license agreement are non-transferable and may not be sublicensed without NASA's consent. The license agreement terminates upon the expiration of all of the licensed patents, currently December 16, 2002. The Registrant is only aware of one additional non-USA based non-exclusive licensee in Japan. This licensee has limited its product development to large motors that range in size from 100 HP and up and also has focused its sales effort solely within the Japanese market.

The Registrant believes that its products and other proprietary rights do not infringe any proprietary rights known to be 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 extensive.

The Registrant has obtained U.S. Trademark registration of the Power Commander(R) mark.

Employees

At the date of this document, the Registrant employs 10 persons on a full time basis. Of this number, one person is engaged in administration/international sales, one in operations management, two in sales and marketing, one in engineering/administration, two in engineering/production, one in accounting and finance, one in technical support and one in clerical, stenographic and reception. At such time as business conditions dictate, the Registrant expects to hire additional personnel for, among other things, increased production, marketing and sales. The Registrant has no collective bargaining agreements and considers its relationship with its employees to be good. The Registrant utilizes consultants in the areas of electrical and mechanical engineering, manufacturing engineering, and financing and strategy on an ongoing basis.

Customers

The Registrant currently does business with approximately 25 customers. Of this number, four, including Otis Elevator Company (Division of United Technologies), KONE, Inc., Millar Elevator Service Co. (the service arm of Schindler Elevator), and the Defense Logistics Agency of the federal government of the United States of America, presently account for approximately 80% of the Registrant's gross revenues. In light of the Registrant's intentions to focus its business on OEMs in the elevator, oil field pump and manufacturing industries, the Registrant may be deemed to be and 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 upon the Registrant's business.

Government Regulation

The Registrant is not required to be certified by any government agencies. However, the Registrant's products are manufactured to comply with specific Underwriters' Laboratory codes that meet national safety standards. Presently, the Registrant's products comply with UL 508 standards and the Registrant has also begun the certification to meet CSA (Canadian electrical standards). The Department of Commerce does not require the Registrant's technology to be certified for export. The Registrant's industrial code is 421610 and the SIC code is 5063.

Deregulation of Electrical Energy

Deregulation of the electrical energy markets is widely expected to create increased competition and increased demand for all products that reduce energy consumption.

Effect of Environmental Regulations

The Registrant 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 Registrant has had, or is expected to have, a material effect upon the capital expenditures, earnings, or competitive position of the Registrant.

Risk Factors

Limited Capitalization. As of the date of this document, the Registrant continues to have limited working capital and will be dependent upon additional financing to meet its capital needs. There can be no assurance that any additional financing will be available on acceptable terms, if at all. The Registrant needs additional capital to expand its operations and fully implement its business plan.

Limited Operating History, Manufacturing and Distribution Arrangements. To date, and principally attributable to a lack of working capital, the Registrant's operations have been limited in scale. Although the Registrant has an arrangement with an automated production facility, has established relationships with suppliers, and received contracts for its products, the Registrant may experience difficulties in production scale-up, inventory management, product distribution and obtaining and maintaining working capital until such time as the Registrant's operations have been scaled-up to normal commercial levels. There can be no assurance that the Registrant will operate profitably.

Registrant's License From NASA About to Expire. The basic technology upon which the Registrant's products are based is derived from a patent license agreement by and between the Registrant and NASA, which expires December 16, 2002. The Registrant's license from NASA is exclusive for the USA and non-exclusive worldwide, although the Registrant is one of only two licensees of NASA's Power Factor Controller Technology worldwide. NASA has waived any and all future payments by the Registrant for use of the NASA patents. The license expires upon expiration of NASA's underlying patents, at which time anyone, including the Registrant, will be free to use the underlying NASA technology. The Registrant has also made certain improvements to the basic technology covered by the NASA license, which may place the Registrant in a competitively superior position to the other licensee. No assurance can be given, however, that the other licensee (a Japan based company) will not seek to improve the basic technology in a manner similar to that of the Registrant.

Supplier Dependence. Although the Registrant believes that 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 that they will 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 the Registrant. Also, in the event that the Registrant, or its contract manufacturer, as applicable, is unable to develop or acquire components in a timely fashion, the Registrant's ability to achieve production yields, revenues and net income would be adversely affected.

Sales and Marketing Risks. The Registrant's products are currently distributed through OEMs. The Registrant's future growth and profitability will depend upon the successful development of business relationships with additional OEMs and upon their ability to penetrate the market with the Registrant's products.

Competition; Rapid Technological Change. The Registrant competes against a number of 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 Registrant 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 Registrant to expand its operations or operate profitability. The motor control industry is highly competitive and characterized by rapid technological change. The Registrant's future performance will depend in large part upon its 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 the Registrant is not competitive in its ongoing research and development efforts, its products may become obsolete, or be priced above competitive levels. Although management believes that, based upon their performance and price, the Registrant's products are attractive to customers, there can be no assurance that competitors will not introduce comparable or technologically superior products, which are priced more favorably than the Registrant's products.

Retail Price of Electrical Energy. A customer's decision to purchase the Power Commander(R) is partly 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 the Registrant's products, there can be no assurances that future retail pricing of electrical energy will remain at such levels.

No Cash Dividends on Common Stock. The Registrant has not paid or declared any dividends on its common stock and does not anticipate paying or declaring any cash dividends on its common stock in the foreseeable future.

Possible Resales Under Rule 144.

Of the approximately 6,523,120 shares of the Registrants common stock outstanding on February 8, 2002, 1,928,100 shares are freely trading in the market place (the "Free Trading Shares"). The Free Trading Shares are comprised mostly of shares that were originally issued to officers, directors and 10% shareholders (the "Affiliates") of the Registrant, which shares were, over time, resold pursuant to Rule 144, as set forth below.

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The remaining 4,595,020 shares of the Registrant's common stock outstanding are restricted securities as defined in Rule 144 under the Securities and under certain circumstances may be resold without registration pursuant to Rule 144. Approximately 950,424 shares of the restricted securities are held by non-Affiliates.

In addition, the Registrant has issued approximately 810,720 common stock purchase warrants and has granted approximately 1,958,640 stock options. Neither the granting of options nor the issuance of warrants have been registered under the Securities Act, but may, under certain circumstances, be available for public sale in the open market pursuant to Rule 144, subject to certain limitations.

In general, under Rule 144, a person (or persons whose shares are aggregated) who has satisfied a one-year holding period 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. Rule 144 also permits, under certain circumstances, the sale of securities, without any limitation, by a person who is not an Affiliate, as such term is defined in Rule 144(a)(1), of the Registrant and who has satisfied a two-year holding period. Any substantial sale of the Registrant's common stock pursuant to Rule 144 may have an adverse effect on the market price of the Registrant's shares.

Potential Effect of Penny Stock Rules on Liquidity of Shares. If the

Registrant's securities are not listed on The Nasdaq Stock Market or certain other national securities exchanges and the price thereof is below $5.00, then subsequent purchases of such securities will be subject to the requirements of the penny stock rules absent the availability of another exemption. The SEC has adopted rules that regulate broker-dealer practices in connection with transactions in "penny stocks." Penny stocks generally are equity securities with a price of less than $5.00 (other than securities registered on certain national securities exchanges or quoted on The Nasdaq Stock Market). The penny stock rules require a broker-dealer to deliver a standardized risk disclosure document required by the SEC, to provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, monthly account statements showing the market value of each penny stock held in the customer's account, to make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. These disclosure requirements may have the effect of reducing the level of trading activity in the secondary market for a stock that becomes subject to the penny stock rules.

Limitation on Directors' Liabilities under Delaware Law. Pursuant to the Registrant's Certificate of Incorporation and under Delaware law, directors of the Registrant are not liable to the Registrant or its 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 involve 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.

Authorization and Discretionary Issuance of Preferred Stock. The Registrant'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, the Registrant's 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 the Registrant's common stock. In the event of issuance, the preferred stock could be used, under certain circumstances, as a method of discouraging, delaying or preventing a change in control of the Registrant, which could have the effect of discouraging bids for the Registrant and thereby prevent stockholders from receiving the maximum value for their shares. Although the Registrant has no present intention to issue any shares of its preferred stock, there can be no assurance that the Registrant will not do so in the future.

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Product Liability Risk. The Registrant may be subject to potential product liability claims that could, in the absence of sufficient insurance coverage, have a material adverse impact on the Registrant. Presently, the Registrant has general liability coverage that includes product liability up to two million dollars. Any large product liability suits occurring early in the Registrant's growth may significantly and adversely affect the Registrant's ability to expand the market for its Power Commander(R) line of products.

No Key Man Insurance. The Registrant presently has no key man life insurance policies. As soon as practicable following the commencement of profitable operations (of which there can be no assurance), the Registrant intends to purchase key man life insurance on the lives of its two principal executive officers, Stephen L. Shulman and Nicholas Anderson. Upon purchase of such insurance, the Registrant intends to pay the premiums and be the sole beneficiary. The lack of such insurance may have a material adverse effect upon the Registrant's business.

Line of Credit with Bank One. In December 2000, the Registrant obtained an asset-based bank line of credit of up to $750,000, with borrowings secured by all of the Registrant's assets. Borrowings under the line are based on a formula derived from the levels of the Registrant's eligible accounts receivable and inventory. The line of credit agreement was extended effective February 1, 2002 until April 30, 2002. This extension was retroactive and occurred after the date of the Auditor's Report included in this filing. At the time of this filing, the Company was in default under the terms of the line of credit agreement. Under the agreement, the Company's borrowings may not exceed the amount calculated pursuant to a borrowing formula (see Note 8 to the Financial Statements). Based on the formula, the Company exceeded its borrowing capacity by approximately $132,000 on December 31, 2001. On May 31, 2002, the Company received a letter from Bank One, a copy of which is attached hereto as Exhibit 10.22, in which Bank One agreed to forebear from taking any collection activity concerning the expired line of credit until June 17, 2002. If an extension of the line of credit is not received by June 17, 2002, the bank has the right under the line of credit agreement to demand immediate payment of all amounts owed. In such an event, it is unlikely the Company would have sufficient available funds to pay Bank One all amounts owed and could be forced to transfer other assets, including inventory and accounts receivable, to Bank One in satisfaction of the debt, which would have a material adverse effect on the future operations, cash flow and liquidity of the Company. Management is currently negotiating an extension of the line of credit agreement and is hopeful that the default will be waived or cured.

Potential Violation of Section 5 of the Securities Act. In its original Form 10-SB, filed on October 20, 2000, the Company inadvertently filed its Private Placement Memorandum as an Exhibit. This may constitute general solicitation under Rule 502(c) of Regulation D and the Registrant may be in violation of Section 5 of the Securities Act of 1933 and be unable to avail itself of the exemption found in Rule 506 of Regulation D as to that offering. The Company believes it can establish pre-existing connections with all purchasers under the Private Placement Memorandum. If proceedings based on this inadvertent filing were commenced against the Registrant, purchasers under the Private Placement Memorandum, possibly together with other purchasers of the Company's securities, may make claim for rescission of their investments, which if successful may exceed $725,000. Such claims would be subject to any applicable defenses that the Registrant may assert, including statute of limitations. The last sales under the Private Placement Memorandum were made in March 2001. Therefore, the Registrant believes that the statute of limitations for such claims under the Securities Act has expired.

PART II

Item 6. Management's Discussion and Analysis or Plan of Operation

Overview

The Registrant generates revenues from a single business segment: the design, development, marketing and sale of proprietary solid state electrical components designed to reduce energy consumption in alternating current induction motors.

The Registrant began generating revenues from sales of its patented

Power Commander(R) line of motor controllers in late 1995. As of December 31, 2001, the Registrant had total stockholders' equity of $1,386,929 primarily as a result of the Registrant's August 7, 2000, purchase of the assets of Percon, formerly the largest distributor of the Registrant's products. The transaction was accounted for as a purchase and the Registrant's Statement of Operations includes Percon's results of operations since the date of acquisition.

The consolidation of both the operations of entities allowed the Registrant to integrate the administrative, sales, marketing and manufacturing operations of Percon. Percon had developed sales contacts with major OEM's in the elevator/escalator industry and transferred those agreements to the Registrant as part of the Asset Agreement. The fully integrated organization allowed the Registrant to obtain an asset-based bank line of credit of up to $750,000 for the build up in inventory collateralized by the current inventory and accounts receivable. Also, capital raised in the May 2000 Private Placement (see PART II, Item 5) enabled the Registrant to address the consolidated accounts payable.

Results of Operations: Fiscal 2001 Compared to Fiscal 2000

Revenues. Revenues for the twelve months ended December 31, 2001, were $633,563 compared to $179,524 for the twelve months ended December 31, 2000, an increase of $454,039, or 253%. The increase in revenues was principally attributable to the increase in sales by the Company's OEM's and major accounts expanding their use of the Company's products.

The Company had negative sales in the 4th quarter of fiscal year 2001 because of a sales return during that quarter which was due to a customer overstocking the Company's products. In connection with this sales return, the Company expensed $219,881 in cost of sales in the operating results for this quarter which is reflected in the "fixed manufacturing overhead expenses," (e.g. salaries, payroll taxes, employee benefits, insurance, travel, tools and supplies, etc.) incurred during the 4th quarter. As these costs could not be booked to inventory or be capitalized, the Company expensed these costs as "cost of sales," in the 4th quarter.

Cost of revenues. Cost of revenues for the twelve months ended December 31, 2001, increased to $597,018, or 94.2% of revenues, from $157,035, or 87.4% of revenues, for the twelve months ended December 31, 2000. The increase in cost of revenues was primarily due to the increase in revenues and the cost of materials attributable to the acquisition of Percon inventory.

Research and development. Research and development expenses were $242,243, or 38% of revenues, for the twelve months ended December 31, 2001, as compared to $120,429, or 67% of revenues, for the twelve months ended December 31, 2000. The development of automatic safety systems for products with public applications increased research and development costs.

Selling, general and administrative. Selling, general and administrative expenses decreased to $1,652,404, or 261% of revenues, for the twelve months ended December 31, 2001, from $4,255,940, or 2,371% of revenues, for the twelve months ended December 31, 2000. The significant decrease in selling, general and administrative expenses was due primarily to the prior year's recognition of compensation expense attributable to the issuance and repricing of options. The options were issued with an exercise price of $2.00 per share, which was below the fair market value of the stock at the time of issuance. The difference between the exercise price and the fair market value was recorded as compensation expense in the amount of $3,649,776. There was an increase in 2001 general expenses due to increases in sales, marketing and administrative personnel from eight to ten.

Financial Condition, Liquidity, and Capital Resources: For the Year Ended December 31, 2001

Since inception, the Registrant has financed its operations primarily through the sale of its equity securities and using bank borrowings. As of December 31, 2001, the Registrant has received a total of approximately $2,257,261 from public and private offerings of its equity securities and received approximately $445,386 under a bank line of credit. As of December 31, 2001, the Registrant had cash and cash equivalents of $35,245.

Cash used for operating activities for the twelve months ended December 31, 2001, was $1,107,265 and was $669,184 in 2000. Of the $1,107,265 of cash used for operating activities in 2001, the largest contributing factors were a net loss of $1,863,802, depreciation and amortization of $281,587, additional paid in capital related to write-off of deferred financing costs of $38,502, debt restructuring of $130,000, issuance of stock options of $47,300, decreases in accounts receivable of approximately $103,048, increases in inventory of approximately $83,091 and increases in prepaid expenses and deposits of $9,057. In addition, operating activities reflected a $216,426 increase in accounts payable and accrued expenses and an increase in accrued salaries and payroll taxes of $31,822. Of the $669,184 of net cash used for operating activities in fiscal 2000, the largest contributing factors were a net loss of $4,354,080 and repricing and issuance of stock options of $3,649,776, which were offset by approximately $138,154 in depreciation and amortization and an increase in accounts receivable of approximately $43,916. In addition, there was a decrease in accounts payable and accrued expenses of approximately $106,727 and an increase in accrued salaries and payroll taxes of approximately $14,930.

The Registrant expects to experience growth in 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 Registrant anticipates that operating expenses, as well as planned increases in inventory expenditures, will constitute a material use of any cash resources.

Since capital resources are insufficient to satisfy the Registrant's liquidity requirements, management intends to seek to sell additional equity securities or debt securities or obtain debt financing. In December 2000, the Registrant obtained an asset-based bank line of credit of up to $750,000, with borrowings secured by all of the Registrant's assets. Borrowings under the line are based on a formula derived from the levels of the Registrant's eligible accounts receivable and inventory. The line of credit agreement was extended effective February 1, 2002 until April 30, 2002. This extension was retroactive and occurred after the date of the Auditor's Report included in this filing. At the time of this filing, the Company was in default under the terms of the line of credit agreement. Under the agreement, the Company's borrowings may not exceed the amount calculated pursuant to a borrowing formula (see Note 8 to the Financial Statements). Based on the formula, the Company exceeded its borrowing capacity by approximately $132,000 on December 31, 2001. On May 31, 2002, the Company received a letter from Bank One in which Bank One agreed to forebear from taking any collection activity concerning the expired line of credit until June 17, 2002. If an extension of the line of credit is not received by June 17, 2002, the bank has the right under the line of credit agreement to demand immediate payment of all amounts owed. In such an event, it is unlikely the Company would have sufficient available funds to pay Bank One all amounts owed and could be forced to transfer other assets, including inventory and accounts receivable, to Bank One in satisfaction of the debt, which would have a material adverse effect on the future operations, cash flow and liquidity of the Company. Management is currently negotiating an extension of the line of credit agreement and is hopeful that the default will be waived or cured.

In its original Form 10-SB, filed on October 20, 2000, the Company inadvertently filed its Private Placement Memorandum as an Exhibit. This may constitute general solicitation under Rule 502(c) of Regulation D and the Registrant may be in violation of Section 5 of the Securities Act of 1933 and be unable to avail itself of the exemption found in Rule 506 of Regulation D as to that offering. The Company believes it can establish pre-existing connections with all purchasers under the Private Placement Memorandum. If proceedings based on this inadvertent filing were commenced against the Registrant, purchasers under the Private Placement Memorandum, possibly together with other purchasers of the Company's securities, may make claim for rescission of their investments, which if successful may exceed $725,000. Such claims would be subject to any applicable defenses that the Registrant may assert, including statute of limitations. The last sales under the Private Placement Memorandum were made in March 2001. Therefore, the Registrant believes that the statute of limitations for such claims under the Securities Act has expired.

Cash Requirements and Need for Additional Funds

The Registrant anticipates a substantial need for cash to fund its working capital requirements for the next twelve months. During the next 12 months in accordance with the Registrant's prepared expansion plan, it is the opinion of management that approximately $3,000,000 would be required to fill existing orders and to expand the Registrant's marketing, sales and operations during the next twelve months.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities -- Deferral of the Effective Date of FASB No. 133," and SFAS No. 138, "Accounting for Certain Derivative Instruments and Hedging Activities." SFAS 133 requires that all derivative financial instruments be recorded on the balance sheet at their fair market value. Changes in the fair market value of derivatives are recorded each period in current earnings (loss) or comprehensive income (loss), depending on whether a derivative is designed as part of a hedge transaction, and if so, the type of hedge transaction. Virtually all of the Registrant's revenues and the majority of its costs are denominated in U.S. dollars, and to date, the Registrant has not entered into any derivative contracts. The effective date of SFAS 133, as amended by SFAS 137 and SFAS 138, is for fiscal years beginning after June 15, 2000.

In December 1999, the Securities and Exchange Commission released Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"), which provides guidance on the recognition, presentation and disclosure of revenue in financial statements. The Registrant has complied with the provisions of SAB 101 for all periods presented.

In March 2000, the FASB issued Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation -- an Interpretation of APB 25" ("FIN 44"). This interpretation clarifies the definition of an employee for purposes of applying Opinion 25; the criteria for determining whether a plan qualifies as a noncompensatory plan; the accounting consequence of various modifications to the terms of a previously fixed stock option plan or award; and the accounting for an exchange of stock compensation awards in business combinations. FIN 44 is generally effective July 1, 2000. The adoption of certain of the provisions of FIN 44 prior to December 31, 2000, did not have a material effect on the financial statements. The Registrant does not expect that the adoption of the remaining provisions will have a material effect on the financial statements.

The Registrant will adopt the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," for the year ended December 31, 2002. SFAS No. 142 requires that goodwill shall no longer be amortized. Goodwill amortization for the year ended December 31, 2001 was $142,080. Goodwill shall be tested for impairment on an annual basis and between annual tests in certain circumstances. SFAS No. 142 shall initially be applied at the beginning of the fiscal year. Previously recognized intangible assets deemed to have indefinite useful lives will be tested for impairment as of the beginning of fiscal 2002 and transitional intangible impairment tests will be completed in the first interim period. Any resulting impairment loss shall be recognized as a change in accounting principle. An annual goodwill impairment test will be performed in addition to the transitional goodwill impairment test. The impairment test shall consist of a comparison of the fair value of an intangible asset with its carrying amount. If the carrying amount of an intangible asset exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess. The loss recognized cannot exceed the carrying amount of goodwill. After an impairment loss is recognized, the adjusted carrying amount of the intangible asset shall be its new accounting basis. Subsequent reversal of a previously recognized impairment loss is prohibited. The Registrant does not expect this new reporting standard to have any immediate, significant impact on operations because the quoted market price of the Registrant's common stock on the balance sheet date and the date of this report exceeds the stock valuation at the August 7, 2000 acquisition date.

Item 7. Financial Statements

POWER EFFICIENCY CORPORATION

DECEMBER 31, 2001 AND 2000

INDEX

INDEPENDENT AUDITORS' REPORT

Board of Directors and Stockholders
Power Efficiency Corporation
Ann Arbor, Michigan

We have audited the accompanying balance sheet of Power Efficiency Corporation, (a Delaware corporation) (the "Company") as of December 31, 2001, and the related statements of operations, changes in stockholders' equity, and cash flows for each of the years ended December 31, 2001 and 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of Power Efficiency Corporation at December 31, 2001 and the results of its operations and its cash flows for the years ended December 31, 2001 and 2000 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the financial statements, the Company has suffered recurring losses from operations, current liabilities exceed current assets by $650,533, the balance sheet reflects a negative tangible net worth, and the line of credit agreement expired January 31, 2002 and is subject to call. These matters raise substantial doubt as to the Company's ability to continue as a going concern. Management's plans in regard to these matters are also discussed in Note 3. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Sobel & Co., LLC
Certified Public Accountants

March 5, 2002, except for the last paragraphs
of Notes 8 and 17, as to which the dates are
May 31, 2002 and May 5, 2002, respectively.
Livingston, New Jersey

POWER EFFICIENCY CORPORATION

BALANCE SHEET
DECEMBER 31, 2001

ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 35,245
Accounts receivable, net of reserve of $5,000	11,118
Inventory	609,545
Total Current Assets	655,908
PROPERTY AND EQUIPMENT, Net	148,565
OTHER ASSETS:	
Deposits	15,500
Patent application costs, net	15,987
Goodwill, net	1,929,963
Customer contracts, manuals and sales literature, net	154,352
Website and customer list, net	73,095
Total Other Assets	$ 2,188,897
	$ 2,993,370
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Line of credit agreement	$ 445,386
Accounts payable and accrued expenses	672,122
Accrued salaries and payroll taxes	83,433
Stockholder and officers' loans payable	105,500
Total Current Liabilities	1,306,441
LONG-TERM LIABILITIES	
Stockholder note payable	300,000
Total Liabilities	1,606,441
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS' EQUITY:	
Preferred stock, $.001 par value, 10,000,000 shares authorized, none outstanding	--
Common stock, $.001 par value, 50,000,000 shares	
Additional paid-in capital	8,869,914
Accumulated deficit	(7,489,508)
Total Stockholders' Equity	1,386,929
	$ 2,993,370

See independent auditors' report and notes to financial statements.

POWER EFFICIENCY CORPORATION
STATEMENTS OF OPERATIONS

	Year Ended December 31, 2001	Year Ended December 31, 2000 (Restated)
REVENUES	$ 633,563	$ 179,524
COSTS AND EXPENSES:		
Cost of sales	597,018	157,035
Research and development	242,243	120,429
Selling, general and administrative	1,652,404	4,255,940
Total Costs and Expenses	2,491,665	4,533,404
LOSS BEFORE PROVISION FOR INCOME TAXES	(1,858,102)	(4,353,880)
PROVISION FOR INCOME TAXES	(5,700)	(200)
NET LOSS	$(1,863,802)	$(4,354,080)
BASIC LOSS PER COMMON SHARE	$ (0.29)	$ (0.86)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	6,409,000	5,034,000

See independent auditors' report and notes to financial statements.

POWER EFFICIENCY CORPORATION
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2002 AND 2000

Common Stock Additional

	Shares	Amount	Paid-in Capital	Accu De
BALANCE, January 1, 2000	4,383,600	$ 4,384	$ 1,123,718	$(1,
Common stock sold at various times during the year, net of costs	500,000	500	434,559	
Common stock issued for services rendered	47,525	47	73,765	
Repricing and issuance of stock options	--	--	3,649,776	
Common stock issued in conjunction with acquisition of assets of Performance Control, LLC	1,112,245	1,112	2,668,276	
Net loss, 2000	--	--	--	(4,
BALANCE, December 31, 2000 (restated)	6,043,370	6,043	7,950,094	(5,
Common Stock sold at various times during the year, net of costs	343,750	344	609,656	
Issuance of stock options	--	--	47,300	
Shares issued in conjunction with extinguishment of debt for common stock	125,000	125	229,875	
Common stock issued for services rendered	10,000	10	29,990	
Exercise of warrants for common stock	1,000	1	2,999	
Net loss, 2001	--	--	--	(1,
BALANCE, December 31, 2001	6,523,120	$ 6,523	$ 8,869,914	$ (7

See independent auditors' report and notes to financial statements.

POWER EFFICIENCY CORPORATION
STATEMENTS OF CASH FLOWS

	Year Ended December 31, 20	
CASH FLOWS PROVIDED BY (USED FOR):		
OPERATING ACTIVITIES:		
Net loss	$(1,863,802)	$(4,354
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation and amortization	281,587	138
Write-off of deferred financing costs	38,502	
Debt restructuring	130,000	
Additional paid-in capital related to repricing and issuance of stock options	47,300	3,649
Changes in certain assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	103,048	(43
Inventory	(83,091)	28
Prepaid expenses	443	
Deposits	(9,500)	4
Increase (decrease) in:		
Accounts payable and accrued expenses	216,426	(106
Accrued salaries and payroll taxes	31,822	14
Net Cash Used for Operating Activities	(1,107,265)	(669
INVESTING ACTIVITIES:		
Purchase of fixed assets	(51,981)	
FINANCING ACTIVITIES:		
Proceeds from issuance of equity securities, net of costs	613,000	435
Costs associated with obtaining credit agreement	--	(34
Advances on line of credit agreement	167,499	277
Loans from stockholders and officers	405,500	
Net Cash Provided by Financing Activities	1,185,999	678
INCREASE IN CASH AND CASH EQUIVALENTS	26,753	8
CASH AND CASH EQUIVALENTS:		
Beginning of year	8,492	
End of year	$ 35,245	$ 8

See independent auditors' report and notes to financial statements.

POWER EFFICIENCY CORPORATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

NOTE 1 -- NATURE OF BUSINESS:

Power Efficiency Corporation ("Power Efficiency" and/or the "Company"), was incorporated in Delaware on October 19, 1994. Power Efficiency designs, develops, markets and sells proprietary solid state electrical devices designed to effectively reduce energy consumption in alternating current induction motors. Alternating current induction motors are commonly found in industrial and commercial facilities throughout the world. The Company currently has two principal and proprietary products: the Three Phase Power Commander(R), which is used in industrial applications, and the Single Phase Power Commander(R), which is used in consumer applications. The Company also engages in research and development of new related energy saving products.

The Company's primary customers are original equipment manufacturers (OEM's) and commercial accounts located throughout the United States of America, Mexico, China, and Canada.

NOTE 2 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Cash Equivalents:

The Company considers all highly liquid investments with an original maturity of three months or less to be "Cash Equivalents".

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 warrant.

Research and Development:

Research and development expenditures are charged to expense as incurred.

Property, Equipment and Depreciation:

Property and equipment are stated at cost. Maintenance and repairs are expensed as incurred, while betterments are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 5 to 7 years.

Website, Customer List and Amortization:

Website and customer lists are stated at cost. Website costs capitalized include application and infrastructure development stage costs and graphics. Amortization is computed based upon the estimated useful life of the website and customer list, which is three years. Website maintenance and hosting costs are charged to expense as incurred.

Shipping and Handling Costs:

The Company bills customers for freight. Actual costs for shipping and handling are included as components of costs of sales.

Patent Application Costs:

Patent application costs consist of costs incurred in applying for U.S. patents based upon technology developed by the Company. These costs are capitalized until the patent is awarded. At that time, the asset will be amortized over the estimated useful life of the patent. If no patent is issued, these costs will be expensed in the period when it is determined that no patent will be issued.

Revenue Recognition:

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

Loss Per Common Share:

Loss per common share is determined by dividing net loss available to common stockholders by the weighted average number of common shares outstanding during the year. Diluted loss per share is not presented since giving effect to potential common shares would be anti-dilutive.

Accounting for Stock Based Compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB25). If the option price under the Stock Option Plans equals or exceeds the fair market value of the common shares on the date of grant, no compensation cost is recognized under the provisions of APB25 for stock options. If the option price under the Stock Option Plans is less than the fair market value of the common stock on the date of grant, compensation cost is recognized for the difference.

The Company adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," for stock options issued. Under SFAS No. 123, compensation cost is measured at the grant date based on the value of award and is recognized over the service (or vesting period.

Product Warranties:

The Company warrants its products for eighteen months. During the warranty period, the Company's policy is to replace the defective product. The Company has been providing for warranty costs as they are incurred. The Company periodically reviews warranty claims and will establish a reserve for warranty claims when such amount is determinable and necessary based on historical information.

Goodwill and Amortization:

Goodwill (costs in excess of net assets of an acquired business) is amortized on the straight-line method over 15 years. Goodwill is reviewed for recoverability based on the undiscounted cash flows of the business acquired over the remaining amortization period. Should such review indicate that goodwill is not recoverable, the carrying value of the goodwill would be reduced by the estimated shortfall of the cash flows.

The Company will adopt the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," for the year ended December 31, 2002. SFAS No. 142 requires that goodwill shall no longer be amortized. Goodwill amortization for the year ended December 31, 2001 was $142,080. Goodwill shall be tested for impairment on an annual basis and between annual tests in certain circumstances. SFAS No. 142 shall initially be applied at the beginning of the fiscal year.

Previously recognized intangible assets deemed to have indefinite useful lives will be tested for impairment as of the beginning of fiscal 2002 and transitional intangible impairment tests will be completed in the first interim period. Any resulting impairment loss shall be recognized as a change in accounting principle. An annual goodwill impairment test will be performed in addition to the transitional goodwill impairment test. The impairment test shall consist of a comparison of the fair value of an intangible asset with its carrying amount. If the carrying amount of an intangible asset exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess. The loss recognized cannot exceed the carrying amount of goodwill. After an impairment loss is recognized, the adjusted carrying amount of the intangible asset shall be its new accounting basis. Subsequent reversal of a previously recognized impairment loss is prohibited. The Company does not expect this new reporting standard to have any immediate, significant impact on operations because the quoted market price of the Company's common stock on the balance sheet date and the date of this report exceeds the stock valuation at the August 7, 2000 acquisition date.

Customer Contracts, Manuals and Sales Literature and Amortization:

Customer contracts, manuals and sales literature acquired in connection with a business acquisition are deferred and amortized on the straight-line method over five years.

Advertising:

Advertising costs are expensed as incurred.

NOTE 3 -- GOING CONCERN:

The accompanying financial statements have been prepared assuming the Company is a going concern, which assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has suffered recurring losses from operations, current liabilities exceed current assets by $650,533, tangible net worth is approximately $(786,000), and the line of credit agreement expired January 31, 2002, and is subject to call. These factors raise substantial doubt about the Company's ability to continue as a going concern. The 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 the Company be unable to continue in existence. Continuation of the Company as a going concern is dependent upon achieving profitable operations. Management's plans to achieve profitability include developing new products, obtaining new customers and increasing sales to existing customers. Management also plans to raise additional capital through equity issuance or other types of financing.

NOTE 4 -- ACQUISITION OF CERTAIN ASSETS AND LIABILITIES OF PERFORMANCE CONTROL, LLC:

On August 7, 2000, the Company purchased certain assets and assumed certain liabilities of Performance Control, LLC ("Performance Control"), its then major customer, for an aggregate of 1,112,245 newly issued shares of the Company's common stock. This acquisition was accounted for as a purchase in accordance with APB16. The statement of operations includes Performance Control's results of operations since August 7, 2000, the date of purchase. The newly issued stock was valued at $2.40 per share. The purchase price of $2,669,388 was allocated as follows:

Accounts receivable	$ 9,120
Inventory	488,725
Prepaid expenses	443
Security deposit	6,000
Fixed assets	118,875
Manuals/sales literature	68,137
Contracts/customer lists	247,237
Website	38,495
Goodwill	2,131,244
Accounts payable	(314,707)
Notes payable	(124,181)
	$ 2,669,388

In accordance with APB16, the Company identified and assigned a value to intangible assets acquired which included (a) manuals/sales literature, (b) contracts/customer lists and (c) website. Such intangible assets were separately identified and assigned fair values based on management's judgement and present value computations and are not included in goodwill. The contracts and customer lists acquired from Performance Control included different contacts than the Company maintained. The Company acquired six significant cancelable contracts with total value of approximately $13,000,000 over the next three years and a customer list of approximately one hundred possible customers. The Company is not currently able to determine if the acquired cancelable contracts or potential sales volume will ever be realized.

Performance Control's website was capitalized since it is a viable working site and continues to function. Such site continues to generate sales, leads, contacts and inquiries about the Company's products. The Company's primary website is www.powerefficiencycorp.com with an automatic re-routing from www.performancecontrol.com.

NOTE 5 -- PROPERTY AND EQUIPMENT:

At December 31, 2001, property and equipment is comprised as follows:

	2001
Machinery and equipment	$ 146,192
Office furniture and equipment	81,411
	227,603
Less: accumulated depreciation	79,038
Property and Equipment, Net	$ 148,565

Depreciation for the years ended December 31, 2001 and 2000 amounted to $35,171 and $20,351, respectively.

NOTE 6 -- CONCENTRATIONS OF RISKS:

Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and temporary cash investments and accounts receivable.

POWER EFFICIENCY CORPORATION
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The Company maintains cash balances at several financial institutions. Amounts at each of these institutions are insured by the Federal Deposit Insurance Corporation up to $100,000. The Company may from time to time maintain balances in excess of the insured limits.

Sales and accounts receivable currently are from a relatively small number of customers of the Company's products. The Company closely monitors extensions of credit.

Four customers accounted for approximately 84% of 2001 sales and 49% of accounts receivable at December 31, 2001. Two customers accounted for approximately 72% of 2000 sales and 83% of accounts receivable at December 31, 2000.

International sales as a percentage of total revenues for the years ended December 31, 2001 and 2000 are as follows:

Country	2001	2000
Mexico	9%	-
China	3%	12%

Canada	15%	15%

NOTE 7 -- INVENTORIES:

Inventories consist of the following:

	December 31, 2001
Raw materials	$ 269,880
Finished goods	339,665
	$ 609,545

NOTE 8 -- LINE OF CREDIT AGREEMENT:

On December 6, 2000, the Company entered into a line of credit agreement with a bank in the sum of $750,000. The aggregate principal amount outstanding at any one time shall not exceed the lesser of the bank's "borrowing formula" or $750,000. The bank's borrowing formula means: (a) 80% of the Company's trade accounts receivable in which the bank has a perfected, first priority security interest, excluding amounts more than 90 days past due from the date of invoice, and accounts otherwise unacceptable to the bank, plus (b) inventory of the Company in which the bank has a perfected first priority security interest, revalued at the lower of cost or market, but not exceeding $500,000, reducing to $450,000 at February 28, 2001, $400,000 at March 31, 2001, and $350,000 at April 30, 2001, in the aggregate, as follows: (1) 50% of raw material inventory, and (2) 50% of finished goods inventory.

The line of credit agreement bears interest at 2.5% per annum above the prime rate (7.25% at December 31, 2001). The line of credit expired January 31, 2002, and the Company is working toward negotiating, extending or modifying the agreement. The line of credit agreement is collateralized by all inventory, accounts receivable, equipment and instruments. The bank has a general lien on all corporate assets.

In addition, the line of credit agreement contains restrictive covenants. These include, among other things, certain requirements for financial reporting, and restrictions on dividends (no declaration or payment of dividends), sales of shares (unable to issue, sell or otherwise dispose of capital stock), guarantees, advances and investments.

The Company's outstanding borrowings of $445,386 at December 31, 2001, exceeded its total availability under the line of credit agreement by approximately $132,000. No waiver has been received from the bank authorizing such excess borrowings or waiving the default.

At December 31, 2001, the Company wrote-off approximately $38,500 of deferred financing costs. Such costs were expensed since renewal of the line of credit is not assured.

On May 31, 2002, the Company received a letter from the bank, whereby the bank advised the Company that it will forbear from taking any collection activity concerning the expired line of credit agreement until June 17, 2002. The bank did not waive any of the existing defaults. Upon the occurrence of a further default, or an action that threatens the bank's collateral, the bank reserved its right, in its sole discretion, to immediately demand payment of all amounts owed and take those actions it deems appropriate to protect the bank's interests.

NOTE 9 -- INCOME TAXES:

As of December 31, 2001, the Company has available, on a federal tax basis, net operating loss carryforwards of approximately $3,800,000 which expire at varying amounts through 2021. The net operating loss carryforwards result in deferred tax assets of approximately $1,300,000 at December 31, 2001; however, a valuation reserve has been recorded for the full amount due to the uncertainty of realization of the deferred tax assets.

The provision for income taxes represents state franchise taxes.

NOTE 10 -- WARRANTS AND STOCK OPTION PLAN:

Warrants:

In connection with a limited public offering of its common stock pursuant to a Rule 504 offering memorandum dated July 15, 1996, the investment banker received, for nominal consideration, five-year warrants to purchase 36,720 shares of common stock. These warrants are exercisable at any time during the five-year period commencing October 17, 1997, for $5.50 per share of common stock. In addition to permitting the payment of the exercise price in cash, the holder of the warrant may surrender the warrant to the Company for cancellation in lieu of cash for the exercise price. Under this alternative, the Company would issue a lesser number of shares of common stock (determined in accordance with a formula), retire the warrants, and receive no cash. The exercise price was amended to $2.00 per share on September 7, 2000. The Company has extended the date of expiration of the warrants to October 15, 2002.

In connection with the May 16, 2000, Private Placement Memorandum, the Company issued 725,000 placement warrants pursuant to a Rule 506 Private Placement. The placement warrants are five-year warrants to purchase additional shares of the Company's common stock at $3.00 per warrant share during the first year; $4.00 per warrant share the second year; and $5.00 per warrant share during the third year. During 2001, 1,000 placement warrants were exercised at $3.00 per warrant share.

In connection with the Performance Control acquisition, a financial consultant received five-year warrants to purchase 50,000 shares of common stock. These warrants are exercisable at any time during the five-year period commencing August 1, 2000, for $2.00 per share of common stock.

Warrant activity during the years ended December 31, 2001 and 2000 follows:

	Warrants	Average Exercise Price
Outstanding at January 1, 2000	36,720	$ 2.00
Issued during 2000	550,000	3.00
Warrants outstanding at December 31, 2000	586,720	2.94
Issued during 2001	225,000	3.00
Exercised during 2001	(1,000)	3.00
Warrants outstanding at December 31, 2001	810,720	$ 2.96

Stock Option Plan:

In 1994, the Company adopted a Stock Option Plan (the "1994 Plan"). The 1994 Plan provides for the granting of options to purchase up to 500,000 shares of common stock at an exercise price equal to the fair market value of the common stock (110% of fair market value for a holder in excess of 10%) on the date of the grant. These options were repriced by the Board of Directors on September 7, 2000, to $2.00 per share. No options have been exercised to date. Because the exercise price is less than the average market price per share, the Company recognized $973,276 as additional compensation expense in 2000. Options for 38,180 shares issued under the 1994 Plan expired on October 31, 2001. At December 31, 2001, there are 443,640 options outstanding under the 1994 Plan.

In 2000, the Company adopted the 2000 Stock Option and Restricted Stock Plan (the "2000 Plan"). Under the 2000 Plan, options to purchase 1,325,000 shares of common stock at an exercise price of $2.00 were granted. No options have been exercised to date. Because the exercise price is less than the average market price per share, the Company recognized $2,676,500 as additional compensation expense in 2000.

Plan activity during the years ended December 31, 2001 and 2000 follows:

	Options	Exercise Price
Outstanding at January 1, 2000	500,000	$ 2.00
Granted during 2000	1,325,000	2.00
Exercised during 2000	--	--
Expired during 2000	(18,180)	2.00

Options outstanding and exercisable at December 31, 2000	1,806,820	2.00
Granted during 2001	190,000	2.00
Exercised during 2001	--	--
Expired during 2001	(38,180)	2.00
Options outstanding and exercisable at December 31, 2001	1,958,640	$ 2.00

Weighted average remaining contractual life at December 31, 2001, for all options is 7.6 years.

The Board of Directors authorized the issuance of 1,325,000 options at an exercise price of $2.00 per share. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants: expected volatility of 51%; risk-free interest rate of 6.0%; and expected lives of 9.8 years.

Had compensation cost for the Company's stock option plan been recognized based on the fair value at the grant date for awards consistent with the provisions of SFAS No. 123, the Company's net loss and loss per share for the years ended December 31, 2001 and 2000, would have been as follows:

	2001	2000
Net loss -- as reported	$ (1,863,802)	$ (4,354,080)
Net loss -- pro forma	$ (2,287,141)	$ (5,255,080)
Loss per common share - as reported	$ (0.29)	$ (0.86)
Loss per common share - pro forma	$ (0.36)	$ (1.04)

On March 23, 2001, the Company granted 180,000 stock options at an exercise price of $2.00. Because the weighted average price per share was $1.83, the Company is not required to recognize compensation expense.

On May 23, 2001, the Company granted 10,000 stock options at an exercise price of $2.00. Because the weighted average price per share was $6.73, the Company recognized additional compensation expense of $47,300. This additional compensation expense is included in selling, general and administrative expenses.

On May 23, 2001, the Company's board of directors ratified an agreement with a strategic advisor, owned by a director of the Company, to provide strategic direction and operational strategies to the Company. The initial term of this agreement is one year (January 1 to December 31, 2001) and it shall automatically renew for successive thirty-six month periods. The agreement may be terminated by either party giving notice of termination at least 180 days prior to its conclusion. The strategic advisor receives $500 per month, plus expenses, until the Company raises $1.0 million or more in investments at which time the monthly compensation shall increase to $4,500 per month, plus expenses. The strategic advisor was paid approximately $5,700 in 2001. The agreement also provides for the strategic advisor to receive non-qualified stock options to purchase 50,000 shares of common stock at an exercise price of $2.00 per share each year. These non-qualified stock options are exercisable at any time during each year the agreement is in effect. The non-qualified stock options were issued to the strategic advisor in 2002. No options were issued to the strategic advisor under the agreement in 2001. Therefore, the tables in this note do not reflect any options issued to the strategic advisor.

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NOTE 11 -- COMMITMENTS AND CONTINGENCIES:

The Company leases office, warehouse and research facilities under operating leases. The Ann Arbor, Michigan lease expired on June 30, 2001. This lease continues on a month to month basis. The Company and the landlord are informally discussing the possibility of relocating to a larger facility. The New Hyde Park, New York lease expires on June 30, 2004.

In July 2001, the Company opened a research, development and marketing facility in New York. Initial costs incurred in opening the facility were approximately $19,300, and were attributable to furniture, telephones, electrical build-outs and moving costs. The New Hyde Park, New York lease expires on June 30, 2004.

Minimum future rentals which consist of the New Hyde Park facility lease are as follows:

Year	
2002	$ 55,410
2003	56.244
2004	28,332
	$139,986

Rent expense, including base rent and additional charges, for the year ended December 31, 2001 and 2000 was $94,431 and $35,159, respectively.

Power Efficiency is an exclusive licensee pursuant to a patent license agreement of certain power factor controller technology owned by the United States, as represented by the National Aeronautics and Space Administration (NASA). This license agreement covers the United States of America and its territories and possessions on an exclusive basis and foreign sales on a non-exclusive basis. Such license agreement does 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 agreement terminates upon the expiration of all of the licensed patents, currently December 2002. The Company filed and received its own patent (No. 5.821.726) that expires in 2017 that management believes will protect the Company's intellectual property position when the last of the NASA patents expire in December 2002.

The Company is involved with certain claims and counterclaims related to litigation for breach of contract arising out of the manufacture and assembly of certain electronic component parts. The Company has accrued approximately $21,300 at December 31, 2001, related to these claims. In November 2001, the parties agreed to settlement of all of their respective claims. In exchange for full releases, the essential terms of the settlement are: (a) the Company agreed to pay $5,000 plus 7,500 newly issued shares of common stock to the manufacturer; and (b) the manufacturer agreed to return to the Company items provided in order to fulfill the Company's contracts. The settlement agreement has not been executed as of the report date. In the opinion of management, after consultation with legal counsel, the outcome of such matter is not expected to have a material adverse effect on the Company's financial position or results of operations.

The Company entered into requirements contracts with four customers for the purchase of motor controllers. The quantities are not fixed or guaranteed. For financial reporting purposes, the Company incurred no liabilities or commitments as a result of these contracts.

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POWER EFFICIENCY CORPORATION
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Power Efficiency currently utilizes three subcontractors to manufacture the Company's controller boards. These subcontractors provide facilities, equipment, supervision and labor required to assemble; wire; check; test; package; and ship the controller boards. These subcontractors are hired on an as needed basis to produce a minimum number of units via a purchase order. Power Efficiency does not incur any liabilities to subcontractors until purchase orders are issued. No purchase orders were issued or outstanding to subcontractors at December 31, 2001.

In its original Form 10-SB, filed on October 20, 2000, the Company inadvertently filed its Private Placement Memorandum as an Exhibit. This may constitute general solicitation under Rule 502(c) of Regulation D and the Registrant may be in violation of Section 5 of the Securities Act of 1933 and be unable to avail itself of the exemption found in Rule 506 of Regulation D as to that offering. The Company believes it can establish pre-existing connections with all purchasers under the Private Placement Memorandum. If proceedings based on this inadvertent filing were commenced against the Company, purchasers under the Private Placement Memorandum, possibly together with other purchasers of the Company's securities, may make claim for rescission of their investments, which if successful may be as low as zero or exceed $725,000. Such claims would be subject to any applicable defenses that the Registrant may assert, including statute of limitations. The last sales under the Private Placement Memorandum were made in March, 2001. Therefore, the Company believes that the statute of limitations for such claims under the Securities Act has expired.

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POWER EFFICIENCY CORPORATION
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NOTE 12 -- RELATED PARTY TRANSACTIONS:

During the years ended December 31, 2001 and 2000, salaries and/or consulting fees of $306,000 and $134,732 were paid to officers/directors/stockholders of the Company, respectively. These amounts are included in research and development and in selling, general and administrative expenses for the years ended December 31, 2001 and 2000.

On May 23, 2001, the Company's board of directors ratified an agreement with a strategic advisor, owned by a director of the Company, to provide strategic direction and operational strategies to the Company. The initial term of this agreement is one year (January 1 to December 31, 2001) and it shall automatically renew for successive thirty-six month periods. The agreement may be terminated by either party giving notice of termination at least 180 days prior to its conclusion. The strategic advisor receives $500 per month, plus expenses, until the Company raises $1.0 million or more in investments at which time the monthly compensation shall increase to $4,500 per month, plus expenses. The strategic advisor was paid approximately $5,700 in 2001. The agreement also provides for the strategic advisor to receive non-qualified stock options to purchase 50,000 shares of common stock at an exercise price of $2.00 per share each year. These non-qualified stock options are exercisable at any time during each year the agreement is in effect. The exercise price of $2.00 per share was negotiated by the parties and was primarily based upon the fact that the Company had previously re-priced outstanding options held by other employees on September 7, 2000, and issued new options in 2000 with exercise prices of $2.00 per share, as discussed in Note 10.

During 2001 and 2000, the Company incurred legal fees of $102,215 and $52,501 to a law firm. A partner in that firm and the firm are currently stockholders of the Company.

Included in accounts payable and accrued expenses at December 31, 2001 is approximately $71,100 due to certain employees for back pay and reimbursable expenses. Also included in accounts payable and accrued expenses at December 31, 2001, is approximately $113,400 due to officers for back pay, interest and expense reimbursements.

NOTE 13 -- INSURANCE COVERAGE:

The Company's general liability and product liability insurance coverage lapsed in mid-August 1999 for non-payment of premiums. Subsequent to the Company's purchase of certain assets and liabilities of Performance Control in August 2000, the Company again obtained general liability and product liability insurance coverages. The Company believes that there is no material risk of loss to the Company from possible product liability claims against the Company during the lapse in coverage. No product liability claims have been filed against the Company to date.

NOTE 14 -- SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:

Cash paid during the year ended December 31, for:

	2001	2000
Income Taxes	$ --	$ 328
Interest	$ 34,843	$ 18,905

NON-CASH INVESTING AND FINANCING ACTIVITIES:

2001

Common stock issued in connection with extinguishment of stockholder note payable	$ 230,000
Common stock issued for services rendered	$ 30,000

2000

Common stock issued in connection with acquisition of certain assets and liabilities of Performance Control (Note 4)	$2,669,388
Common stock issued for settlement of outstanding professional fees	$ 73,812

NOTE 15 -- DEBT RESTRUCTURING:

The Board of Directors, on September 7, 2000, authorized renegotiating a $100,000 loan from a stockholder until the earlier of (i) January 31, 2001; or (ii) the closing date of the Company's receipt of $625,000 in gross proceeds from an equity financing. As additional consideration for the extension of the due date, the Company granted an option to purchase an aggregate 75,000 authorized but unissued shares of the Company's common stock at the set exercise price of $2.00 per share.

On March 15, 2001, the $100,000 loan, plus accrued interest thereon, and the option to purchase 75,000 shares of common stock were renegotiated and converted into 125,000 shares of Power Efficiency's common stock.

The Company accounted for this transaction as a capital transaction between related parties during the first quarter of 2001. The difference of $130,000 between the fair value of the equity interest and the carrying amount of the payable was recognized as a loss by the Company and is included in selling, general and administrative expenses.

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NOTE 16 -- EMPLOYMENT AGREEMENTS:

On August 7, 2000, the Company agreed to enter into five-year employment and compensation agreements with the Company's two principal executive officers. On May 23, 2001, the Company's board of directors ratified the authorization to enter into these employment agreements. The agreements provide for first year salaries of $120,000 for the period from September 2000 to August 31, 2001. The salaries for the second through fifth years shall be $120,000 plus annual increases in $18,000 increments. In order to provide performance-based incentive compensation to the executives, bonuses tied to the level of the Company's net pre-tax income will be paid. For bonus purposes, the Company's net pre-tax income will be multiplied by the applicable percentage which shall equal (a) 4.0% if net pre-tax income of the Company is at least $500,000 but less than $750,000; (b) 4.25% if net pre-tax income is at least $750,000 but less than $1,000,000; and (c) 4.5% if net pre-tax income is at least $1,000,000. Net pre-tax income of the Company shall be determined by the Board of Directors in a consistent manner in accordance with accounting principles generally accepted in the United States of America.

In addition to comprehensive health benefits, the agreements include vacation, expense reimbursement, confidentiality, non-compete and disability provisions.

Each agreement also provides for severance payments equal to the greater of (i) $468,000 or (ii) the executive's base salary for the preceding three years, in the event that at any time during the employment term the agreement is terminated by the Company (a) without cause, (b) for disability, or (c) for death, or if the executive terminates the agreement for cause. Each agreement also provides for a payment to the executive upon a change in control equal to the product of the executive's base salary in the year of the change in control times 2.99.

NOTE 17 -- PRIVATE STOCK OFFERING:

The May 16, 2000 Private Placement involved the sale of up to 40 Units. The closing of the Company's purchase of certain assets and assumption of certain liabilities of Performance Control was conditioned upon the sale of a minimum of 12 Units ($300,000). Each Unit was comprised of 25,000 shares of common stock at $1.00 per share and a warrant to purchase an additional 25,000 shares of common stock. If reached, the maximum offering would have involved a total of 2 million shares of common stock: 1 million shares of stock issued with the 40 Units and 1 million shares of stock that were available under the 40 warrants. The Units were sold at a price of $25,000 per Unit. The Company sold a total of 29 Units with total proceeds of $725,000. The Company sold 20 Units in 2000 and nine Units from the beginning of 2001 through March 7, 2001, the date the Company's board of directors agreed to terminate the Private Placement. The proceeds from the sale of these Units were deposited to the general operating account of the Company to be utilized for working capital purposes.

In its original Form 10-SB, filed on October 20, 2000, the Company inadvertently filed its Private Placement Memorandum as an Exhibit. This may constitute general solicitation under Rule 502(c) of Regulation D and the Company may be in violation of Section 5 of the Securities Act of 1933 and be unable to avail itself of the exemption found in Rule 506 of Regulation D as to that offering. The Company believes it can establish pre-existing connections with all qwpurchasers under the Private Placement Memorandum. If proceedings based on this inadvertent filing were commenced against the Company, purchasers under the Private Placement Memorandum, possibly together with other purchasers of the Company's securities, may make claim for rescission of their investments, which if successful may exceed $725,000. Such claims would be subject to any applicable defenses that the Registrant may assert, including statute of limitations. The last sale under the Private Placement Memorandum was made on March 1, 2001 and the shares were delivered to the investor on May 4, 2001. The Company, in consultation with legal counsel, believes that, although rescission claims are possible, liability is remote. Therefore, the Company believes that the statute of limitations for such claims under the Securities Act has expired.

NOTE 18 -- STOCKHOLDER AND OFFICERS' LOANS:

On May 24, 2001, the Company borrowed $300,000 from a stockholder. The loan is due and payable in a single payment of principal and interest on June 1, 2003. The loan bears interest at 10% per annum payable on the due date. The note is subordinated to the bank as required under the terms of the Company's line of credit agreement.

On August 30, 2001, and September 12, 2001, this same stockholder advanced the Company an additional $50,000. These promissory notes are due and payable in a single payment of principal and interest on demand. The notes bear interest at 10% per annum payable on demand.

At various times during the fourth quarter of 2001, the two principal officers advanced the Company funds with a total of $31,500 and $24,000, respectively. These advances are evidenced by promissory notes, which are due and payable in a single payment, principal and interest on demand. The notes bear interest at 10% per annum payable on demand.

Another stockholder advanced the Company $10,245 during February 2002. The two principal officers also advanced the Company $4,000 and $14,396, respectively, at various times during January and February 2002.

NOTE 19 -- STOCKHOLDERS' EQUITY:

On May 14, 2001, the Company sold 118,750 shares of common stock to an accredited investor, as that term is defined in Rule 501(a) of Regulation D under the Securities Act of 1933. The first 25,000 shares were sold for $100,000 and the remaining 93,750 shares were sold for $300,000. The shares were sold in reliance on Rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933.

On June 19, 2001, the Company issued 10,000 shares of common stock for payment of services. The total fees that were set aside in exchange for the stock were equal to $30,000. The shares were issued in reliance on Rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933.

During 2000, the Company agreed to issue 17,525 and 30,000 shares of common stock for legal and consulting services rendered and such shares were issued in 2001. The total services that were provided totaled $43,812 and $23,000, respectively. The shares were issued in reliance on Rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933.

The stockholders of the Company on November 26, 2001 approved an amendment to the Certificate of Incorporation to increase the Company's capitalization to 50,000,000 shares of common stock, $.001 par value and 10,000,000 shares of preferred stock, $.001 par value.

The Company is presently in the process of having the Certificate of Incorporation amended. Such authorized increased capitalization amounts have been shown on the balance sheet.

NOTE 20 -- CORRECTIONS TO PREVIOUSLY ISSUED FINANCIAL STATEMENTS:

Certain corrections were made to previously issued financial statements for

2000. Such corrections related primarily to the valuation of assets acquired from Performance Control, valuation of the repriced options and the value of the options issued during the year.

The effect of such corrections for the year ended December 31, 2000 were as follows:

	As Previously Reported	As Restated
Net Loss	$(661,050)	$(4,354,080)
Basic Loss Per Common Share	$ (.13)	$ (.86)

Item 8. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

PART III

Item 9. Director, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

See the information under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" contained in the Proxy Statement for the Annual Meeting of Stockholders of the Company to be held on November 26, 2001, which information is incorporated herein by reference.

Item 10. Executive Compensation

See the information under the caption "Compensation of Executive Officers and Directors" contained in the Proxy Statement for the Annual Meeting of Stockholders of the Company to be held on November 26, 2001, which information is incorporated herein by reference.

Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

See the information under the captions "Voting Securities" and "Directors and Executive Officers" contained in the Proxy Statement for the Annual Meeting of Stockholders of the Company to be held on November 26, 2001, which information is incorporated herein by reference

Item 12. Certain Relationships and Related Transactions

See the information under the caption "Certain Relationships and Related Transactions" contained in the Proxy Statement for the Annual Meeting of Stockholders of the Company to be held on November 26, 2001, which information is incorporated herein by reference.

Item 13. Exhibits and Reports on Form 8-K

(a) Exhibits

The following exhibits are filed as part of this report:

Description of Document	
2.1	Asset Purchase Agreement by and between the Registrant and Performance Control, L.L.C. dated August 7, 2000.
3.1	Certificate of Incorporation.
3.2	By-Laws.
4.1	Certificate of Incorporation. See Exhibit 3.1 above.
4.2	By-Laws. See Exhibit 3.2 above.
10.1	Asset based lending agreement with Bank One dated December 6, 2000.
10.2	August 7, 2000 Stockholders' Agreement.
10.3	Lease Agreement for Registrant's Ann Arbor, Michigan facility dated February 16, 1996.
10.4	Purchase Agreement between the Registrant and Millar Elevator Service Company dated August 17, 2000.
10.5	Purchase Agreement between the Registrant and Montgomery Kone, Inc. dated December 1, 1998.
10.6	Certificate of Liability Insurance.
10.7	United States Patent #5,821,726.
10.8	Purchase Agreement between the Registrant and Defense Supply Center Richmond dated January 12, 2000.

10.9	1994 Stock Option Plan.
10.10	Patent License Agreement (DN-858) with NASA.
10.11	Patent License Agreement (DE-256) with NASA.
10.12	Settlement and Release Agreement with NASA.
10.13	Modification No. 1 to Patent License Agreement (DE-256) with NASA.
10.14	Purchase Order from Otis Elevator Co.
10.15	Letter Agreement with Lee W. Greenberg d/b/a ARI Group.
10.16	Product Warranty.
10.17	Test Report from Medsker Electric, Inc.
10.18	Test Report from Oak Ridge National Laboratory.
10.19	Test Report from Oregon State University -- The Motor Systems Resource Facility.
10.20	Test Report from Otis Elevator Co.
10.21	Line of Credit Agreement with Bank One, Michigan dated May 10, 2001.
10.22	Waiver Letter from Bank One dated May 31, 2002
10.23	2000 Stock Option Plan
10.24	Employment Agreement with Stephen Shulman
10.25	Employment Agreement with Nicholas Anderson

** Previously filed by the Registrant as an Exhibit on Form 10-SB, on October 20, 2000.
*** Previously filed by the Registrant as an Exhibit on Form 10-SB/A, on April 12, 2001.
**** Previously filed by the Registrant as an Exhibit on Form 10-SB/A, on October 26, 2001.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

POWER EFFICIENCY CORPORATION

Dated: September 6, 2002

By: /s/ Raymond J. Skiptunis

Raymond J. Skiptunis, President

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Dated: September 6, 2002

By: /s/ Raymond J. Skiptunis

Raymond J. Skiptunis,
President and Director

Dated: September 6, 2002

By: /s/ Nicholas Anderson

Nicholas Anderson, Director

Dated: September 6, 2002

By: /s/ Scott Straka

Scott Straka, Director

Dated: September 6, 2002

By: /s/ Leonard Bellezza

Leonard Bellezza, Director

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EXHIBIT INDEX

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