

POWER EFFICIENCY CORP  
Form 10QSB  
November 14, 2005

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-QSB

**ý** QUARTERLY REPORT UNDER SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: September 30, 2005

OR

**o** TRANSITION REPORT UNDER SECTION 13 OR 15 (d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from                      to

Commission File No. 0-31805

## POWER EFFICIENCY CORPORATION

(Exact Name of Small Business Issuer as Specified in its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**22-3337365**  
(I.R.S. Employer Identification No.)

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**3900 Paradise Road, Suite 283**  
**Las Vegas, NV 89109**  
(Address of Principal Executive Offices)

**(702) 697-0377**  
(Issuer's Telephone Number,  
Including Area Code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of shares outstanding of the Issuer's Common Stock, \$.001 Par Value, as of October 31, 2005 was 23,439,266.

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

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Certification of Chief Executive Officer as Adopted

Certification of Chief Financial Officer as Adopted

**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****POWER EFFICIENCY CORPORATION**  
CONDENSED BALANCE SHEET

Unaudited

	<b>September 30, 2005</b>
<b>ASSETS</b>	
<b>CURRENT ASSETS:</b>	
Cash	\$ 1,626,826
Accounts receivable, net	92,172
Inventory, net of reserve	162,444
Prepaid expenses and other current assets	90,602
Total Current Assets	1,972,044
PROPERTY AND EQUIPMENT, Net	15,845
<b>OTHER ASSETS:</b>	
Patents, net	12,221
Goodwill	1,929,963
Website, net	4,887
Deferred financing costs, net	98,193
Total Other Assets	2,045,264
Total Assets	\$ 4,033,153
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
<b>CURRENT LIABILITIES:</b>	
Accounts payable and accrued expenses	\$ 456,623
Accrued salaries and payroll taxes	65,574
Notes payable	79,236
Notes payable - former officers	43,918
Total Current Liabilities	645,351
<b>LONG TERM LIABILITIES</b>	
Notes payable - Pali Capital, net	1,288,532
Notes payable	14,617
Total Long Term Liabilities	1,303,149
Total Liabilities	1,948,500
<b>COMMITMENTS AND CONTINGENCIES</b>	
<b>STOCKHOLDERS' EQUITY:</b>	
Series A-1 Convertible Preferred Stock, \$.001 par value, 10,000,000 shares authorized, none issued and outstanding	
Common stock, \$.001 par value, 100,000,000 shares authorized, 23,439,266 issued and outstanding	23,439
Additional paid-in capital	19,146,792
Accumulated deficit	(17,085,578)

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Total Stockholders' Equity		2,084,653
Total Liabilities and Stockholders' Equity	\$	4,033,153

**Accompanying notes are an integral part of the financial statements**

**POWER EFFICIENCY CORPORATION**  
**CONDENSED STATEMENTS OF OPERATIONS**

Unaudited

	For the three months ended Sept 30,		For the nine months ended Sept 30,	
	2005	2004	2005	2004
<b>REVENUES</b>				
Product, net	\$ 75,952	\$ 46,585	\$ 221,737	\$ 188,005
Miscellaneous		18,130		30,855
<b>Total Revenues</b>	<b>75,952</b>	<b>64,715</b>	<b>221,737</b>	<b>218,860</b>
<b>COMPONENTS OF COST OF PRODUCT REVENUES:</b>				
Material and labor	56,092	20,712	167,924	88,505
Allocated costs	4,353	5,285	19,059	41,815
Inventory obsolescence and other write-offs				29,484
<b>Total Cost of Product Revenues</b>	<b>60,445</b>	<b>25,997</b>	<b>186,983</b>	<b>159,804</b>
<b>GROSS MARGIN</b>	<b>15,507</b>	<b>38,718</b>	<b>34,754</b>	<b>59,056</b>
<b>COSTS AND EXPENSES:</b>				
Research and development	186,668	82,469	313,318	290,766
Selling, general and administration	461,317	378,030	1,073,528	1,288,327
Depreciation and amortization	5,032	18,007	17,360	55,510
<b>Total Costs and Expenses</b>	<b>653,017</b>	<b>478,506</b>	<b>1,404,206</b>	<b>1,634,603</b>
<b>LOSS FROM OPERATIONS</b>	<b>(637,510)</b>	<b>(439,788)</b>	<b>(1,369,452)</b>	<b>(1,575,547)</b>
<b>OTHER (EXPENSE) INCOME</b>				
Interest (expense) income - net	(130,217)	(8,858)	(391,398)	(16,454)
<b>Total Other (Expense) Income</b>	<b>(130,217)</b>	<b>(8,858)</b>	<b>(391,398)</b>	<b>(16,454)</b>
<b>NET LOSS</b>	<b>\$ (767,727)</b>	<b>\$ (448,646)</b>	<b>\$ (1,760,850)</b>	<b>\$ (1,592,001)</b>
<b>BASIC AND FULLY DILUTED LOSS PER COMMON SHARE</b>				
	\$ (.03)	\$ (.09)	\$ (.16)	\$ (.36)
<b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING</b>				
	23,258,497	5,020,447	11,122,128	4,426,976

Accompanying notes are an integral part of the financial statements

## POWER EFFICIENCY CORPORATION

## CONDENSED STATEMENTS OF CASH FLOWS

Unaudited

	For the nine months ended Sept 30,	
	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (1,760,850)	\$ (1,592,001)
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation and amortization	17,360	55,510
Amortization of deferred financing costs	63,982	
Bad debt expense	4,530	5,493
Inventory obsolescence reserve and other write-offs		29,484
Loss on sale of fixed assets		31,226
Debt discount related to issuance of debt securities	181,726	
Settlement of litigation	93,853	
Warrants and options issued in connection with the issuance of debt securities, employment agreements, and consulting fees	27,549	
Changes in assets and liabilities:		
(Increase) Decrease in:		
Accounts receivable	(65,165)	14,010
Inventory	25,373	40,518
Prepaid expenses and other current assets	(20,916)	(13,481)
Restricted cash for interest escrow	165,416	
Increase(Decrease) in:		
Accounts payable and accrued expenses	(180,742)	298,236
Customer deposits		6,983
Accrued salaries and payroll taxes	(62,893)	386,383
Net Cash Used for Operating Activities	(1,510,777)	(737,639)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(1,373)	(21,576)
Net Cash Used for Investing Activities	(1,373)	(21,576)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Deferred financing costs	(63,457)	
Proceeds from line of credit related party	300,000	300,000
Proceeds from issuance of equity securities	2,741,378	184,800
Proceeds from issuance of debt securities	125,000	
Payments on line of credit related party	(300,000)	
Payments to former officers	(56,416)	(10,000)
Net Cash Provided by Financing Activities	2,746,505	474,800
Increase(Decrease) in cash	1,234,355	(284,415)
Cash at beginning of period	392,471	285,508
Cash at end of period	\$ 1,626,826	\$ 1,093
NON-CASH FINANCING TRANSACTIONS- Common stock issued in conjunction with the settlement of accounts payable and accrued salaries\ payroll\ other expenses settlement of accounts payable and accrued salaries\ payroll\ other accrued expenses	\$	\$ 37,400

Accompanying notes are an integral part of the financial statements



**NOTE 1 - BASIS OF PRESENTATION**

The accompanying financial statements have been prepared by the Company, without an audit. In the opinion of management, all adjustments have been made, which include normal recurring adjustments necessary to present fairly the condensed financial statements. Operating results for the nine months ended September 30, 2005 are not necessarily indicative of the operating results for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The Company believes that the disclosures provided are adequate to make the information presented not misleading. Certain amounts in the financial statements have been reclassified from prior period presentations. These unaudited condensed financial statements should be read in conjunction with the audited financial statements and related notes included in the Company's Annual Report for the year ended December 31, 2004 on Form 10-KSB, Form 10-KSB/A 1, Form 10-KSB/A 2 and SB-2.

The preparation of condensed 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 dates of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**NOTE 2 - 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 suffered recurring losses from operations, a recurring deficiency of cash from operations, including a cash deficiency of approximately \$1,510,000 from operations for the nine months ended September 30, 2005, and lacks sufficient liquidity to continue its operations.

On July 8, 2005 and on August 31, 2005, the Company closed a private offering of Common Stock which grossed \$2,900,000, and produced net proceeds of \$2,232,750, from which the Company will use to fund its operations (see Note 5). It is anticipated that such net proceeds will last for up to 15 months. When its operations require additional financing, if the Company is unable to obtain it on reasonable terms, the Company will be forced to restructure, file for bankruptcy or cease operations.

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 in the long-term and raising additional capital to support existing operations for at least the next twelve months. Management's plans to achieve profitability include developing new products, obtaining new customers and increasing sales to existing customers.

**NOTE 3 - NOTES PAYABLE**

On February 24, 2005, the Company entered into a financing transaction in which the Company issued \$125,000 in senior secured notes under the same offering through which the Company issued \$1,464,806 in senior secured notes in October 2004. This offering was originally intended to close on December 31, 2004, however, the placement agent and the Company agreed to keep the offering open past the original closing date. After the February 24 closing the offering was terminated. Under the original terms, all of the senior secured notes were to become due one year after issuance, but on March 28, 2005, the Company received consent, from all of the senior secured note holders of the first and secondary offering, to extend the maturity date for an additional year. Accordingly, these notes will now mature in October 2006 and February 2007, respectively.

The holders of the \$125,000 in notes issued in February were issued 144,232 warrants, with an exercise price of \$0.65 per share. The value of such warrants approximates \$24,000 and was reflected as debt discount which is being amortized to interest expense over the term of the notes. The Company paid a placement agent a commission of \$12,500 and 14,423 warrants which are being amortized over the life of the notes, with the same rights and provisions as the warrants issued to the holders of the notes.

**NOTE 4 RELATED PARTY TRANSACTIONS**

On June 9, 2005 and on June 16, 2005, the Company entered into financing transactions in which the Company issued a \$200,000 convertible, unsecured note, and a \$100,000 convertible, unsecured note respectively (collectively, the Bridge Notes ) to Summit Energy Ventures LLC, an entity owned entirely by the Company's current Chief Executive Officer, and Chief Operating Officer and Chief Financial Officer that is also one of the Company's principal stockholders. The Notes bear interest of 10% per annum. The Bridge Notes accrued interest and principal were due on July 23, 2005. The Bridge Notes were converted into equity on July 8, 2005 (see Note 5).

**NOTE 5 - STOCKHOLDERS EQUITY**

On July 8, 2005 the Company completed the first closing of private offering of Common Stock (the Offering ) for \$2,430,000, which netted approximately \$1.8 million. On August 31, 2005 the Company completed the second and final closing under the Offering for \$470,000, which netted approximately \$400,000. In this offering, the Company issued a total of 14,500,000 shares of Common Stock and 7,250,000 Common Stock Warrants (the Investor Warrants ). The per share purchase price of the Common Stock was \$0.20 (the Common Stock Purchase Price ). The Investor Warrants have a per share exercise price of \$0.44 and expire 5 years from the date of issuance. The value of the Investor Warrants was approximately \$990,000.

Joseph Stevens & Company, Inc. (the Placement Agent ), a registered broker dealer, acted as the sole placement agent for the Offering. For its services, the Placement Agent received commissions and non-accountable fees totaling \$237,900 and 3,450,000 warrants (the Placement Agent Warrants ). The Placement Agent Warrants have a per share exercise price of \$0.20 and expire five years from the date of issuance. The value of the Placement Agent Warrants was approximately \$832,000.

Two convertible notes (the Bridge Notes ) issued by the Company, to Summit Energy Ventures, LLC, on June 9, 2005 and June 16, 2005, in the aggregate principal amount of \$300,000, were converted into 1,500,000 shares of common stock and 750,000 Investor Warrants on the same terms as those offered to investors in the Offering and no commissions, fees or securities were issued to the Placement Agent in connection with such conversion.

On July 8, 2005, the Company's 4,714,279 shares of outstanding Series A-1 Preferred Stock were converted into 3,918,848 shares of common stock.

In conjunction with the Offering, the Company entered into an agreement with the Placement Agent (the Placement Agency Agreement ). The Placement Agency Agreement requires, among other things, the Company to pay certain fees related to the Offering; provides the Placement Agent a right of first refusal to manage any private or public offering of equity securities of the Company, under certain defined conditions, for a period of one year after the Offering; requires the Company to enter Lock-Up Agreements (as defined below) with all of the Company's directors, officers and significant shareholders; grants the investors in the Offering and the Placement Agent certain registration rights, which require the Company to register their common stock as well as the common stock underlying the Investor Warrants and Placement Agent Warrants through filing a registration statement within sixty (60) days of closing the Offering, and make the registration statement effective (the Effective Date ) within one hundred and twenty days (120) of closing the Offering; and grants the common stock, Investor Warrants and Placement Agent Warrants issued through the Offering weighted average anti-dilution protection for subsequent issuances of common stock (or securities convertible into common stock) at less than the Common Stock Purchase Price.

On various dates preceding July 8, 2005, the Company entered into lock-up agreements (the Lock-Up Agreements ) with all of the Company's officers, members of the board of directors and shareholders that held, prior to the Offering, more than 5% of the outstanding shares of the Company's common stock. Specifically, the persons entering Lock-Up Agreements with the Company included: Nicholas Anderson, Leonard Bellezza, John (BJ) Lackland, Rick Pulford, Raymond Skiptunis, Steven Strasser, Commerce Energy Group, and Summit Energy Ventures LLC. The Lock-Up Agreements restrict all of these Persons from selling any shares of common stock for a period of twelve months from the Effective Date (the Lock-Up Period ); provided, however, that the Lock-Up Period shall terminate if at any time after the date which is ninety days after the Effective Date, the 20-day average of the closing bid price of the shares of common stock on the OTC Bulletin Board exceeds two hundred percent of the Common Stock Purchase Price of \$0.20, or \$0.40.

**NOTE 6 - SUBSEQUENT EVENTS**

On September 15, 2005, the Board of Directors of the Company unanimously voted to recommend to the shareholders that the Articles of Incorporation be amended to increase the Company's authorized shares of Common Stock from 50,000,000 shares to 100,000,000 shares. On October 13, 2005, a majority of the shareholders voted to amend the Articles of Incorporation to increase the Company's authorized shares.

On October 17, 2005, the Company settled litigation with the owner of the former office space in Livonia, Michigan. The Company vacated these facilities in 2004. Under the settlement the Company paid its former landlord \$50,000 in cash on October 17, 2005, and will pay the former landlord an additional \$50,000 in 18 monthly installments of \$2,778. After application of the Company's accrued loss contingency reserve, it recognized a loss of approximately \$65,000 on its September 30, 2005 financial statements.

**ITEM 2. 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*® line of motor controllers in late 1995.

**RESULTS OF OPERATIONS: FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004.**

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

We may, in discussions of our future plans, objectives and expected performance in periodic reports filed by us with the Securities and Exchange Commission (or documents incorporated by reference therein) and written and oral presentations made by us, include projections or other forward-looking statements within the meaning of Section 27A of the Securities Exchange Act of 1933 or Section 21E of the Securities Act of 1934, as amended. Such projections and forward-looking statements are based on assumptions, which we believe are reasonable but are, by their nature, inherently uncertain. In all cases, results could differ materially from those projected. Some of the important factors that could cause actual results to differ from any such projections or other forward-looking statements are discussed below, and in other reports filed by us under the Securities Exchange Act of 1934, including under the caption *Risk Factors* in our Annual Report on Form 10-KSB. Our forward looking statements are based on information available to us today, and except as required by law, we undertake no obligation to update any forward looking statement, whether as a result of new information, future events or otherwise.

**REVENUES**

Total revenues for the three months ended September 30, 2005, were approximately \$76,000, compared to \$65,000 for the three months ended September 30, 2004, an increase of \$11,000 or 17%. This increase is mainly attributable to an increase in sales in the elevator and escalator market segment. Sales to a new international customer totaled approximately \$20,000 during the three months ended September 30, 2005. Sales to two new international distributors totaled approximately \$1,500 during the three months ended September 30, 2004. Revenue of \$18,000 was recognized for a government grant received associated with development expenses related to a medium voltage product application during the three months ended September 30, 2004. For the three months ending September 30, 2005, there was no revenue from the government agency.

Total revenues for the nine months ended September 30, 2005, were approximately \$222,000, compared to \$219,000 for the nine months ended September 30, 2004, an increase of \$3,000 or 1%. This increase is mainly attributable to an increase in sales in the elevator and escalator market segment. Sales to a government agency totaled approximately \$50,000, and sales to a new international customer totaled approximately



\$20,000 during the nine months ended September 30, 2005. Sales to three international distributors totaled approximately \$41,000 during the nine months ended September 30, 2004. Revenue of \$30,725 was recognized for a government grant received associated with development expenses related to a medium voltage product application during the nine months ended September 30, 2004. During 2005, there was no grant money received.

#### **COST OF PRODUCT REVENUES**

Total cost of product revenues, which includes material and direct labor, allocated costs, and inventory obsolescence and other write-offs for the three months ended September 30, 2005 were approximately \$60,500 compared to \$26,000 for the three months ended September 30, 2004, an increase of \$34,500 or 133%. As a percentage of product revenues, total cost of revenues increased to approximately 80% for the three months ended September 30, 2005 compared to approximately 56% for the three months ended September 30, 2004. The increase in the costs as a percentage of product revenues was primarily due an increase in the production of higher costing units in 2005. Also, allocated costs were approximately \$4,400 for the three months ended September 30, 2005 compared to \$5,300 for the three months ended September 30, 2004, a decrease of \$900 or 17%. As a percentage of product revenues allocated costs were 6% for the three months ended September 30, 2005 compared to 11% for the three months ended September 30, 2004. The allocated costs as a percentage of product revenues decreased as the allocated costs were absorbed by a higher volume of product revenues. Material and labor costs as a percentage of product revenues increased to 74% for the three months ended September 30, 2005 compared to 44% for the three months ended September 30, 2004. This increase was largely due to outsourcing a greater portion of the manufacturing process, resulting in higher direct labor costs per unit and lower allocated costs as a whole in 2005.

Total cost of product revenues, which includes material and direct labor, allocated costs, and inventory obsolescence and other write-offs for the nine months ended September 30, 2005 were approximately \$187,000 compared to approximately \$160,000 for the nine months ended September 30, 2004, an increase of \$27,000 or 17%. As a percentage of product revenues, total costs of product revenues decreased to approximately 84% for the nine months ended September 30, 2005 compared to approximately 85% for the nine months ended September 30, 2004. The decrease in the costs as a percentage of product revenues was primarily due to no charges to inventory for obsolescence and other write-offs for the nine months ended September 30, 2005 compared to \$30,000 for the nine months ended September 30, 2004, offset by the Company utilizing an outsourced manufacturer for production in 2005. Also, allocated costs were approximately \$19,000 for the nine months ended September 30, 2005 compared to approximately \$42,000 for the nine months ended September 30, 2004, a decrease of \$23,000 or 121%. As a percentage of product revenue allocated costs were 9% for the nine months ended September 30, 2005 compared to 22% for the nine months ended September 30, 2004. The allocated costs as a percentage of product revenues decreased as the allocated costs were absorbed by a higher volume of product revenues and because the Company began the use of a turnkey manufacturer.

## **OPERATING EXPENSES**

### **Research and Development Expenses**

Research and development expenses were approximately \$187,000 for the three months ended September 30, 2005, as compared to approximately \$82,000 for the three months ended September 30, 2004, a \$105,000 or a 128% increase. This increase is mainly attributable to the Company's laboratory testing done for further product development which incurred a charge of \$76,000 during the three months ended September 30, 2005.

Research and development expenses were approximately \$313,000 for the nine months ended September 30, 2005, as compared to approximately \$291,000 for the nine months ended September 30, 2004, a \$22,000 or an 8% increase. This increase is mainly attributable to the Company's reorganizing and cost reduction program implemented in August and September of 2004, offset by a \$76,000 charge during the nine months ended September 30, 2005, related to laboratory testing done for further product development.

### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses were approximately \$427,000 for the three months ended September 30, 2005, as compared to \$378,000 for the three months ended September 30, 2004 an increase of \$49,000 or 13%. The increase in selling, general and administrative expenses over the prior year was due primarily to an increase in payroll and payroll related costs, as well as recruiting fees for new employees in the third quarter, offset by the elimination of some fixed costs related to the reduction in workforce and the Company's decision to restructure its operations in August and September of 2004.

Selling, general and administrative expenses were approximately \$1,039,000 for the nine months ended September 30, 2005, as compared to \$1,288,000 for the nine months ended September 30, 2004 a decrease of \$249,000 or 19%. The decrease in selling, general and administrative expenses over the prior year was due primarily to a decrease in payroll and payroll related costs for the whole year, as well as the elimination of some fixed costs related to the reduction in workforce and the Company's decision to reorganize its operations in August and September of 2004.

### **Financial Condition, Liquidity, and Capital Resources: For the Nine Months Ended September 30, 2005**

Since inception, the Registrant has financed its operations primarily through the sale of its equity securities, debt securities and using available bank lines of credit. As of September 30, 2005, the Registrant had cash of \$1,626,826.

Cash used for operating activities for the nine months ended September 30, 2005 was \$1,510,777 which consisted of: a net loss of \$1,760,850; less depreciation and amortization of \$17,360, amortization of deferred financing costs of \$63,982, bad debt expenses of \$4,530, amortization of debt discount related to issuance of debt securities of \$181,726, the settlement of a litigation for \$93,853, warrants issued in connection with the issuance of debt, employment agreements, and consulting fees of \$27,549; offset by increases in accounts receivable of \$65,165, and prepaid expenses and other current assets of \$20,916 and decreases in inventory of \$25,373, restricted cash of \$165,416, accounts payable and accrued



expenses of \$180,742 and accrued salaries and payroll taxes of \$62,893.

Cash used for operating activities for the nine months ended September 30, 2004 was \$737,639, which consisted of: a net loss of \$1,592,001; less depreciation and amortization of \$55,510, bad debt expense of \$5,493, inventory obsolescence reserve of \$29,484, loss on sale of fixed assets of \$31,226, decreases in accounts receivable of \$14,010, inventory of \$40,518, increases in prepaid expenses and other assets of \$13,481, accounts payable and accrued expenses of \$298,236, customer deposits of \$6,983 and accrued salaries and payroll taxes of \$386,383.

Cash used in investing activities for the nine months ended September 30, 2005 was \$1,373 compared with \$21,576 in the nine months ended September 30, 2004. The amounts for both years consisted of the purchase of fixed assets.

Net cash provided by financing activities for the nine months ended September 30, 2005 was \$2,746,505 which consisted of: proceeds from the issuance of debt securities and notes payable of \$125,000 and \$300,000, respectively; proceeds from the issuance of equity securities of \$2,741,378, partially offset by repayments of loans to former officers of \$56,416 and the conversion of a note payable to equity of \$300,000, and an increase in deferred financing costs of \$63,457.

Net cash provided by financing activities for the nine months ended September 30, 2004 was \$474,800, which primarily consisted of proceeds of \$174,800 from the issuance of equity securities related to the Company's Regulation S stock offering and \$300,000 of proceeds from the Summit Energy Ventures line of credit. Net cash provided by financing activities for the nine months ended September 30, 2004 was \$474,800, which primarily consisted of proceeds of \$184,800 from the issuance of equity securities related to the Company's Reg S stock offering and \$300,000 of proceeds from the Summit Energy Ventures line of credit. This was partially offset by payments to a former officer of \$10,000.

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 will constitute a material use of any cash resources.

Since capital resources are insufficient to satisfy the Registrant's liquidity requirements, management intends to sell additional equity or debt securities or obtain debt financing. The Registrant believes it can raise additional funds through private placements of equity. However, there are no assurances that sufficient capital can be raised.

#### **Cash Requirements and Need for Additional Funds**

The Registrant anticipates a substantial need for cash to fund its working capital requirements. In accordance with the Registrant's prepared expansion plan, it is the opinion of management that approximately \$2.0 million will be required to cover operating expenses, including, but not limited to, marketing, sales and operations during the next twelve months. On July 8, 2005 and on August 31, 2005 the Company completed, in two phases, a stock offering for approximately \$2.9 million in gross proceeds (see Note 5 to the Financial Statements), which netted approximately \$2.2 million.

**ITEM 3. CONTROLS AND PROCEDURES**

**(a) Evaluation of Disclosure Controls and Procedures.** Under the supervision and with the participation of its Chief Executive Officer, and Chief Operating Officer and Chief Financial Officer, management has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act). Based on that evaluation, the Chief Executive Officer, and Chief Operating Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed in the Company's Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to the Company's management, including its Chief Executive Officer, and Chief Operating Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**(b) Changes in Internal Controls.** There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, nor were there any significant deficiencies or material weaknesses in the Company's internal controls. Accordingly, no corrective actions were required or undertaken.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

The Registrant has recently settled litigation with the owner of the former office space in Livonia, Michigan. The Registrant vacated the office space in 2004. Under the settlement the Registrant has paid their former landlord \$50,000 in cash on October 17, 2005, and will pay the former landlord an additional \$50,000 in 18 monthly installments of \$2,778.

### **ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS**

#### **Recent Sales of Unregistered Securities**

The following details several recent sales of unregistered securities the Registrant made to Summit Energy Ventures, LLC, a private equity firm specializing in energy related technologies owned by the Chief Executive Officer, and Chief Operating Officer and Chief Financial Officer ( Summit ) and Commonwealth Energy Corporation. All of the sales were exempt from the registration requirements of the Securities Act pursuant to Section 4(2) of the Securities Act.

On April 28, 2005, the Registrant issued 1,204,819 shares of Series A-1 Convertible Preferred Stock, convertible into 1,000,000 shares of Common Stock, and Warrants to purchase 500,000 shares of Common Stock to Summit for an aggregate purchase price of \$200,000 in cash. The requisite percentage of current holders consented and waived the anti-dilution provisions.

On April 28, 2005, the Registrant issued 180,723 shares of Series A-1 stock, convertible into 150,000 shares of Common Stock, and Warrants to purchase 75,000 shares of Common Stock, to Commerce Energy Group, Inc., the parent of Commonwealth Energy Corporation, in consideration of Commerce Energy Group's cancellation of a license agreement with the Registrant. The requisite percentage of current holders consented and waived the anti-dilution provisions.

On July 8, 2005, the Registrant issued 3,000,000 shares of Common Stock and 1,500,000 Stock Purchase Warrants to Summit for \$300,000 in cash and the conversion of a \$300,000 note payable.

On July 8, 2005, the Registrant converted all 4,714,279 outstanding shares of its Series A-1 Convertible Preferred Stock into 3,918,848 shares of Common Stock owned by Summit and Commonwealth Energy Corporation.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None

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**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits

<b>Number</b>	<b>Description of Document</b>	<b>Location</b>
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith
32.1	Certification by the Chief Executive Officer pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed herewith
32.2	Certification by the Chief Financial Officer pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed herewith

(b) Reports on Form 8-K.

On July 13, 2005, the Company filed a current report on Form 8-K reporting an Item 8 event. The Item 8 event involved the Company entering into employment contracts with its Chief Executive Officer, Chief Financial and Operating Officer, and Chief Technology Officer.

On July 15, 2005, the Company filed a current report on Form 8-K reporting an Item 1 and an Item 3 event. The Item 1 event involved the Company entering into a material definitive agreement in connection with the issuance of 12,150,000 shares of Common Stock. The Item 3 event involved an unregistered sale of equity securities in connection with the issuance of 12,150,000 shares of Common Stock and 6,075,000 warrants.

On September 8, 2005, the Company filed a current report of Form 8-K reporting an Item 3 event. The Item 3 event involved an unregistered sale of equity securities in connection with the issuance of 2,350,000 shares of Common Stock and 1,175,000 warrants.

On October 11, 2005, the Company filed a current report on Form 8-K reporting an Item 5 event. The Item 5 event involved the election of a new Director to the Board of Directors of the Company.



**SIGNATURES**

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

POWER EFFICIENCY CORPORATION  
(Registrant)

Date: November 11, 2005

By: /s/ Steven Strasser  
Chief Executive Officer

Date: November 11, 2005

By: /s/ John Lackland  
Chief Operating Officer and Chief Financial  
Officer (Principal Financial and Accounting  
Officer)