

2014

ANNUAL REPORT

ELEGANT TECHNOLOGY • PASSIONATE PEOPLE • GREAT CUSTOMERS



GLOBAL PRESENCE

2014 was an exciting year for Active Power as we demonstrated wide diversity in our shipments, providing solutions to a variety of global locations and applications. The map below shows some notable installations, highlighting our deployments around the world across our product lines (CleanSource UPS, CleanSource HD UPS, and CleanSource PowerHouse) and for a variety of end user applications.



DataBank

Eagan, Minnesota
Colocation data center
CleanSource PowerHouse

Parkland Health and Hospital System

Dallas, Texas
Hospital data center and imaging equipment
CleanSource UPS

ABN Amro

Amsterdam, Netherlands
Data center
CleanSource UPS

Tianjin Zhonghuan Group

Hohhot, China
Solar panel cutting equipment
CleanSource UPS

Jamsil Stadium

Seoul, South Korea
Stadium lighting
CleanSource UPS

Capgemini UK

Swindon, England
Colocation data center
CleanSource PowerHouse/HD UPS

Heineken

Bujumbura, Africa
Bottling production lines
CleanSource UPS

Pemex Refinación

Degollado, Jalisco
Oil re-pumping station
CleanSource PowerHouse



TO OUR SHAREHOLDERS

Elegant technology. Passionate people. Great customers. These elements have not changed since I returned to lead Active Power nearly 18 months ago, nor have they changed through new strategies we set in motion across the organization in 2014. We believe these strategies and the steady progress made in 2014 have set us on a path for improved performance and consistency in 2015.

2014 IN REVIEW

Despite a challenging year for our modular infrastructure solutions business, we made a number of positive changes to the organization in 2014 with a primary focus on increasing bookings.

By increasing the technical capability of our global sales organization to accelerate direct sales and strengthening our engagement with our OEM partner Caterpillar, we increased bookings \$6.4 million or 25 percent in the second half of 2014 to \$32.1 million compared to the second half of 2013. Backlog improved 91 percent from \$14.0 million at December 31, 2013, compared to \$26.7 million at December 31, 2014. Our core UPS sales improved 24 percent or \$5.4 million to \$28.1 million compared to 2013.

We added to our growing marquee customer base with Texas Christian University, Jamsil Stadium in South Korea, and University Medical Center Groningen in the Netherlands, to name a few, and won repeat business from a number of key accounts. Customers also continue to select our products for use in non-IT mission critical applications worldwide which is a testament to our products' rugged design and the unmatched combination of power density, reliability, and total cost of ownership they deliver.

We made a number of strategic moves that we believe will help us identify and pursue microgrid and smart grid projects with our existing product platform. We now have new relationships in place that will help us optimize our products specifically for these applications and expand our distribution capabilities worldwide.

We increased productivity and strengthened our operating platform resulting in a net inventory reduction of 43 percent or \$5.2 million during fiscal 2014. We also reduced our operating expenses by nearly 9 percent or \$2.3 million in 2014 compared to 2013.

2015 OUTLOOK

In August 2014, we introduced our new positioning statement – Driven by Motion. This statement epitomizes the products we offer, our commitment to our customers, and how we want to do business moving forward. For 2015, we will demonstrate this motion in action directed at three key priorities – increasing bookings and backlog, improving operational efficiencies, and controlling costs.

We will support these priorities by boosting the productivity of our sales resources, identifying and eliminating waste to drive efficiencies throughout the organization, and accelerating book-to-cash conversion. We will continue to improve inventory turns and factory utilization as we work to increase sales volume.

I'm also excited about the addition of Peter Gross to our board of directors. Peter is a highly respected industry leader in the mission critical and modular design space with more than 30 years of experience, having led the design and build of mission critical facilities around the globe for some of the largest companies in the world. We look forward to benefit from his insights and counsel as we grow the business.

I believe we have the right organization, right talent, and right products in place to successfully execute against our key priorities. We have a unique and compelling value proposition that delivers tangible performance and operational benefits to our customers and a stronger platform in place to operate the business.

I want to thank you, our shareholders, for your unwavering support. I also want to recognize our employees as I am proud of their passion for Active Power. I especially want to acknowledge our customers who entrust us every day to protect their most mission critical assets.

Sincerely,



Mark A. Ascolese
President and CEO



**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2014

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number: 000-30939

ACTIVE POWER, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

74-2961657
(I.R.S. Employer Identification No.)

2128 W. Braker Lane, BK 12, Austin, Texas
(Address of principal executive offices)

78758
(Zip Code)

(512) 836-6464
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Exchange on Which Registered
Common Stock, \$0.001 per share	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☒ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. ☐ Yes ☒ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not 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-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based upon the closing sale price of its common stock on the last day of registrant's most recently completed second fiscal quarter, June 30, 2014, as reported on The Nasdaq Stock Market, was approximately \$53.7 million (affiliates being, for these purposes only, directors and executive officers and holders of 10% or more of the registrant's outstanding shares).

As of February 25, 2015, the registrant had 23,157,509 shares of common stock outstanding.

Documents Incorporated by Reference

Certain information required by Part III of Form 10-K is incorporated by reference to the registrant's proxy statement for its 2015 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the registrant's fiscal year ended December 31, 2014.

Active Power, Inc.

Unless otherwise indicated, “we,” “us,” “our,” and “Active Power” mean Active Power, Inc., including our predecessor Texas corporation and our subsidiary companies. References in this report to “\$” or “dollars” are to United States of America currency.

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Special Note Regarding Forward-Looking Statements

This report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). All statements other than statements about historical or current facts, including, without limitation, statements about our business strategy, plans, and objectives of management and our future prospects, are forward-looking statements. These include, among other things, statements regarding:

- our expectations that we can increase bookings and backlog;
- our belief that we can control our future expenses;
- our expectations regarding market acceptance of our current and new products;
- our international operations providing a significant portion of our total revenues;
- our future anticipated working capital needs;
- our ability to improve inventory turns and factory utilization;
- our expectation that we will improve the productivity of sales resources;
- our expectation to continue to make significant investments in research and development;
- our belief that the outcome of certain legal proceedings and claims to which we are a party will not, individually or in the aggregate, result in losses that are materially in excess of amounts already recognized, if any; and
- our expectation that seasonal trends will continue in fiscal 2015.

You can identify forward-looking statements by words such as “may,” “will,” “expect,” “intend,” “anticipate,” “believe,” “estimate,” “seek,” “continue,” and other similar words. You should read statements that contain these words carefully because they discuss our future expectations, make projections of our future results of operations or financial condition, or state other “forward-looking” information.

We claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 for all forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about our business that could affect our future results and could cause those results or other outcomes to differ materially from those expressed or implied in the forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in “Risk Factors” included in Item 1A of this report and as may be updated in filings we make from time to time with the U.S. Securities and Exchange Commission (the “SEC”), including the Quarterly Reports on Form 10-Q to be filed by us in our fiscal year 2015.

We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or risks, except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements. New information, future events or risks could cause the forward-looking events we discuss in this report not to occur. You should not place undue reliance on these forward-looking statements, which reflect our expectations only as of the date of this report.

PART I.

ITEM 1. Business.

Overview

Active Power designs, manufactures, sells, and services flywheel-based uninterruptible power supply (“UPS”) products that use kinetic energy to provide short-term power as a cleaner alternative to electro-chemical battery-based energy storage. We also design, manufacture, sell, and service modular infrastructure solutions (“MIS”) that integrate critical power components into a pre-packaged, purpose built enclosure that may include our UPS products as a component. Our products and solutions are based on our patented flywheel and power electronics technology and are designed to ensure continuity for data centers and other mission critical operations in the event of power disturbances.

Our UPS products and solutions are designed to deliver continuous conditioned power during short-term power disturbances and outages, such as voltage sags and surges, and to provide ride-through power in the event of a utility failure, supporting operations until utility power is restored or a longer term alternative power source, such as a diesel generator, is started. We believe our products offer an advantage over those of our competitors in the areas of system reliability, power density (less floor space), and total cost of ownership.

We have sold our flywheel-based UPS products which we call CleanSource® UPS since 1999. As of December 31, 2014, we have shipped more than 4,000 flywheels in UPS systems, delivering nearly 1 gigawatt of power to customers in more than 50 countries around the world, and providing more than 200 million runtime hours of operation.

In addition to selling stand-alone UPS products, our MIS products integrate critical power components into a pre-packaged, purpose built enclosure that can be deployed by customers indoors or outdoors. These solutions can provide the customer benefits of our UPS systems along with the advantages of capital expense, speed to deployment, and system management controls. Our MIS products, for example, can include our UPS products with other related equipment including switchboards and automatic transfer switch; monitoring and control systems; fire detection; lighting; security; and air conditioning. When integrated with our UPS, this product, known as CleanSource PowerHouse™, is sold as a complete stand-alone power solution.

We also integrate and build modular power and IT infrastructure solutions to specification based on customer designs. These solutions are typically enclosures that have a fully built out interior including electrical, cooling, monitoring, and other elements ready for the customer to add its IT racks and servers. These solutions typically do not include our UPS products. These modular IT solutions serve as the physical infrastructure for modular data center products which are self-contained, fully functioning data centers once the customer adds its IT equipment. These products can be deployed rapidly and at a lower cost than traditional brick-and-mortar solutions, and are optimally suited for hyperscale IT and cloud applications.

To date, we have deployed more than 190 infrastructure modules worldwide, which include both CleanSource PowerHouse and our modular IT solutions.

We offer worldwide customer support services, including hardware and software maintenance, on all Active Power products, and other professional services such as assessment, implementation and lifecycle support for our customers’ infrastructure projects.

We are headquartered in Austin, Texas, with international offices in the United Kingdom, Germany, and China.

In 2014, 78% of our product revenue came from the sale of UPS products and 22% from the sale of MIS products. For additional financial detail on each of our segments, see Note 8 to the condensed consolidated financial statements of this Form 10-K.

Customer and Target Markets

According to a 2014 report on the world UPS market by IHS Research, a provider of global market, industry, and technical expertise, the global UPS market was estimated to be approximately \$7.6 billion in 2014. IHS Research projects the market will increase to approximately \$7.8 billion in 2015 and will grow to approximately \$8.5 billion by 2017 with a projected compound annual growth rate of nearly 3% from 2013 to 2018.

UPS products can be classified into single phase and three phase systems. We compete in the higher power, three phase range. Demand for three phase systems is typically segmented by kVA (kilo-Volt-Amps or power level) and by geography. We focus on customers in the 250 kVA and higher segment in the Americas; Europe, Middle East, and Africa (EMEA); and Asia.

In 2014, IHS Research estimated our total available market in this segment to be \$2.1 billion with a served addressable market in the 250 kVA and above segment of approximately \$1.2 billion globally. In 2018, our total available market is forecasted to be approximately \$2.7 billion with a served addressable market in the 250 kVA and above segment of approximately \$1.6 billion. The 250 kVA and higher segment is one of the fastest growing segments of the UPS market according to IHS Research, with a compound annual growth rate projected at nearly 3% from 2014 to 2018.

451 Research, an IT research and advisory company, estimated our total available market for modular data center products in 2014 was \$1.5 billion with a served addressable market of approximately \$900 million globally. The total available market is anticipated to grow to approximately \$4.0 billion by 2018 with a served addressable market of more than \$1.5 billion, according to a 2015 report published by 451 Research. We serve the modular data center market with our CleanSource PowerHouse and modular IT products.

We deliver products and solutions that support and enable mission critical applications that cannot tolerate downtime due to a power disturbance. Although data center deployments represent more than half of our installed base, we also have had success in selling into non-IT environments. Below is a list of where these applications can be found and examples of the types of mission critical loads we protect with our products and solutions.

- Data Center – IT equipment in extreme/hyperscale, enterprise, and colocation facilities
- Industrial/Manufacturing – precision machining, plastic extrusion equipment, and bottling equipment
- Healthcare – imaging equipment (i.e. CAT, MRI, PET, etc.) and hospital data centers
- Casino and Gaming – gaming machines and casino data centers
- Transportation – runway and taxiway lighting at airports
- Broadcast – master control rooms and transmitter sites
- Government – data centers at military installations.

The following list provides a representative sample of end user customers that use our products and solutions to support and enable their operations. The list includes customers to whom such products and solutions have been sold directly by us or via our Original Equipment Manufacturer (“OEM”) partners, manufacturer’s representatives, distributors, or strategic IT partners:

Representative Customers

Capgemini UK plc
 Verizon Terremark
 Heineken
 Pemex
 Parkland Health and Hospital System
 Merck
 Cherokee Casinos
 Osage Casino
 Amsterdam Airport Schiphol
 Mexico City International Airport
 WCBD-TV
 WFFF-TV / WVNY-TV

Industry

Data Center
 Data Center
 Industrial/Manufacturing
 Industrial/Manufacturing
 Healthcare
 Healthcare
 Casino/Gaming
 Casino/Gaming
 Transportation
 Transportation
 Broadcast
 Broadcast

Distribution

We continue to develop client relationships by selling directly and through our network of partners. Specifically, we use the following distribution methods:

- direct sales;
- manufacturer's representatives;
- distributors;
- OEM partners; and
- strategic IT partners.

Direct Sales. Our direct sales teams are located in The Americas, Europe and Asia, and are supported by our four regional offices located in the U.S., United Kingdom, Germany, and China. Our direct sales teams are focused on establishing and expanding local presence and brand awareness, winning large customer orders, and developing the foundation for long-term client relationships in their local markets.

Manufacturer's Representatives. We have relationships with a group of manufacturer's representatives primarily in North America. Representatives have been granted rights to sell Active Power products in specific geographic territories. This channel remains integral to the distribution of our products in North America and increases our geographic sales coverage without adding fixed costs. Products are marketed and sold under the Active Power brand through this channel.

Distributors. In certain markets outside of the United States, we recruit and retain specific distributors to market our products and services. The distributor buys products from us and resells them to the end user, often with other products or services. Distributors may also perform service and warranty work for end users. This strategy has been successful for us in markets where we choose not to deploy direct sales or service resources.

OEM Partners. OEM partners remain critical to our overall business strategy. Our primary OEM partner and one of our largest customers is Caterpillar, Inc. ("Caterpillar"). Caterpillar markets Active Power's UPS products under the Caterpillar brand name "CAT UPS" and as a complement to its electric power product lines of diesel engines and switchgear. By offering the CAT UPS with a standby generator and switchgear, Caterpillar can transform a standby power system into a continuous power system. We believe this total solution gives Caterpillar and us significant competitive advantages in the power quality market. In 2011, we signed a five-year distribution agreement with Caterpillar, continuing this important relationship that started in 1999. Unless terminated, this contract automatically renews for successive one-year periods. Our sales to Caterpillar represented 18%, 14%, and 13% of our total revenue for the years ended December 31, 2014, 2013, and 2012, respectively.

Strategic IT Partners. We have entered into agreements with leading global organizations in the data center market who have the ability to collaborate with us on new sales opportunities. These relationships help us expand potential opportunities to market our products and services through all of our distribution channels. Our primary IT partner is Hewlett Packard Corporation ("HP"). HP accounted for 1%, 22%, and 35% of our total revenue during 2014, 2013, and 2012, respectively.

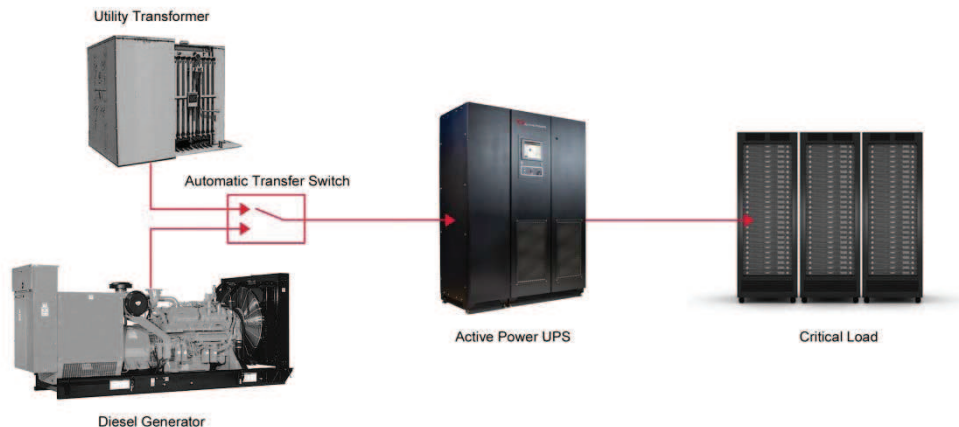
Geography

We focus our marketing and customer identification efforts globally, supported by our four regional offices. Located in Austin, Texas; Osterode, Germany; Evesham, United Kingdom; and Beijing, China, our regional offices provide local sales and service, applications engineering, project management, and system integration for UPS and MIS products. Sales outside of North America accounted for approximately 42%, 20%, and 40% of our total revenues in 2014, 2013, and 2012, respectively. We expect a significant portion of our total revenue will continue to be through international sales. For additional detail on revenue from external customers attributed to foreign operations, see Footnote 8 to the condensed consolidated financial statements in this Form 10-K. For risks related to revenue from external customers attributed to foreign operations, see Part I – Item 1A. Risk Factors, "We derive a substantial portion of our revenues from international markets and plan to continue to expand such efforts, which subjects us to additional business risks including increased logistical and financial complexity, managing internal controls and processes, political instability, and currency fluctuations."

Products: UPS and MIS

UPS

Our UPS products serve two primary functions. First, during normal operations they are continuously conditioning (“cleaning”) the incoming power from the utility and delivering “conditioned” power to the client’s mission critical load. In this mode, the UPS regulates incoming utility power fluctuations in voltage and frequency. Second, if there is any interruption in the utility source, the UPS will provide temporary, or bridging power, until either the utility power is restored or an alternative generating source, such as a diesel generator, begins to provide power. This role of the UPS in the context of a continuous power application is illustrated below:



CleanSource 300/250 Series UPS

Active Power introduced the world’s first integrated flywheel UPS product in 1999, integrating UPS power electronics with flywheel energy storage technology. The flywheel stores kinetic energy – energy produced by motion – by constantly spinning a compact rotor in a low friction environment. When short-term backup power is required due to utility power fluctuations or losses, the UPS draws upon the stored kinetic energy of the spinning flywheel to generate electricity for the load until utility power returns. The flywheel immediately supports the critical load upon loss of utility power. Combining CleanSource UPS with a generator provides customers with complete short- and long-term protection in the event of a power disturbance. Within seconds of an extended outage occurring, the UPS signals the generator to start via the automatic transfer switch. The generator then carries the load until utility power is restored. The following is an illustration of our typical flywheel-based UPS system:



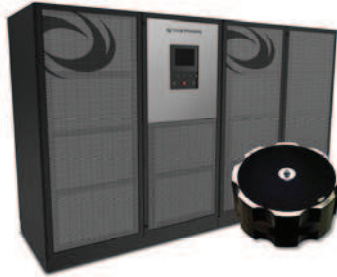
We market our flywheel-based UPS systems under the brand name CleanSource UPS rated at 300 kVA and 250 kVA for 480V and 400V applications, respectively. CleanSource UPS is a battery-free UPS system that integrates proprietary UPS electronics and our flywheel energy storage system into one compact cabinet lineup. We currently offer CleanSource UPS products in power configurations ranging up to 1.5 MVA (million volt ampere) with the ability to parallel these products to provide even more protected power.

CleanSource HD UPS Series

In November 2012, we introduced our CleanSource 750/625HD UPS (see illustration below) which is available in standalone modules rated at 750 kVA and 625 kVA for 480V and 400V applications, respectively. This system is

scalable and can be paralleled together to provide even more protected power. The product's design allows for the use of auxiliary batteries in the event the customer requires extended, autonomous run time for certain applications. We believe CleanSource 750/625HD provides the reliability, power density, and total cost of ownership benefits that will make it a favorable complement to our existing products for large data center and other mission critical applications.

Our UPS products represented 57%, 37%, and 46% of total revenue in 2014, 2013, and 2012, respectively.



Modular Infrastructure Solutions (MIS)

CleanSource PowerHouse

For customers looking for a complete, integrated continuous power system, we package our CleanSource UPS along with switchboards and automatic transfer switch; monitoring and control systems; fire detection; lighting; security; and air conditioning into a fully integrated system. Due to the space efficiencies of our UPS products, we are able to offer all of these components in a pre-packaged containerized solution that we market under the brand name CleanSource PowerHouse (see illustration below). This solution offers customers the key benefits of our CleanSource UPS product line, including space efficiency and high operating temperature ranges compared to a legacy battery-based UPS.



CleanSource PowerHouse is packaged in a purpose-built enclosure that can be deployed by customers indoors or outdoors, with size and features customized depending upon the customer's power load requirements and local and national regulatory requirements. These systems are specifically designed to handle the demands of data centers and other mission critical applications requiring the highest power integrity available while maximizing uptime, useable floor space, and operational efficiency. Our systems are offered in eight standard modular power configurations that enable sizing for power (and cooling) infrastructure. CleanSource PowerHouse delivers significant value to customers as the entire system is integrated and tested prior to delivery for a repeatable and simple solution.

CleanSource PowerHouse is used to support a variety of applications including facility expansion, temporary critical power needs such as event support, disaster recovery, or to support a containerized data center.

In March 2013, we introduced a redesigned CleanSource PowerHouse product line that provides lower acquisition cost, faster time to deployment, and improved monitoring, controls, and analytics software versus a conventional data center electrical room.

Modular IT

To better serve our customers, we use our expertise in integration, containerization, and power distribution to manufacture containerized infrastructure solutions designed to specification for select business partners on a contract basis. Modular IT infrastructure solutions refer to the components of a containerized data center. These modular IT

products can include an outer shell and outfitting the interior of the enclosure with electrical, cooling, and monitoring components. Our clients then add IT equipment including servers and racks, resulting in a self-contained modular data center that our partners deliver to end users. Modular IT systems may be rapidly deployed with CleanSource PowerHouse as a cost-effective alternative to traditional data center construction.

Our products are designed to perform well in harsh environments where power quality or reliability are particularly poor, which makes them a good fit for countries with poor power infrastructure; in harsh manufacturing or process environments; or situations where reliability is paramount. Therefore, we have traditionally focused our direct sales efforts on these types of customer applications.

Our MIS products (CleanSource PowerHouse and modular IT) represented 17%, 35%, and 35% of total revenue in 2014, 2013, and 2012, respectively.

Service

We deliver worldwide customer support that offers clients assessment, implementation, and lifecycle support services for all Active Power products. Building a portfolio of services to work with clients through the lifecycle of their power assessment design and implementation process is a key element of our service growth strategy. We offer the following services to our clients:

- *Deployment.* Our experienced group of project managers will work with a client to develop a timely deployment schedule that avoids disrupting day-to-day business activity. We ensure expectations are clearly defined through the deployment phase;
- *Start-Up and Commissioning.* Once the system is deployed, our team takes the system through a rigorous commissioning process to help ensure the system is working to specification. Our engineers work closely with the client's team to make certain they are educated and trained on the successful operation of the system;
- *Service, Support and Monitoring.* Clients can choose from a variety of comprehensive service and support offerings, tiered to match an organization's internal capabilities and requirements. We also offer remote monitoring service through our headquarters in Austin, Texas, locally at the client's facility, or as a combination offering;
- *Infrastructure Needs Assessment.* We work locally through our global network of mission critical infrastructure engineers and project managers to assess the power and cooling needs of a client's facility;
- *Vetting and Validation.* Our teams of experienced application engineers use comprehensive assessments to vet and validate the optimal solution that complements a client's business continuity plan;
- *Alignment with Business Objectives.* Through continuous communication, our teams help ensure the solution accurately aligns with the original needs assessment and a client's short-term and projected future business objectives; and
- *System Design.* We design client solutions to ensure all components are optimized with a particular focus on reliability, efficiency, and cost effectiveness in determining the correct match and interoperability between components.

Service revenues represented 26%, 28%, and 19% of our total revenue in 2014, 2013, and 2012, respectively.

UPS and MIS Market Drivers

We believe there are several market dynamics fueling the growth of the UPS and MIS markets and the need for power dense (less floor space is used), reliable, and low cost backup power. These include:

Increase in data usage and storage and in data center density:

- Growth of enterprise data, social networking sites, web-based applications, cloud computing, and other similar technologies requires data centers to invest in more IT and physical infrastructure equipment to support growth in use and storage requirements;
- Additional IT and infrastructure requires more floor space; and
- Enterprises' need for more power density to accommodate IT equipment more efficiently within a given space.

More awareness of energy efficiency from both a corporate social responsibility and financial perspective:

- More investment in highly efficient, sustainable technologies to keep electricity costs down and to stay competitive in the marketplace;
- Customer preferences for clean, green technologies that do not contain toxic, harmful chemicals and avoid disposal costs associated with electro-chemical battery-based energy storage;
- Government legislation like the United Kingdom Carbon Reduction Commitment Energy Scheme and other cap and trade programs are becoming more prominent to help control carbon emissions; and
- Electricity costs are the single highest operating costs for many organizations due to the substantial amount of power needed to support data center facilities.

Modular data centers are becoming more commonplace, not only for specific niche applications like military and high density computing environments:

- Colocation sites that house modular data centers are becoming more prevalent due to performance and tangible economic benefits;
- Short lead times and rapid deployment capability due to use of factory built and tested systems are expected to increase demand for modular data center products, particularly for those organizations that do not have capital readily available to commit to building a brick and mortar facility; and
- A modular design-build approach is a more capital efficient model that enables organizations to deploy IT and infrastructure as business and IT needs evolve, reducing underutilization.

Customers focused on convenience and improving margins:

- More mission critical organizations are moving towards innovatively designed, turnkey data center and infrastructure solutions that involve less risk, cost, and complexity and more automation; and
- Organizations want the ability to rapidly deploy IT and associated power and cooling infrastructure.

Increase in global energy consumption:

- Rapid industrialization of highly populated world regions is increasing global energy demand and placing a premium on reliability of energy supply and sensitivity to loss of power; and
- There is an increasing cost to produce and consume electricity due to depletion of finite fossil fuel sources, instability in oil-producing regions, and a preference for green energy sources.

Increasing economic impact of a power interruption to users:

- The financial cost of a power interruption through loss of products, manufacturing down time, and computer processing interruptions; and
- Reputational cost of a power interruption to businesses.

Value Proposition

We believe our offerings deliver an unmatched combination of reliability, power density, and low total cost of ownership. The core differentiators for our products and solutions are the following:



- Proven to reduce failure risk by 80% versus legacy UPS
- Unique patented design delivers predictable, consistent, and continuous operation



- Superior power density: critical power delivered in about half the space of legacy UPS
- Frees up more floor space for revenue generating equipment (i.e. IT equipment, etc.)



- Lower operating expenses through superior energy efficiency, reduced cooling needs, lower maintenance costs, and no battery changes
- Delivers up to 60% in total cost of ownership savings to customers

Competition

We compete with two primary products: UPS products and MIS products.

UPS Products. Our CleanSource UPS products compete primarily against conventional battery-based UPS systems from vendors such as Emerson/Liebert, Eaton/Powerware, and APC/MGE. We also compete against rotary (battery-free) UPS systems from vendors such as Piller, Eurodiesel, and Hitec. For applications requiring less than one megawatt of critical load, we largely compete against battery-based competitors and for applications greater than one megawatt we tend to compete against rotary systems vendors. We believe there is greater market acceptance of battery-free solutions (such as flywheel and rotary) compared to battery-based solutions in the one-megawatt and higher power range, making this a very strong market for our CleanSource 750/625HD UPS. Several of the leading conventional UPS battery vendors offer flywheel-based energy storage in place of batteries. Vycon is the principal manufacturer of these flywheel systems.

Our primary basis of competition as compared to battery-based UPS systems is product differentiation and our advantages in reliability, power density (less floor space is used), and total cost of ownership.

Modular Infrastructure Solutions. We provide competitive offerings in both the modular power and modular IT infrastructure segments. There are a variety of competitors with similar capabilities including systems integrators and value added service providers who may procure system components and assemble custom solutions. We believe that we are one of only a few manufacturers in the world offering pre-packaged standard MIS solutions for quick delivery globally. Because of the significant up-front investment required, and the longer period between order and delivery relative to our UPS products, a significant increase in sales of our MIS products may materially increase the amount of working capital required to fund our operations.

The power density advantages we enjoy with our UPS products allow us to offer higher continuous power levels within the physical constraints of the containerized space compared to our battery-based competitors, which we believe is a barrier to entry for them. Our UPS products' ability to operate in temperatures of up to 40 degrees Celsius in non-air -conditioned environments (such as a shell building or open-air facility) also acts as a competitive advantage for us compared to battery-based UPS systems which require sufficient air conditioning to operate.

We believe our experience with the power and cooling requirements of the infrastructure provides us with a competitive advantage in the design and manufacturing of these products compared to less experienced manufacturers. Further, the joint offering of our CleanSource PowerHouse with our modular IT solutions provides efficiencies, scale, and advantages in sales, marketing, and engineering we expect customers to find increasingly compelling.

Intellectual Property and Assets

We rely upon a combination of patents, trademarks, confidentiality agreements, and other contractual restrictions with employees and third parties to establish and protect our proprietary rights. Our general policy has been to seek patent protection for those inventions likely to be incorporated into our products or where obtaining such proprietary rights will improve our competitive position. We have filed many applications before the U.S. Patent and Trademark Office. We also seek patent protection abroad for our technology by filing patent applications in Europe and Asia. These efforts have resulted in a total of 116 active issued patents and pending applications worldwide.

We own the registered trademarks ACTIVE POWER and CLEANSOURCE in the United States and abroad. PowerHouse and the Active Power logo are trademarks of Active Power, Inc. All other trademarks, service marks, or trade names referred to in this report are the property of their respective owners.

Research and Development

We believe research and development efforts are essential to successfully delivering innovative products that address the current and emerging customer needs, particularly as power management/infrastructure needs evolve. Our research and development team works closely with our marketing and sales teams, IT channel partners, and OEMs to define product requirements that address specific customer needs. Our research and development expenses were \$6.7 million, \$7.4 million, and \$5.4 million in 2014, 2013, and 2012, respectively. As of December 31, 2014, our research and development and engineering teams consisted of 30 engineers and technicians.

Manufacturing

We manufacture all of our UPS and our MIS products for customers in the Americas at our headquarters in Austin, Texas. We are an ISO 9001:2008 quality certified operation. We source the majority of our components from contract manufacturers to enhance our ability to scale operations and minimize costs. This approach allows us to respond quickly to customer orders while maintaining high quality standards and optimizing inventory levels.

We strive to continually improve inventory turns through effective sourcing plans and supplier relationship management programs. We also have Lean Six Sigma programs in place to help us identify and eliminate waste and drive efficiencies throughout the company.

Our internal manufacturing process consists of the fabrication of certain critical components within the flywheel energy storage system and the assembly, functional testing, and quality control of our finished products. We also test components, parts, and subassemblies obtained from contract manufacturers for quality control purposes.

We have entered into long-term agreements with some of our key suppliers, but we currently purchase most of our components on a purchase order basis. We are working to renew or establish more long-term agreements with our sole suppliers and other key vendors, using a rolling sales volume forecast to better ensure component availability. We use standard parts and components for our products where possible, and have developed multiple sources for some of our most critical components including the flywheel rotors. Lead times for ordering materials and components vary significantly and depend on factors such as specific supplier requirements, contract terms, production time required, and current market demand for such components or commodities.

We believe our current workforce, facilities, and inventory levels will be sufficient to handle our near-term projected sales demand. However, over time, we may need to hire additional manufacturing personnel to address sales volume increases.

Local Assembly

A key component of our strategy is to maintain a flexible operating model that allows us to perform local integration, assembly, and testing of certain MIS products. We perform this work either at company managed facilities or with local integration partners that have assembly, integration, and test resources. We also have a full complement of integration, assembly, and test capabilities at our Austin, Texas facility.

Environmental Regulation

We must comply with many different federal, state, local, and foreign governmental regulations related to the use, storage, discharge, and disposal of certain chemicals and gases used in our manufacturing processes. Our facilities have been designed to comply with these regulations and we believe our activities are conducted in material compliance with such regulations. Any changes in such regulations or in their enforcement could require us to acquire costly equipment or to incur other significant expenses to comply with environmental regulations. Any failure by us to adequately control the storage, use, discharge, and disposal of regulated substances could result in significant future liabilities. Increasing public attention has been focused on the environmental impact of manufacturing operations. While we have not experienced any material adverse effects on our operations from recently adopted environmental regulations, our business and results of operations could suffer if for any reason we fail to control the storage or use of, or to adequately restrict the discharge or disposal of, hazardous substances under present or future environmental regulations.

Backlog

Normally, our products are shipped and revenue is recognized within three to six months from the date of the order. Product revenue in any quarter is often dependent on orders booked and shipped throughout that quarter as historically our backlog has only provided a portion of the next quarter's revenue. Service contracts, however, may extend for one or more years. We are attempting to increase the size of our backlog to promote greater efficiency in production, to facilitate business planning, and to improve revenue visibility. To support these efforts, we are working to drive consistent sales performance through targeted investing in and allocation of resources to our sales organization and distribution channels to build our backlog.

The dollar amount of backlog believed to be firm was approximately \$26.7 million, and \$14.0 million at December 31, 2014, and 2013, respectively. This increase in backlog is primarily due to the restructuring of our sales organization, a shift in our market approach, and reengagement with our OEM partner Caterpillar. Of the total backlog, approximately \$5.4 million and \$4.6 million at December 31, 2014, and 2013, respectively, was not expected to be filled in the following year. Backlog represents:

- anticipated revenue from unfulfilled product orders believed to be firm; and
- service work not yet performed under signed contracts.

Due to possible changes in product delivery schedules and the potential cancellation of unfulfilled product orders and service contracts, our backlog at any particular date should not be relied upon as being indicative of revenue for any succeeding period.

Employees

As of December 31, 2014, we had 204 total employees in the following areas:

- 30 in research and development;
- 105 in manufacturing, sourcing, and service;
- 43 in sales and marketing; and
- 26 in administration, information technology, human resources, and finance.

None of our employees are represented by a labor union. We have not experienced any work stoppages and consider our relations with our employees to be good.

Seasonality

Our business has experienced seasonal customer buying patterns for a number of years. In recent years, both UPS and MIS sales were weaker in the first calendar quarter of the year. We believe this pattern, which we attribute to annual capital budgeting procedures, will continue. We also have historically seen a decline in demand for our products in Europe in the summer months compared to other regions because of reduced corporate buying patterns during the vacation season.

Where You Can Find Other Information

Active Power is a Delaware corporation originally founded in 1992 as a Texas corporation. We file annual, quarterly, current, and other reports, proxy statements, and other information with the SEC pursuant to the Exchange Act. You may read and copy any materials the company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the SEC's Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy, and other information statements, and other information regarding issuers, including Active Power, that file electronically with the SEC. The address of that site is www.sec.gov.

We maintain a website at www.activepower.com. We make available free of charge through this site our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practical after we electronically file such material with, or furnish it to, the SEC. This information can be found in the Investor Relations section of our website. The website and the information contained therein or connected thereto are not intended to be incorporated in this Annual Report on Form 10-K.

Executive Officers of the Company

The following table sets forth certain biographical information concerning our current executive officers:

Name	Age	Position(s)
Mark A. Ascolese	64	President and Chief Executive Officer
James A. Powers	53	Chief Financial Officer and Vice President Finance
Randall J. Adleman	57	Vice President of Global Sales and Marketing

Mark A. Ascolese became President and Chief Executive Officer of Active Power on October 14, 2013. Mr. Ascolese has more than 40 years of experience serving a variety of mission critical and energy markets, including data centers. Prior to joining Active Power, Mr. Ascolese first served as CEO and then as Executive Board Chairman of Power Analytics Corporation (now part of Causam Energy, Inc.), an electrical infrastructure enterprise software firm focused on the mission critical and smart grid markets. Mr. Ascolese was appointed CEO of Power Analytics in March 2008 where he recruited the organization's management team and created and implemented a successful strategic plan, transitioning the firm from a family owned company to a professionally managed business. In August 2012, Mr. Ascolese was appointed Executive Board Chairman at Power Analytics and served in this role prior to joining Active Power in October 2013. Previously, he served as President at Powerware Corporation (now part of Eaton Corporation) and in senior management positions at General Electric Company. From 2000 through 2002, Mr. Ascolese served as Senior Vice President of Business Development at Active Power during the company's initial public offering. Mr. Ascolese earned a bachelor's of Science in Commerce from the University of Louisville.

James A. Powers has served as Chief Financial Officer and Vice President of Active Power since December 4, 2013. As Chief Financial Officer, Vice President of Finance, he oversees all accounting, finance, treasury, and investor relations activities, as well as the company's IT organization. From May 2013 until he joined Active Power, he served as Senior Vice President of Finance of the U.S. Windows and Doors division of Ply Gem Industries, Inc., a North American manufacturer of exterior building products. In this role, he managed the finance and IT organizations, leading all accounting, forecasting, budgeting, reporting, business analysis, internal controls, and working capital management activities. From May 2006 through May 2013, Mr. Powers served in various executive finance positions at Xerium Technologies Inc., a global manufacturer and supplier of consumable products and services used in various industries. From January 2011 through May 2013, he served as Vice President and Global Controller where he managed all corporate controllership functions, including SEC reporting and board financial reporting and analysis. From June 2008 through December 2010, Mr. Powers was Vice President of Finance, North America, at Xerium where he directed a broad range of financial functions. Prior to 2006, Mr. Powers served in various executive finance positions for international electrical equipment manufacturing businesses within Invensys Group PLC and ABB Ltd. Mr. Powers received a bachelor's of Science in Accounting from the State of University of New York at Albany.

Randall J. Adleman joined Active Power on November 18, 2013, as Vice President of Global Sales and Marketing. In this role, he has overall responsibility for the company's global sales and marketing organizations. From March 2010 until he joined Active Power, Mr. Adleman served as Vice President of Sales and Marketing for Valence Technology, Inc., a global manufacturer of lithium-ion energy storage solutions. There, he directed all worldwide sales and marketing efforts for the company's motive, backup, industrial, and marine segments. Valence Technology filed a voluntary petition for chapter 11 business reorganization in the U.S. Bankruptcy Court for the Western District of Texas on July 12, 2012, during Mr. Adleman's tenure as an executive officer. The U.S. Bankruptcy Court for the Western District of Texas approved the company's exit from chapter 11 on November 13, 2013. Prior to that position, Mr. Adleman held various sales, marketing, and service leadership positions, including having founded and served as Principal at Fords Barron Advisership, a corporate consultancy focused on sales force effectiveness. Mr. Adleman holds an undergraduate degree from Colgate University and a master's in Business Administration with a concentration in Marketing from Fairleigh Dickinson University.

ITEM 1A. Risk Factors

You should carefully consider the risks described below before making a decision to invest in our common stock or in evaluating Active Power and our business. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we do not presently know, or that we currently view as immaterial, may also impair our business operations.

This Form 10-K contains forward-looking statements that involve risks and uncertainties. Our results could materially differ from those anticipated in these forward-looking statements as a result of certain factors, including the risks described below and elsewhere. See “Special Note Regarding Forward-Looking Statements.”

Risks Related to our Business

We have a history of significant operating losses.

We have incurred annual operating losses each year since our inception in 1992. Although we achieved operating profitability on a quarterly basis in the second quarter of 2012, we have not been able to sustain this and achieve quarterly or annual operating profitability since then. As of December 31, 2014, we had an accumulated deficit of \$284.0 million. To date, we have funded our operations principally through the public and private sales of our stock, from borrowings under our credit facilities, from product and service revenue, and from development funding. We will need to generate significant additional revenue while maintaining our current margins to achieve annual profitability, and we cannot assure you that we will ever realize such revenue levels or achieve profitability on a consistent basis.

If our revenues do not meet our expectations, our costs exceed our estimates, or our working capital needs are greater than anticipated, we may not have adequate liquidity to continue operating our business. Our cash requirements will depend on many factors, including:

- future sales growth;
- the demand for our products;
- the gross profit we are able to generate from our sales;
- the timing, level, and extent of our research and development funding;
- the rate of expansion of our sales and marketing activities;
- the rate of expansion of our manufacturing processes;
- our overall level of operating expenses;
- the payment terms we negotiate with our suppliers; and
- our default rates on receivables.

A substantial increase in sales of our MIS solutions or a substantial increase in UPS sales may materially impact the amount of working capital required to fund our operations. In order to increase our MIS sales, we may be required to make larger investments in inventory and to increase the amount of our outstanding receivables. These larger investments may require us to obtain additional sources of working capital, debt, or equity financing in order to fund our business. Even if we obtain additional debt financing, a substantial portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness.

A significant increase in sales of our MIS products may materially increase the amount of working capital required to fund our operations.

Because of the significant up-front investment required, and the longer period between order and delivery relative to our UPS products, a significant increase in sales of our MIS products may materially increase the amount of working capital required to fund our operations. The amount of time between the receipt of payment from our customers and our expenditures for raw materials, manufacturing, and shipment of products (the cash cycle) for MIS sales can be as much as 210 days, depending on customer payment terms. If we experience a substantial increase in the size or number of MIS orders, we may need to obtain additional sources of working capital, debt, or equity financing to fund the business. If we are unsuccessful at obtaining additional sources of working capital, we may be required to curtail our level of MIS sales or we may lose potential customers, either of which may adversely impact our results of operations.

We may need additional capital in the future, and it may not be available to us on favorable terms, or at all.

We have historically relied on outside financing and cash flow from operations to fund our operating losses, operations, capital expenditures, and expansion. We may require additional capital from equity or debt financing in the future to fund our operations or respond to competitive pressures or strategic opportunities. We may not be able to secure timely additional financing on favorable terms, or at all. The terms of any additional financing may place limits on our financial and operating flexibility. If we are unable to obtain adequate financing or financing on terms satisfactory to us, if and when we require it, our ability to grow or support our business and to respond to business challenges could be significantly limited. We do not know whether we will be able to secure additional funding, or funding on terms acceptable to us, to continue our operations as planned. If financing is not available, we may be required to reduce, delay, or eliminate certain activities or to license or sell to others some of our proprietary technology.

Our reliance on large and complex system solutions and customer concentration may adversely affect our ability to accurately predict the timing of revenues and to meet short-term expectations of operating results.

Our reliance on large and complex system solutions means that we must devote substantial effort and time to complete sales to customers. Further, a large portion of our quarterly revenue is derived from relatively few large transactions with relatively few customers. For example, in 2014 and 2013, our three largest customers contributed 30% and 45% of our revenue, respectively. Any delay in completing these large sales transactions or any reduction in the number of customers or large transactions, may result in significant adverse fluctuations in our quarterly revenue. Further, we use anticipated revenues to establish our operating budgets and a large portion of our expenses, particularly rent and salaries are fixed in the short term. As a result, any shortfall or delay in revenue could result in increased losses and would likely cause our operating results to be below public expectations. The occurrence of any of these events would likely materially adversely affect our results of operations.

Our business may be affected by general economic conditions and uncertainty that may cause customers to defer or cancel sales commitments previously made to us.

Any future economic uncertainty in the United States or certain international markets may lead to an economic recession or lower capital spending and credit availability in some or all of the markets in which we operate. A recession or even the risk of a potential recession or uneven economic growth conditions may be sufficient reason for customers to delay, defer, or cancel purchase decisions, including decisions previously made. This risk is magnified for capital goods purchases such as UPS and MIS products that we supply. Although we believe that our competitive advantage and our efforts to broaden the number of different markets in which we sell may help mitigate the economic risk associated with any one country or market vertical, any customer delays or cancellation in sales orders could materially adversely affect our level of revenues and operating results.

Our business could be impacted by customer credit risk on receivables.

Most of our sales are on an open credit basis. Our failure to collect receivables from any of our customers in a timely manner could have a significant adverse effect on our liquidity. The collection risk may potentially increase if we sell a higher proportion of MIS, such as our CleanSource PowerHouse products, due to their higher average selling price. If future actual default rates on receivables differ from those currently anticipated, our working capital could decrease and we may not have adequate liquidity to continue operating our business.

Our financial results may vary significantly from quarter to quarter.

Our product revenue, operating expenses, and quarterly operating results have varied in the past and may fluctuate significantly from quarter to quarter in the future due to a variety of factors, many of which are outside of our control. As a result, you should not rely on our operating results during any particular quarter as an indication of our future performance in any quarterly period or fiscal year. The factors which may affect our business include, among others:

- timing of orders from our customers and the possibility that customers may change their order requirements with little or no notice to us;
- demand for our flywheel-based energy storage system as an alternative to lead-acid batteries and our continuous power and infrastructure solutions;

- ongoing need for short-term power outage protection in traditional UPS systems;
- deferral of customer orders in anticipation of new products from us or other providers of power quality systems;
- our order backlog may not increase and does not always result in revenue;
- limited visibility into customer spending plans;
- timing of deferred revenue components associated with large orders;
- ability to manage capital requirements associated with large orders;
- timing and execution of our new product introductions;
- new product releases, licensing, or pricing decisions by our competitors;
- commodity and raw material component prices;
- ability to adjust our cost structure in response to reductions in income;
- loss of a significant customer or distributor;
- impact of changes to our product distribution strategy and pricing policies;
- failure to achieve our anticipated revenue growth rate;
- impact of changes to our product distribution strategy and pricing policies of our distributors;
- changes in product mix;
- fluctuations in currency exchange rates;
- changes in the mix of domestic and international sales;
- rate of market growth for our products; and
- acceptance of our latest generation UPS product in the marketplace.

The market for power quality products is evolving and it is difficult to predict its potential size or future growth rate. Most of the organizations that may purchase our products have invested substantial resources in their existing power systems and, as a result, have been reluctant or slow to adopt a new technology, particularly during a period of reduced capital expenditures. Moreover, our current products are alternatives to traditional battery-based UPS systems and may never be accepted by our customers or may be made obsolete by other advances in power quality technologies.

Significant portions of our expenses are not variable in the short term and cannot be quickly reduced to respond to decreases in revenue. Therefore, if our revenue is below our expectations, our operating results are likely to be adversely and disproportionately affected. In addition, we may change our prices; modify our distribution strategy and policies; accelerate our investment in research and development; or shift our sales and marketing efforts in response to competitive pressures or to pursue new market opportunities. Any one of these activities may further limit our ability to adjust spending in response to revenue fluctuations. We use forecasted revenue to establish our expense budget. Because most of our expenses are fixed in the short term or incurred in advance of anticipated revenue, any shortfall in revenue may result in significant losses.

We derive a substantial portion of our revenues from international markets and plan to continue to expand such efforts, which subjects us to additional business risks including increased logistical and financial complexity, managing internal controls and processes, political instability, and currency fluctuations.

The percentage of our total revenue derived from customers located outside of North America was 42%, 20%, and 40% in 2014, 2013, and 2012, respectively. Our international operations are subject to a number of risks, including:

- foreign laws and business practices that favor local competition;
- dependence on local channel partners;
- compliance with multiple, conflicting, and changing government laws and regulations;
- longer cash cycles;
- difficulties in managing and staffing foreign operations;
- foreign currency exchange rate fluctuations and the associated effects on product demand and timing of payment;
- political and economic stability, particularly in the Middle East and Africa;
- greater difficulty in the contracting and shipping process and in accounts receivable collection including longer collection periods;
- ability to fund working capital requirements;
- greater difficulty in hiring qualified technical sales and application engineers; and
- difficulties with financial reporting in foreign countries.

To date, the majority of our sales to international customers and purchases of components from international suppliers have been denominated in U.S. dollars, Euros, and British Pounds. All of our UPS products are manufactured in the U.S. and then sold to our foreign subsidiaries and customers, normally in U.S. dollars. An increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive for our international customers to purchase, thus rendering our products less competitive. We also source the non-UPS components for our modular power infrastructure products locally where possible and pay for these components in local currencies as a way to mitigate the impact of fluctuations in foreign currencies and lessen the impact of any unfavorable fluctuations with the U.S. dollar. We and many of our subsidiaries sell products outside of the country of incorporation, and often in foreign currencies. To the extent we record sales in other than our local currency; this can result in translation gains and losses. Currently, we do not engage in hedging activities for our international operations to offset this currency risk. However, we may engage in hedging activities in the future.

We are subject to risks relating to product concentration and lack of revenue diversification.

We derive a substantial portion of our revenue from a limited number of products, particularly from our CleanSource 300/250 Series UPS product family. These UPS products are also an integral component of our CleanSource PowerHouse products. We expect these products to continue to account for a large percentage of our revenues in the near term. Continued market acceptance of these products is therefore critical to our future success.

Our future success will also depend on our ability to reduce our dependence on these few products by developing and introducing new products and product or feature enhancements in a timely manner. Specifically, our ability to capture significant market share depends on our ability to develop and market extensions to our existing product lines at higher and lower power range offerings and as containerized solutions. We are currently investing significant amounts in our UPS and MIS products to broaden our product portfolio. Even if we are able to develop and commercially introduce new products and enhancements, they may not achieve market acceptance and the revenue generated from these new products and enhancements may not offset the costs, which would substantially impair our revenue, profitability, and overall financial prospects. Successful product development and market acceptance of our existing and future products depend on a number of factors, including:

- changing requirements of customers;
- accurate prediction of market and technical requirements;

- timely completion and introduction of new designs;
- quality, price, and performance of our products;
- availability, quality, price, and performance of competing products and technologies;
- our customer service and support capabilities and responsiveness;
- successful development of our relationships with existing and potential customers; and
- changes in technology, industry standards, or end-user preferences.

We must expand our distribution channels and manage our existing and new product distribution relationships to grow our business.

The future growth of our business will depend on our ability to expand our existing relationships with distributors; to identify and develop additional channels for the distribution and sale of our products; and to manage these relationships. As part of our growth strategy, we may expand our relationships with distributors and develop relationships with new distributors. We will also look to identify and develop new relationships with additional third parties that could serve as outlets for our products, or provide additional opportunities for our existing sales channels, such as the relationships we have developed with IT hardware manufacturers such as HP. Our inability to execute this strategy successfully and to integrate and manage our existing OEM channel partners and our new distributors and manufacturer's representatives would likely impede our future growth.

Our backlog may not result in revenue.

Our backlog is not necessarily a meaningful predictor of future results. Backlog represents anticipated revenue from unfulfilled product orders and from service work not yet performed under signed contracts. Due to possible changes in product delivery schedules and the potential for cancellation of unfulfilled product orders and service contracts by our customers, our backlog at any particular date should not be relied upon as being indicative of revenue for any succeeding period. Time periods from receipt of an order to shipment date and installation vary widely, and may be determined by a number of factors, including the terms of the customer contract and the customer's deployment plan. The value of service contracts included in backlog could cover services extending one or more years into the future. The size of an order or the scope of a service contract can be reduced significantly during the course of a project. If the scope of an order or contract is revised or an order or contract is cancelled, we adjust backlog accordingly. Also, some of the orders we accept from customers require certain conditions or contingencies to be satisfied prior to shipment or prior to commissioning or installation, some of which are outside of our control and some of which may not be satisfied. For these and other reasons, we may not fully realize our entire backlog as revenue.

We must continue to hire and retain skilled personnel.

We believe our future success will depend upon our ability to attract, motivate, and retain highly skilled managerial, engineering, sales, and product marketing personnel. There is a limited supply of skilled employees in the power quality marketplace. Our small size relative to our competitors, our history of significant operating losses and our lack of brand equity, particularly in foreign markets, makes it very difficult for us to attract new personnel. If we are unable to attract the new personnel we desire, retain personnel we currently employ, or if we are unable to replace departing employees quickly, our operations and new product development may suffer.

We are significantly dependent on our relationships with Caterpillar and Hewlett Packard. If these relationships are unsuccessful, for whatever reason, our business and financial prospects would likely suffer.

Caterpillar, together with its dealer network, is our primary OEM customer and the single largest customer for our flywheel-based UPS products. Caterpillar accounted for 18%, 14%, and 13% of our revenue in 2014, 2013, and 2012, respectively. HP is our largest IT channel partner and accounted for 1%, 22%, and 35% of our revenue in 2014, 2013, and 2012, respectively. A number of factors could cause these customers to cancel or defer orders, including interruptions to their operations due to a downturn in their industries; delays or changes in their product offerings; securing other sources for the products we manufacture; or developing such products internally. If our relationships with Caterpillar or HP are not successful or suffer a material adverse change, such as a material reduction in the level of orders due to an inability to win customer projects or other factors outside of our control; or their failure to pay us on a timely basis, our business and operating results would suffer unless we are able to replace these revenues from another source or sources in a timely manner.

We have underutilized manufacturing capacity and have no experience manufacturing our products in large quantities.

In 2001, we leased and equipped a 127,000 square foot facility used for manufacturing and testing of our three-phase product line, including our UPS and energy storage products. To be financially successful and to fully utilize the capacity of our facility and allocate its associated overhead, we must achieve significantly higher sales volumes. We must accomplish this while also preserving the quality levels we achieved when manufacturing these products in more limited quantities. To date, we have not been successful at increasing our sales volume to a level that fully utilizes the capacity of the facility and we may never increase our sales volume to necessary levels. If we do not reach these necessary sales volume levels, or if we cannot sell our products at our suggested prices, our ability to reach profitability on a quarterly or annual basis would be adversely impacted.

Achieving the necessary production levels to absorb the capacity of our manufacturing facility efficiently presents a number of technological and engineering challenges for us. We have not previously manufactured our products in high volume. We do not know whether or when we will be able to develop efficient, low-cost manufacturing capability and processes that will enable us to meet the quality, price, engineering, design, and product standards or production volumes required to manufacture large quantities of our products successfully. Even if we are successful in developing our manufacturing capability and processes, we do not know whether we will do so in time to meet our product commercialization objectives or to satisfy the requirements of our customers.

We must build quality products to ensure acceptance of our products.

The market perception of our products and related acceptance of such products is highly dependent upon the quality and reliability of the products we build. Any quality problems attributable to our UPS or MIS product lines may substantially impair our revenue and operating results. Moreover, quality problems for our product lines could cause us to delay or cease shipments of products or have to recall or field upgrade products, thus adversely affecting our ability to meet revenue or cost targets. In addition, while we seek to limit our liability as a result of product failure or defects through warranty and other limitations, if one of our products fails, a customer could suffer a significant loss and seek to hold us responsible for that loss and our reputation with other current or potential customers would likely suffer.

Seasonality may contribute to fluctuations in our quarterly operating results.

Historically, our business has experienced seasonal customer buying patterns. In recent years, our business has generally experienced relatively weaker demand in the first calendar quarter of the year. We believe this pattern, which we attribute to annual capital budgeting procedures, may possibly continue. In addition, we anticipate demand for our products in Europe may decline in the summer months, compared to other regions, because of reduced corporate buying patterns during the vacation season.

We depend on sole and limited source suppliers and outsource selected component manufacturing.

We purchase some of our critical component parts from sole source and limited source suppliers. If our suppliers receive excess demand for their products, we may receive a low priority for order fulfillment as large volume customers may receive priority that may result in delays in our acquiring components. A delay in acquiring components for our products may delay the manufacture and shipment of our products. Some of these delays may be substantial. As a result, we may purchase critical long-lead time or single-sourced components in large quantities to help protect our ability to deliver finished products on time. If we overestimate our component requirements, we may have excess inventory, which will increase our costs. If we underestimate our component requirements, we will have inadequate inventory, which will delay our manufacturing and render us unable to deliver products to customers on scheduled delivery dates. If we are unable to obtain a component from a supplier or if the price of a component has increased substantially, we may be required to manufacture the component internally, which will also result in delays or we may be required to absorb price increases. Manufacturing delays could negatively impact our ability to sell our products and could damage our customer relationships.

To assure the availability of our products to our customers, we outsource the manufacturing of selected components prior to the receipt of purchase orders from customers based on their forecasts of their product needs and internal product sales revenue forecasts. However, these forecasts do not represent binding purchase commitments from our customers. We do not recognize revenue for such products until we receive an order from the customer and the product is shipped to the customer. As a result, we incur inventory and manufacturing costs in advance of

anticipated revenue. As demand for our products may not materialize, this product delivery method subjects us to increased risks of high inventory carrying costs, obsolescence and excess, and may increase our operating costs. In addition, we may from time to time make design changes to our products, which could lead to obsolescence of inventory.

Our manufacturing operations are concentrated in a small number of nearby facilities.

All of our UPS systems and our MIS products for customers in the Americas are manufactured in our Austin, Texas facility. Our manufacturing, research and development, and administrative activities are concentrated in two nearby facilities. If, for any reason, including as a result of a natural disaster, act of terrorism, or other similar event, either of these facilities should be damaged or destroyed or become inoperable or inaccessible, our ability to conduct our business could be adversely affected or interrupted entirely.

We face significant competition from other companies.

The markets for power quality and power reliability systems are intensely competitive. There are many companies engaged in all areas of traditional and alternative UPS and backup power systems in the U.S. and abroad, including, among others, major electric and specialized electronics firms, as well as universities, research institutions, and foreign government-sponsored companies. There are many companies that are developing flywheel-based energy storage systems and flywheel-based power quality systems. We may face future competition from companies that are developing other types of emerging power technologies, such as advanced new battery chemistries, high-speed composite flywheels, ultra capacitors, and superconducting magnetic energy storage.

Many of our current and potential competitors have longer operating histories, significantly greater financial, technical, service, marketing, and other resources, broader name and brand recognition, and a larger installed base of customers. As a result, these competitors may have greater credibility with our existing and potential customers and greater service infrastructure than we do. Given our current production volumes and lack of strategic supplier management programs, we may receive less favorable pricing from our suppliers than some of our larger competitors. Our competitors may be able to adopt more aggressive pricing policies and devote greater resources to the development, promotion, and sale of their products than we can, which would allow them to respond more quickly than us to new or emerging technologies or changes in customer requirements.

In addition, some of our current and potential competitors have established supplier or joint development relationships with our current or potential customers. These competitors may be able to use their existing relationships to discourage these customers from purchasing products from us or to persuade them to replace our products with their products. Increased competition could decrease our prices, reduce our sales, lower our margins, or decrease our market share. These and other competitive pressures could prevent us from competing successfully against current or future competitors and could materially harm our business.

We may be unable to protect our intellectual property and proprietary rights.

We expect future technological advancements made by us will be critical to achieving and sustaining market acceptance of our products. We rely on a combination of patent, copyright, trademark, and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We also enter into confidentiality or license agreements with our employees, consultants, and business partners and control access to and distribution of our software, documentation, and other proprietary information.

Despite these efforts, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our products is difficult, and we cannot be certain the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where applicable laws may not protect our proprietary rights as fully as in the U.S. In addition, the measures we undertake may not be sufficient to protect our proprietary technology adequately and may not preclude competitors from independently developing products with functionality or features similar to those of our products. We believe that our success depends more on the knowledge, passion, experience and technological expertise of our employees than on the legal protection that our patents and other proprietary rights might afford.

We may be subject to claims by others that we infringe on their proprietary technology.

In recent years, there has been significant litigation in the U.S. involving patents, trademarks, and other intellectual property rights. We may become involved in litigation in the future to protect our intellectual property or defend allegations of infringement asserted by others. Legal proceedings could subject us to significant liability

for damages or invalidate our intellectual property rights. Any litigation, regardless of its merits or its outcome, would likely be time consuming and expensive to resolve and would divert management's time and attention. Any potential intellectual property litigation also could force us to take specific actions, including:

- cease selling our products that use the challenged intellectual property;
- obtain from the owner of the infringed intellectual property right a license to sell or use the relevant technology or trademark, which license may not be available on reasonable terms, or at all;
- redesign those products that use infringing intellectual property; or
- cease to use an infringing trademark.

Our involvement in any such litigation may cause us to incur unexpected litigation costs, require modifications to or limit our ability to sell our products, and adversely impact our business and reputation.

Our internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations.

Pursuant to the Sarbanes-Oxley Act of 2002, we are required to provide a report by management on our internal control over financial reporting, including management's assessment of the effectiveness of such control. Internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Therefore, even effective internal controls can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. In addition, projections of any evaluation of effectiveness of our internal control over financial reporting to future periods are subject to the risk that the control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. If we fail to maintain the adequacy of our internal controls, including any failure to implement required new or improved controls, or if we experience difficulties in their implementation, our business and operating results could be harmed and we could fail to meet our reporting obligations.

A material weakness or other control deficiency could result in errors in our reported results and could have a material adverse effect on our operations.

A material weakness is a control deficiency or combination of control deficiencies, such that there is a reasonable possibility that a material misstatement of annual or interim financial statements will not be prevented or detected. In 2013, our management identified a material weakness resulting from control deficiencies related to our credit approval process whereby we did not confirm information from an employee of ours in China regarding the facts surrounding Qi Yuan, a distributor with which we entered into a distribution agreement.

In response to such material weakness, management implemented additional credit approval process procedures including actions to further verify the financial condition and ownership structure of all new customers. The material weakness was remediated as of December 31, 2013. Any further material weakness or unsuccessful remediation could adversely impact investor confidence in the accuracy and completeness of our financial statements. As a result, our ability to obtain any additional financing could be materially and adversely affected, which in turn could materially and adversely affect our business and our financial condition. In addition, perceptions of us among customers, lenders, investors, securities analysts, and others could also be adversely affected. We can give no assurances the measures we have taken to date, or any future measures we may take, will prevent or remediate any additional material weaknesses in the future.

Our pending legal matters have increased our costs and could result in fines and penalties.

We are involved in ongoing legal matters as described in the section below titled "Legal Proceedings." These matters may harm our business and liquidity in the future. We have incurred and expect to continue to incur substantial expenses for legal and accounting services related to such matters. These matters have also required significant time and attention from our management. At this point, we remain unable to predict the duration, scope, or results of the pending SEC investigation. In connection with our pending legal matters, including any further litigation that may be pursued, we may incur defense costs that may exceed our insurance coverage. We may also incur costs if the insurers of our directors and officers and our liability insurers deny coverage for the costs and expenses related to any litigation. Adverse outcomes or other developments during the course of such matters may harm our business, financial condition, results of operations, or liquidity.

Cybersecurity incidents could disrupt business operations, result in loss of critical and confidential information, and adversely impact our reputation and results of operation.

Global cybersecurity threats can range from uncoordinated individual attempts to gain unauthorized access to our information technology (IT) systems to sophisticated and targeted measures known as advanced persistent threats. While we employ comprehensive measures to prevent, detect, address, and mitigate these threats (including access controls, data encryption, vulnerability assessments, continuous monitoring of our IT networks, and systems and maintenance of backup and protective systems), cybersecurity incidents, depending on their nature and scope, could potentially result in the misappropriation, destruction, corruption, or unavailability of critical data and confidential or proprietary information (our own or that of third parties) and the disruption of business operations. The potential consequences of a material cybersecurity incident include reputational damage; litigation with third parties; diminution in the value of our investment in research; development and engineering; and increased cybersecurity protection and remediation costs; which in turn could adversely affect our competitiveness and results of operations.

Tax matters could adversely impact our results of operations and financial condition.

We are subject to potential income tax and other taxes in the United States and in foreign jurisdictions. Our tax liabilities are affected by the amount of income we have in various jurisdictions and the amounts we charge in intercompany transactions for products, services, funding, and other items. We are subject to periodic tax audits in the United States and in other various jurisdictions. Tax authorities may disagree with our intercompany charges, cross-jurisdictional transfer pricing, or other matters and assess additional taxes. We assess the likelihood of adverse outcomes resulting from these examinations to determine the need for and adequacy of a provision for income taxes. However, the outcomes from these examinations could have an adverse effect on our provision for income taxes and cash tax liability. In addition, our income taxes and other tax liability in the future could be adversely affected by numerous factors including changes in tax laws, regulations, accounting principles, or interpretations thereof, which could adversely impact our results of operations and financial condition.

Risks Related to our Common Stock

We have anti-takeover provisions that could discourage, delay or prevent our acquisition.

Provisions of our certificate of incorporation and bylaws could have the effect of discouraging, delaying, or preventing a merger or acquisition that a stockholder may consider favorable. We also are subject to the anti-takeover laws of the State of Delaware, which may further discourage, delay, or prevent someone from acquiring or merging with us. In addition, our agreement with Caterpillar for the distribution of UPS products provides that Caterpillar may terminate the agreement in the event we are acquired or undergo a change in control. The possible loss of a significant customer could be a significant deterrent to possible acquirers and may substantially limit the number of possible acquirers. All of these factors may decrease the likelihood we would be acquired, which may depress the market price of our common stock.

The trading price of our common stock has been volatile and is likely to be volatile in the future.

Historically, the market price of our common stock has fluctuated significantly. In 2014, the sales price of our common stock ranged from \$1.63 to \$3.67 per share. In addition to the other risks described in the “Risk Factors” section of this Form 10-K, the market price of our common stock can be expected to fluctuate significantly in response to numerous other factors, many of which are beyond our control, including the following:

- actual or anticipated fluctuations in our operating results;
- changes in financial estimates by securities analysts, any financial guidance we may provide, or our failure to perform in line with such estimates or guidance;
- changes in market valuations of other technology companies, particularly those that sell products used in power quality systems;
- announcements by us or our competitors of significant sales, technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;
- introduction of technologies or product enhancements that reduce the need for flywheel energy storage or modular infrastructure products;
- our loss of one or more key OEM customers or channel partners;

- an inability to expand our distribution channels successfully;
- departures of key personnel;
- our ability to obtain additional equity capital or borrowings under our credit agreement;
- the outcome of our pending litigation and SEC investigation; and
- changing external capital market conditions.

If the market for technology stocks or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, operating results, or financial condition. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry or the stock market generally even if these events do not directly affect us. Each of these factors, among others, could cause our stock price to decline.

We have not in the past and do not currently intend to pay cash dividends on our common stock.

We have never declared or paid any cash dividends on our common stock, and we do not expect to declare or pay any cash dividends on our common stock in the foreseeable future. Future cash dividends, if any, will be determined by our Board of Directors, in its discretion, based upon our earnings, financial condition, cash flow, capital resources, capital requirements, charter restrictions, contractual restrictions including those under our bank credit facility, and such other factors as our Board of Directors deems relevant.

ITEM 1B. Unresolved Staff Comments.

None.

ITEM 2. Properties.

Our corporate headquarters facility is a 127,000 square foot building we lease in Austin, Texas. We lease this building pursuant to a lease agreement that expires in December 2016. Our manufacturing, administrative, information systems, sales and service groups currently utilize this facility.

Our engineering facility of approximately 12,150 square feet is also located in Austin, Texas and is leased pursuant to a lease agreement that expires in March 2016.

In addition to these properties, we lease facilities totaling 12,979 square feet in the United Kingdom, Germany and China for sales and service activities.

Our current manufacturing and test facilities located at our corporate headquarters can support a business volume significantly in excess of our current revenues primarily with the addition of direct labor only and no need for additional significant capital investment. We believe our existing facilities are adequate to meet our current needs and plans.

ITEM 3. Legal Proceedings.

Refer to Footnote 6, “Contingencies,” of the condensed consolidated financial statements on pages 66 to 67 of this Form 10-K.

ITEM 4. Mine Safety Disclosures.

Not applicable.

PART II.

ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is traded on The NASDAQ Stock Market LLC under the symbol "ACPW." The following table lists the high and low per share sales prices for our common stock as reported by The NASDAQ Stock Market LLC for the periods indicated:

	<u>High</u>	<u>Low</u>
2014		
Fourth Quarter	\$2.00	\$1.63
Third Quarter	\$2.79	\$1.88
Second Quarter	\$3.40	\$2.63
First Quarter	\$3.67	\$3.15
2013		
Fourth Quarter	\$3.38	\$2.81
Third Quarter	\$4.32	\$2.83
Second Quarter	\$4.77	\$4.09
First Quarter	\$4.91	\$3.43

As of February 25, 2015, there were 23,157,509 shares of our common stock outstanding held by 125 stockholders of record.

We have never declared or paid cash dividends on our capital stock. We currently intend to retain any earnings for use in our business and do not anticipate paying any cash dividends in the foreseeable future. Future dividends, if any, will be determined by our board of directors.

We did not repurchase any of our securities during 2014.

Please refer to "Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" in this Form 10-K for the information required by Item 201(d) of Regulation S-K with respect to securities authorized for issuance under our equity compensation plans at December 31, 2014.

Sale of Unregistered Securities

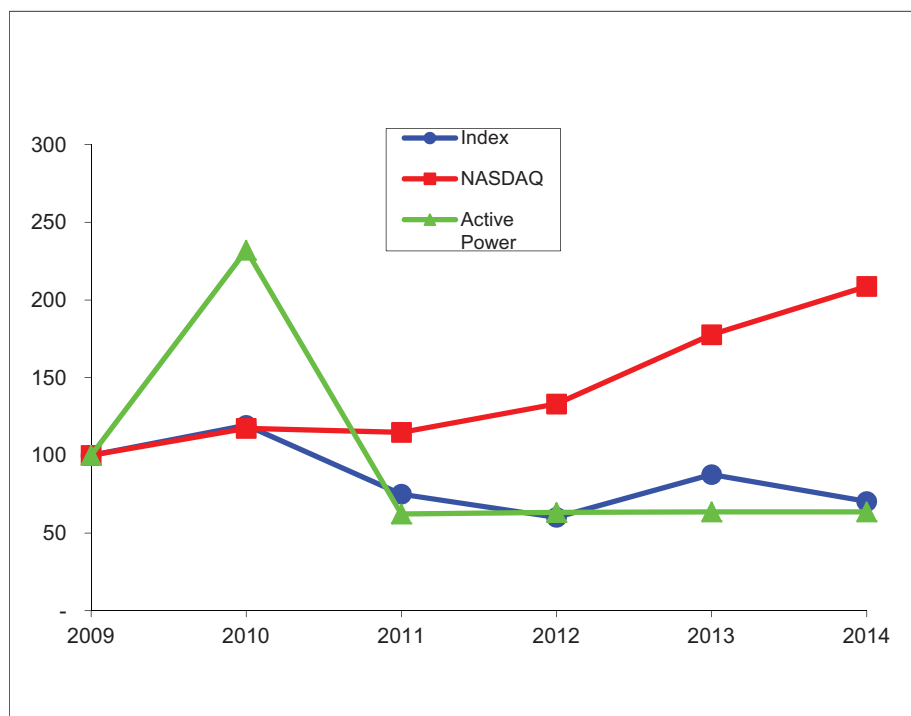
None.

Stock Performance Graph

The following stock performance graph and related information shall not be deemed “soliciting material” or “filed” with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act or the Exchange Act of 1934.

The graph depicted below shows a comparison of cumulative total stockholder returns for an investment in our common stock, The NASDAQ Stock Market (US) Composite Index, and a peer group of power technology companies having similar market capitalizations.

COMPARISON OF CUMULATIVE TOTAL RETURN



- (1) The Power Index peer group consists of an equal weighting of the following companies, all traded on The NASDAQ Stock Market: Active Power, Inc. (ACPW), Capstone Turbine, Inc. (CPST), FuelCell Energy, Inc. (FCEL), Maxwell Technologies (MXWL), and PowerSecure (POWR).
- (2) The graph covers the period from December 31, 2009, the last trading day before the beginning of our six preceding fiscal years, through December 30, 2014, the last trading day of our most recently completed fiscal year.
- (3) The graph assumes that \$100 was invested in our common stock on December 31, 2009 at the adjusted closing price on that date of \$5.30 per share, in The NASDAQ Stock Market Composite Index and the peer group Power Index, and that all dividends, if any, were reinvested. No cash dividends have been declared or paid on our common stock.
- (4) Stockholder returns over the indicated period should not be considered indicative of future stockholder returns.

ITEM 6. Selected Financial Data.

The following tables include selected consolidated financial data for each of our last five fiscal years. The consolidated statement of operations data for the years ended December 31, 2014, 2013, and 2012 and consolidated balance sheet data at December 31, 2014 and 2013 have been derived from the audited consolidated financial statements appearing elsewhere in this Form 10-K. The consolidated statement of operations data for the years ended December 31, 2011 and 2010 and the consolidated balance sheet data at December 31, 2012, 2011 and 2010, have been derived from audited consolidated financial statements not appearing in this document. This data should be read in conjunction with the consolidated financial statements and notes thereto, with “Management’s Discussion and

Analysis of Financial Condition and Results of Operations” in Item 7 and with the other financial data set forth elsewhere in this Form 10-K. Our historical results of operations are not necessarily indicative of results of operations to be expected for future periods.

Consolidated Statement of Operations Data
In thousands except per share data

	Year Ended December 31,				
	2014	2013	2012	2011	2010
Total revenue	\$ 49,136	\$61,699	\$76,315	\$75,482	\$64,955
Total cost of goods sold.....	\$ 36,484	\$42,303	\$51,601	\$57,581	\$46,953
Gross profit.....	\$ 12,652	\$19,396	\$24,714	\$17,901	\$18,020
Total operating expenses	\$ 24,672	\$27,013	\$26,440	\$24,781	\$21,824
Operating loss.....	\$(12,020)	\$(7,617)	\$(1,726)	\$(6,880)	\$(3,804)
Net loss.....	\$(12,827)	\$(8,351)	\$(1,922)	\$(7,094)	\$(3,925)
Basic and diluted net loss per share	\$ (0.57)	\$ (0.43)	\$ (0.10)	\$ (0.11)	\$ (0.25)

Consolidated Balance Sheet Data
In thousands

	Year Ended December 31,				
	2014	2013	2012	2011	2010
Cash and investments.....	\$14,824	\$12,261	\$13,524	\$10,746	\$15,550
Working capital	\$17,247	\$17,696	\$23,945	\$13,753	\$19,082
Total assets	\$36,098	\$37,907	\$45,799	\$35,027	\$39,518
Long-term obligations	\$ 821	\$ 741	\$ 713	\$ 726	\$ 579
Total stockholders' equity	\$18,793	\$20,306	\$25,999	\$16,292	\$20,822

ITEM 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the financial statements and related notes appearing elsewhere in this Form 10-K. This report contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act, that involve risks and uncertainties. Our expectations with respect to future results of operations that may be embodied in oral and written forward-looking statements, including any forward looking statements that may be included in this report, are subject to risks and uncertainties that must be considered when evaluating the likelihood of our realization of such expectations. Our actual results could differ materially. The words “believe,” “expect,” “intend,” “plan,” “project,” “will” and similar phrases as they relate to us are intended to identify forward-looking statements. For further discussion regarding forward-looking statements, please see “Special Note Regarding Forward-Looking Statements.” In addition, please see the risk factors section above for a discussion of items that may affect our future results.

Management’s Discussion and Analysis (“MD&A”) of Financial Condition and Results of Operations is designed to provide readers with narrative from the perspective of our management on our financial condition, results of operations, liquidity, and certain other factors that may impact our future results. Our MD&A is presented in the following sections:

- 2014 Highlights
- 2015 Plan
- Results of Operations
- Critical Accounting Policies and Estimates
- Liquidity and Capital Resources
- Contractual Obligations
- Off-Balance Sheet Arrangements
- New Accounting Pronouncements

2014 Highlights

Our total revenue in 2014 was \$49.1 million, a decrease of \$12.6 million or 20% from 2013, primarily driven by a decrease in MIS sales, which were down \$13.4 million or 62% over 2013. This decrease in MIS sales is primarily

attributable to lower sales via HP in 2014 which fluctuates depending on their success and needs for MIS products. MIS sales made up 22% of total product revenue in 2014 compared to 49% in 2013. The decrease in MIS sales was partly offset by an increase in UPS, our core business, by \$5.4 million or 24% from 2013.

In early 2014 with a new executive team in place, we made a number of changes to the organization aimed at increasing bookings and backlog and controlling expenses. We also took steps to improve our working capital position and strengthen our operating platform. A number of these changes and achievements from 2014 are highlighted below.

- Changed go-to-market approach from a distribution model to a more direct sales model and restructured sales organization with sales personnel who possess both commercial sales and technical acumen to engage our customers who are technically savvy including end users, specifying engineers, electrical contractors, and general contractors
- Reorganized engineering, product marketing, service, and manufacturing teams to improve our go-to-market support and enable us to better support our sales and service teams and respond to customer needs
- Our focus on increasing bookings and backlog yielded steady progress in 2014 as we achieved four consecutive quarters of a book-to-bill ratio greater than 1. Bookings also improved with a 25% increase in second half 2014 bookings compared to bookings in the second half 2013.
- Completed a public offering of 3.7 million newly issued shares at a price of \$3.15 per share, generating approximately \$10.4 million in net proceeds to the Company
- Completed an expanded three-year \$15.0 million credit facility in July 2014 with Silicon Valley Bank providing for greater borrowing capability with a lower interest
- Reduced net inventory 43% or \$5.2 million from December 31, 2013, through December 31, 2014, as part of the Company's inventory reduction program
- Reduced operating expenses 9% or \$2.3 million in 2014 compared to 2013
- Reached agreements in principle and entered into memorandums of understanding on September 23, 2014, to the class action complaint and consolidated derivative actions in connection with the Company's prior public disclosures regarding its relationships with Digital China Information Services Company Limited and Qiyuan Network System Limited

The restructuring of our sales organization, the shift in our go-to-market approach, and reengagement with Caterpillar helped us in part achieve higher core UPS sales in 2014. UPS sales increased \$5.4 million or 24% compared to 2013, making up 78% of total product revenue versus 51% in 2013.

Service sales decreased \$4.6 million or 26% in 2014 compared to 2013. This decrease is primarily attributable to higher MIS sales recorded in 2013 compared to 2014 and their associated services revenue which we did not repeat in 2014.

Our gross profit was 26% of revenue for fiscal 2014 compared to 31% in fiscal 2013. This margin decrease is related to under absorption of fixed overhead costs in manufacturing and service due to the lower revenue and manufacturing production in 2014.

Operating expenses decreased 9% or \$2.3 million in 2014 compared to 2013, primarily due to decreased engineering costs associated with the rollout and development of our latest UPS product which we began shipping in late 2013; lower general and administrative expenses associated with executive transition costs and legal fee expenses; and lower overall headcount.

Net loss was \$12.8 million in 2014 compared to \$8.4 million in 2013. The increase in net loss from 2013 to 2014 was due to the decline in revenue coupled with a decline in gross margin.

Cash and cash equivalents totaled \$14.8 million at December 31, 2014, compared to \$12.3 million at December 31, 2013. Management believes this available cash balance, combined with cash we anticipate to generate from operations and the credit facility we have in place, will be sufficient to fund our operations as we work to increase sales volume and scale the business. In March 2014, we raised additional funds through a public offering to provide additional funds for our future anticipated working capital needs. See Note 3 to the condensed consolidated financial statements of this Form 10-K for more information.

2015 Plan

Going forward, we will focus on increasing bookings and backlog, improving operational efficiencies, and controlling costs. We will also continue our product development efforts on our core flywheel energy storage and power electronics technology. We will support these priorities through a number of efforts including improving productivity of our sales resources, identifying and eliminating waste to drive efficiencies throughout the Company, and improving book-to-conversion. We will continue to improve inventory turns and factory utilization as we work to increase sales volume. However, a number of risks and challenges face our business going forward.

- The higher sales price of our CleanSource PowerHouse and modular IT infrastructure orders can cause large quarterly fluctuations in our inventory, receivables and payables balances, depending on the number of such orders in progress at any point in time. This can cause material fluctuations in the level of working capital we require. If the number of such orders increases rapidly or any of these orders have payment terms that are less favorable, we will need access to more working capital to fund the growth of our business and to fulfill these orders. We extended our bank credit facility in 2014 to help fund our growth and manage our working capital requirements.
- We have a history of operating losses and have not yet reached operating profitability on an annual basis. We believe the success of our UPS and MIS products and our service offerings combined with our focus on direct sales to customers and a lower overall operating cost base, will help us to further increase our revenues and reduce our level of operating losses. We will need to continue to focus on our operating costs and cash and working capital management in 2015 to maintain sufficient funds for our operating activities.
- Our sales cycle is such that we generally have some visibility in advance for future orders. However, a sudden change in business volume or product mix, positive or negative, from any of our business or channel partners or in our direct business can significantly impact our expected revenues and impact our ability to quickly respond to opportunities. The continued slow global economic growth has reduced our confidence in the ability to predict future revenues, and even with improving economic conditions, there is still uncertainty and risk in our forecasting. Our limited window of sales visibility does provide us with some opportunity to adjust expenditures or take other measures to reduce our cash consumption if we can see and anticipate a shortfall in revenue. This window may also give us time to identify additional sources of funding if we anticipate an increase in our working capital requirements due to increased revenues or changes in our revenue mix. A significant increase in sales, especially in our MIS business, would likely increase our working capital requirements due to the longer production time and cash cycle of sales of these products.
- Foreign currency volatility could make it more challenging for us to sell outside of the US. As foreign currencies strengthen against the dollar, our pricing may not be competitive in certain geographies.

Results of Operations

Below are our revenues and costs and expenses for fiscal 2014, 2013, and 2012. This information should be read in conjunction with our Consolidated Financial Statements and notes thereto.

(\$ in thousands)	Year Ended December 31,				Year Ended December 31,			
	2014	2013	\$ change	% change	2013	2012	\$ change	% change
Product revenue	\$ 36,211	\$44,158	\$ (7,947)	-18%	\$44,158	\$62,031	\$(17,873)	-29%
Service and other revenue	12,925	17,541	(4,616)	-26%	17,541	14,284	3,257	23%
Total revenue	49,136	61,699	(12,563)	-20%	61,699	76,315	(14,616)	-19%
Cost of product revenue	29,182	32,825	(3,643)	-11%	32,825	42,510	(9,685)	-23%
Cost of service and other revenue	7,302	9,478	(2,176)	-23%	9,478	9,091	387	4%
Total cost of goods sold	36,484	42,303	(5,819)	-14%	42,303	51,601	(9,298)	-18%
Gross profit	12,652	19,396	(6,744)	-35%	19,396	24,714	(5,318)	-22%
Operating expenses:								
Research and development	6,689	7,430	(741)	-10%	7,430	5,440	1,990	37%
Selling and marketing	11,940	12,032	(92)	-1%	12,032	14,139	(2,107)	-15%
General and administrative	6,043	7,551	(1,508)	-20%	7,551	6,861	690	10%
Total operating expenses	24,672	27,013	(2,341)	-9%	27,013	26,440	573	2%
Loss from Operations	(12,020)	(7,617)	(4,403)	58%	(7,617)	(1,726)	(5,891)	341%
Interest expense, net	(395)	(370)	(25)	7%	(370)	(327)	(43)	13%
Other income (expense), net	(160)	(364)	204	-56%	(364)	131	(495)	-378%
Loss before income taxes	(12,575)	(8,351)	(4,224)	51%	(8,351)	(1,922)	(6,429)	334%
Income tax expense	(252)	—	(252)	100%	—	—	—	0%
Net Loss	<u>\$(12,827)</u>	<u>\$ (8,351)</u>	<u>\$ (4,476)</u>	<u>54%</u>	<u>\$ (8,351)</u>	<u>\$ (1,922)</u>	<u>\$ (6,429)</u>	<u>334%</u>

Fiscal 2014 Compared to Fiscal 2013

Product Revenue. Our product revenue was derived from the following sources:

(\$ in thousands)	Year Ended December 31,				Year Ended December 31,			
	2014	2013	\$ change	% change	2013	2012	\$ change	% change
Product revenue:								
UPS product revenue	\$28,064	\$22,620	\$ 5,444	24%	\$22,620	\$35,366	\$(12,746)	-36%
Modular Infrastructure Solutions	8,147	21,538	(13,391)	-62%	21,538	26,665	(5,127)	-19%
Total product revenue	<u>\$36,211</u>	<u>\$44,158</u>	<u>\$ (7,947)</u>	<u>-18%</u>	<u>\$44,158</u>	<u>\$62,031</u>	<u>\$(17,873)</u>	<u>-29%</u>

Total product revenue for fiscal 2014 was \$36.2 million, compared to \$44.2 million in fiscal 2013, a \$8.0 million decrease. The decrease in our product revenue in 2014 compared to 2013 came from lower sales from our MIS products primarily related to HP, which fluctuates depending on their success and needs for modular infrastructure solutions, partially offset by an increase in our UPS sales. In 2014, 78% of our product revenue came from the sale of UPS systems and 22% from the sale of MIS products. Sales of our UPS products increased by approximately \$5.4 million, or 24%, compared to 2013 as we saw an increase in our direct sales to our customers.

Product revenue from our OEM channel for fiscal 2014 was \$7.8 million, compared to \$7.2 million in 2013, a \$0.6 million increase or 7%. The size and volume of orders from our OEM channel can fluctuate significantly on a quarterly basis, and we continue to see a small number of large transactions from our OEM channel. Sales to Caterpillar, our primary OEM customer, represented 18% of our total revenue for fiscal 2014 compared to 14% in fiscal 2013. We have supported our OEM partners' efforts to sell total solutions to their customers that include generators and switchgear that they manufacture along with our UPS products as a total solution.

Product revenue from our IT channel partners for fiscal 2014 were \$2.1 million, compared to \$11.1 million in 2013, a decrease of \$9.0 million or 81%. This reduction reflects decreased demand of our MIS products during 2014 from our IT channel partners, primarily HP. The level of orders may continue to fluctuate depending on our partner's success and need for modular infrastructure solutions.

Product revenue in the North and South America (“the Americas”) was \$21.3 million, or 59% of our total product revenue for 2014, a decrease of \$15.1 million or 41%, compared to \$36.4, or 82%, for 2013. Our revenue in the Americas decreased in 2014 compared to 2013, primarily as a result of lower MIS revenues and the decrease in sales from our OEM channels, which historically have largely originated in the North American market.

Product sales to customers in Europe, the Middle East, and Africa (“EMEA”) increased by approximately \$7.7 million, or 195% to \$11.7 million in fiscal 2014 compared to \$4.0 million in fiscal 2013. This increase is due to two large orders, one approximately \$3.3 million and another approximately \$1.2 million.

Our product sales in the Asia and Pacific Region (“APAC”) decreased by 18%, or \$0.7 million in 2014 to \$3.1 million compared to \$3.8 million in 2013. This decrease is primarily due to reduced sales in China. We still see this region as having opportunity for long-term growth as Asia represents one of the largest UPS markets in the world.

We did not have any revenues greater than 10% concentrated in a single country outside of the United States in 2014 or 2013.

Service and other revenue. Service and other revenue decreased by approximately \$4.5 million, or 26%, to \$13.0 million in fiscal 2014, compared to \$17.5 million in fiscal 2013. The decrease primarily reflects reduced service revenue and professional fees stemming from lower MIS product demand in 2014.

Cost of product revenue. The cost of product revenue as a percentage of total product revenue was 81% and 74% in 2014 and 2013, respectively. During 2014 and 2013, we operated a manufacturing facility that has a manufacturing and testing capacity significantly greater than required by our current product revenue levels. Our manufacturing operational costs include a large portion of fixed costs relative to our operational needs. We incurred approximately \$5.8 million and \$6.9 million, in 2014 and 2013, respectively, in fixed costs related to our manufacturing facility.

Cost of service and other revenue. The cost of service and other revenue as a percentage of total service and other revenue increased by 2%, to 56% in 2014 compared to 54% in 2013. A large portion of the costs involved in operating our service organization are fixed in nature and we incurred approximately \$2.3 million and \$3.0 million in unabsorbed overhead costs in fiscal 2014 and 2013, respectively. The utilization of our service personnel will be affected by the number of MIS products implemented in a particular period. When we have a lower number of installation projects we would expect our costs as a percentage of revenue to increase due to lower employee utilization.

Gross profit. Our gross profit was 26% of revenue for fiscal 2014 compared to 31% in fiscal 2013. This margin decrease is related to under absorption of fixed overhead costs in manufacturing and service due to the lower revenue and manufacturing production in 2014. Our gross margins fluctuate on a quarterly basis depending on changes in the product and geographic mix of our revenues and were as high as 30% during the third quarter of 2014 and as low as 19% in the second quarter of 2014.

Research and development. Research and development expenses were approximately \$6.7 million, \$0.7 million or 10%, lower in fiscal 2014 compared to \$7.4 million in fiscal 2013. The decrease was primarily due to reduced costs for development activities on our next generation of UPS products.

Selling and marketing. Selling and marketing costs were approximately \$11.9 million in fiscal 2014, compared to \$12.0 million for the same period of 2013. The decrease was primarily due to severance expense to former executives in 2013 offset by payroll expense in 2014.

General and administrative. General and administrative expenses were approximately \$6.0 million, \$1.5 million or 20%, lower in fiscal 2014 compared to \$7.6 million in 2013. The decreases were primarily due to reductions in (i) relocation and temporary living costs for executives of \$0.4 million; (ii) severance payments to former executives of \$0.3 million, and (iii) legal fees of \$0.3 million from 2013.

Interest expense, net. Net interest expense was relatively flat in fiscal 2014 compared to 2013. The interest expense incurred during 2014 and 2013 was in connection with the outstanding balance on our revolving credit facility.

Other income (expense), net. Other income (expense), net was \$0.2 million in fiscal 2014 and \$0.4 million in fiscal 2013, a \$0.2 million decrease or 56%. This decrease primarily reflects foreign exchange losses or gains on settlement of intercompany balances and sales contracts held in foreign currencies.

Income tax expense. Our income tax expense for 2014 was approximately \$0.3 million with an effective tax rate of 2%, compared to \$0 for 2013. The increase in the effective tax rate for fiscal 2014 was primarily due to settlement under tax examination by the German tax authorities. In September 2014, we settled a tax examination of our German subsidiary for years 2007 through 2011. In the settlement, we agreed to transfer pricing adjustments for the period under examination resulting in a reduction of loss carryovers and a deemed distribution subject to withholding taxes under German law. We recorded a provision for income taxes of \$0.3 million in the quarter ended September 30, 2014 related to settlement of the German tax examination.

As a result of the examination, the Company also adjusted net operating losses in jurisdictions impacted by the transfer pricing adjustments to account for appropriate intercompany pricing for years prior to 2014. There was no overall tax impact as the net operating loss deferred tax assets are fully offset by a valuation allowance. Both the settlement and the adjustments to the net operating losses are reflected in the Company's rate reconciliation of the income tax footnote.

Fiscal 2013 Compared to Fiscal 2012

Total revenues in fiscal 2013 were \$61.7 million, compared to \$76.3 million in fiscal 2012, a \$14.6 million, or 19% decrease. The decrease in revenue was lower across all product lines, but primarily UPS products which were offset by an increase in service revenue.

Total product revenue for fiscal 2013 was \$44.2 million, compared to \$62.0 million in fiscal 2012, a \$17.8 million decrease. The decrease in our product revenue in 2013 compared to 2012 came primarily from lower sales of our UPS products.

Product revenue from our OEM channel for fiscal 2013 was \$7.2 million, compared to \$9.4 million in 2012, a \$2.2 million decrease or 23%. This decline reflects decreased performance from our OEM partners, primarily in the U.S. market. Sales to Caterpillar, our primary OEM customer, represented 14% of our total revenue for fiscal 2013 compared to 13% in fiscal 2012.

Product revenue from our IT channel partners for fiscal 2013 was \$11.1 million, compared to \$22.6 million in 2012, a decrease of \$11.5 million or 51%. This reduction reflects decreased demand for our MIS products during 2013 from our IT channel partners, primarily HP. The level of orders may continue to fluctuate depending on our partner's success and need for infrastructure solutions.

Product revenue in the Americas was \$36.4 million, or 82% of our total product revenue for 2013, a decrease of \$1.4 million or 4%, compared to \$37.8, or 61%, for 2012. Our revenue in the Americas decreased in 2013 compared to 2012, primarily as a result of lower UPS product revenue and the decrease in sales from our OEM channel.

Product sales to customers in EMEA decreased by approximately \$14.8 million, or 79%, to \$4.0 million in fiscal 2013 compared to \$18.8 million in fiscal 2012. This decrease relates primarily to a single larger order in fiscal 2012 that did not repeat in 2013. Revenue in Switzerland was \$9.3 million, or 12%, in 2012. We did not have any revenues greater than 10% concentrated in a single country outside of the United States in 2013.

Our product sales in APAC decreased by 30%, or \$1.6 million, in 2013 to \$3.8 million compared to \$5.4 million in 2012. This decrease is primarily due to reduced sales in China.

Service and other revenue. Service and other revenue increased by approximately \$3.2 million, or 23%, to \$17.5 million in fiscal 2013, compared to \$14.3 million in fiscal 2012. This increase primarily comes from increased sales in spare parts, start-up services, and project management.

Cost of product revenue. The cost of product revenue as a percentage of total product revenue was 74% and 69% in 2013 and 2012, respectively. During 2013 and 2012, we operated a manufacturing facility that has a manufacturing and testing capacity significantly greater than required by our current product revenue levels.

Our manufacturing facility is comprised of a large portion of our fixed costs. We incurred approximately \$6.9 million and \$5.8 million, in 2013 and 2012, respectively, in fixed costs for our manufacturing facility. Our manufacturing capacity is in excess of our current business requirements. We expense the excess costs of the underutilization of this facility as part of our cost of product revenues.

Cost of service and other revenue. The cost of service and other revenue as a percentage of total service and other revenue decreased by 10%, to 54% in 2013 compared to 64% in 2012. This decrease in the cost of service and

other revenue reflects higher utilization of service personnel and improved margins for MIS systems installations. A large portion of the costs involved in operating our service organization are fixed in nature and we incurred approximately \$3.0 million in 2013.

Gross profit. Our gross profit was 31% of revenue for fiscal 2013 compared to 32% in fiscal 2012. The decrease in gross profit margin in 2013 compared to 2012 is related to a few higher margin orders in 2012 that did not repeat in 2013 along with higher unabsorbed overhead costs compared to 2012 from our manufacturing operations due to lower UPS product revenue.

Research and development. Research and development expenses were approximately \$7.4 million, \$2.0 million or 37%, higher in fiscal 2013 compared to \$5.4 million in fiscal 2012. This was primarily related to the final testing and release of our latest generation UPS product in 2013 along with increased headcount to support the development of this new product and new modular infrastructure products we believe will contribute to future growth for us.

Selling and marketing. Selling and marketing costs were approximately \$12.0 million in fiscal 2013, compared to \$14.1 million for the same period in 2012. The decrease from 2012 is primarily related to a reduction in headcount and lower commissions expense. Selling and marketing expenses also includes \$0.3 million in severance for terminated executives.

General and administrative. General and administrative expenses were approximately \$7.6 million, \$0.7 million or 10%, higher in fiscal 2013 compared to \$6.9 million in 2012. This increase primarily reflects unexpected costs associated with \$0.4 million in relocation and temporary living costs for executives and an increase in professional fees of \$0.4 million associated with our investigations and pending lawsuits.

Interest expense, net. Net interest expense was relatively flat in fiscal 2013 compared to 2012. We negotiated a \$12.5 million revolving credit facility with our bank in August 2010, amended in 2012, that incurs a minimum monthly interest liability.

Other income (expense), net. Other income (expense), net was an expense of \$0.4 million in fiscal 2013 compared to income of \$0.1 million in 2012. This decrease primarily reflects foreign exchange losses or gains on settlement of intercompany balances and sales contracts held in foreign currencies.

Income tax expense.

Due to operating losses, we have not recorded any income tax expenses, other than minimum or statutory costs. As of December 31, 2013 and 2012, our accumulated net operating loss carry-forward was \$218.0 million and \$208.0 million, respectively, and our research and development credit carry-forwards were \$3.7 million and \$3.3 million, respectively. We anticipate these loss carry-forward amounts may offset future taxable income that we may achieve and thus reduce future tax liabilities. However, because of uncertainty regarding our ability to use these carry-forwards and the potential limitations due to ownership changes, we have established a valuation allowance for the full amount of our net deferred tax assets.

Critical Accounting Policies and Estimates

We consider an accounting policy to be critical if:

- the accounting estimate requires us to make assumptions about matters that are highly uncertain or require the use of judgment at the time we make that estimate; and
- changes in the estimate that are reasonably likely to occur from period to period, or use of different estimates that we could have reasonably used instead in the current period, would have a material impact on our financial condition or results of operations.

Management has reviewed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors. In addition, there are other items within our financial statements that require estimation, but are not deemed critical as defined above. Changes in these and other items could still have a material impact upon our financial statements.

Revenue recognition

We generally recognize revenue when four criteria are met: (i) persuasive evidence that an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the sales price is fixed or determinable; and (iv) collectability is reasonably assured. Revenue-generating transactions generally fall into one of the following categories of revenue recognition:

- We recognize product revenue at the time of shipment for a significant portion of all products sold directly to customers and through distributors because title and risk of loss pass on delivery to the common carrier. Our customers and distributors do not have the right to return products. If title and risk of loss pass at some other point in time, we recognize such revenue for our customers when the product is delivered to the customer and title and risk of loss have passed. We may enter into bill-and-hold arrangements and when this happens delivery may not occur, but other criteria are reviewed to determine proper timing of revenue recognition.
- We recognize installation, service and maintenance revenue at the time the service is performed.
- We recognize revenue associated with extended maintenance agreements (“EMAs”) over the life of the contracts using the straight-line method, which approximates the expected timing in which applicable services are performed. Amounts collected in advance of revenue recognition are recorded as a current liability in the deferred revenue line of the consolidated balance sheet or long-term liability based on the time from the balance sheet date to the future date of revenue recognition.
- We recognize revenue on certain rental programs over the life of the rental agreement using the straight-line method. Amounts collected in advance of revenue recognition are recorded as a current or long-term liability based on the time from the balance sheet date to the future date of revenue recognition.
- Shipping costs reimbursed by the customer are included in revenue.

Multiple element arrangements (“MEAs”) are arrangements to sell products to customers that frequently include multiple deliverables. Our most significant MEAs include the sale of one or more of our CleanSource UPS or CleanSource PowerHouse products, combined with one or more of the following products: design services, project management, commissioning and installation services, spare parts or consumables, and EMAs. Delivery of the various products or performance of services within the arrangement may or may not coincide. Certain services related to design and consulting may occur prior to product delivery. Commissioning and installation typically take place within six months of product delivery, depending upon customer requirements. EMAs, consumables, and repair, maintenance or consulting services generally are delivered over a period of one to five years. In certain arrangements revenue recognized is limited to the amount invoiced or received that is not contingent on the delivery of future products and services.

When arrangements include multiple elements, we allocate revenue to each element based on the relative selling price and recognize revenue when the elements have standalone value and the four criteria for revenue recognition have been met. We establish the selling price of each element based on Vendor Specific Objective Evidence (“VSOE”) if available, Third Party Evidence (“TPE”) if VSOE is not available, or Best Estimate of Selling Price (“BESP”) if neither VSOE nor TPE is available. We generally determine selling price based on amounts charged separately for the delivered and undelivered elements to similar customers in standalone sales of the specific elements. When arrangements include an EMA, we recognize revenue related to the EMA at the stated contractual price on a straight-line basis over the life of the agreement.

Any taxes imposed by governmental authorities on our revenue-producing transactions with customers are shown in our consolidated statement of operations on a net-basis; that is, excluded from our reported revenues.

Inventories

Inventories are priced at the lower of cost (using the first-in, first-out method) or market. We estimate inventory reserves on a quarterly basis and record reserves for obsolescence or slow-moving inventory based on assumptions about future demand and marketability of products, the impact of new product introductions, inventory turns and specific identification of items, such as product discontinuance, damaged goods or engineering/material changes.

Warranty liability

Estimated warranty liability costs are accrued for each of our products at the time of sale. Our estimates are principally based on assumptions regarding the lifetime warranty costs of each product, including where little or no claims experience may exist. Due to the uncertainty and potential volatility of these estimates, changes in our assumptions could have a material effect on our reported operating results. Our estimate of warranty liability is reevaluated on a quarterly basis. Experience has shown that initial data for a new product can be very volatile due to factors such as product and component failure rates, material usage and service delivery costs in correcting product failures; therefore our process relies upon long-term historical averages until actual data is available. As actual experience becomes available, it is used to modify the historical averages to ensure that the forecast is within the range of likely outcomes. The resulting balances are then compared to current spending rates to help ensure that the accruals are adequate to meet expected future obligations.

Stock-based compensation

Stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as an expense ratably over the requisite service period of the award. Determining the appropriate fair-value model and calculating the fair value of stock-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates. We develop our estimates based on historical data and market information that can change significantly over time. A small change in estimates used can have a relatively large impact on the estimated valuation.

We use the Black-Scholes option valuation model to value employee stock awards. We estimate stock price volatility based upon our historical volatility. Estimated option life and forfeiture rate assumptions are derived from historical data.

Liquidity and Capital Resources

Our primary sources of liquidity at December 31, 2014 are our cash and cash equivalents, our bank credit facilities and projected cash flows from operating activities. If we meet our cash flow projections, we expect that we will have adequate capital resources to continue operating our business for at least the next twelve months. Our projections and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, there are scenarios in which our revenues may not meet our projections, our costs may exceed our estimates or our working capital needs may be greater than anticipated. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in 2015 and beyond or significantly affect our level of liquidity.

In August 2010, we entered into a Second Amended and Restated Loan and Security Agreement (the “Loan Agreement”) with Silicon Valley Bank (“SVB”) which increased the total line of credit available to \$12.5 million subject to certain borrowing bases. This facility expanded our ability to borrow funds from U.S. receivables to include qualifying receivables from our UK operations as well, increased our ability to use inventory as collateral, and also added an ability to borrow against purchase orders. These additional bases of borrowing were designed to allow us to use the credit facility to fund inventory purchases in the event we received large or multiple sales orders that would require a major investment in inventory and work in progress such as our MIS products, to help fund our business and to manage our working capital requirements.

The Loan Agreement provides for a secured revolving line of credit in an aggregate amount of up to eighty percent (80%) of the facility amount of \$15.6 million, or \$12.5 million, subject to certain borrowing bases. In the event we have maintained unrestricted cash and cash equivalents of at least \$6.25 million with SVB for at least 30 consecutive days, which is referred to as being in a “Streamline Period”, the borrowing base formula is based on eligible accounts receivable, eligible purchase orders and eligible inventory, subject to a sublimit of \$5.0 million for U.K. accounts receivable, \$3.5 million for inventory and \$1.5 million for purchase orders. When we are not in a Streamline Period, our borrowings are limited based on accounts receivable and purchase orders that SVB has specifically agreed to finance and a borrowing base for eligible inventory. We may also request that SVB issue letters of credit on our behalf, of up to \$1.5 million, as a portion of our total loan facility.

In August 2012, we entered into the Second Amendment to Second Amended and Restated Loan and Security Agreement with SVB (“Second Amendment”) which amends the Loan Agreement, by and between us and SVB. Pursuant to the Second Amendment, the maturity date of the loan facility was extended by two years, to August 5,

2014, unless earlier terminated by us, subject to any then applicable early termination fee. The Second Amendment further provides for, among other things, (i) adding a \$1.5 million sublimit under the borrowing base formula for 91-120 day aged accounts receivable, (ii) removing eligible purchase orders from the borrowing base formula, and (iii) removing sublimits providing for the issuance of letters of credit and cash management services. Additionally, pursuant to the Second Amendment, the definition of “Streamline Period” was amended such that the Company will be deemed to be in a Streamline Period in the event that it has a liquidity ratio of greater than or equal to 1.75:1.00 at all times for at least 60 consecutive days; provided that a Streamline Period will automatically be in effect if we achieve such liquidity ratio as a result of the sale of our equity securities.

Further, the Second Amendment provides for, among other things, (i) amending the finance charge on each eligible account financed by SVB to a per annum rate equal to SVB’s prime rate, subject to a minimum prime rate of four percent (4.00%), plus (a) one and one-quarter percent (1.25%) when we are in a Streamline Period or (b) one and three-quarters percent (1.75%) for eligible accounts (other than eligible 91-120 day aged accounts) and two percent (2.00%) for eligible 91 to 120 day aged accounts when we are not in a Streamline Period, and (ii) reducing the interest rate upon which each inventory advance accrues interest such that each advance based upon inventory accrues interest at a per annum rate equal to SVB’s prime rate, subject to a minimum prime rate of four percent (4.00%), plus (a) one and one-quarter percent (1.25%) when we are in a Streamline Period or (b) three and one half percent (3.50%) when we are not in a Streamline Period.

On July 28, 2014, we entered into a Third Amendment to Second Amended and Restated Loan and Security Agreement with SVB (“Third Amendment”). The amended three-year loan facility provides for a secured revolving line of credit in an aggregate amount of up to eighty percent (80%) of the facility amount of \$18.8 million, or \$15.0 million, and increases our inventory and purchase order availability from \$3.5 million to \$7.0 million subject to certain borrowing bases. Purchase orders and eligible inventory are subject to a sublimit of \$4.0 million and accounts receivable for UK and Germany have a \$5.0 million sublimit. If we maintain our liquidity ratio of 2.50:1.00 for the immediately preceding reconciliation periods the sublimit will be uncapped. We are currently in compliance with all loan covenants under the Loan Agreement. Further, the Third Amendment extends the maturity date to August 5, 2017 and reduces the finance charge to a per annum rate equal to SVB’s prime rate, subject to a minimum prime rate of 4.00%, plus (a) 0.50% for eligible accounts, inventory and purchase orders when we are Borrowing Base Eligible (as defined in the Loan Agreement), or (b) 1.20% for eligible accounts when we are not Borrowing Base Eligible.

The revolving loans made to us under this loan facility are secured by a lien on substantially all of our assets, including the assets of Active Power Solutions Limited, our wholly-owned United Kingdom subsidiary, and the assets of Active Power (Germany) GmbH, our indirect wholly-owned German subsidiary. The only direct or indirect subsidiaries of Active Power, Inc. that are not guarantors under the Loan Agreement are Active Power China (Beijing) Co. Ltd. and immaterial subsidiaries that are not operating companies. There are no restrictions on the ability of any of the subsidiary guarantors to transfer funds to Active Power, Inc. in the form of loans, advances or dividends, except as provided by applicable law.

The Loan Agreement includes customary affirmative covenants for a credit facility of this size and type, including delivery of financial statements, compliance with laws, maintenance of insurance, and protection of intellectual property rights. Further, the Loan Agreement contains customary negative covenants for a credit facility of this size and type, including covenants that limit or restrict our ability, among other things, to dispose of assets, change our business, change our CEO or CFO without replacing such person within 120 days, have a change in control, make acquisitions, be acquired, incur indebtedness, grant liens, make investments, make distributions, repurchase stock, and enter into certain transactions with affiliates.

The Loan Agreement contains customary events of default that include, among other things, non-payment defaults, covenant defaults, material adverse change defaults, insolvency defaults, material judgment defaults and inaccuracy of representations and warranty defaults. The occurrence of an event of default could result in the acceleration of obligations under the Loan Agreement, in which case we must repay all loans and related charges, fees and amounts then due and payable, and our subsidiary may be required to pay any such amounts under the Guarantee and Debenture. At the election of SVB, upon the occurrence and during the continuance of an event of default, finance charges or interest rates, as applicable, will increase an additional five percentage points (5.00%) per annum above the rate that is otherwise applicable thereto upon the occurrence of such event of default, and the collateral handling fees will increase by one-half percent (0.50%).

During 2012, we borrowed amounts under this credit facility based on our short term liquidity requirements. As of December 31, 2014, we had outstanding borrowings of \$5.5 million under this loan facility. Based on the borrowing base formula subsequent to the Third Amendment, the additional amount available for use ranged between \$2.6 million and \$5.2 million for 2014.

In March 2014, we sold approximately 3.7 million shares of common stock at a purchase price of \$3.15 per share, for proceeds, net of fees and expenses, of approximately \$10.4 million, in a public underwritten offering made under a shelf registration statement that we had filed with the SEC and that had been declared effective in June 2013. The proceeds from this offering will be used by us to help fund our working capital requirements and for general corporate purposes.

Should additional funding be required or desirable, we would expect to raise the required funds through borrowings or public or private sales of debt or equity securities. If we raise additional funds through the issuance of convertible debt or equity securities, the ownership of our existing stockholders could be significantly diluted. If we obtain additional debt financing, a substantial portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, and the terms of the debt securities issued could impose significant restrictions on our operations. We do not know whether we will be able to secure additional funding, or funding on terms acceptable to us, to continue our operations as planned. If financing is not available, we may be required to reduce, delay or eliminate certain activities or to license or sell to others some of our proprietary technology.

Significant uses of cash

Operating Activities

The following table summarizes the yearly changes in cash used in operating activities (in thousands):

Year	Annual Amount	Change from Prior Year	Percent Change
2014	\$(7,228)	\$(5,921)	-453%
2013	\$(1,307)	\$ 4,683	78%
2012	\$(5,990)	\$ 660	10%

Cash used in operating activities was \$7.2 million in 2014 compared to \$1.3 million in 2013. Cash used in operating activities was primarily related to our net loss of \$12.8 million partially offset by the change in our inventory of \$5.3 million initiated by our current management team to bring inventory levels down. Changes in our net working capital resulted in cash provided of \$3.1 million in 2014, compared to \$4.3 million in 2013. The frequent changes in our working capital can result in very large fluctuation in inventory, payables and receivables, even weekly, based on the large size of some of our orders. Our change in inventory also includes a non-cash charge of \$44,000 in 2014 related to items purchased as inventory for our latest generation UPS product, but later capitalized to property and equipment as test units. Cash used in operating activities in 2013 primarily related to our net loss of \$8.4 million partially offset by changes in our net accounts receivable and deferred revenue.

Our top five customers represented 40% of our 2014 total revenue and 47% of our total receivables at December 31, 2014. As a result of this customer concentration, our failure to collect receivables from any of these customers in a timely manner could have a significant adverse effect on our liquidity. This risk may potentially increase as we sell more modular infrastructure solutions due to their higher average selling price. We do continue to request deposits and periodic payments from large customers where commercially possible, particularly for projects with multiple deliverables. However, the amount of such advance payments can fluctuate significantly on a quarterly basis, depending on the size and scope of customer orders at any point in time. As a result, we will need to continue to focus on management of cash and working capital in 2015 to manage the level of funds we use in our operating activities.

Cash used in operating activities was \$1.3 million in 2013 compared to \$6.0 million in 2012. Cash used in operating activities was primarily related to our net loss of \$8.4 million partially offset by changes in our net accounts receivable and deferred revenue. Changes in our net working capital, resulted in cash provided of \$4.2 million in 2013, compared to cash used of \$6.9 million in 2012. Our change in inventory includes a non-cash charge of \$0.9 million in 2013 related to items purchased as inventory for our latest generation UPS product, but later capitalized to property and equipment as test units.

Investing Activities

Investing activities primarily consist of purchases of property and equipment. The cash used in investing activities decreased to \$0.3 million in 2014 from \$0.9 million in 2013 as we invested less in capital improvements in 2014. Capital expenditures decreased in 2014 from 2013 by approximately \$0.7 million. Our capital expenditures in 2014 primarily included investments in equipment to support our manufacturing facility, computers, software, and test units of our latest generation UPS product.

The cash used in investing activities decreased to \$0.9 million in 2013 from \$1.1 million in 2012 as we invested less in capital improvements in 2013. Capital expenditures decreased in 2013 from 2012 by approximately \$0.3 million. Our capital expenditures in 2013 primarily included investments in equipment to support our manufacturing facility, test units of our latest generation UPS product, leasehold improvements, and software.

Financing Activities

Funds provided by financing activities during 2014 was \$10.6 million compared to \$0.6 million in 2013, a \$10.0 million increase. This increase primarily includes the sale of approximately 3.7 million shares of our common stock at a purchase price of \$3.15 per share, for proceeds, net of fees and expenses, of approximately \$10.4 million, in a public underwritten offering. Proceeds from the exercise of employee stock options were approximately \$0.1 million.

Funds provided by financing activities during 2013 was \$0.6 million compared to \$10.1 million in 2012, a \$9.5 million decrease. This decrease primarily reflects the sale of approximately 2.9 million shares of our common stock at a purchase price of \$3.40 per share, for proceeds, net of issuances costs, of approximately \$9.6 million in 2012. Proceeds from employee stock purchases were \$0.6 million in 2012.

Contractual Obligations

In our day-to-day operations, we incur commitments to make future payments for goods and services. These arise from entering into operating leases and as we make commitments to vendors to purchase materials and services. The following table summarizes our significant contractual obligations and commitments at December 31, 2014 (in thousands):

	Payment due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual Obligations					
Operating lease obligations	\$2,521	\$1,260	\$1,189	\$ 72	\$ —
Purchase obligations	\$6,103	\$5,832	\$ 271	\$ —	\$ —

Our principal lease commitments consist of our leases for our corporate headquarters, engineering and administration facilities, and our global sales offices.

Future uses of cash

We believe that our cash and investments, projected cash flows from operations and sources of available liquidity will be sufficient to fund our operations for the next twelve months. However, a sudden change in business volume, positive or negative, from any of our business or channel partners, or in our direct business, or any customer-driven events such as order or delivery deferral, could significantly impact our expected revenues and cash needs. The continuing global economic instability and currency fluctuation has increased the already present challenge of predicting future revenues. We do have some opportunity to adjust expenditures or take other measures to reduce our cash consumption if we see and anticipate a shortfall in revenue, or give us time to identify additional sources of funding if we anticipate an increase in our working capital requirements due to increased revenues or changes in our revenue mix. A significant increase in sales, especially in our MIS business, would likely increase our working capital requirements, due to the longer production time and cash cycle of sales of these products.

We do not expect our level of capital investments to significantly fluctuate in 2015 compared to 2014.

Other factors that may affect liquidity

Our cash requirements will depend on many factors, including any sales growth, the market acceptance of our products, the gross profit we are able to generate with our sales, the timing and level of development funding, the rate of expansion of our sales and marketing activities, the rate of expansion of our manufacturing processes, and the

timing and extent of research and development projects. Although we are not a party to any agreement or letter of intent with respect to a potential acquisition or merger, we may enter into acquisitions or strategic arrangements in the future to help support our growth, which could also require us to seek additional equity or debt financing. Should additional funding be required or desirable, we may need to raise the required funds through borrowings or public or private sales of debt or equity securities. If we raise additional funds through the issuance of convertible debt or equity securities, the percentage ownership of our existing stockholders could be significantly diluted. If we obtain additional debt financing, a substantial portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, and the terms of the debt securities issued could impose significant restrictions on our operations. We do not know whether we will be able to secure additional funding, or funding on terms acceptable to us, to continue our operations as planned. If financing is not available, we may be required to reduce, delay or eliminate certain activities or to license or sell to others some of our proprietary technology.

In March 2014, we sold approximately 3.7 million shares of common stock at a purchase price of \$3.15 per share, for proceeds, net of fees and expenses, of approximately \$10.4 million, in a public underwritten offering made under a shelf registration statement that we had filed with the SEC and that had been declared effective in June 2013. The proceeds from this offering will be used by us to help fund our working capital requirements and for general corporate purposes.

Off-Balance Sheet Arrangements

During the years ended December 31, 2014, 2013, and 2012, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

New Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) No. 2014-15, (“ASU 2014-15”), “*Disclosure of Uncertainties About an Entity’s Ability to Continue as a Going Concern*”. ASU 2014-15 requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity’s ability to continue as a going concern. ASU 2014-15 applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The Company does not expect that the adoption of this standard will have a material effect on its financial statements.

In May 2014, the FASB issued ASU 2014-09, “*Revenue from Contracts with Customers*”, “*Topic 606*”. This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance, and creates a Topic 606 Revenue from Contracts with Customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company will adopt this guidance January 1, 2017. We are evaluating the new guidelines to see if they will have a significant impact on our consolidated results of operation, financial condition or cash flows.

ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk.

We invest our cash in a variety of financial instruments, including bank time deposits, and taxable variable rate and fixed rate obligations of corporations, municipalities, and local, state and national government entities and agencies. These investments are denominated in U.S. dollars.

Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since the majority of our investments are in short-term instruments. We believe that our investment policy is conservative, both in terms of the average maturity of investments that we hold and in terms of the credit quality of our investments. Because of the nature of the majority of our investments, we do not believe a 1% decline in interest rates would have a material effect on our interest income or on the fair value of our investments.

Our international sales were historically made in U.S. dollars. As we have increased sales in foreign markets and opened operations in multiple foreign countries, we have executed more transactions that are denominated in other

currencies, primarily Euro and British pounds. Those sales and expenses in currencies other than U.S. dollars can result in translation gains and losses which have not been significant to date. Currently, we do not engage in hedging activities for our international operations other than an increasing amount of sales and support expenses being incurred in foreign currencies as a natural hedge. However, recent volatility in currencies, particularly with the Pound and Euro, is increasing the amount of potential translation gains and losses and we may engage in hedging activities in the future to mitigate the risks caused by such currency volatility. A hypothetical 10% increase or decrease in foreign currencies in which we transact would not have a material adverse effect on our financial condition or results of operations other than the impact on the unrealized gain (loss) on the intercompany receivables held by us from our other subsidiaries.

Our international business is subject to the typical risks of any international business, including, but not limited to, the risks described in Item 1A, "Risk Factors." Accordingly, our future results could be materially harmed by the actual occurrence of any of these or other risks.

ITEM 8. Financial Statements and Supplementary Data.

The Financial Statements and Selected Quarterly Financial Data required by this item are included in Part IV, Item 15(a)(1) and are presented beginning on Page 43.

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

ITEM 9A. Controls and Procedures.

Effectiveness of Disclosure Controls and Procedures.

Our Chief Executive Officer and our Chief Financial Officer, based on the evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Exchange Act required by paragraph (b) of Rule 13a-15 or Rule 15d-15, have concluded that, as of December 31, 2014, our disclosure controls and procedures were effective to ensure that the information we are required to disclose in reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management's Report on Internal Control over Financial Reporting.

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Internal control over financial reporting is a process, designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and effected by our Board, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting, and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with the authorizations of our management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2014. In making this assessment, management used the criteria set forth in Internal Control – Integrated Framework issued by COSO (2013 framework). A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Based on our assessment, management concluded that, as of December 31, 2014, our internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Our independent registered public accounting firm, Grant Thornton LLP, audited our consolidated financial statements, and independently assessed the effectiveness of our internal control over financial reporting. Grant Thornton LLP has issued their report, which is included in Part IV of this Form 10-K.

Changes in Internal Control over Financial Reporting.

There have been no changes in our internal control over financial reporting during the quarter ended December 31, 2014 that have materially affected, or are reasonably likely to affect materially, our internal control over financial reporting.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Forward looking statements regarding the effectiveness of internal controls during future periods are subject to the risk that controls may become inadequate because of change in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

ITEM 9B. Other Information.

On February 25, 2015, the Board of Directors of the Company approved the 2015 Adleman Incentive Plan (“2015 Incentive Plan”) for Mr. Randall Adleman, the Company’s Vice President of Global Sales and Marketing. In 2015, under the 2015 Incentive Plan, Mr. Adleman will be eligible to receive cash incentive compensation at a rate of 0.225% of bookings up to a specified target and at a rate of 0.295% of bookings in excess of such target, up to a maximum amount of \$500,000.

The description of the 2015 Incentive Plan is qualified in its entirety by reference to the actual terms of the 2015 Incentive Plan, which is attached hereto as Exhibit 10.29 and is incorporated by reference into this Item 9B.

PART III.

ITEM 10. Directors, Executive Officers and Corporate Governance.

Pursuant to General Instruction G(3) of Form 10-K, the information required by this item relating to our executive officers is included under the caption “Executive Officers of the Company” in Part I of this Form 10-K.

The other information required under Item 10, including information about our directors, disclosure of delinquent Section 16 filings, our Code of Ethics and matters relating to our audit committee and its members will be included under the sections captioned “Matters to be Considered at Annual Meeting, Proposal One: Election of Directors”, “Section 16(A) Beneficial Ownership Reporting Compliance”, “Corporate Governance” and “Meetings and Committees of the Board,” respectively, in our Proxy Statement for the 2015 Annual Meeting of Stockholders, which information is incorporated into this Annual Report by reference.

ITEM 11. Executive Compensation.

The information required by this Item will be included under the sections captioned “Compensation Discussion and Analysis,” “Compensation Committee Interlocks and Insider Participation,” “Compensation Committee Report,” “Certain Transactions,” and “Director Compensation” in our definitive Proxy Statement for the 2015 Annual Meeting of Stockholders, which information is incorporated into this Annual Report by reference.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this Item will be included under the sections captioned “Ownership of Securities,” “Equity Compensation Plan Information” and “Potential Payments upon Termination or Change of Control” in our definitive Proxy Statement for the 2015 Annual Meeting of Stockholders, which information is incorporated into this Annual Report by reference.

ITEM 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this Item will be included under the sections captioned “Certain Transactions” and “Director Independence” in our definitive Proxy Statement for the 2015 Annual Meeting of Stockholders, which information is incorporated into this Annual Report by reference.

ITEM 14. Principal Accounting Fees and Services.

The information required by this Item will be included under the section captioned “Proposal Three: Ratification of Appointment of Independent Registered Public Accounting Firm” in our definitive Proxy Statement for the 2015 Annual Meeting of Stockholders, which information is incorporated into this Annual Report by reference.

PART IV.

ITEM 15. Exhibits, Financial Statement Schedules.

(a)

1. *Financial Statements.*

The following financial statements of Active Power, Inc. were filed as a part of the Annual Report on Form 10-K for the fiscal year ending December 31, 2014:

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Consolidated Statements of Cash Flows	54
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2. *Schedules.*

All schedules have been omitted since the information required by the schedule is not applicable, or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Financial Statements and notes thereto.

3. *Exhibits.*

The exhibits listed on the accompanying index to exhibits immediately following the financial statements are filed herewith, or are incorporated by reference as indicated below.

(b) Exhibits

See the Exhibit Index beginning on page 45 of this Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ACTIVE POWER, INC.

Dated: February 27, 2015

By: /s/ MARK A. ASCOLESE
President and Chief Executive Officer

Power of Attorney

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby severally constitutes and appoints, Mark A. Ascolese and James A. Powers, and each or any of them, his true and lawful attorney-in-fact and agent, each with the power of substitution and resubstitution, for him in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each said attorney-in-fact and agent, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Name</u>	<u>Title</u>	<u>Date</u>
<u>/s/ MARK A. ASCOLESE</u> Mark A. Ascolese	President and Chief Executive Officer (principal executive officer)	February 27, 2015
<u>/s/ JAMES A. POWERS</u> James A. Powers	Vice President—Finance, Chief Financial Officer (principal financial and accounting officer)	February 27, 2015
<u>/s/ AKE ALMGREN</u> Ake Almgren	Chairman of the Board, Director	February 27, 2015
<u>/s/ JAMES E. DEVENNY III</u> James E. deVenny III	Director	February 27, 2015
<u>/s/ ROBERT S. GREENBERG</u> Robert S. Greenberg	Director	February 27, 2015
<u>/s/ STEPHEN J. CLEARMAN</u> Stephen J. Clearman	Director	February 27, 2015
<u>/s/ T. PATRICK KELLY</u> T. Patrick Kelly	Director	February 27, 2015

INDEX TO EXHIBITS

Exhibit Number	Description
3.1*	Restated Certificate of Incorporation of Active Power, Inc., as amended (filed as Exhibit 3.1 to Active Power Inc.'s Quarterly Report on Form 10-Q filed on August 1, 2014)
3.2*	Second Amended and Restated Bylaws of Active Power, Inc., as amended (filed as Exhibit 3.2 to Active Power Inc.'s Quarterly Report on Form 10-Q filed on May 1, 2014)
4.1*	Specimen certificate for shares of Common Stock (filed as Exhibit 4.1 to Active Power's IPO Registration Statement on Form S-1 (SEC File No. 333-36946) (the "IPO Registration Statement"))
4.2*	See Exhibits 3.1 and 3.2 for provisions of the Certificate of Incorporation and Bylaws of the registrant defining the rights of holders of common stock
10.1*	Form of Indemnity Agreement (filed as Exhibit 10.1 to the IPO Registration Statement)
10.2*†	Active Power, Inc. 2000 Stock Incentive Plan (filed as Exhibit 10.2 to the IPO Registration Statement)
10.3*†	Active Power, Inc. 2010 Equity Incentive Plan, as amended (filed as Exhibit 10.1 to Active Power's Quarterly Report on Form 10-Q filed on August 3, 2012)
10.4*†	Form of Standard Stock Option Agreement (filed as Exhibit 10.2 to Active Power's Current Report on Form 8-K filed on May 18, 2010)
10.5*†	Form of Standard Restricted Stock Agreement Stock Agreement (filed as Exhibit 10.3 to Active Power's Current Report on Form 8-K filed on May 18, 2010)
10.6*†	Form of Standard Restricted Stock Unit Agreement (filed as Exhibit 10.4 to Active Power's Current Report on Form 8-K filed on May 18, 2010)
10.7*	Lease Agreement between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.9 to the IPO Registration Statement)
10.8*	First Amendment to Lease Agreement between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.10 to the IPO Registration Statement)
10.9*	Second Amendment to Lease Agreement between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.11 to the IPO Registration Statement)
10.10*	Third Amendment to Lease Agreement between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.12 to the IPO Registration Statement)
10.11*	Fourth Amendment to Lease Agreement between Active Power, Inc. and Metropolitan Life Insurance Company (filed as Exhibit 10.13 to the IPO Registration Statement)
10.12*	Fifth Amendment to Lease Agreement between Active Power, Inc. and Metropolitan Life Insurance Company (filed as Exhibit 10.14 to the IPO Registration Statement)
10.13*	Sixth Amendment to Lease Agreement between Active Power, Inc. and Metropolitan Life Insurance Company (filed as Exhibit 10.18 to Active Power's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 (the "2000 10-K"))
10.14*	Seventh Amendment to Lease Agreement between Active Power, Inc. and Metropolitan Life Insurance Company (filed as Exhibit 10.19 to the 2000 10-K)
10.15	Eight Amendment to Lease Agreement between Active Power, Inc. and Metropolitan Life Insurance Company

Exhibit Number	Description
10.16	Ninth Amendment to Lease Agreement between Active Power, Inc. and Metropolitan Life Insurance Company
10.17	Tenth Amendment to Lease Agreement between Active Power, Inc. and Metropolitan Life Insurance Company
10.18	Eleventh Amendment to Lease Agreement between Active Power, Inc. and Metropolitan Life Insurance Company
10.19	Twelfth Amendment to Lease Agreement between Active Power, Inc. and Metropolitan Life Insurance Company
10.20	Thirteenth Amendment to Lease Agreement between Active Power, Inc. and Braker-Stonehollow, Ltd. (successor to Metropolitan Life Insurance Company)
10.21	Fourteenth Amendment to Lease Agreement between Active Power, Inc. and Windsor at Stonehollow, LP (successor to Braker-Stonehollow, Ltd.)
10.22	Fifteenth Amendment to Lease Agreement between Active Power, Inc. and Windsor at Stonehollow, LP
10.23	Sixteenth Amendment to Lease Agreement between Active Power, Inc. and Stonehollow Industrial Investors, LLC
10.24*	Lease Agreement between Active Power, Inc. and BC12 99, Ltd. (filed as Exhibit 10.17 to the 2000 10-K)
10.25	First Amendment to Lease Agreement between Active Power, Inc. and BC 12 99, LTD.
10.26	Second Amendment to Lease Agreement between Active Power, Inc. and BC 12 99, LTD.
10.27	Third Amendment to Lease Agreement between Active Power, Inc. and BC 12 99, LTD.
10.28	Fourth Amendment to Lease Agreement between Active Power, Inc. and Levy Braker 12 Associates, LLC (successor in interest to BC 12 99, LTD.)
10.29†	2015 Adleman Incentive Plan
10.30*†	Form of Severance Benefits Agreement (filed as Exhibit 10.4 to Active Power's Quarterly Report on Form 10-Q filed on April 27, 2010)
10.31*†	Offer Letter, effective September 26, 2013, between Active Power, Inc. and Mark A. Ascolese (filed as Exhibit 10.1 to Active Power's Quarterly Report on Form 10-Q filed on November 18, 2013)
10.32*†	Severance Benefits Agreement, effective September 26, 2013, between Active Power, Inc. and Mark A. Ascolese (filed as Exhibit 10.2 to Active Power's Quarterly Report on Form 10-Q filed on November 18, 2013)
10.33*†	Offer Letter, effective November 4, 2013, between Active Power, Inc. and Randall J. Adleman (filed as Exhibit 10.3 to Active Power's Quarterly Report on Form 10-Q filed on November 18, 2013)
10.34*†	Severance Benefits Agreement, effective November 4, 2013, between Active Power, Inc. and Randall J. Adleman (filed as Exhibit 10.4 to Active Power's Quarterly Report on Form 10-Q filed on November 18, 2013)
10.35*†	Offer Letter, dated November 14, 2013, between Active Power, Inc. and James A. Powers (filed as Exhibit 10.21 to Active Power's Annual Report on Form 10-K filed on March 4, 2014)

Exhibit Number	Description
10.36*†	Severance Benefits Agreement, dated November 14, 2013, between Active Power, Inc. and James A. Powers (filed as Exhibit 10.22 to Active Power's Annual Report on Form 10-K filed on March 4, 2014)
10.37*†	Separation Agreement and Release, effective April 22, 2013, between Active Power, Inc. and Lisa Brown (filed as Exhibit 10.1 to Active Power's Quarterly Report on Form 10-Q filed on May 3, 2013)
10.38*†	Separation Agreement and Release, dated November 7, 2013, between Active Power, Inc. and Martin T. Olsen (filed as Exhibit 10.5 to Active Power's Quarterly Report on Form 10-Q filed on November 18, 2013)
10.39*†	Separation Agreement and Release, dated November 20, 2013, between Active Power, Inc. and Steven R. Fife (filed as Exhibit 10.25 to Active Power's Annual Report on Form 10-K filed on March 4, 2014)
10.40*†	Separation and Release Agreement, effective January 4, 2014, between Active Power, Inc. and J. Noel Foley (filed as Exhibit 10.1 to Active Power's Quarterly Report on Form 10-Q filed on May 1, 2014)
10.41*	Second Amended and Restated Loan and Security Agreement dated as of August 5, 2010 between Active Power, Inc. and Silicon Valley Bank (filed as Exhibit 10.1 to Active Power's Quarterly Report on Form 10-Q filed on October 27, 2010)
10.42*	First Amendment to Second Amended and Restated Loan and Security Agreement, dated March 5, 2012, between Active Power, Inc. and Silicon Valley Bank (filed as Exhibit 10.3 to Active Power's Quarterly Report on Form 10-Q filed on August 3, 2012)
10.43*	Second Amendment to Second Amended and Restated Loan and Security Agreement dated August 15, 2012 between Active Power, Inc. and Silicon Valley Bank (filed as Exhibit 10.1 to Active Power's Current Report on Form 8-K filed on August 20, 2012)
10.44*	Third Amendment to Second Amended and Restated Loan and Security Agreement dated July 28, 2014 between Active Power, Inc. and Silicon Valley Bank (filed as Exhibit 10.1 to Active Power's Current Report on Form 8-K filed on July 29, 2014)
10.45*	Guarantee and Debenture Agreement, dated as of August 5, 2010 between Active Power Solutions Limited and Silicon Valley Bank (filed as Exhibit 10.2 to Active Power's Quarterly Report on Form 10-Q filed on October 27, 2010)
10.46*	Side Letter Agreement dated March 7, 2012 between Active Power, Inc. and Kinderhook Partners, L.P. (filed as Exhibit 10.2 to Active Power's Current Report on Form 8-K filed on March 8, 2012)
10.47*+	Purchase Agreement effective as of June 1, 2011 between Active Power, Inc. and Caterpillar, Inc. (filed as Exhibit 10.6 to Active Power's Quarterly Report on Form 10-Q filed on April 30, 2012)
10.48*†	2015 Management Incentive Plan (filed as Exhibit 10.1 to Active Power's Current Report on Form 8-K filed on February 17, 2015)
10.49*+	Hardware Product Purchase Agreement, dated April 30, 2010 between Active Power, Inc. and Hewlett-Packard Company (filed as Exhibit 10.25 to Active Power's Annual Report on Form 10-K filed on March 1, 2012)
21.1	Subsidiaries of the Registrant
23.1	Consent of Grant Thornton LLP

Exhibit Number	Description
24.1	Power of Attorney, pursuant to which amendments to this Form 10-K may be filed, is included on the signature page contained in Part IV of this Form 10-K
31.1	Certification of Principal Executive Officer as required by Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer as required by Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Principal Executive Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Principal Financial Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002
101	The following financial statements from Active Power's Annual Report on Form 10-K for the fiscal year ended December 31, 2014, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statement of Operations and Comprehensive Loss, (iii) Consolidated Statement of Cash Flows, and (iv) Notes to Consolidated Financial Statements.

* Incorporated by reference to the indicated filing.

+ Portions of this exhibit have been omitted pursuant to a confidential treatment previously granted.

† Management contract or compensatory plan or arrangement.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

Active Power, Inc.

We have audited the internal control over financial reporting of Active Power, Inc. (a Delaware corporation) and subsidiaries as of December 31, 2014, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in the 2013 *Internal Control-Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended December 31, 2014, and our report dated February 27, 2015 expressed an unqualified opinion on those financial statements.

/s/ Grant Thornton LLP

Dallas, Texas
February 27, 2015

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

Active Power, Inc.

We have audited the accompanying consolidated balance sheets of Active Power, Inc. (a Delaware corporation) and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of operations and comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. 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 the standards of the Public Company Accounting Oversight Board (United States). 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Active Power, Inc. and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Active Power, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2015 expressed an unqualified opinion.

/s/ Grant Thornton LLP

Dallas, Texas
February 27, 2015

Active Power, Inc.
Consolidated Balance Sheets
(in thousands, except par value)

	<u>December 31, 2014</u>	<u>December 31, 2013</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,824	\$ 12,261
Restricted cash	40	520
Accounts receivable, net of allowance for doubtful accounts of \$212 and \$313 at December 31, 2014 and December 31, 2013, respectively	11,222	9,075
Inventories, net	6,845	12,020
Prepaid expenses and other	<u>800</u>	<u>680</u>
Total current assets	33,731	34,556
Property and equipment, net	2,076	3,056
Deposits and other	<u>291</u>	<u>295</u>
Total assets	<u>\$ 36,098</u>	<u>\$ 37,907</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 4,044	\$ 2,993
Accrued expenses	4,134	5,583
Deferred revenue	2,771	2,749
Revolving line of credit	<u>5,535</u>	<u>5,535</u>
Total current liabilities	16,484	16,860
Long-term liabilities	821	741
Commitments and contingencies		
Stockholders' equity		
Preferred stock - \$0.001 par value; 2,000 shares authorized	—	—
Common stock - \$0.001 par value; 40,000 and 30,000 shares authorized; 23,162 and 19,452 issued and 23,094 and 19,388 outstanding at December 31, 2014 and 2013, respectively	23	19
Treasury stock	(231)	(215)
Additional paid-in capital	302,667	290,964
Accumulated deficit	(283,995)	(271,168)
Other accumulated comprehensive income	<u>329</u>	<u>706</u>
Total stockholders' equity	18,793	20,306
Total liabilities and stockholders' equity	<u>\$ 36,098</u>	<u>\$ 37,907</u>

See accompanying notes.

Active Power, Inc.
Consolidated Statement of Operations and Comprehensive Loss
(in thousands, except per share amounts)

	<u>Year Ended December 31,</u>		
	<u>2014</u>	<u>2013</u>	<u>2012</u>
Revenues:			
Product revenue	\$ 36,211	\$44,158	\$62,031
Service and other revenue	<u>12,925</u>	<u>17,541</u>	<u>14,284</u>
Total revenue.	49,136	61,699	76,315
Cost of goods sold:			
Cost of product revenue	29,182	32,825	42,510
Cost of service and other revenue	<u>7,302</u>	<u>9,478</u>	<u>9,091</u>
Total cost of goods sold	<u>36,484</u>	<u>42,303</u>	<u>51,601</u>
Gross profit	12,652	19,396	24,714
Operating expenses:			
Research and development.	6,689	7,430	5,440
Selling and marketing.	11,940	12,032	14,139
General and administrative.	<u>6,043</u>	<u>7,551</u>	<u>6,861</u>
Total operating expenses	<u>24,672</u>	<u>27,013</u>	<u>26,440</u>
Loss from Operations	(12,020)	(7,617)	(1,726)
Interest expense, net	(395)	(370)	(327)
Other income (expense), net	<u>(160)</u>	<u>(364)</u>	<u>131</u>
Loss before income taxes	(12,575)	(8,351)	(1,922)
Income tax expense	<u>(252)</u>	<u>—</u>	<u>—</u>
Net Loss	<u><u>\$(12,827)</u></u>	<u><u>\$(8,351)</u></u>	<u><u>\$(1,922)</u></u>
Net Loss per share, basic and diluted	\$ (0.57)	\$ (0.43)	\$ (0.10)
Shares used in computing net loss per share, basic and diluted	22,494	19,329	18,584
Comprehensive loss:			
Net loss	\$(12,827)	\$(8,351)	\$(1,922)
Translation gain (loss) on subsidiaries denominated in foreign currencies	<u>(377)</u>	<u>384</u>	<u>123</u>
Comprehensive loss	<u><u>\$(13,204)</u></u>	<u><u>\$(7,967)</u></u>	<u><u>\$(1,799)</u></u>

See accompanying notes.

Active Power, Inc.
Consolidated Statement of Stockholders' Equity
(in thousands, except per share amounts)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Deficit	Other Accumulated Comprehensive Income (Loss)	Total Stockholders' Equity
	Number of Shares	Par Value	Number of Shares	At Cost				
Balance at December 31, 2011 . . .	16,116	\$16	28	\$(115)	\$277,087	\$(260,895)	\$ 199	\$ 16,292
Employee stock option exercises . .	155	—	—	—	562	—	—	562
Sale of common stock, less issuance costs	2,868	3	—	—	9,560	—	—	9,563
Release of Restricted Stock	32	—	—	—	—	—	—	—
Shares held in treasury	—	—	5	(29)	—	—	—	(29)
Net translation gain on foreign subsidiaries	—	—	—	—	—	—	123	123
Stock-based compensation	—	—	—	—	1,410	—	—	1,410
Net Loss	—	—	—	—	—	(1,922)	—	(1,922)
Balance at December 31, 2012 . . .	<u>19,171</u>	<u>\$19</u>	<u>33</u>	<u>\$(144)</u>	<u>\$288,619</u>	<u>\$(262,817)</u>	<u>\$ 322</u>	<u>\$ 25,999</u>
Employee stock option exercises . .	200	—	—	—	711	—	—	711
Release of Restricted Stock	81	—	—	—	4	—	—	4
Shares held in treasury	—	—	18	(71)	—	—	—	(71)
Net translation gain on foreign subsidiaries	—	—	—	—	—	—	384	384
Stock-based compensation	—	—	—	—	1,689	—	—	1,689
Issuance costs, shelf registration . .	—	—	—	—	(59)	—	—	(59)
Net Loss	—	—	—	—	—	(8,351)	—	(8,351)
Balance at December 31, 2013 . . .	<u>19,452</u>	<u>\$19</u>	<u>51</u>	<u>\$(215)</u>	<u>\$290,964</u>	<u>\$(271,168)</u>	<u>\$ 706</u>	<u>\$ 20,306</u>
Employee stock option exercises . .	43	—	—	—	129	—	—	129
Sale of common stock, less issuance costs	3,651	4	—	—	10,434	—	—	10,438
Release of Restricted Stock	16	—	—	—	—	—	—	—
Shares held in treasury	—	—	5	(16)	—	—	—	(16)
Net translation loss on foreign subsidiaries	—	—	—	—	—	—	(377)	(377)
Stock-based compensation	—	—	—	—	1,140	—	—	1,140
Net Loss	—	—	—	—	—	(12,827)	—	(12,827)
Balance at December 31, 2014 . . .	<u>23,162</u>	<u>\$23</u>	<u>56</u>	<u>\$(231)</u>	<u>\$302,667</u>	<u>\$(283,995)</u>	<u>\$ 329</u>	<u>\$ 18,793</u>

See accompanying notes.

Active Power, Inc.
Consolidated Statement of Cash Flows
(in thousands)

	Year ended December 31,		
	2014	2013	2012
Operating activities			
Net Loss	\$(12,827)	\$ (8,351)	\$ (1,922)
Adjustments to reconcile net loss to cash used in operating activities:			
Depreciation expense	1,220	1,084	1,282
Change to allowance for doubtful accounts	(101)	(175)	151
Loss (gain) on disposal of fixed assets	4	30	(35)
Impairment on fixed assets	57	69	218
Stock-based compensation	1,140	1,700	1,410
Changes in operating assets and liabilities:			
Restricted cash	480	(520)	389
Accounts receivable	(2,046)	8,962	(6,850)
Inventories	5,257	(1,796)	(1,640)
Prepaid expenses and other assets	(116)	(99)	(58)
Accounts payable	1,051	(1,043)	(721)
Accrued expenses	(1,449)	623	(403)
Deferred revenue	22	(1,819)	2,202
Long term liabilities	<u>80</u>	<u>28</u>	<u>(13)</u>
Net cash used in operating activities	(7,228)	(1,307)	(5,990)
Investing activities			
Purchases of property and equipment	(343)	(996)	(1,274)
Proceeds from sale of fixed assets	<u>19</u>	<u>71</u>	<u>212</u>
Net cash used in investing activities	(324)	(925)	(1,062)
Financing activities			
Proceeds from public offering of common stock, net of issuance cost	10,438	—	—
Proceeds from private placement of common stock	—	—	9,750
Issuance costs of private placement	—	—	(187)
Proceeds from draw on revolving line of credit	—	—	2,017
Payments on revolving line of credit	—	—	(2,017)
Proceeds from employee stock option exercises	129	711	562
Issuance costs, shelf registration	—	(59)	—
Taxes paid related to the net share settlement of equity awards	<u>(16)</u>	<u>(67)</u>	<u>(29)</u>
Net cash provided by financing activities	10,551	585	10,096
Effects of exchange rates on cash	(436)	384	123
Change in cash and cash equivalents	2,563	(1,263)	3,167
Cash and cash equivalents, beginning of period	<u>12,261</u>	<u>13,524</u>	<u>10,357</u>
Cash and cash equivalents, end of period	<u>\$ 14,824</u>	<u>\$12,261</u>	<u>\$13,524</u>
Supplemental Cash Flow Information:			
Interest Paid	\$ 401	\$ 380	\$ 335
Income Tax Paid	\$ 252	\$ —	\$ —

See accompanying notes.

ACTIVE POWER, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2014
(in thousands, except share and per share amounts)

1. Summary of Significant Accounting Policies

Description of Business

Active Power, Inc. and its subsidiaries (collectively, “we”, “us”, “Active Power” or “Company”) design, manufacture, sell and service flywheel-based uninterruptible power supply (“UPS”) products that use kinetic energy to provide short-term power as a cleaner alternative to conventional electro-chemical battery-based energy storage. We also design, manufacture, sell, and service modular infrastructure solutions (“MIS”) that integrate critical power components into a pre-packaged, purpose built enclosure that may include our UPS products as a component. Our products and solutions are based on our patented flywheel and power electronics technology and are designed to ensure continuity for data centers and other mission critical operations in the event of power disturbances.

Our products and solutions are designed to deliver continuous conditioned power during power disturbances such as voltage sags and surges, and to provide ride-through power in the event of a brief utility failure, supporting operations until utility power is restored or a longer term alternative power source, such as a diesel generator, is started. We sell our products globally through our direct sales force, manufacturer’s representatives, distributors, Original Equipment Manufacturer (“OEM”) channel, and IT partners in the Americas, in Europe, Middle East, and Africa (“EMEA”), and in the Asia Pacific region (“APAC”).

We also offer services, including hardware and software maintenance, on all Active Power products, and other professional services such as assessment and implementation, for our customers’ infrastructure projects.

We were founded as a Texas Corporation in 1992 and reincorporated in Delaware in 2000. Our headquarters are in Austin, Texas with international offices in the United Kingdom, Germany and China.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) and include the accounts of the Company and its consolidated subsidiaries. All intercompany transactions and balances have been eliminated upon consolidation.

The accompanying consolidated financial statements have also been prepared on the assumption that the Company will continue to operate as a going concern. Accordingly, assets and liabilities are recorded on the basis that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. The Company’s history of operating losses and use of cash, in the absence of other factors, may cause uncertainty as to its ability to continue as a going concern. We have reviewed the current and prospective sources of liquidity, significant conditions and events and forecast financial results and concluded that we have adequate resources to continue to operate as a going concern. Our business plan and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, our revenues may not meet our projections or our costs may exceed our estimates. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in 2015 or significantly affect our level of liquidity, which may require us to seek additional financing or take other measures to reduce our operating costs in order to continue operating. These financial statements do not include any adjustments that might result from the Company not being able to continue as a going concern.

All common stock information and related share prices included in these notes to financial statements have been adjusted to reflect the five for one reverse stock split that occurred on December 21, 2012.

Use of Estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Changes in the estimates or assumptions used by management could have a material impact upon reported amounts and our results of operations.

Revenue Recognition

In general, we recognize revenue when four criteria are met: (i) persuasive evidence that an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the sales price is fixed or determinable; and

(iv) collectability is reasonably assured. In general, revenue is recognized when revenue-generating transactions generally fall into one of the following categories of revenue recognition:

- We recognize product revenue at the time of shipment for a significant portion of all products sold directly to customers and through distributors because title and risk of loss pass on delivery to the common carrier. Our customers and distributors do not have the right to return products. If title and risk of loss pass at some other point in time, we recognize such revenue for our customers when the product is delivered to the customer and title and risk of loss has passed. We may enter into bill-and-hold arrangements and when this happens delivery may not occur, but other criteria are reviewed to determine proper timing of revenue recognition.
- We recognize installation, service and maintenance revenue at the time the service is performed.
- We recognize revenue associated with extended maintenance agreements (“EMAs”) over the life of the contracts using the straight-line method, which approximates the expected timing in which applicable services are performed. Amounts collected in advance of revenue recognition are recorded as a current liability in the deferred revenue line of the consolidated balance sheet or long-term liability based on the time from the balance sheet date to the future date of revenue recognition.
- We recognize revenue on certain rental programs over the life of the rental agreement using the straight-line method. Amounts collected in advance of revenue recognition are recorded as a current or long-term liability based on the time from the balance sheet date to the future date of revenue recognition.

When collectability is not reasonably assured, we defer revenue and will recognize revenue as payments are received.

Multiple element arrangements (“MEAs”) are arrangements to sell products to customers that frequently include multiple deliverables. Our most significant MEAs include the sale of one or more of our CleanSource UPS or CleanSource PowerHouse products, combined with one or more of the following products: design services, project management, commissioning and installation services, spare parts or consumables, and EMA’s. Delivery of the various products or performance of services within the arrangement may or may not coincide. Certain services related to design and consulting may occur prior to product delivery. Commissioning and installation typically take place within six months of product delivery, depending upon customer requirements. EMAs, consumables, and repair, maintenance or consulting services are generally delivered over a period of one to five years. In certain arrangements revenue recognized is limited to the amount invoiced or received that is not contingent on the delivery of future products and services.

When arrangements include multiple elements, we allocate revenue to each element based on the relative selling price and recognize revenue when the elements have standalone value and the four criteria for revenue recognition have been met. We establish the selling price of each element based on Vendor Specific Objective Evidence (“VSOE”) if available, Third Party Evidence (“TPE”) if VSOE is not available, or best estimate of selling price (“BESP”) if neither VSOE nor TPE is available. We generally determine selling price based on amounts charged separately for the delivered and undelivered elements to similar customers in standalone sales of the specific elements. When arrangements include an EMA, we recognize revenue related to the EMA at the stated contractual price on a straight-line basis over the life of the agreement.

Any taxes imposed by governmental authorities on our revenue-producing transactions with customers are shown in our consolidated statements of operations on a net-basis; that is, excluded from our reported revenues.

Shipping and Handling Costs

We classify shipping and handling costs related to product sales as cost of revenue, and any payments from customers for shipping and handling are categorized in revenue. We classify shipping and handling costs associated with receiving production inventory as cost of product revenue. Any materials received or shipped which are related to our engineering, sales, marketing and administrative functions are classified as operating expenses.

Cash and Cash Equivalents

Investments with a contractual maturity of three months or less when purchased are classified as cash equivalents.

Fair Value of Financial Instruments

Fair value is measured based on an exit price, representing the amount that would be received to sell an asset or paid to satisfy a liability in an orderly transaction between market participants. Fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, a fair value hierarchy is established, which categorizes the inputs used in measuring fair value as follows:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Significant observable inputs other than quoted prices in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3—One or more significant inputs that are unobservable and supported by little or no market data.

Highest priority is given for Level 1 input and lower propriety to Level 3 inputs. A financial instruments level is based on the lowest level of any input that is significant to the fair value measurement. No changes were made to our methodology.

Our Level 1 assets consist of cash equivalents, which are primarily invested in money-market funds. These assets are classified as Level 1 because they are valued using quoted prices in active markets and other relevant information generated by market transactions involving identical assets and liabilities. The fair value was \$3.1 million as of December 31, 2014 and 2013.

For cash and cash equivalents, accounts receivable, accounts payable and our revolving line of credit, the carrying amount approximates fair value because of the relative short maturity of those instruments.

Allowance for Doubtful Accounts

We estimate an allowance for doubtful accounts based on factors related to the credit risk of each customer. Historically, credit losses were minimal, primarily because the majority of our revenues were generated from large customers, primarily Caterpillar, Inc. (“Caterpillar”) and Hewlett Packard Corporation (“HP”). We perform credit evaluations of new customers and often require deposits, prepayments or use of bank instruments such as trade letters of credit to mitigate our credit risk. We write off uncollectable trade receivables, and record any recoveries of previous write offs against the allowance. Our standard terms are net 30 days; however we may have agreements with our larger customers and certain distributors, OEM customers, and IT channel that allow for more extended terms at or above net 60 days.

The following table summarizes the annual changes in our allowance for doubtful accounts (in thousands):

Balance at December 31, 2011	\$ 337
Change in provision charged to expense	151
Write-off of uncollectible accounts, net of recoveries	—
Balance at December 31, 2012	\$ 488
Change in provision charged to expense	(139)
Write-off of uncollectible accounts, net of recoveries	(36)
Balance at December 31, 2013	\$ 313
Change in provision charged to expense	(67)
Write-off of uncollectible accounts, net of recoveries	(34)
Balance at December 31, 2014	<u>\$ 212</u>

Inventories, net

Inventories, net are stated at the lower of cost or market, using the first-in-first-out method, and consisted of the following at December 31 (in thousands, net of allowances):

	<u>2014</u>	<u>2013</u>
Raw materials	\$5,440	\$ 4,521
Work in progress	473	2,429
Finished goods	<u>932</u>	<u>5,070</u>
	<u>\$6,845</u>	<u>\$12,020</u>

Property and Equipment

Property and equipment is stated at cost and is depreciated using the straight-line method over the estimated useful lives of the assets, as follows (in years):

Equipment	2 - 10
Demonstration units	3 - 5
Computers and purchased software	2 - 3
Furnitures and fixtures	2 - 5

Leasehold improvements are depreciated over the shorter of the life of the improvement or the remainder of the property lease term, including renewal options, generally three to five years. Repairs and maintenance is expensed as incurred.

Long-Lived Assets

Long-lived assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that their net book value may not be recoverable. When such factors and circumstances exist, we compare the projected undiscounted future cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets and is recorded in the period in which the determination was made.

Accrued Expenses

Accrued expenses consist of the following at December 31 (in thousands):

	<u>2014</u>	<u>2013</u>
Compensation, severance and benefits	\$1,296	\$2,685
Warranty liability	475	529
Taxes, other than income	1,080	483
Professional fees	463	759
Other	<u>820</u>	<u>1,127</u>
	<u>\$4,134</u>	<u>\$5,583</u>

Warranty Liability

Generally, the warranty period for our power quality products is 12 months from the date of commissioning or 18 months from the date of shipment from Active Power, whichever period is shorter. Occasionally we offer longer warranty periods to certain customers. The warranty period for products sold to our primary OEM customer, Caterpillar, is 12 months from the date of shipment to the end-user, or up to 36 months from shipment from Active Power. This is dependent upon Caterpillar complying with our storage requirements for our products in order to preserve this warranty period beyond the standard 18-month limit. We provide for the estimated cost of product warranties at the time revenue is recognized and this accrual is included in accrued expenses and long term liabilities on the accompanying consolidated balance sheet.

Changes in the Company's warranty liability are as follows (in thousands):

Balance at December 31, 2011	\$ 613
Warranty expense	1,294
Payments	<u>(1,152)</u>
Balance at December 31, 2012	\$ 755
Warranty expense	589
Payments	<u>(782)</u>
Balance at December 31, 2013	\$ 562
Warranty expense	660
Payments	<u>(695)</u>
Balance at December 31, 2014	\$ 527
Warranty liability included in accrued expenses	\$ 475
Long term warranty liability	<u>52</u>
Balance at December 31, 2014	<u>\$ 527</u>

Long-Term Liabilities

Long term liabilities consisted of the following at December 31 (in thousands):

	<u>2014</u>	<u>2013</u>
Deferred revenue	\$751	\$601
Technology licensing agreement	—	88
Warranty liability	52	33
Sublease deposits	<u>18</u>	<u>19</u>
	<u>\$821</u>	<u>\$741</u>

Stock-Based Compensation Expense

We account for our stock-based compensation using the Black Scholes option valuation model. Stock-based compensation cost is estimated at the grant date based on the fair-value of the award and is recognized as expense ratably over the requisite service period of the award, generally four years. We develop our estimates of expected life and forfeitures based on historical data. We estimate stock price volatility based on historical volatilities. The risk-free rates are based on the U.S. Treasury yield in effect at the time of grant. Details of our stock-based compensation include the following (in thousands):

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Stock-based compensation expense by caption:			
Cost of product revenue	\$ 110	\$ 254	\$ 216
Cost of service and other revenue	111	116	70
Research and development	207	204	153
Selling and marketing	370	587	484
General and administrative	<u>342</u>	<u>539</u>	<u>486</u>
	<u>\$1,140</u>	<u>\$1,700</u>	<u>\$1,409</u>
Stock-based compensation expense by type of award:			
Stock options	\$1,068	\$1,488	\$1,213
Restricted stock awards	<u>72</u>	<u>212</u>	<u>196</u>
	<u>\$1,140</u>	<u>\$1,700</u>	<u>\$1,409</u>

Assumptions used in the Black-Scholes model for our stock plans are presented below:

	2014	2013	2012
Weighted average expected life in years	6.27 years	6.35 years	6.83 years
Weighted average expected volatility	75%	76%	77%
Volatility Range	73%-76%	75%-76%	75%-78%
Risk-free interest rate range	1.96%-2.12%	1.13%-2.38%	0.63%-1.00%
Weighted average forfeiture rate	29.7%	18.9%	17.0%

Income Taxes

We account for income taxes using the liability method of accounting for income taxes. Under the liability method, deferred taxes are determined based on the differences between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not such assets will not be realized. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

We recognize the financial statement benefit of a tax position that does not meet the more-likely-than-not threshold only after the statute of limitations expire of the relevant tax authority sustains the Company's position following an audit. For tax positions meeting the more likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon the ultimate settlement with the relevant tax authority. At December 31, 2014 and 2013, the Company had no material unrecognized tax benefits.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of December 31, 2014, the Company had no accrued or expensed interest or penalties related to uncertain tax positions.

Segment Reporting

Active Power's chief operating decision makers allocate resources and assess the performance of its power management product development and sales activities as one segment.

Concentration of Credit Risk

Financial instruments which potentially subject Active Power to concentrations of credit risk consist of cash and cash equivalents, investments and accounts receivable. Active Power's cash and cash equivalents and investments are placed with high credit quality financial institutions and issuers. From time to time, we may have amounts on deposit with financial institutions that are in excess of the federally insured limit. We have not experienced any losses on deposits of cash and cash equivalents.

Active Power performs credit evaluations of its customers' financial condition prior to entering into commercial transactions. We generally require letters of credit or prepayments from higher-risk customers as deemed necessary to ensure collection. Our allowance for doubtful accounts is estimated based on factors related to the credit risk of each customer. Individual receivables are written off after they have been deemed uncollectible. We also purchase several components from sole source or limited source suppliers.

Economic Dependence

We are significantly dependent on our relationships with HP and Caterpillar. If these relationships are unsuccessful or discontinue, our business and revenue may suffer. The loss of, or a significant reduction in, orders from HP or Caterpillar, or the failure to provide adequate service and support to the end-users of our products by HP or Caterpillar, could significantly reduce our revenue. Our operating results in the foreseeable future will continue to depend on the sales made by a relatively small number of customers, including HP and Caterpillar.

The following customers accounted for a significant percentage of Active Power's total revenue during each of the years ended December 31:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Caterpillar	18%	14%	13%
HP	1%	22%	35%
European based IT Customer	—	—	12%

No other customer represented more than 10% of our revenues in any of the years reported. Caterpillar represented 18% and 23% of our outstanding accounts receivable at December 31, 2014 and 2013, respectively. HP represented 22% of our outstanding receivables at December 31, 2013.

Advertising Costs

We expense advertising costs as incurred. These expenses were immaterial in 2014, 2013, and 2012, respectively.

Net Loss Per Share

The following table sets forth the computation of basic and diluted net loss per share (in thousands) for the years ended December 31:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Net loss	\$(12,827)	\$(8,351)	\$(1,922)
Basic and diluted:			
Weighted-average shares of common stock outstanding used in computing basic and diluted net loss per share	<u>22,494</u>	<u>19,329</u>	<u>18,584</u>
Basic and diluted net loss per share	<u>\$ (0.57)</u>	<u>\$ (0.43)</u>	<u>\$ (0.10)</u>

The calculation of diluted net loss per share excludes 2,399,890, 2,407,664, and 1,882,584 shares of common stock issuable upon exercise of employee stock options as of December 31, 2014, 2013, and 2012, respectively, and 21,994, 53,038, and 200,071 non-vested shares of common stock issuable upon exercise of restricted stock awards as of December 31, 2014, 2013, and 2012, respectively, because their inclusion in the calculation would be anti-dilutive.

Recent Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2014-15, ("ASU 2014-15"), "*Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*". ASU 2014-15 requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity's ability to continue as a going concern. ASU 2014-15 applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The Company does not expect that the adoption of this standard will have a material effect on its financial statements.

In May 2014, the FASB issued ASU 2014-09, "*Revenue from Contracts with Customers*", "*Topic 606*". This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance, and creates a Topic 606 Revenue from Contracts with Customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company will adopt this guidance January 1, 2017 as required. We are evaluating the new guidelines to see if they will have a significant impact on our consolidated results of operation, financial condition or cash flows.

2. Property and Equipment

Property and equipment consists of the following at December 31 (in thousands):

	<u>2014</u>	<u>2013</u>
Equipment	\$ 9,122	\$ 9,168
Demonstration units	1,836	1,470
Computers and purchased software	3,321	3,273
Furnitures and fixtures	366	380
Leasehold improvements	7,225	7,216
Construction in progress	<u>19</u>	<u>458</u>
	21,889	21,965
Accumulated depreciation	<u>(19,813)</u>	<u>(18,909)</u>
	<u>\$ 2,076</u>	<u>\$ 3,056</u>

In 2014, we reclassified \$44,000 of inventory into demonstration units. In 2013, we reclassified \$0.9 million of inventory into equipment related to test units for our latest generation UPS product.

3. Stockholders' Equity

Common Stock

Common stock reserved for future issuance at December 31, 2014 consisted of 3,461,909 shares of common stock reserved under our 2010 Stock Incentive Plan, of which 2,409,590 shares were subject to outstanding options and restricted shares and 1,052,319 shares were available for future grants of awards.

On May 28, 2014, our stockholders approved an amendment to the Company's Restated Certificate of Incorporation to increase the number of authorized shares of common stock from 30 million shares to 40 million shares.

In March 2014, we sold approximately 3.7 million shares of common stock at a purchase price of \$3.15 per share in a public underwritten offering made under a shelf registration statement that we had filed with the SEC and that had been declared effective in June 2013. This offering resulted in proceeds, net of expenses including underwriting discounts, commissions and fees of \$0.8 million and professional service expenses of \$0.2 million, of approximately \$10.4 million. The proceeds from this offering will be used by us to help fund our working capital requirements and for general corporate purposes.

In May 2012, our Board of Directors approved the addition of 1.7 million shares of our common stock to be issued in accordance with our 2010 Equity Incentive Plan, and such addition was subsequently approved by our stockholders. Options are subject to terms and conditions as determined by the Compensation Committee of our Board of Directors.

In March 2012, we sold approximately 2.9 million shares of common stock at a purchase price of \$3.40 per share, for proceeds, net of fees and expenses, of approximately \$9.6 million, in an offering made under a shelf registration statement that we filed with the Securities and Exchange Commission and that had been declared effective in December 2009. The proceeds from this offering were used by us to help fund our working capital requirements and for general corporate purposes.

Stock Option Plan

Since its inception, we have authorized 5,682,296 shares of common stock for issuance under our 2000 and 2010 Stock Incentive Plans, however, we are only issuing new shares of common stock under our 2010 Stock Incentive Plan. We grant options under these plans that vest over periods of up to four years. The term of each option is no more than ten years from the date of grant. Our policy is to issue new shares when required to issue shares upon option exercises. The total fair value of options vested in the year was \$1.8 million, \$1.4 million, and \$1.7 million in 2014, 2013, and 2012, respectively.

A summary of common stock option activity is as follows:

	<u>Number of Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Contractual Life (in years)</u>	<u>Aggregate Intrinsic Value (whole dollars)</u>
Outstanding at December 31, 2013.....	2,407,664	\$5.27		
Granted	993,725	3.01		
Exercised.....	(42,600)	3.03		
Canceled	(958,899)	5.44		
Outstanding at December 31, 2014.....	<u>2,399,890</u>	<u>\$4.30</u>	<u>7.57</u>	<u>\$2,000</u>
Vested and expected to vest at December 31, 2014...	<u>1,901,476</u>	<u>\$4.63</u>	<u>7.18</u>	<u>\$1,000</u>
Exercisable at December 31, 2014	<u>1,028,618</u>	<u>\$5.83</u>	<u>5.64</u>	<u>\$ —</u>

The weighted average grant date fair value per share of options granted during 2014, 2013, and 2012 was \$2.03, \$2.60, and \$2.60, respectively. The total intrinsic value of options exercised (which is the amount by which the stock price exceeded the exercise price of the options at the date of exercise) during the years ended December 31, 2014, 2013, and 2012 was \$14,000, \$0.1 million, and \$0.1 million, respectively.

As of December 31, 2014, there was \$2.6 million of total unrecognized compensation cost, related to non-vested stock options, that is expected to be recognized over a weighted-average vesting period of 2.8 years.

Restricted (non-vested) Shares

In 2013 and 2012, we issued approximately 6,000 and 248,000 restricted shares, respectively, to directors and employees of the Company. The restrictions lapse as the shares vest in equal quarterly installments over a four year period from the date of issuance. We recorded stock compensation expense related to restricted share units of \$0.1 million in 2014. A summary of our restricted, non-vested, shares is as follows:

	<u>Number of Shares</u>	<u>Weighted- Average Grant Date Fair Value</u>
Outstanding at December 31, 2013	53,038	\$4.00
Granted	—	—
Vested	(18,681)	4.00
Canceled	(12,363)	4.00
Outstanding at December 31, 2014	<u>21,994</u>	<u>\$4.00</u>

As of December 31, 2014, there was \$0.1 million of total unrecognized compensation cost related to restricted shares that is expected to be recognized over a weighted-average vesting period of 1.1 years. The total fair value of restricted share units vested in 2014 and 2013 was \$0.1 million and \$0.3 million, respectively.

4. Income Taxes

The Company's pretax loss for the three years ended December 31, 2014, 2013, and 2012 were allocated between domestic and foreign operations as follows:

	<u>Year Ended December 31,</u>		
	<u>2014</u>	<u>2013</u>	<u>2012</u>
Domestic	\$(15,909)	\$(9,105)	\$(1,642)
Foreign.....	3,334	754	(280)
Total	<u>\$(12,575)</u>	<u>\$(8,351)</u>	<u>\$(1,922)</u>

In September 2014, we settled a tax examination of our German subsidiary for years 2007 through 2011. In the settlement, we agreed to transfer pricing adjustments for the period under examination resulting in a reduction of loss carryovers and a deemed distribution subject to withholding taxes under German law. We recorded a provision for foreign income taxes of \$0.3 million in the quarter ended September 30, 2014 related to the settlement of the German tax examination.

As of December 31, 2014, the Company had federal net operating loss carry-forwards of approximately \$232.0 million and research and development credit carry-forwards of approximately \$4.0 million. The net operating loss and credit carry-forwards will expire beginning in 2018, if not utilized. The Company is currently in the process of analyzing potential limitations on the future utilization of the net operating losses and credit carry-forwards due to the “change of ownership” provisions of the Internal Revenue Code of 1986. Any annual limitation may result in the expiration of net operating losses and credit carry-forwards before utilization.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company’s deferred taxes as of December 31 are as follows (in thousands):

	<u>2014</u>	<u>2013</u>
Deferred tax assets:		
Current deferred tax assets		
Reserves and allowances	\$ 751	\$ 1,177
Deferred Rent.	45	55
Deferred revenue	255	328
Valuation allowance for current deferred tax assets.	(1,049)	(1,558)
Net current deferred tax assets	<u>\$ 2</u>	<u>\$ 2</u>
Noncurrent deferred tax assets		
Acquired technology	571	695
Capital expenses.	1,652	1,624
Stock compensation	594	699
Net operating loss and tax credit carryforwards.	84,047	84,356
Valuation allowance for noncurrent deferred tax assets.	(86,687)	(87,263)
Net noncurrent deferred tax assets	<u>\$ 177</u>	<u>\$ 111</u>
Deferred tax liabilities:		
Current deferred tax liabilities		
Prepaid expenses	(179)	(113)
Total current deferred tax liabilities	<u>\$ (179)</u>	<u>\$ (113)</u>
Total net deferred taxes	<u><u>\$ —</u></u>	<u><u>\$ —</u></u>

The Company has established a valuation allowance equal to the net deferred tax asset due to uncertainties regarding the realization of deferred tax assets based on the Company’s lack of earnings history. The valuation allowance decreased by approximately \$1.1 million during 2014.

The Company’s provision for income taxes differs from the expected tax expense (benefit) amount computed by applying the statutory federal income tax rate of 34% to income before taxes due to the following:

	<u>Year Ended December 31,</u>		
	<u>2014</u>	<u>2013</u>	<u>2012</u>
Federal statutory rate	(34.0)%	(34.0)%	(34.0)%
State taxes, net of federal benefit	(1.0)	(13.5)	7.2
R&D credits	(1.8)	(5.6)	1.3
Stock compensation	3.8	6.2	14.5
Effect of current foreign operations	5.5	(20.5)	157.3
Expiration and adjustment of net operating losses.	26.7	—	63.2
Foreign tax audit settlement	2.0	—	—
Loss carryforward adjustments due to tax audit methodologies	9.1	—	—
Permanent items and other	0.3	(1.9)	6.8
Change in valuation allowance	(8.6)	69.3	(216.3)
	<u>2.0%</u>	<u>—%</u>	<u>—%</u>

The Company recognized no material adjustment in the liability for unrecognized income tax benefits. The reconciliation of the Company's unrecognized tax benefits at the beginning and end of the year is as follows:

Balance at January 1, 2014	\$1,990
Additions based on tax positions related to the current year.	257
Additions for tax positions of prior years.	<u>24</u>
Balance at December 31, 2014	<u>\$2,271</u>

Due to the existence of the valuation allowance, future changes in our unrecognized tax benefits will not materially impact the Company's effective tax rate. The Company's assessment of its unrecognized tax benefits is subject to change as a function of the Company's financial statement audit.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of December 31, 2014, the Company had no accrued interest or penalties related to uncertain tax positions.

The tax years 2009 through 2014 remain open to examination by the major taxing jurisdictions to which the Company is subject.

5. Commitments

We lease our office, manufacturing and engineering facilities and our foreign sales offices under operating lease agreements. These facilities' leases are non-cancelable and obligate us to pay taxes and maintenance costs. In addition, we lease certain equipment such as copiers and phone systems under non-cancelable leases. Our leases expire at various dates through 2018. Rent expense for leases with escalating or de-escalating rent payments are recorded on a straight-line basis over the period of the lease. Net deferred rent on the consolidated balance sheet as of December 31, 2014 and 2013 was \$0.1 million and \$0.1 million, respectively. There was no deferred rent in 2012. Rent expense was \$1.5 million, \$1.7 million, and \$1.7 million for the years ended December 31, 2014, 2013, and 2012, respectively.

Future minimum payments under these leases at December 31, 2014 are as follows (in thousands):

	<u>Rental payments</u>
2015	\$1,260
2016	1,073
2017	116
2018	<u>72</u>
Total future minimum lease payments	<u>\$2,521</u>

We enter into certain commitments to purchase inventory and other items in the course of normal operations. At December 31, 2014, the total of these commitments was \$6.1 million, of which \$5.8 million, \$0.2 million, and \$45,000 will mature in 2015, 2016, and 2017, respectively.

We have entered into Severance Benefits Agreements with our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") and with each of our other executive officers. These agreements generally provide that, if within 12 months following a change in control the executive officer's employment is terminated for reasons other than for cause (as defined in the agreement) or by the executive for good reason, including a significant reduction in the role and/or responsibility of the executive within 12 months of the change in corporate control, then all outstanding stock options or restricted shares held by the executive would vest as of the date of the termination and certain severance payments would be payable. In the case of our CEO and CFO, in the event of termination by the Company for reasons other than for cause or by him for good reason, he would be entitled to a severance payment equal to 12 months of salary and be entitled to receive health benefits for 12 additional months after termination. In the case of our other executive officer, in the event of a termination by the Company for reasons other than for cause or by the officer for good reason, he would be entitled to a severance payment equivalent to six months of salary and be entitled to receive health benefits for six additional months after termination.

6. Contingencies

The Company may be involved, either as plaintiff or defendant, in a variety of ongoing claims, demands, suits, investigations, tax matters and proceedings that arise from time to time in the ordinary course of its business. In evaluating whether a contingency should be disclosed, the Company considers if there is at least a reasonable possibility that a loss or an additional loss may have been incurred, and either an accrual is not made because any of the conditions, or an exposure to loss exists in excess of the amount accrued. The Company evaluated all potentially significant litigation, government investigations, claims or assessments in which the Company is involved and determined there were no contingent losses, either accrued or reasonably possible of loss that could materially affect its results of operations, financial condition, or cash flows.

The Company records an accrual with respect to a claim, suit, investigation or proceeding when it is reasonably probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Any recorded liabilities, including any changes to such liabilities for the year ended December 31, 2014, were not material to the Consolidated Financial Statements.

The following is a summary of the significant legal matters involving the Company.

SEC Inquiry

By letter dated September 30, 2013, the SEC Division of Enforcement notified us that it is conducting an investigation regarding us, including matters relating to our public statements regarding Digital China Information Services Company Limited (“Digital China”) and our distribution relationships in China. We have been and intend to continue cooperating fully with the SEC. As of the date of this filing, we believe we have provided all requested material to the SEC.

Stockholder Litigation

Class action complaint

On September 10, 2013, a purported class action complaint was filed in the United States District Court for the Western District of Texas against us and certain of our former executives. The case is captioned Don Lee v. Active Power, Inc., et. al. (Civil Action No. 1:13-cv-00797-SS). As amended, the complaint alleges that on February 19, 2013, we reported that we had begun working with an unnamed Chinese distributor partner, and that on April 30, 2013, we announced in press releases and conference calls that we had entered into a strategic distribution partnership with Digital China. However, on September 5, 2013, after the close of trading, we disclosed that our partnership was with Qiyuan Network System Limited, which is neither an affiliate nor a subsidiary of Digital China. The amended complaint asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder, and seeks unspecified damages on behalf of all stockholders who purchased common stock between February 19 and September 5, 2013. On March 7, 2014, we filed a motion to dismiss the class action complaint. Our motion was denied by the Court on July 2, 2014. On August 11, 2014, we filed an answer to the class action complaint, and on September 2, 2014, the Court declined to certify its order of July 2, 2014 for an interlocutory appeal to the United States Court of Appeals for the Fifth Circuit.

On September 23, 2014, we reached an agreement in principle and entered into a memorandum of understanding to settle the class action complaint. The parties to the class action signed a definitive settlement agreement on December 2, 2014, which was granted preliminary approval by the Court on January 7, 2015. The proposed settlement would resolve for all defendants all of the issues that are pending in the class action complaint. If completed, the class action settlement would result in a payment of \$1.5 million to the settlement class, inclusive of fees and expenses. We anticipate that the total settlement amount and related expenses would be paid from insurance proceeds. The proposed settlement is not yet consummated, and is subject to a number of conditions. The proposed settlement is also subject to final approval by the Court at a hearing scheduled for May 15, 2015.

Derivative actions

On September 13, 2013 and October 14, 2013, two separate stockholders filed complaints in the District Court of Travis County, Texas, purporting to bring derivative actions on behalf of us against certain current and former officers and directors of the Company. The first derivative action is captioned Okumura v. Almgren, et. al. (Cause No. D-1-GN-13-003230), and the second derivative action is captioned Shaev v. Milner, et. al. (Cause No. D-1-GN-13-003557). The allegations of each derivative complaint mirror those of the class action complaint, and

they assert claims for breach of fiduciary duty, unjust enrichment, and/or abuse of control and seek damages on our behalf. These derivative actions were stayed by agreement pending resolution of the motion to dismiss the securities class action. The stay was lifted and on August 4, 2014, the parties filed a joint motion to consolidate the two derivative cases. On September 18, 2014, the District Court appointed lead counsel in the consolidated derivative action.

On September 23, 2014, we reached an agreement in principle and entered into a memorandum of understanding to settle the consolidated derivative actions. The parties to the consolidated derivative actions signed a definitive settlement agreement on January 30, 2015. The proposed settlement would resolve for all defendants all of the issues that are pending in the consolidated derivative actions. The proposed consolidated derivative settlement includes, among other things, certain governance improvements by us. We anticipate that the settlement fees and related expenses would be paid entirely from insurance proceeds. The proposed settlement is not yet consummated, and is subject to a number of conditions. The proposed settlement is also subject to approval by the Court following completion of a fairness hearing. The initial Court hearing is scheduled for March 10, 2015.

7. Employee Benefit Plan

We maintain a 401(k) Plan that covers substantially all full-time employees. Company contributions to the plan are determined at the discretion of the Board of Directors and vest ratably over five years of service starting after the first year of employment. We did not contribute to this plan in 2014, 2013, or 2012.

8. Geographic Information

Revenues for the year ended December 31 were as follows (in thousands):

	2014	2013	2012
Americas	\$31,495	\$50,365	\$48,190
Europe, Middle East and Africa	13,998	6,941	21,917
Asia	3,643	4,393	6,208
Total	<u>\$49,136</u>	<u>\$61,699</u>	<u>\$76,315</u>

Revenues from foreign countries above represented shipments to customers located in 38 countries during 2014. We often ship to areas that are outside of the jurisdiction in which revenue is recognized. Substantially all of our property, plant and equipment are located in the United States. Net assets of operations in foreign countries (excluding intercompany receivables and payables eliminated in consolidation) were \$2.8 million at December 31, 2014 and were mostly located in the UK, Germany, and China.

9. Guarantees

In certain geographical regions, particularly Europe, we are sometimes required to issue performance guarantees to our customers as a condition of sale. These guarantees usually provide financial protection to our customers in the event that we fail to fulfill our delivery or warranty obligations. We secure these guarantees with standby letters of credit through our bank. At December 31, 2014 we had a \$6,000 deposit guarantee for our building lease in the United Kingdom, which expires in April 2015 and a \$34,000 performance guarantee to a customer that was secured with a letter of credit, which expires in June 2017. At December 31, 2013, we had a \$0.5 million performance guarantee outstanding to a customer that was secured with a letter of credit. There is no foreseeable risk that we will not be able to meet the performance obligations. Our restricted cash, as shown on the balance sheet, is related to these guarantees.

10. Revolving Credit Facility

In August 2010, we entered into a Second Amended and Restated Loan and Security Agreement (the “Loan Agreement”) with Silicon Valley Bank (“SVB”) which increased the total line of credit available to \$12.5 million subject to certain borrowing bases. This facility expanded our ability to borrow funds from U.S. receivables to include qualifying receivables from our UK operations as well, increased our ability to use inventory as collateral, and also added an ability to borrow against purchase orders. These additional bases of borrowing were designed to allow us to use the credit facility to fund inventory purchases in the event we received large or multiple sales orders that would require a major investment in inventory and work in progress such as our MIS products, to help fund our business and to manage our working capital requirements.

This loan facility provides for a secured revolving line of credit in an aggregate amount of up to eighty percent (80%) of the facility amount of \$15.625 million, or \$12.5 million, subject to certain borrowing bases. In the event

we have maintained unrestricted cash and cash equivalents of at least \$6.25 million with SVB for at least 30 consecutive days, which is referred to as being in a “Streamline Period”, the borrowing base formula is based on eligible accounts receivable, eligible purchase orders and eligible inventory, subject to a sublimit of \$5.0 million for U.K. accounts receivable, \$3.5 million for inventory and \$1.5 million for purchase orders. When we are not in a Streamline Period, our borrowings are limited based on accounts receivable and purchase orders that SVB has specifically agreed to finance and a borrowing base for eligible inventory. We may also request that SVB issue letters of credit on our behalf, of up to \$1.5 million, as a portion of our total loan facility.

In August 2012, we entered into the Second Amendment to Second Amended and Restated Loan and Security Agreement with SVB (“Second Amendment”) which amends the Second Amended and Restated Loan and Security Agreement, dated as of August 5, 2010, by and between us and SVB. Pursuant to the Second Amendment, the maturity date of the loan facility was extended by two years, to August 5, 2014, unless earlier terminated by us, subject to any then applicable early termination fee. The Second Amendment further provides for, among other things, (i) adding a \$1.5 million sublimit under the borrowing base formula for 91-120 day aged accounts receivable, (ii) removing eligible purchase orders from the borrowing base formula, and (iii) removing sublimits providing for the issuance of letters of credit and cash management services. Additionally, pursuant to the Second Amendment, the definition of “Streamline Period” was amended such that the Company will be deemed to be in a Streamline Period in the event that it has a liquidity ratio of greater than or equal to 1.75:1.00 at all times for at least 60 consecutive days; provided that a Streamline Period will automatically be in effect if we achieve such liquidity ratio as a result of the sale of our equity securities.

Further, the Second Amendment provides for, among other things, (i) amending the finance charge on each eligible account financed by SVB to a per annum rate equal to SVB’s prime rate, subject to a minimum prime rate of four percent (4.00%), plus (a) one and one-quarter percent (1.25%) when we are in a Streamline Period or (b) one and three-quarters percent (1.75%) for eligible accounts (other than eligible 91-120 day aged accounts) and two percent (2.00%) for eligible 91 to 120 day aged accounts when we are not in a Streamline Period, and (ii) reducing the interest rate upon which each inventory advance accrues interest such that each advance based upon inventory accrues interest at a per annum rate equal to SVB’s prime rate, subject to a minimum prime rate of four percent (4.00%), plus (a) one and one-quarter percent (1.25%) when we are in a Streamline Period or (b) three and one half percent (3.50%) when we are not in a Streamline Period.

On July 28, 2014, we entered into a Third Amendment to Second Amended and Restated Loan and Security Agreement with SVB (“Third Amendment”). The amended three-year loan facility provides for a secured revolving line of credit in an aggregate amount of up to eighty percent (80%) of the facility amount of \$18.8 million, or \$15.0 million, and increases our inventory and purchase order availability from \$3.5 million to \$7.0 million subject to certain borrowing bases. Purchase orders and eligible inventory are subject to a sublimit of \$4.0 million and accounts receivable for UK and Germany have a \$5.0 million sublimit. If we maintain our Liquidity Ratio of 2.50:1.00 for the immediately preceding reconciliation periods the sublimit will be uncapped. We are currently in compliance with all loan covenants under the Loan Agreement. Further, the Third Amendment extends the maturity date to August 5, 2017 and reduces the finance charge to a per annum rate equal to Silicon Valley Bank’s prime rate, subject to a minimum prime rate of 4.00%, plus (a) 0.50% for eligible accounts, inventory and purchase orders when we are Borrowing Base Eligible (as defined in the Loan Agreement), or (b) 1.20% for eligible accounts when we are not Borrowing Base Eligible.

The revolving loans made to us under this loan facility are secured by a lien on substantially all of our assets, including the assets of Active Power Solutions Limited, our wholly-owned United Kingdom subsidiary, and the assets of Active Power (Germany) GmbH, our indirect wholly-owned German subsidiary. The only direct or indirect subsidiaries of Active Power, Inc. that are not guarantors under the Loan Agreement are Active Power China (Beijing) Co. Ltd. and immaterial subsidiaries that are not operating companies. There are no restrictions on the ability of any of the subsidiary guarantors to transfer funds to Active Power, Inc. in the form of loans, advances or dividends, except as provided by applicable law.

The Loan Agreement includes customary affirmative covenants for a credit facility of this size and type, including delivery of financial statements, compliance with laws, maintenance of insurance, and protection of intellectual property rights. Further, the Loan Agreement contains customary negative covenants for a credit facility of this size and type, including covenants that limit or restrict our ability, among other things, to dispose of assets, change our business, change our CEO or CFO without replacing such person within 120 days, have a change in control, make acquisitions, be acquired, incur indebtedness, grant liens, make investments, make distributions, repurchase stock, and enter into certain transactions with affiliates.

The Loan Agreement contains customary events of default that include, among other things, non-payment defaults, covenant defaults, material adverse change defaults, insolvency defaults, material judgment defaults and inaccuracy of representations and warranty defaults. The occurrence of an event of default could result in the acceleration of obligations under the Loan Agreement, in which case we must repay all loans and related charges, fees and amounts then due and payable, and our subsidiary may be required to pay any such amounts under the Guarantee and Debenture. At the election of SVB, upon the occurrence and during the continuance of an event of default, finance charges or interest rates, as applicable, will increase an additional five percentage points (5.00%) per annum above the rate that is otherwise applicable thereto upon the occurrence of such event of default, and the collateral handling fees will increase by one-half percent (0.50%).

During 2012, we borrowed amounts under this credit facility based on our short term liquidity requirements. As of December 31, 2014, we had outstanding borrowings of \$5.5 million under this loan facility. Based on the borrowing base formula subsequent to the amendment, the additional amount available for use at December 31, 2014 was approximately \$4.6 million.

11. Selected Quarterly Consolidated Financial Data (unaudited)

The following tables present selected unaudited consolidated statement of operations information for each of the quarters in the years ended December 31, 2014 and 2013 (in thousands, except per share data):

Year Ended December 31, 2014	For the Quarter Ended			
	December 31	September 30	June 30	March 31
Selected consolidated statement of operations information:				
Total revenue	\$15,352	\$12,692	\$10,154	\$10,938
Total cost of goods sold	\$11,303	\$ 8,932	\$ 8,239	\$ 8,010
Gross profit	\$ 4,049	\$ 3,760	\$ 1,915	\$ 2,928
Operating expenses	\$ 6,015	\$ 5,862	\$ 6,221	\$ 6,574
Operating loss	\$ (1,966)	\$ (2,102)	\$ (4,306)	\$ (3,646)
Net loss	\$ (2,044)	\$ (2,496)	\$ (4,413)	\$ (3,874)
Basic and diluted net loss per share	\$ (0.09)	\$ (0.11)	\$ (0.19)	\$ (0.19)

Selected consolidated balance sheet information:

Current assets	\$33,731	\$34,711	\$36,427	\$42,070
Total assets	\$36,098	\$37,341	\$39,350	\$45,164
Current liabilities	\$16,484	\$15,720	\$15,529	\$17,069
Working capital	\$17,247	\$18,991	\$20,898	\$25,001
Long term obligations	\$ 821	\$ 852	\$ 697	\$ 746
Stockholders' equity	\$18,793	\$20,769	\$23,124	\$27,349

Year Ended December 31, 2013	For the Quarter Ended			
	December 31	September 30	June 30	March 31
Selected consolidated statement of operations information:				
Total revenue	\$13,926	\$13,154	\$20,195	\$14,424
Total cost of goods sold	\$ 9,750	\$ 9,210	\$13,273	\$10,070
Gross profit	\$ 4,176	\$ 3,944	\$ 6,922	\$ 4,354
Operating expenses	\$ 7,990	\$ 6,909	\$ 6,412	\$ 5,702
Operating profit (loss)	\$ (3,814)	\$ (2,965)	\$ 510	\$ (1,348)
Net income (loss)	\$ (4,127)	\$ (3,135)	\$ 332	\$ (1,421)
Basic and diluted new income (loss) per share	\$ (0.21)	\$ (0.16)	\$ 0.02	\$ (0.07)

Selected consolidated balance sheet information:

Current assets	\$34,556	\$39,110	\$45,722	\$42,019
Total assets	\$37,907	\$42,263	\$49,052	\$44,748
Current liabilities	\$16,860	\$18,194	\$22,758	\$19,208
Working capital	\$17,696	\$20,916	\$22,964	\$22,811
Long term obligations	\$ 741	\$ 737	\$ 689	\$ 774
Stockholders' equity	\$20,306	\$23,332	\$25,605	\$24,766

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934

Filed by the Registrant ☒

Filed by a Party other than the Registrant ☐

Check the appropriate box:

☐ Preliminary Proxy Statement

☐ Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

☒ Definitive Proxy Statement

☐ Definitive Additional Materials

☐ Soliciting Material Pursuant to §240.14a-2

ACTIVE POWER, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

☒ No fee required.

☐ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

☐ Fee paid previously with preliminary proxy materials.

☐ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement no.:

(3) Filing Party:

(4) Date Filed:



**ACTIVE POWER, INC.
NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD ON APRIL 24, 2015**

TO THE STOCKHOLDERS OF ACTIVE POWER, INC.:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders ("Annual Meeting") of Active Power, Inc., a Delaware corporation, will be held on Friday, April 24, 2015, at 8:00 a.m. Central Time, at our principal executive offices, located at 2128 W. Braker Lane, BK 12, Austin, Texas 78758, for the following purposes, as more fully described in the proxy statement accompanying this notice:

1. To elect three Class III Directors to serve until our 2018 Annual Meeting of Stockholders, and one Class II Director to serve until our 2017 Annual Meeting of Stockholders, or until their successors are duly elected and qualified.
2. To hold a non-binding advisory vote to approve our executive compensation.
3. To ratify the appointment of Grant Thornton LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2015.
4. To approve the amendment and restatement of our 2010 Equity Incentive Plan and the material terms of the performance goals thereunder.
5. To amend our Restated Certificate of Incorporation, as amended ("Certificate of Incorporation"), to declassify our Board of Directors and provide for the annual election of directors beginning with our 2016 Annual Meeting of Stockholders.
6. To transact such other business as may properly come before the meeting or any postponements or adjournments thereof.

Only stockholders of record at the close of business on March 2, 2015 are entitled to notice of and to vote at the Annual Meeting. A list of stockholders entitled to vote at the Annual Meeting will be available for inspection at our principal executive offices.

All stockholders are cordially invited to attend the meeting in person. Whether or not you plan to attend, please sign and return the proxy in the envelope enclosed for your convenience, or vote your shares by telephone or by the Internet as promptly as possible. Telephone and Internet voting instructions can be found on the attached proxy. Should you receive more than one proxy because your shares are registered in different names and addresses, each proxy should be signed and returned to assure that all your shares will be voted. You may revoke your proxy at any time prior to the Annual Meeting. If you attend the Annual Meeting and vote, your proxy will be revoked automatically and only your vote at the Annual Meeting will be counted.

Sincerely,

/s/ James A. Powers

James A. Powers
*Chief Financial Officer and
Vice President of Finance*

Austin, Texas
March 19, 2015

YOUR VOTE IS VERY IMPORTANT, REGARDLESS OF THE NUMBER OF SHARES YOU OWN. PLEASE READ THE ATTACHED PROXY STATEMENT CAREFULLY, AND VOTE YOUR SHARES BY TELEPHONE, BY THE INTERNET OR BY COMPLETING, SIGNING AND DATING THE ENCLOSED PROXY CARD AS PROMPTLY AS POSSIBLE AND RETURNING IT IN THE ENCLOSED ENVELOPE.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON APRIL 24, 2015

Our financial and other information is contained in our Annual Report to Stockholders for the fiscal year ended December 31, 2014. Pursuant to rules promulgated by the U.S. Securities and Exchange Commission, we have elected to provide access to our proxy materials both by sending you this full set of proxy materials, including a proxy card, and by notifying you of the availability of our proxy materials on the Internet. This proxy statement and our 2015 Annual Report to Stockholders, including our Form 10-K for the year ended December 31, 2014, are available on our website at www.activepower.com.

ACTIVE POWER, INC.
2128 W. Braker Lane, BK 12
Austin, Texas 78758

PROXY STATEMENT
FOR THE ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD ON APRIL 24, 2015

General

The enclosed proxy is solicited on behalf of the Board of Directors of Active Power, Inc., a Delaware corporation, for use at the Annual Meeting of Stockholders to be held on April 24, 2015 ("Annual Meeting"). The Annual Meeting will be held at 8:00 a.m. Central Time at our principal executive offices, located at 2128 W. Braker Lane, BK 12 Austin, Texas 78758. These proxy solicitation materials were mailed on or about March 19, 2015, to all stockholders entitled to vote at our Annual Meeting.

Voting

The specific proposals to be considered and acted upon at our Annual Meeting are summarized in the accompanying notice and are described in more detail in this proxy statement. On March 2, 2015, the record date for determination of stockholders entitled to notice of, and to vote at, the Annual Meeting, there were 23,159,954 shares of our common stock outstanding and no shares of our preferred stock were outstanding.

Each stockholder is entitled to one vote for each share of common stock held by such stockholder on March 2, 2015. The presence, in person or by proxy, of the holders of a majority of our shares entitled to vote is necessary to constitute a quorum at this Annual Meeting. Shares that are voted "FOR," "AGAINST," "WITHHELD" or "ABSTAIN" are treated as being present at the meeting for purposes of establishing a quorum. Shares that are voted "FOR," "AGAINST" and "WITHHELD" are also treated as votes cast ("Votes Cast") with respect to a matter. Abstentions generally will not be counted for purposes of determining the number of Votes Cast with respect to a particular proposal, except with respect to the amendment of our certificate of incorporation, where abstentions will have the same effect as a vote "AGAINST" the proposal. Broker non-votes will be counted for purposes of determining the presence or absence of a quorum for the transaction of business, but such non-votes will not be counted for purposes of determining the number of Votes Cast with respect to the particular proposal on which a broker has expressly not voted. Generally, broker non-votes occur on a matter when a broker is not permitted to vote on that matter without instructions from the beneficial owner and instructions are not given. At this Annual Meeting, brokers will only be permitted to vote on the ratification of the appointment of Grant Thornton LLP without the written instruction of the beneficial owner.

The vote of a plurality of the shares of our common stock present in person or represented by proxy at the Annual Meeting and entitled to vote in the election of directors is necessary for the election of a director. Thus, the nominees receiving the greatest number of votes at the Annual Meeting will be elected to our Board of Directors ("Board"), even if the nominee receives votes from less than a majority of the Votes Cast. Stockholders may not cumulate votes in the election of directors. The proposals regarding the non-binding advisory vote on executive compensation, the ratification of the appointment of Grant Thornton LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2015, and the amendment and restatement of our Amended and Restated 2010 Equity Incentive Plan each require the affirmative vote of a majority of the Votes Cast on the proposal at the Annual Meeting. Proposal Five regarding the amendment to our certificate of incorporation to declassify our Board of Directors requires the affirmative vote of the holders of at least two-thirds of the shares of common stock issued and outstanding on the record date.

All votes will be tabulated by the inspector of election appointed for the Annual Meeting, who will separately tabulate affirmative and negative votes, abstentions and broker non-votes.

Proxies

If the enclosed form of proxy is properly signed and returned or if you properly follow the instructions for telephone or Internet voting, the shares represented thereby will be voted at the Annual Meeting in accordance with the instructions specified thereon. If you sign and return your proxy without specifying how the shares represented thereby are to be voted, the proxy will be voted FOR the election of the directors proposed by our Board, FOR the

approval of Proposal Two, FOR the approval of Proposal Three, FOR the approval of Proposal Four, and FOR the approval of Proposal Five, each as described in this Notice of Annual Meeting and proxy statement. You may revoke or change your proxy at any time before the Annual Meeting by filing with our Corporate Secretary at our principal executive offices at 2128 W. Braker Lane, Austin, Texas 78758, BK 12, a notice of revocation or another signed proxy with a later date. You may also revoke your proxy by attending the Annual Meeting and voting in person.

Solicitation

We will bear the entire cost of solicitation, including the preparation, assembly, printing and mailing of this proxy statement, the proxy and any additional solicitation materials furnished to our stockholders. Copies of solicitation materials will be furnished to brokerage houses, fiduciaries and custodians holding shares in their names that are beneficially owned by others so that they may forward this solicitation material to such beneficial owners. In addition, we may reimburse such persons for their costs in forwarding the solicitation materials to such beneficial owners. The original solicitation of proxies by mail may be supplemented by a solicitation by telephone, email or other means by our directors, officers or employees. No additional compensation will be paid to these individuals for any such services. We have also retained Alliance Advisors to assist in soliciting proxies for a fee of approximately \$10,000, plus costs and expenses.

If you have additional questions, need assistance in submitting your proxy or voting your shares of our common stock, or need additional copies of the proxy statement or the enclosed proxy card, please contact Alliance Advisors LLC.

Alliance Advisors LLC
200 Broadacres Drive, 3rd Floor, Bloomfield, NJ 07003
855-928-4492

Householding of Annual Meeting Materials

Some brokers and other nominee record holders may be participating in the practice of “householding” proxy statements and annual reports. This means that only one copy of the proxy statement and annual report may have been sent to multiple stockholders in a stockholder’s household. We will promptly deliver a separate copy of either document to any stockholder who contacts our investor relations department at (512) 836-6464 or by mail addressed to Investor Relations, c/o Active Power, Inc., 2128 W. Braker Lane, BK 12, Austin, TX 78758, requesting such copies. If a stockholder is receiving multiple copies of the proxy statement and annual report at the stockholder’s household and would like to receive a single copy of the proxy statement and annual report for a stockholder’s household in the future, stockholders should contact their broker, other nominee record holder, or our investor relations department to request mailing of a single copy of the proxy statement and annual report.

Deadline for Receipt of Stockholder Proposals

Any qualified stockholder proposals (including proposals made pursuant to Rule 14a-8 under the Securities Exchange Act of 1934 (“Exchange Act”) and any notice on Schedule 14N) to be presented at our 2016 Annual Meeting of Stockholders and in our proxy statement and form of proxy relating to that meeting must be received by us at our principal executive offices located at 2128 West Braker Lane, BK 12, Austin, TX 78758, addressed to our Corporate Secretary. In accordance with Regulation 14A and our Amended and Restated Bylaws (“Bylaws”), such proposals must be received by the Company not later than November 20, 2015, the date which is 120 days prior to March 19, 2016. With respect to any stockholder proposal not submitted pursuant to Rule 14a-8 and unless notice is received by us in the manner specified in the previous sentence, the proxy holders shall have discretionary authority to vote on any such proposal presented at our 2016 Annual Meeting of Stockholders. All proposals must comply with applicable Delaware law, the rules and regulations promulgated by the Securities and Exchange Commission and the procedures set forth in our Bylaws.

MATTERS TO BE CONSIDERED AT ANNUAL MEETING
PROPOSAL ONE: ELECTION OF DIRECTORS

Composition of the Board

Our Board currently consists of seven directors. The Board, in accordance with our Certificate of Incorporation, is currently divided into three classes, with Class I having two directors, Class II having one director and Class III having four directors. The terms of each class expire at successive annual meetings so that stockholders elect one class of directors at each annual meeting. The current composition of the Board is:

Class I Directors (<i>serving until the 2016 Annual Meeting</i>)	Stephen J. Clearman T. Patrick Kelly
Class II Director (<i>serving until the 2017 Annual Meeting</i>)	Mark A. Ascolese
Class III Directors (<i>terms expiring at this Annual Meeting</i>)	Ake Almgren James E. J. deVenny III Robert S. Greenberg Peter Gross

The election of three Class III Directors and one additional Class II Director will be considered at the Annual Meeting. At its meeting on February 13, 2015, the Board approved the recommendation of the Nominating and Corporate Governance Committee that:

- the Board be expanded to seven directors, and
- that Mr. Peter Gross be appointed as a Class III Director to fill the vacancy created as a result of the expansion of the Board to seven directors, and
- that Mr. James E. J. deVenny III, Mr. Robert S. Greenberg and Mr. Peter Gross each be nominated for election as Class III Directors for a three-year term, and
- that Mr. Ake Almgren be nominated for election as a Class II Director for a two-year term.

Mr. Peter Gross was recommended to the Nominating and Corporate Governance Committee by our Chief Executive Officer. The election of Mr. Almgren as a Class II Director will more evenly balance the three classes of directors so that each class will consist of either two or three directors. If elected at the Annual Meeting, the Class III Director nominees will serve until our 2018 Annual Meeting and the Class II Director nominee will serve until our 2017 Annual Meeting, or until their successors are duly elected and qualified in accordance with our Bylaws. However, if Proposal Five is approved at this Annual Meeting, the Board will no longer be divided into three classes and all of our directors will serve one-year terms expiring at the 2016 Annual Meeting, or until their successors are duly elected and qualified.

If a nominee should become unable to accept election, the persons named on the proxy card as proxies may vote for or other person selected by the Board or the named proxies. Management has no reason to believe that any nominee for election named below will be unable to serve. Unless otherwise instructed, the proxy holders will vote the proxies received by them FOR the nominees named below.

The vote of a plurality of the shares of common stock present in person or represented by proxy at the Annual Meeting and entitled to vote in the election of directors is necessary for the election of a director. The nominees receiving the greatest number of votes will be elected to our Board, even if the nominee receives votes from less than a majority of the Votes Cast. Stockholders may not cumulate votes in the election of directors. Broker non-votes will not be counted and will have no effect.

THE BOARD UNANIMOUSLY RECOMMENDS A VOTE “FOR” THE FOUR DIRECTOR NOMINEES LISTED BELOW.
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Nominees for Election as Class III Directors with Terms Expiring at the 2018 Annual Meeting of Stockholders

<u>Name</u>	<u>Age</u>	<u>Current Position</u>	<u>Proposed Class of Director</u>
James E. J. deVenny III	67	Director	Class III
Robert S. Greenberg	61	Director	Class III
Peter Gross	64	Director	Class III

Nominee for Election as a Class II Director with a Term Expiring at the 2017 Annual Meeting of Stockholders

<u>Name</u>	<u>Age</u>	<u>Current Position</u>	<u>Proposed Class of Director</u>
Ake Almgren	68	Chairman of the Board and Director	Class II

Dr. Ake Almgren, 68, has served as a board member since March 2004 and as Chairman since December 2012. From March 2009 through September 2011, Dr. Almgren served as Chief Executive Officer and President of International Battery, a manufacturer of lithium ion cells and batteries. Since May 2003, Dr. Almgren has also served as President of his independent consulting company, ORKAS, Inc. The firm provides technology assessments and helps develop commercialization strategies for organizations primarily in the electric energy sector. Dr. Almgren also serves on the board of managers of PJM Interconnection, LLC, a regional transmission organization responsible for moving electricity over large interstate areas in the eastern U.S.

We believe Dr. Almgren’s qualifications to serve on our board include his extensive background in executive management and leadership of companies in the power quality, alternative, and clean technology sectors and his extensive connections throughout the power quality industry. His current and prior CEO experience has qualified him to understand all aspects of managing and building a technology-based business. His direct experience in financing the growth of these businesses and overseeing their overall financial management further qualifies him to serve as a member of our Audit Committee.

James E. J. deVenny III, 67, has served as a board member since March 2008. Mr. deVenny is currently an independent consultant through his business, JD Investments. From 1999 through March 2008, Mr. deVenny served as co-founder, President, and Chief Executive Officer of Dataside, LLC, a Texas-based provider of enterprise data center space and managed network services. Prior to founding Dataside, Mr. deVenny co-founded Computex Support Systems, where he was employed for 15 years and was involved in the design and development of mission critical data centers and telecommunications sites. Prior to this, he spent five years as Vice President of Sales and Marketing for International Power Machines, a manufacturer of uninterruptible power supply (UPS) systems. Mr. deVenny has served on the board of directors at Lumenate, a private technology consulting services company, since 2003, and at Nimbix, a private high performance computing infrastructure company, since 2013.

We believe Mr. deVenny’s qualifications to serve on our board include his extensive experience in the UPS industry, where he held senior sales and marketing positions for a rapidly growing UPS company. He also has relevant industry experience through the founding and operating of hosted data center businesses, which are a primary target market for Active Power. Mr. deVenny’s depth of industry knowledge and contacts uniquely positions him to provide valuable insights to our board and management with respect to strategic and operational matters and markets for the company’s products. Mr. deVenny also brings general financial and personnel management acumen to the board, which he gained from owning and operating his own businesses. We believe this skill set further qualifies him to serve as a member of our Audit Committee and Nominating and Corporate Governance Committee.

Robert S. Greenberg, 61, has served as a board member since March 2009. Since September 2013, Mr. Greenberg has served as the President of RSG Technology Services, LLC, a provider of IT services to private

equity firms (due diligence, operations improvement, IT strategy, and interim CIO services). From January 2009 through August 2013, Mr. Greenberg was the Chief Information Officer and Vice President for AGCO Corporation, a global manufacturer and distributor of agricultural equipment. Prior to joining AGCO Corporation, Mr. Greenberg was Vice President and Chief Information Officer at Nissan Americas, the U.S. subsidiary of Nissan Motor Corp., a global automotive manufacturer. Mr. Greenberg also served in executive and Chief Information Officer capacities for more than 20 years with a number of multinational companies including Avaya, Inc., a global enterprise communications provider; Dell Inc.; and Exxon Mobil, including time spent in the Asia Pacific region.

We believe Mr. Greenberg's qualifications to serve as a board member include his extensive international and multinational management experience as a Chief Information Officer for a number of global companies. This experience allows him to provide the board with unique insights of the CIO community, a key customer segment for our business and important strategic and operational guidance with respect to information technology matters. As a key executive managing business operations and staffing levels significantly greater than Active Power, Mr. Greenberg is able to provide valuable perspective on human resource related matters, which further qualifies him to serve on our Compensation Committee and our Nominating and Corporate Governance Committee.

Peter Gross, 64, was appointed to our Board of Directors in February, 2015. Mr. Gross has more than 30 years' experience in the engineering and design of power systems for applications in data centers, trading floors, command and control centers, and telecommunication and broadcasting facilities. He has led the Mission Critical Systems group at Bloom Energy Corporation, a leading manufacturer of solid-oxide fuel cells, since March 2012. Prior to joining Bloom Energy, from January 2008 through February 2012, Mr. Gross was the Managing Partner for HP's Carbon, Power and Critical Facilities Services where he was responsible for strategic technology planning and business development. Prior to that, he was the co-founder and CEO of EYP Mission Critical Facilities, Inc., a consulting and engineering firm dedicated to the design and operations of data centers until its acquisition by HP in January 2008. Mr. Gross has served on the board of directors at Asetek A/S, a leading provider of liquid cooling systems for data centers, servers, workstations, gaming, and high performance PCs that is listed on the Oslo Stock Exchange, since July 2014.

We believe that Mr. Gross's qualifications to serve as a board member include his extensive background in executive management and leadership of companies engaged in the engineering and design of power systems and his extensive contacts throughout the power and mission critical industry. His prior CEO and other leadership experience has qualified him to understand all aspects of managing and building a technology-based business. Mr. Gross also brings general financial and personnel management acumen to the board.

Continuing Class I Directors with Terms Expiring at the 2016 Annual Meeting of Stockholders

Stephen J. Clearman, 64, was appointed to our Board of Directors in June 2012. Mr. Clearman currently serves as managing partner and co-founder of Kinderhook Partners, LLC, an investment advisory firm. Prior to co-founding Kinderhook Partners in 2003, Mr. Clearman co-founded Geocapital Partners, a leading venture capital firm that managed more than \$500 million in a series of partnerships in North America and Europe. Prior to his work at Geocapital Partners, Mr. Clearman spent four years at Adler and Company which was responsible for the origination and management of numerous venture capital investments. In addition, Mr. Clearman has been a director of a number of public and privately held companies.

In March 2012, Active Power entered into a Securities Purchase Agreement pursuant to which Kinderhook Partners purchased 1,764,705 shares of common stock for an aggregate purchase price of approximately \$6.0 million. In connection with such transaction, Active Power entered into a Side Letter Agreement with Kinderhook Partners pursuant to which Mr. Clearman was appointed to the Board of Directors. Active Power is obligated to use its reasonable best efforts to include Mr. Clearman in the proxy statement as a nominee for election to the Board of Directors in any year in which such inclusion is required by Active Power's governing documents or applicable law.

We believe Mr. Clearman's qualifications to serve on our board include previous general and financial management experience with rapidly growing and publicly traded technology companies. We also believe this skill set qualifies him to serve on our Nominating and Corporate Governance Committee and Compensation Committee.

T. Patrick Kelly, 57, was appointed to our Board of Directors in January 2013. Since July 2014, Mr. Kelly has served as CFO for Vast.com, a venture-backed internet services company based in Austin, Texas. Prior to joining Vast.com, Mr. Kelly was interim CFO for Panera Bread, leading all finance and accounting teams for the bakery-café company, from April 2012 through March 2013. Prior to joining Panera, Mr. Kelly was interim CFO for Hawker

Beechcraft Corp., a Wichita, Kansas based aerospace manufacturing company from February through August 2011. From January 2010 through April 2010, Mr. Kelly served as interim CEO at ExpressJet Holdings, Inc., a regional airline in Houston, Texas. He also served on the board of directors at ExpressJet Holdings, Inc. from September 2007 through November 2010. Prior to that Mr. Kelly has also held a number of senior financial positions at Vignette Corp., which was acquired by Open Text Corp.; Dell Inc.; Trilogy Enterprises; Sabre Holdings; and American Airlines.

We believe Mr. Kelly's qualifications to serve on our board include his extensive experience as a finance professional including seven years as a CFO of publicly owned companies and three years as a director of a public company. We believe these qualifications and experience also qualify him to serve on our Audit Committee and Compensation Committee.

Continuing Class II Director with a Term Expiring at the 2017 Annual Meeting of Stockholders

Mark A. Ascolese, 64, became President and Chief Executive Officer of Active Power on October 14, 2013. Ascolese has more than 40 years of experience serving a variety of mission critical and energy markets, including data centers. Prior to joining Active Power, Ascolese first served as CEO and then as Executive Board Chairman of Power Analytics Corporation (now part of Causam Energy, Inc.), an electrical infrastructure enterprise software firm focused on the mission critical and smart grid markets. Ascolese was appointed CEO of Power Analytics in March 2008 where he recruited the organization's management team and created and implemented a successful strategic plan, transitioning the firm from a family owned company to a professionally managed business. In August 2012, Ascolese was appointed Executive Board Chairman at Power Analytics and served in this role prior to joining Active Power in October 2013. Previously, he served as President at Powerware Corporation (now part of Eaton Corporation) and in senior management positions at General Electric Company. From 2000 through 2002, Ascolese served as Senior Vice President of Business Development at Active Power during the company's initial public offering.

As the only management representative to our board, Mr. Ascolese provides an insider's perspective to our board discussions about our business and strategic direction. In addition, he has had extensive senior management and executive experience within the global power supply industry having spent more than 20 years with Powerware Corporation, a global UPS manufacturer.

CORPORATE GOVERNANCE

Conflicts of Interest

On an annual basis, each director, director nominee and executive officer is obligated to complete a Directors and Officers Questionnaire which requires disclosure of any transactions with Active Power in which the director or executive officer, or any member of his or her immediate family, has a direct or indirect material interest. Pursuant to the Code of Business Conduct and Ethics, the Board is charged with resolving any conflicts of interest involving the Chief Executive Officer, the Chief Financial Officer or any other executive officer of Active Power.

Director Independence

In accordance with the NASDAQ listing requirements, the Board has determined the independence of each director and nominee for election as director in accordance with the guidelines it has adopted. Based on those standards, the Board determined that each of Messrs. Almgren, Clearman, deVenny, Greenberg, Gross, and Kelly, our non-employee directors, is an "independent director" as defined in Rule 5605(a)(2) of the NASDAQ Marketplace Rules, and has no relationship with Active Power except as a director and stockholder, unless otherwise stated under "Certain Transactions" or in the Compensation Discussion and Analysis section of this proxy statement.

Board Leadership Structure and Board's Role in Risk Oversight

We separate the roles of Chief Executive Officer and Chairman of the Board in recognition of the differences between the two roles. The Chief Executive Officer is primarily responsible for developing and executing against the strategic plan adopted by the Board, and for our day-to-day leadership and performance, while the Chairman of the Board provides guidance to the Chief Executive Officer and sets the agenda for Board meetings and presides over meetings of the full Board. Our independent directors meet regularly without the presence of management. The independent directors of our Board met four times during 2014. Our Board Chairman leads these meetings. These

meetings are held in conjunction with regularly scheduled meetings of our Board. Any of our directors may request a session comprised of only independent directors at any time. We believe that this separation represents the appropriate structure for us at this time because it allows our Chairman of the Board to coordinate general oversight and strategic planning for us while the Chief Executive Officer focuses on managing our business.

Our Board oversees risk management in a number of ways. The Audit Committee oversees the management of financial and accounting related risks as an integral part of its duties. Similarly, the Compensation Committee considers risk management when setting the compensation policies and programs for our executives and other employees. The Board receives reports on various risk-related items at its regular meetings including risks related to our manufacturing and sales operations, products, customer relationships and employees. The Board considers these reports and provides feedback to management regarding our risk exposure, the potential impact on us, and steps being taken to mitigate such risks.

Nominations for Directors

The Nominating and Corporate Governance Committee is responsible for screening potential director candidates and recommending qualified candidates to the Board for nomination. The Nominating and Corporate Governance Committee believes that candidates for director should have certain attributes, including leadership, independence, interpersonal skills, financial acumen, business experience, industry knowledge, integrity, competence and dedication. The Nominating and Corporate Governance Committee also considers issues of diversity, such as diversity of gender, race and national origin, education, professional experience and differences in viewpoints and skills. The Nominating and Corporate Governance Committee does not have a formal policy with respect to diversity; however, the Board and the Nominating and Corporate Governance Committee believe that it is important that the Board represent diverse viewpoints. The Nominating and Corporate Governance Committee considers recommendations of potential candidates from current directors, management and stockholders. Stockholders' nominations for directors must be made in writing and be addressed to the Chairman of the Nominating and Corporate Governance Committee in care of our Corporate Secretary at our headquarters address listed below, and must be received by the Company not later than November 25, 2015, to be considered for inclusion in the proxy statement for the next annual election of directors.

Chairman of the Nominating and Corporate Governance Committee
Active Power, Inc.
c/o Secretary
2128 West Braker Lane, BK 12
Austin, Texas 78758

Any such stockholder nomination notice should clearly indicate that it is a recommendation of a director candidate by a stockholder and must set forth (i) the name, age, business address and residential address of the recommended candidate; (ii) the principal occupation or employment of such recommended candidate; (iii) the class and number of shares of our stock that are beneficially owned by such recommended candidate; (iv) a description of all understandings or arrangements between the stockholder and the recommended candidate and any other person or persons pursuant to which the recommendations are to be made by the stockholder; and (v) any other information relating to such recommended candidate that is required to be disclosed in solicitations of proxies for the election of directors. In addition, such notice must contain (i) a representation that the stockholder is a holder of record of our common stock entitled to vote at such meeting; (ii) the name and address, as they appear on our books, of the stockholder proposing such nomination; (iii) the class and number of shares of our common stock that are beneficially owned by such stockholder; (iv) any material interest of the stockholder in such recommendation; and (v) any other information that is required to be provided by the stockholder pursuant to Regulation 14A under the Exchange Act, as amended, in such stockholder's capacity as proponent of a stockholder proposal. Assuming that a stockholder recommendation contains the information required above, the Nominating and Corporate Governance Committee will evaluate a candidate recommended by a stockholder by following substantially the same process, and applying substantially the same criteria, as for candidates identified through other sources.

Communications with the Board

Stockholders and other interested parties may communicate with one or more members of the Board or the non-management directors as a group in writing by regular mail or via email at the following addresses:

[Board of Directors] or [Name of Individual Director(s)]
Active Power, Inc.
c/o Secretary
2128 West Braker Lane, BK 12
Austin, Texas 78758

Email: investor.relations@activepower.com

You may address your message to any one or a combination of directors. Any stockholder communication must contain (i) a representation that the stockholder is a holder of record of our stock, (ii) the name and address, as they appear on our books, of the stockholder sending such communication, and (iii) the class and number of shares of Active Power that are beneficially owned by such stockholder.

The Board has instructed the Secretary to review all communications so received (via regular or electronic mail), and to exercise his discretion not to forward to the Board correspondence that is inappropriate, such as business solicitations, frivolous communications, advertising and personal grievances. However, any director may at any time request the Secretary to forward any and all communications received by the Secretary and not forwarded to the Board.

Code of Ethics

Our Code of Business Conduct and Ethics, which is our code of ethics applicable to all directors, officers, employees and consultants worldwide, embodies our global principles and practices relating to the ethical conduct of our business and our long-standing commitment to honesty, fair dealing and full compliance with all laws affecting our business. The Code of Business Conduct and Ethics is intended to comply with Item 406 of Regulation S-K of the Exchange Act and with NASDAQ listing requirements. Our Code of Business Conduct and Ethics is posted on our Internet website under the "Corporate Governance" link on our "Investor Relations" page. We intend to disclose future amendments to the provisions of our Code of Business Conduct and Ethics, or waivers of such provisions granted to executive officers, on our website within four business days following the date of such amendment or waiver.

The Board has established a means for employees, customers, suppliers, stockholders and other interested parties to submit confidential and anonymous reports of suspected or actual violations of our Code of Business Conduct and Ethics relating, among other things, to:

Accounting practices, internal accounting controls or auditing matters and procedures;
Theft or fraud of any amount;
Insider trading;
Performance and execution of contracts;
Conflicts of interest;
Violations of securities and antitrust laws; and
Violations of the Foreign Corrupt Practices Act.

Any stockholder, employee or interested party can call the following toll-free number to submit a report:

1-800-625-1731

The number is operational 24 hours a day, seven days a week.

MEETINGS AND COMMITTEES OF THE BOARD

Each director is expected to devote sufficient time, energy and attention to ensure diligent performance of his or her duties and to attend all Board, committee and stockholders' meetings. In 2014, the Board met eleven times. All directors attended at least 75% of the meetings of the Board or committees on which they served during the period in which they served on the Board or such committees during the year ended December 31, 2014.

Committees of the Board

The Board has three standing committees to facilitate and assist the Board in the execution of its responsibilities. The standing committees are the Audit Committee, the Compensation Committee, and the Nominating and Corporate Governance Committee. In accordance with the NASDAQ listing requirements, all of the standing committees are comprised solely of non-employee, independent directors. Charters for each of the standing committees are available on our website at www.activepower.com under the heading of "Investor Relations" and subheading of "Corporate Governance". The charter of each standing committee is also available in print to any stockholder who requests it. The table below shows current membership of each of the standing Board committees:

<u>Audit Committee</u>	<u>Compensation Committee</u>	<u>Nominating and Corporate Governance Committee</u>
T. Patrick Kelly*	Robert S. Greenberg*	Stephen Clearman*
Ake Almgren	Stephen Clearman	James E. J. deVenny III
James E. J. deVenny III	T. Patrick Kelly	Robert S. Greenberg

* Committee Chairman

Audit Committee

The Audit Committee is responsible for the selection, retention and oversight of our independent auditors. In addition, the Audit Committee reports to the Board with regard to:

- the scope of our annual audits and fees to be paid to auditors;
- our compliance with legal and regulatory requirements;
- the integrity of our financial statements and the compliance with our accounting and financial policies; and
- management's procedures and policies relative to the adequacy of our internal accounting controls.

The Audit Committee is further responsible for the pre-approval of all audit and non-audit services performed by our independent auditors. The members of the Audit Committee in 2014 were Messrs. Kelly, deVenny and Almgren. Mr. Kelly serves as the Chairman of the Audit Committee. The Audit Committee held six meetings during 2014. The Board has determined that all members of the Audit Committee are "independent" as that term is defined in Rule 5605(a)(2) of the NASDAQ Marketplace Rules. The Board has determined that Mr. Kelly is qualified as an "audit committee financial expert" under Item 407(d)(5) of Regulation S-K.

Compensation Committee

Pursuant to its charter, the Compensation Committee reviews and approves and makes recommendations to the Board regarding our compensation policies and forms of compensation to be provided to our executive officers. The Compensation Committee also approves grants of equity awards to new and existing employees and administers our equity incentive plan. The Compensation Committee reviews and approves bonus arrangements for our executive officers. The Compensation Committee also makes recommendations to the Board regarding the compensation of Board members. The Compensation Committee has the authority to retain independent compensation consultants, legal counsel and other advisers. See "Compensation Discussion and Analysis" for information about the Compensation Committee's 2014 compensation consultant. The members of the Compensation Committee during 2014 were Messrs. Greenberg, Clearman, Kelly and Lindelow (until May 28, 2014). Mr. Greenberg serves as the Chairman of the Compensation Committee. The Compensation Committee held eight meetings during 2014. The Board has determined that all members of the Compensation Committee are "independent" as that term is defined in Rule 5605(a)(2) of the NASDAQ Marketplace Rules.

Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee was established to assist our Board in fulfilling its responsibilities for identifying qualified individuals to become members of the Board; determining the composition

of the Board and its committees; monitoring the effectiveness of the Board and facilitating the measurement of the effectiveness of its committees; and developing, monitoring and evaluating sound corporate governance policies and procedures promoting honest and ethical conduct, including policies pertaining to the identification and treatment of conflicts of interest.

The members of the Nominating and Corporate Governance Committee for 2014 were Messrs. Clearman, Greenberg, and deVenny. Mr. Clearman serves as the Chairman of the Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee held three meetings during 2014. The Board has determined that each member of the Nominating and Corporate Governance Committee is an “independent director” as defined in Rule 5605(a)(2) of the NASDAQ Marketplace Rules.

Attendance at Annual Meetings

We encourage, but do not require, the members of our Board to attend our annual meeting of stockholders. Two of six directors attended our Annual Meeting of Stockholders held on May 28, 2014.

Compensation Committee Interlocks and Insider Participation

During fiscal 2014, all members of the Compensation Committee were independent directors, and none of them were past or present employees or officers of Active Power or any of our subsidiaries. No member of our Compensation Committee has any relationship with us requiring disclosure under Item 404 of Regulation S-K under the Exchange Act. None of our executive officers has served on a board or compensation committee (or other committee serving an equivalent function) of any other entity, one of whose executive officers serves on our Board or our Compensation Committee.

AUDIT COMMITTEE REPORT

The Audit Committee reports as follows with respect to our fiscal 2014 financial statements:

Management is responsible for Active Power’s internal controls and the financial reporting process. Our independent registered public accounting firm is responsible for performing an independent audit of Active Power’s financial statements and internal controls in accordance with U.S. generally accepted auditing standards and to issue a report thereon. The Audit Committee’s responsibility is to monitor and oversee these processes.

In this context, the Audit Committee has met and held discussions with management and the independent auditors. Management represented to the Audit Committee that Active Power’s financial statements were prepared in accordance with U.S. generally accepted accounting principles, and the Audit Committee has reviewed and discussed the financial statements with management and the independent auditors. The Audit Committee has also met and held discussions with management and the independent auditors regarding Active Power’s internal controls. Management provided the Audit Committee management’s assessment of our internal controls, and the Audit Committee has reviewed and discussed the internal controls with management and the independent auditors. The Audit Committee discussed with the independent auditors matters required to be discussed by Auditing Standard No. 16, “Communication with Audit Committees,” as adopted by the Public Company Accounting Oversight Board.

Active Power’s independent auditors also provided to the Audit Committee the written disclosures required by Rule 3526 (Independence Discussions with Audit Committees), and the Audit Committee discussed with the independent auditors that firm’s independence and considered the compatibility of non-audit services with the independent auditors’ independence.

Based upon the Audit Committee’s discussion with management and the independent auditors and the Audit Committee’s review of the representation of management and the reports of the independent auditors to the Audit Committee, the Audit Committee recommended that the Board include the audited financial statements and assessment of internal controls in Active Power’s Annual Report on Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission.

Submitted by the Audit Committee of the Board:

T. Patrick Kelly (Chair)

Ake Almgren

James E. J. deVenny III

COMPENSATION DISCUSSION AND ANALYSIS

Introduction

This Compensation Discussion and Analysis describes our executive compensation philosophy and programs, the compensation decisions the Compensation Committee of the Board of Directors (the “Committee”) has made under those programs, and the considerations in making those decisions. This Compensation Discussion and Analysis focuses on the compensation of our named executive officers (“NEOs”) for fiscal 2014, who were:

- Mark A. Ascolese, President and Chief Executive Officer
- James A. Powers, Chief Financial Officer and Vice President of Finance
- Randall J. Adleman, Vice President of Global Sales and Marketing
- Jason P. Rubin, former Vice President of Operations (until April 18, 2014).

Executive Summary

The cornerstone of our compensation philosophy continues to be pay for performance. We seek to align the compensation paid to our NEOs with our performance on both a short-term and long-term basis and set performance goals that do not promote excessive risk-taking and support our core financial goals.

Improving our results and positioning our business for future success requires that we attract, retain, and foster high caliber talent. We design our executive compensation program to provide a competitive compensation and benefits package that reflects job complexity and the strategic value of the position, while helping to ensure long-term retention and motivation.

The Committee is responsible for all compensation decisions for the CEO and, in consultation with the CEO, for the other NEOs. The highlights of our compensation program include:

- An incentive cash compensation plan that, in addition to a competitive base salary, provides payouts based upon achievement of goals that we believe are consistent with improving stockholder value without undue risk.
- Use of equity awards which encourage retention through time-based vesting to 100% vested over a four-year period which provides a balance between short and long-term decisions.
- Total compensation (at target) is generally designed to compensate our executives at the 50th to 75th percentile when compared to our peer group companies.
- Our change of control agreement with each of our NEOs is “double trigger,” meaning it provides severance or accelerated vesting benefits only upon termination of each such officer’s employment with us without cause or resignation of the executive for good reason within a certain time period following a change of control of Active Power.

The following compensation governance features underlie our compensation program:

- The Committee is composed solely of independent directors, and we have separated the office of the Chairman from the office of the CEO.
- Our compensation programs are designed to reward long-term value creation and avoid inappropriate risk taking by our executives. The Committee believes that the risks arising from our employee compensation program are reasonable, in the best interests of our stockholders, and not likely to have a material adverse effect upon us.
- The Committee retains an independent compensation consultant.
- We have an insider trading policy, applicable to all employees and non-employee directors, which outlines trading restrictions and includes black-out periods, anti-hedging guidelines, and other trading guidelines.

Advisory Vote on Executive Compensation

In May 2014, we held our annual stockholder advisory vote on the compensation of our NEOs, commonly referred to as a say-on-pay vote. Our stockholders overwhelmingly approved the compensation of our NEOs, with approximately 98.4% of stockholder votes cast in favor of our 2014 say-on-pay resolution. As we evaluated our

compensation practices and talent needs in 2014, we were mindful of the support our stockholders had previously expressed for our pay for performance compensation philosophy. As a result, following our annual review of our executive compensation philosophy, the Committee decided to retain our general approach to executive compensation.

Philosophy

All of our compensation programs are designed to satisfy the following objectives:

- To attract, motivate and retain key employees, including highly qualified executive officers;
- To make a substantial portion of their compensation dependent upon our attainment of measurable performance targets; and
- To structure a substantial portion of executive compensation so that it aligns with our stockholders' interests.

Our compensation programs are designed by the Committee in collaboration with management and input from an independent compensation consultant hired by the Committee. Our compensation program for executive officers utilizes cash compensation for short-term incentives and equity compensation for long-term incentives. Cash compensation is paid in the form of a base salary and an annual performance incentive bonus ("annual bonus"), and long-term incentive compensation has typically been paid in the form of stock options.

Our executive compensation philosophy reflects our belief that the compensation of our executives should reflect their success as a management team, rather than as individuals, in attaining key operating objectives such as bookings (i.e. order) growth and achievement of operating profitability, and ultimately, in attaining an increased market price for our stock. We believe that the performance of our NEOs in managing our business considered in light of general economic conditions and specific company, country, industry and competitive conditions, should be the basis for determining their overall compensation. We also believe that their compensation should not be based on the short-term performance of our stock, whether favorable or otherwise, but rather on factors that drive long-term value to our stockholders, as that will more accurately reflect the quality of our operating performance and, ultimately, the management of our business by our NEOs. We also evaluate overall compensation to ensure that we maintain our ability to attract and retain capable executives in key positions, and that the compensation provided to them remains competitive relative to the compensation paid to similarly situated executives of similar or peer companies.

Role of Compensation Committee in Compensation Decisions

The Committee makes all compensation decisions for the CEO and, in consultation with the CEO, for the other NEOs.

For 2014, the Committee directly retained the services of Radford, an Aon Hewitt Company ("Radford"), an outside human resources consulting organization to provide independent advice to the Committee with respect to matters including executive compensation, executive incentive and equity compensation trends and programs, non-employee director compensation, assistance with the design of an appropriate peer group for establishing compensation benchmarks and for equity compensation matters. We do not use Radford for any consulting services related to non-executive compensation matters, although we participate in annual salary surveys conducted by Radford which we use for benchmarking salary and benefits for all of our non-executive employees. Management's only role with respect to the use of Radford is to provide company-specific data to Radford to enable it to complete its engagement for the Committee. The decision to use Radford for consulting services is recommended and approved by the Committee, and not by management.

In 2014, as contemplated by adopted SEC and Nasdaq rules regarding compensation committee consultants, the Committee reviewed the independence of Radford under the independence criteria set forth in the new rules and the Committee charter. As a result of such review, the Committee determined that Radford was an independent advisor within the meaning of applicable SEC and Nasdaq rules and the charter of the Committee.

Setting Executive Compensation

Based on the above objectives, the Committee has structured our annual and long-term incentive-based cash and non-cash executive compensation to motivate executives to achieve our business goals, and to reward the executives for achieving such goals. In furtherance of this, Radford provides the Committee with relevant market data and alternatives and recommendations to consider when making compensation decisions for our executive officers.

Elements of compensation for our executive officers include: base salary, annual bonus, stock incentive awards and employee benefits. Base salaries for our NEOs are set when the executive is hired and adjustments are considered at the regularly scheduled meetings of the Committee in the first quarter of each year. At this meeting, the Committee also approves and adopts the management incentive plan for the new fiscal year, determines the level of achievement and actual awards from the previous year's management incentive plan, and typically grants stock-based awards to our NEOs.

At the beginning of each year, it has been the practice of the Committee to review the recent history of all of the elements of each NEO's total compensation, and compare the compensation of the NEOs with that of other executive officers in an appropriate market comparison group (discussed below), using comparative data supplied by Radford. The comparative data supplied by Radford pertains to base salary, annual bonus and equity awards and is derived from compensation data of other public companies in North America in related industries with similar revenue, market capitalization or expense levels to us. The purpose of this analysis is to determine whether the compensation of each NEO, both in its totality and with respect to each of the constituent components, is competitive with the applicable market comparables that the Committee has reviewed for the corresponding period. However, due to Messrs. Ascolese, Powers and Adleman having been hired near the end of 2013, a review of market comparables was done in connection with their hiring and was not performed during 2014.

For 2014, the market comparables were derived from the following peer group:

- Allied Motion Technologies
- American Electric Technologies
- American Superconductor
- Ballard Power Systems
- Capstone Turbine
- Energy Recovery
- EnerNOC
- Fuel Tech
- FuelCell Energy
- IEC Electronics
- Lime Energy
- Magnetek
- Maxwell Technologies
- PowerSecure International
- SL Industries
- Ultralife Corporation

We used this group of companies in 2014 as there is an absence of other directly comparable and similarly sized publicly traded companies in our industry in the U.S. with which we can benchmark ourselves, and because we believe this population is reflective of the market in which we compete for talent. With Radford's assistance, the Committee reevaluated the composition of our peer group for 2014 to ensure that it reflects changes that occurred during the year, such as changes in business strategy, operations, revenues, product lines or availability of information. For 2014, we added four new peers and removed four.

The Committee generally considers total compensation to be competitive for our NEOs if it is between the 50th and 75th percentiles for the applicable peer group. Where a specific component of compensation is not within this range, the Committee uses the competitive data as a factor for its compensation determination, but may also take into account factors specific to a NEO in making its final compensation decisions, including such officer's position and functional role, seniority, performance and overall level of responsibility.

The amount of each element of compensation is determined by or under the direction of the Committee, which uses the following factors to determine the amount of salary and other benefits to pay each executive:

- performance against corporate objectives for the previous year;
- difficulty of achieving desired results in the coming year;
- value of their unique skills and capabilities to support our long-term growth; and
- demonstrated success of their leadership capabilities.

Role of Executive Officers in Compensation Decisions

The Chief Executive Officer annually reviews the performance of all of our NEOs (other than the Chief Executive Officer, whose performance is reviewed by the Committee and discussed with the full Board). The conclusions reached and recommendations based on those reviews, which may include salary adjustments and annual bonus and equity award amounts, are presented to the Committee by the Chief Executive Officer. The Chief Executive Officer uses benchmark data from the Radford surveys that we participate in as he makes his recommendations to the Committee. Though the Committee is not obligated to follow the Chief Executive Officer's recommendations, the Committee gives them significant weight in making its decisions, as the Committee believes our Chief Executive Officer is in the best position to assess the performance of the other NEOs and identify key

criteria for the Committee to consider in making its final decisions relating to the compensation of the NEOs (other than the Chief Executive Officer). Neither our Chief Executive Officer nor any other executive votes on items before the Committee; however, the Committee and Board solicit the views of the Chief Executive Officer and work with other members of management and outside advisors to prepare meeting materials.

Base Salary

We use the base salary element of executive compensation to provide the foundation of a fair and competitive compensation opportunity for each NEO. We review base salaries annually and target salary compensation between the 50th and 75th percentile of base salary practices of our peer group, but maintain flexibility to deviate from market-median practices for individual circumstances, including the amount of time in the role, qualifications, experience levels, and responsibilities. The Committee also considers an internal review of the NEO's compensation relative to other NEOs and the individual performance of the executive in establishing the base salary. There were no increases in base salary for NEOs in 2014.

Annual Bonus

Management Incentive Program. The management incentive program is an annual bonus program that is designed to motivate and reward our NEOs for their contributions toward the achievement of shorter-term financial and operating goals that we believe drive our operating results and create long-term stockholder value. All of our NEOs except for Mr. Adleman (who participated in a separate incentive program described below) participated in this program.

The Committee, with recommendations provided by our Chief Executive Officer, establishes an annual target award which is typically expressed as a percentage of the executive's base salary. For 2014, this target award level was 100% of base salary for Mr. Ascolese, 60% of base salary for Mr. Powers and 50% of base salary for Mr. Rubin. The Committee makes the determination of the actual bonus earned by a NEO under this program and has discretion to choose to award a bonus or not, and to modify the actual award amount, in light of all relevant factors after completion of the fiscal year.

Under this program, 100% of each of the NEOs' target bonus award was based upon achievement of corporate financial and operating objectives. The corporate goals were established by the Committee at the beginning of 2014 and were tied to our annual operating plan as approved by the Board of Directors. The Committee determined that the corporate goals established for 2014 were attainable, though reasonably difficult to achieve. Since our actual 2014 results fell below the minimum threshold amounts, there were no bonus payouts under this program.

Adleman Incentive Program. This management incentive program is an annual bonus program that is designed to motivate and reward our NEO for his contributions towards the achievement of bookings (i.e. order) growth, a goal that we believe drives our operating results and creates long-term stockholder value. Mr. Adleman's annual incentive plan for 2014 was specified in his offer letter (see "Employment Arrangements with Executive Officers"), and was solely tied to achieving bookings. Mr. Adleman's bonus for 2014 had no minimum threshold and was determined at 0.18% of bookings up to target and at 0.25% of bookings in excess of target, up to a maximum of \$500,000. Since our actual bookings fell below target, Mr. Adleman's payout was determined at 0.18% of bookings. The Committee determined that his booking target established for 2014 was attainable, though reasonably difficult to achieve.

Summary of Annual Incentive Compensation. The Committee considered the input of the Chief Executive Officer before finalizing the bonus award payments. The performance related bonus results for each of our NEOs who participated in a plan for 2014 were as follows:

Named Executive Officer	Target Bonus Award	Actual Bonus Award	% of Target
Mark A. Ascolese, President and Chief Executive Officer	\$450,000	\$ —	0%
James A. Powers, Chief Financial Officer and Vice President of Finance. . . .	\$168,000	\$ —	0%
Jason P. Rubin, former Vice President of Operations (until April 18, 2014) . .	\$122,500	\$ —	0%
Randall J. Adleman, Vice President of Global Sales and Marketing	\$180,000	\$108,449	60%

Stock Option and Equity Incentive Programs

The Committee believes that the interests of our stockholders are best served when a significant proportion of an executive's compensation is comprised of equity-based or other long-term incentives that appreciate in value contingent upon increases in the price of our common stock. This is consistent with our philosophy that in the long term, our stock price will reflect our operating performance and that our management team's compensation should be in a large part driven by our long-term results. Therefore, it has been our practice to make annual grants of equity-based awards to our NEOs. The Committee uses benchmark equity data provided annually by Radford to assist in determining the value and level of annual equity awards to make and usually targets the 50% percentile of equity grants relative to our peer group. The ultimate amount and mix of equity awards vary among NEOs based on their positions within Active Power, their time in role, performance and other factors the Committee deems relevant.

Because Messrs. Ascolese, Powers and Adleman each received grants of stock options in connection with their hire near the end of 2013, the Committee did not award additional equity grants to these NEOs for 2014. Mr. Power's award was approved in 2014 in connection with his hiring in 2013. The grants of stock options to Mr. Powers and Mr. Rubin in 2014 are set forth in the table entitled "Fiscal 2014 Grants of Plan-based Awards" in the Proxy Statement.

Policy Regarding Tax Deductibility of Compensation

Within our performance-based compensation program, we aim to compensate our senior executive management team in a manner that is tax effective for us. However, the Committee may determine that it is appropriate to pay compensation which is not deductible from time-to-time.

Timing of Grants

Equity awards to our executive officers and other key employees are typically granted annually in conjunction with the review of their respective individual performance. This review takes place at regularly scheduled meetings of the Committee, which are typically held in conjunction with the meetings of our Board during the first quarter of each year. Equity awards are automatically granted to our non-employee directors on the date of our Annual Meeting of Stockholders, in accordance with the terms of our director compensation policy. Grants to newly hired executive officers are made in meetings of the Committee, with vesting typically commencing from the actual hire date. Grants to newly hired executive officers are typically made at the next regularly scheduled Committee meeting or at a special meeting on or following their hire date. The exercise price of all stock options is set at the closing price of our common stock on The NASDAQ Capital Market on the date of grant of the award, which is the date of approval of the award or the day that the stock trading black-out window under our insider trading policy opens if the Committee approved the award when the stock trading window was closed.

Stock Ownership Guidelines

We have a stock ownership policy that requires our non-executive directors to obtain a minimum level of stock ownership in Active Power within five years of their appointment to the Board. The stock ownership policy requires the following for our non-executive directors:

- With respect to all individuals who were non-executive directors on February 1, 2007 (the date of the initial adoption of our current equity ownership policy), by February 1, 2012 the directors should own stock with a value equal to three times the annual Board retainer.
- With respect to non-executive directors first appointed or elected to the Board after February 1, 2007, by the fifth-year anniversary of such date of initial appointment or election the director should own stock with a value equal to three times the annual Board retainer.
- The value of such stock is measured by the higher of the original purchase price paid or the current fair market value of the shares at the time of evaluation.

All of our non-executive directors were in compliance with this policy at December 31, 2014. There currently are no stock ownership guidelines for our NEOs.

Our insider trading policy prohibits all directors and NEOs of Active Power from making short sales of our stock, engaging in hedging transactions and other derivative securities involving our stock, using our securities as collateral for loans, and holding our securities in margin accounts.

Perquisites and Other Personal Benefits

The Committee does not believe that providing an executive perquisite is consistent with our pay-for-performance compensation philosophy. In this regard, it should be noted that we do not provide defined benefit pension arrangements, post-retirement health coverage, or similar benefits for our executives or employees.

We provide employee benefits including a 401(k) plan without any matching contributions at this time, and coverage under health and insurance plans, which are the same for all employees. We also offer life insurance for all employees that provides coverage up to an employee's salary or a maximum of \$200,000. For all other compensation, see the "Summary Compensation Table."

Employment Arrangements with Executive Officers

In connection with their initial employment, each NEO executed an offer letter and entered into a severance benefit agreement. The compensation levels for these officers were determined by the Committee after consideration of various factors including data provided by Radford, the compensation paid to the executive that formerly held the same or similar position with Active Power, the background and experience of such executive officer and our need to attract and retain such executives.

Mr. Ascolese's offer letter provides that he will be paid an annual base salary of \$450,000 and, beginning with fiscal year 2014, will be eligible to earn a bonus of up to 100% of his base salary at the target objective, subject to the terms and conditions of our executive bonus program. As contemplated by his offer letter, Mr. Ascolese was granted an option to purchase 340,000 shares of common stock, received a signing bonus of \$100,000, and relocation and temporary living expense assistance. The offer letter also provides for vacation and health benefits and further provides that Mr. Ascolese will, subject to requisite approval, serve on the Board for as long as he is employed as our Chief Executive Officer.

Mr. Adleman's offer letter provides that Mr. Adleman will be paid an annual base salary of \$250,000 and will be eligible to earn incentive compensation at a rate of 0.18% of all bookings up to a specified target and 0.25% of all bookings in excess of such target, up to a maximum amount of \$500,000. As contemplated by his offer letter, Mr. Adleman was granted an option to purchase 200,000 shares of common stock. The offer letter also provides for vacation and health benefits.

Mr. Powers' offer letter provides that he will be paid an annual base salary of \$280,000 and will be eligible to participate in our executive bonus program with an annual target of 60% of base salary. As contemplated by his offer letter, Mr. Powers was granted an option to purchase 175,000 shares of common stock, received a signing bonus of \$25,000 and relocation and temporary living expense assistance. The offer letter also provides for vacation and health benefits.

Please refer to the information under "Potential Payments Upon Termination or Change in Control" for information regarding other employment agreements in place with our NEOs. The Committee relies on recommendations made to it by Radford with respect to competitive compensation amounts provided to executive officers, the nature and type of contractual arrangements with executive officers, including severance agreements and change of control provisions, and which executive officers will be eligible for such benefits. Based on its review of the benchmark data provided by Radford, the Committee believed it was necessary for the retention of officers and to remain competitive in employment markets for us to enter into such agreements with our executive officers.

COMPENSATION COMMITTEE REPORT

The Committee has reviewed and discussed the Compensation Discussion and Analysis (the "CD&A") for the year ended December 31, 2014, with management. In reliance on the review and discussion referred to above, the Compensation Committee recommended to the Board, and the Board has approved, that the CD&A be included in the proxy statement for the year ended December 31, 2014, for filing with the Securities and Exchange Commission.

Submitted by the Compensation Committee of the Board:

Robert S. Greenberg (Chair)

Stephen Clearman

T. Patrick Kelly

SUMMARY COMPENSATION TABLE

The following table summarizes the compensation for the fiscal years ended December 31, 2014, 2013, and 2012.

<u>Name and Principal Position</u>	<u>Year</u>	<u>Salary</u>	<u>Stock Awards</u>	<u>Option Awards</u>	<u>Non-equity incentive plan compensation</u>	<u>All other Compensation</u>	<u>Total Compensation</u>
		[1]	[2]	[3]	[4]	[5]	
Mark A. Ascolese, President . .	2014	\$450,000	\$ —	\$ —	\$ —	\$ 44,122	\$494,122
and Chief Executive Officer	2013	\$ 86,538	\$ —	\$676,464	\$ —	\$115,026	\$878,028
James A. Powers, Chief	2014	\$280,000	\$ —	\$402,868	\$ —	\$ 29,733	\$712,601
Financial Officer and Vice	2013	\$ 14,000	\$ —	\$ —	\$ —	\$ 25,000	\$ 39,000
President of Finance							
Randall J. Adleman, Vice	2014	\$250,000	\$ —	\$ —	\$120,319	\$ —	\$370,319
President of Global Sales	2013	\$ 9,615		\$397,920	\$ —	\$ —	\$407,535
and Marketing							
Jason P. Rubin, Vice	2014	\$ 76,827	\$ 2,625	\$ 69,063	\$ 35,900	\$ 31,240	\$215,655
President Manufacturing	2013	\$231,154	\$ —	\$284,388	\$ 35,900	\$ —	\$551,442
(through April 18, 2014)	2012	\$206,517	\$48,000	\$ 54,439	\$ 29,688	\$ 17,415	\$356,059

[1] Represents total salary earned during the calendar years 2014, 2013, and 2012.

[2] The amounts reported in this column represent the aggregate value of the stock awards granted to the Named Executive Officers during 2014, 2013, and 2012, respectively, based on their grant date fair value, as determined in accordance with the share-based payment accounting guidance under the Financial Accounting Standards Board Accounting Standards Codification Topic 718 (“ASC 718”). Refer to the section titled “Stock-Based Compensation Expense” under Note 1, “Summary of Significant Accounting Policies,” in the Notes to the Consolidated Financial Statements included in the Annual Report on Form 10-k filed February 27, 2015 for the relevant assumptions used to determine the valuation of our restricted awards.

[3] The amounts reported in this column represent the aggregate value of the stock options granted to the Named Executive Officers during 2014, 2013, and 2012, respectively, based on their grant date fair value, as determined in accordance with the share-based payment accounting guidance under ASC 718. Refer to the section titled “Stock-Based Compensation Expense” under Note 1, “Summary of Significant Accounting Policies,” in the Notes to the Consolidated Financial Statements included in the Annual Report on Form 10-k filed February 27, 2015 for the relevant assumptions used to determine the valuation of our stock option awards. Mr. Power’s award was approved in 2014 in connection with his hiring in 2013.

[4] Represents (i) commissions Mr. Alderman earned in 2014 under his management incentive plan of \$108,449 and \$11,870.38 of commissions earned in 2013 but paid in 2014.(ii) amounts Mr. Rubin earned under the Company’s 2013 management incentive plan paid in March 2014, amounts earned under the Company’s 2012 management incentive plan paid in March 2013 and amounts earned under the Company’s 2011 management incentive plan paid in March 2012 .

[5] Includes (i) Mr. Ascolese’s 2014 relocation costs (\$35,962) and use of a company car (\$8,160) and 2013 signing bonus (\$100,000) and relocation costs (\$15,026); (ii) Mr. Powers’ 2014 relocation costs and 2013 signing bonus; and (iii) Mr. Rubin’s company - wide vacation buy back in 2012 and 2014.

FISCAL 2014 GRANTS OF PLAN-BASED AWARDS

Name and Principal Position	Estimated future payouts under non-equity incentive plan awards [1]				All other option awards: Number of securities underlying options.	Exercise or base price of option awards (\$/share)	Grant Date Fair Value of Stock or Option Awards
	Grant Date	Threshold	Target	Maximum			
					[2]	[3]	[4]
Mark A. Ascolese, President and Chief Executive Officer	2/13/2014	\$ —	\$450,000	\$675,000			
James A. Powers, Chief Financial Officer and Vice President of Finance	2/13/2014	\$ —	\$168,000	\$252,000			
	2/28/2014	\$ —	\$ —	\$ —	175,000	\$ 3.39	\$402,868
Randall J. Adleman, Vice President of Global Sales and Marketing	2/13/2014	N/A	\$180,000	\$500,000			
Jason P. Rubin, Vice President Manufacturing (Through April 18, 2014)	2/13/2014	\$ —	\$122,500	\$183,750			
	2/28/2014	\$ —			30,000	\$ 3.39	\$ 69,063

[1] Other than Mr. Adleman, no NEO received payouts under these plans because the threshold was not exceeded. Except for Mr. Adleman, the payout at threshold is \$0. See “Summary of Annual Incentive Compensation” above.

[2] Mr. Power’s award was approved in 2014 in connection with his hiring in 2013.

[3] The exercise price of the stock option awards is equal to the closing price of the common stock as reported by The NASDAQ Capital Market on the date of grant of the award.

[4] Refer to the section titled “Stock-Based Compensation Expense” under Note 1, “Summary of Significant Accounting Policies,” in the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K filed on February 27, 2015 for the relevant assumptions used to determine the valuation of our option awards.

The following table of “Outstanding Equity Awards at Fiscal Year End” shows the equity awards held by our NEOs as of December 31, 2014. No amounts are reflected for Mr. Rubin in the table because he did not hold any equity awards as of December 31, 2014.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR END

	Option Awards					Stock Awards	
	Number of securities underlying unexercised options (#) Exercisable	Number of securities underlying unexercised options (#) Unexercisable	Option exercise price (\$)	Option expiration date	Number of options vested at 12/31/14	Number of shares of stock that have not vested (#)	Market value of shares or units of stock that have not vested (\$)
Mark A. Ascolese, President and Chief Executive Officer . . .	85,000	255,000	2.91	11/21/2023	85,000[1]	—	\$—
James A. Powers, Chief Financial Officer and Vice President of Finance	43,749	131,251	3.39	2/28/2024	43,749[2]	—	\$—
Randall J. Adleman, Vice President of Global Sales and Marketing	50,000	150,000	2.91	11/21/2023	50,000[3]	—	\$—

- [1] This option vests over a four-year period from November 21, 2013, with 25% of the award vesting on November 21, 2014 and then 1/16th of the total award vesting in 12 quarterly installments over the subsequent three-year period, in each case subject to continued service with us.
- [2] This option vests over a four-year period from December 4, 2013, with 25% of the award vesting on December 4, 2014 and then 1/16th of the total award vesting in 12 quarterly installments over the subsequent three-year period, in each case subject to continued service with us.
- [3] This option vests over a four-year period from November 21, 2013, with 25% of the award vesting on November 21, 2014 and then 1/16th of the total award vesting in 12 quarterly installments over the subsequent three-year period, in each case subject to continued service with us.

OPTION EXERCISES AND STOCK VESTED

The following table shows options exercised and restricted stock vested for our NEOs during 2014:

Name	Option Awards		Stock Awards	
	Number of shares acquired on exercise	Value realized on exercise	Number of shares acquired on vesting	Value realized on vesting
Mark A. Ascolese, President and Chief Executive Officer.	—	\$ —	—	\$—
James A. Powers, Chief Financial Officer and Vice President of Finance	—	\$ —	—	\$—
Randall J. Adleman, Vice President of Global Sales and Marketing	—	\$ —	—	\$—
Jason P. Rubin, Vice President [1] Manufacturing	8,500	\$22,283	—	\$—

[1] Amount calculated based on the closing price of our common stock as reported by the NASDAQ Capital Market on July 18, 2014, the date of exercise.

POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE OF CONTROL

Amended and Restated 2010 Equity Incentive Plan (the “2010 Plan”)

In the event of a Change in Control (as defined in the 2010 Plan), each outstanding Award (as defined in the 2010 Plan) will be treated as the Administrator (as defined in the 2010 Plan) determines without a participant’s consent, including, without limitation, that (i) Awards will be assumed, or substantially equivalent Awards will be substituted, by the acquiring or succeeding corporation (or an affiliate thereof) with appropriate adjustments as to the number and kind of shares and prices; (ii) upon written notice to a participant, that the participant’s Awards will terminate upon or immediately prior to the consummation of such merger or Change in Control; (iii) outstanding Awards will vest and become exercisable, realizable, or payable, or restrictions applicable to an Award will lapse, in whole or in part prior to or upon consummation of such merger or Change in Control, and, to the extent the Administrator determines, terminate upon or immediately prior to the effectiveness of such merger or Change in Control; (iv) (A) the termination of an Award in exchange for an amount of cash and/or property, if any, equal to the amount that would have been attained upon the exercise of such Award or realization of the participant’s rights as of the date of the occurrence of the transaction, or (B) the replacement of such Award with other rights or property selected by the Administrator in its sole discretion; or (v) any combination of the foregoing.

In the event that the successor corporation does not assume or substitute for the Award (or portion thereof), the participant will fully vest in and have the right to exercise all of his or her outstanding options and stock appreciation rights that are not assumed or substituted for, including shares as to which such Awards would not otherwise be vested or exercisable, all restrictions on Restricted Stock, Restricted Stock Units, and Performance Shares/Units (each as defined in the 2010 Plan) not assumed or substituted for will lapse, and, with respect to Awards with performance-based vesting not assumed or substituted for, all performance goals or other vesting criteria will be deemed achieved at one hundred percent (100%) of target levels and all other terms and conditions met. In addition, if an option or stock appreciation right is not assumed or substituted for in the event of a Change in Control, the Administrator will notify the participant in writing or electronically that the option or stock appreciation right will be fully vested and exercisable for a period of time determined by the Administrator in its sole discretion, and the option or stock appreciation right will terminate upon the expiration of such period.

An Award will be considered assumed if, following the merger or Change in Control, the Award confers the right to purchase or receive, for each share subject to the Award immediately prior to the Change in Control, the consideration (whether stock, cash, or other securities or property) or, in the case of a stock appreciation right upon the exercise of which the Administrator determines to pay cash or a Restricted Stock Unit, Performance Share or Performance Unit which the Administrator can determine to pay in cash, the fair market value of the consideration received in the merger or Change in Control by holders of the common stock of Active Power for each share held

on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding shares); provided, however, that if such consideration received in the merger or Change in Control is not solely common stock of the successor corporation or its parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of an option or stock appreciation right or upon the payout of a Restricted Stock Unit, Performance Unit or Performance Share, for each share subject to such Award (or in the case of an Award settled in cash, the number of implied shares determined by dividing the value of the Award by the per share consideration received by holders of common stock in the merger or Change in Control), to be solely common stock of the successor corporation or its parent equal in fair market value to the per share consideration received by holders of Common Stock in the merger or Change in Control.

For purposes of the 2010 Plan, “Change in Control” means the occurrence of any of the following events: (i) a change in the ownership of Active Power which occurs on the date that any one person, or more than one person acting as a group (“Person”), acquires ownership of the stock of Active Power that, together with the stock held by such Person, constitutes more than fifty percent (50%) of the total voting power of the stock of Active Power; provided, however, that for purposes of this subsection (i), the acquisition of additional stock by any one Person, who is considered to own more than fifty percent (50%) of the total voting power of the stock of Active Power will not be considered a Change in Control, (ii) if we have a class of securities registered pursuant to Section 12 of the Exchange Act, a change in the effective control of Active Power which occurs on the date that a majority of members of the Board is replaced during any twelve (12) month period by Directors whose appointment or election is not endorsed by a majority of the members of the Board prior to the date of the appointment or election. For purposes of this subsection (ii), if any Person is considered to be in effective control of Active Power, the acquisition of additional control of Active Power by the same Person will not be considered a Change in Control; or, or (iii) a change in the ownership of a substantial portion of our assets which occurs on the date that any Person acquires (or has acquired during the twelve (12) month period ending on the date of the most recent acquisition by such person or persons) assets from us that have a total gross fair market value equal to or more than fifty percent (50%) of the total gross fair market value of all of the assets of Active Power immediately prior to such acquisition or acquisitions; provided, however, that for purposes of this subsection (iii), the following will not constitute a change in the ownership of a substantial portion of our assets: (A) a transfer to an entity that is controlled by our stockholders immediately after the transfer, or (B) a transfer of assets by Active Power to: (1) a stockholder of Active Power (immediately before the asset transfer) in exchange for or with respect to Active Power stock, (2) an entity, fifty percent (50%) or more of the total value or voting power of which is owned, directly or indirectly, by Active Power, (3) a Person, that owns, directly or indirectly, fifty percent (50%) or more of the total value or voting power of all the outstanding stock of Active Power, or (4) an entity, at least fifty percent (50%) of the total value or voting power of which is owned, directly or indirectly, by a Person described in subsection (iii)(B)(3). For purposes of this subsection (iii), gross fair market value means the value of the assets of Active Power, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets. Persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with Active Power. Notwithstanding the foregoing, a transaction shall not be deemed a Change in Control unless the transaction qualifies as a change in control event within the meaning of Section 409A of the Internal Revenue Code of 1986, as it has been and may be amended from time to time, and any proposed or final Treasury Regulations and Internal Revenue Service guidance that has been promulgated or may be promulgated thereunder from time to time.

Termination and Change in Control Agreements

Each of Messrs. Ascolese, Powers and Adleman has entered into a Severance Benefit Agreement (“Severance Agreements”). The Severance Agreement signed by Mr. Adleman provides that if the executive’s employment is terminated for reasons other than Cause (as defined in the Severance Agreements) or by the executive for Good Reason (as defined by the Severance Agreements) then the executive shall be entitled to receive continued severance pay equal to six months of his then-current base salary payable over such period, as well as reimbursement of health benefits during such period and vesting under all unvested options and restricted stock would be accelerated by six months. Upon termination without Cause or resignation for Good Reason, Mr. Ascolese and Mr. Powers are each entitled to severance equal to twelve months of his then-current base salary, as well as reimbursement of health benefits during such period and vesting under all unvested options and restricted stock would be accelerated by twelve months. The Severance Agreements further provide that each executive execute a release of claims in favor of us, and the Severance Agreements signed by Messrs. Powers and Adleman include noncompetition and

non-solicitation covenants for a period of up to six months following his termination of employment. Mr. Ascolese's Severance Agreement includes noncompetition and non-solicitation covenants for a period of up to twelve months following termination of employment.

Each of the Severance Agreements also provides that if within twelve months following a Change in Control (as defined in the Severance Agreements) the executive officer's employment is terminated for reasons other than Cause, or by the executive for Good Reason, then any unvested options or shares of restricted stock held by the executive on the date of such change in control would accelerate and vest in full as of the date of the termination.

Had their employment been terminated on December 31, 2014 by us for reasons other than cause or by the executive for good reason, our NEOs would have been eligible to receive the payments set forth in the table below. These payments include amounts earned through such time and are only estimates of the amounts that would be paid to these executives upon their termination. The actual amounts to be paid out can only be determined at the time of such executive's separation from Active Power.

If their employment had been terminated on December 31, 2014 by us for reasons other than cause or by the executive for good reason of Active Power, our NEOs would have been eligible to receive the payments set forth in the table below. These payments include amounts earned through such time and are only estimates of the amounts that would be paid to these executives upon their termination. The actual amounts to be paid out can only be determined at the time of such executive's separation from Active Power. The benefits payable in connection with a termination following a change in control as of December 31, 2014, would have been the same since, as set forth in footnote 1 below, all outstanding equity awards were underwater at such time.

POTENTIAL PAYMENTS UNDER TERMINATION ARRANGEMENTS AND CHANGE IN CONTROL

	<u>Salary</u>	<u>Benefits</u>	<u>Accrued Vacation Pay</u>	<u>Accelerated Vesting of Restricted Stock</u>	<u>Accelerated Vesting of Stock Options [1]</u>	<u>Total</u>
Mark A. Ascolese	\$450,000	\$12,822	\$—	\$—	\$—	\$462,822
James A. Powers	\$280,000	\$12,822	\$—	\$—	\$—	\$292,822
Randall J. Adleman	\$125,000	\$ 6,411	\$—	\$—	\$—	\$131,411

[1] Accelerated vesting has no value because the outstanding equity awards were under water as of December 31, 2014. In general, options may be exercised only within three months of termination of employment.

In 2014, our non-employee directors received the following fees for their service as a director:

DIRECTOR COMPENSATION

<u>Name</u>	<u>Fees earned or paid in cash \$</u>	<u>Stock awards \$</u>	<u>Option awards \$</u>	<u>Total compensation</u>
			[1]	
Mark A. Ascolese	included in executive compensation table			
Ake Almgren	\$ 54,000		\$ 27,774	\$ 81,774
T. Patrick Kelly [2]	\$ 63,374		\$ 27,774	\$ 91,148
James E. J. deVenny III [2]	\$ 44,000		\$ 27,774	\$ 71,774
Robert S. Greenberg [2]	\$ 50,000		\$ 27,774	\$ 77,774
Stephen J. Clearman [3]	\$ —		\$ —	\$ —
Jan H. Lindelow [4]	<u>\$ 22,355</u>	<u> </u>	<u>\$ —</u>	<u>\$ 22,355</u>
total - all directors	\$233,729	\$ —	\$111,096	\$344,825

[1] Reflects the dollar amounts recognized for financial statement purposes for the fiscal year ended December 31, 2014, in accordance with the FASB ASC 817, excluding the impact of estimated forfeitures related to service-based vesting.

[2] On February 14, 2014, the Board approved compensation for the members of the committee which conducted an independent investigation. The compensation amounts were \$20,000 for the committee chairperson (Mr. Kelly) and \$8,000 for the other members of the committee (Messrs. deVenny and Greenberg).

[3] Mr. Clearman declined to receive director compensation (cash or equity) in 2014.

[4] Mr. Lindelow was a board member until May 28, 2014.

The following table shows the aggregate number of option awards outstanding for each of our directors as of December 31, 2014, as well as the number of shares underlying option awards during 2014 and the grant date fair value of option grants made to directors during 2014:

	<u>Aggregate number of options outstanding at December 31, 2014</u>	<u>option awards made during 2014</u>	<u>Grant date fair value of option awards made during 2014</u>
Mark A. Ascolese	included in executive compensation table		
Ake Almgren	72,000	15,000	\$ 27,774
T. Patrick Kelly	33,000	15,000	\$ 27,774
James E. J. deVenny III	54,000	15,000	\$ 27,774
Robert S. Greenberg	51,000	15,000	\$ 27,774
Jan H. Lindelow [1]	45,400	—	\$ —
Stephen J. Clearman [2]	—	—	\$ —
Total - all directors	<u>255,400</u>	<u>60,000</u>	<u>111,096</u>

[1] Mr. Lindelow was a board member until May 28, 2014.

[2] Voluntarily relinquished all director compensation.

Overview of Director Compensation and Procedures

We use a combination of cash and stock-based incentive compensation to attract and retain qualified candidates to serve on our Board. In setting director compensation, we consider the amount of time that directors expend in fulfilling their duties to us as well as the skill level required to serve as a member of the Board.

<u>Service</u>	<u>Annual Fee</u>
Director fee	\$30,000
Chairman of the Board fee	\$20,000
Audit Committee participation fee	\$ 4,000
Audit Committee chairperson (in addition to fee for serving on the Audit Committee)	\$ 8,000
Compensation Committee participation fee	\$ 4,000
Compensation Committee chairperson (in addition to fee for serving on the Compensation Committee)	\$ 6,000
Nominating & Corporate Governance Committee participation fee	\$ 2,000
Nominating & Corporate Governance Committee chairperson (in addition to fee for serving on the Nominating & Corporate Governance Committee)	\$ 1,000

All of the above fees are paid to directors on a quarterly basis in arrears. When the Board appoints a special committee, additional compensation may be paid to those directors who serve on the special committees.

On the date of our 2014 Annual Meeting of Stockholders, each non-employee director who continued to serve as a non-employee director was automatically granted an option to purchase 15,000 shares of common stock. Under this program, on May 28, 2014, each of Messrs. Almgren, deVenny, Greenberg and Kelly received an option to purchase 15,000 shares of common stock with an exercise price of \$2.79 per share, the closing sale price of our common stock on The Nasdaq Capital Market on the date of our 2014 Annual Meeting. Mr. Clearman declined to receive director compensation (cash or equity) for 2014. In connection with the revised non-employee director

compensation policy (described below), starting with the 2015 Annual Meeting of Stockholders each non-employee director who continues to serve as a non-employee director will be automatically granted an option to purchase 30,000 shares of common stock. Annual awards fully vest on the day immediately prior to the next annual meeting of stockholders.

Starting on February 13, 2015, new non-employee directors are automatically awarded an option to purchase a pro-rata portion of 30,000 shares under our 2010 Plan upon joining the Board. Under this program, on February 26, 2015, Mr. Gross received an option to purchase 7,500 shares of common stock with an exercise price of \$2.00 per share, the closing sale price of our common stock on The Nasdaq Capital Market on February 26, 2015.

In early 2015, the Compensation Committee completed a review of our non-employee director compensation policies and procedures, with assistance from Radford to provide benchmarking data on comparable companies. As a result of this review, the Compensation Committee recommended, and the Board subsequently approved on February 13, 2015, changes to the equity compensation for the non-employee members of our Board. The equity compensation issued when a non-employee director first joins the Board was changed from 20,000 option shares to a pro-rata portion of 30,000 option shares based on 12 months divided by the number of months remaining from the appointment month until the next annual meeting of stockholders, inclusive. Options granted to new directors under our revised program have an exercise price per share equal to the fair market value per share of the underlying shares of common stock at the date of grant and fully vest in one year. In addition, the equity compensation issued on an annual basis to a non-employee director was increased from 15,000 option shares to 30,000 option shares. No changes were made to the cash compensation for the non-employee members of our Board.

Directors who are also our employees do not receive cash or equity compensation for service on the Board in addition to their compensation payable for their service as our employees.

Indemnification Agreements

Our certificate of incorporation limits the liability of our directors to us and our stockholders for breaches of the directors' fiduciary duties to the fullest extent permitted by Delaware law. In addition, our certificate of incorporation and bylaws provide for mandatory indemnification of directors and officers to the fullest extent permitted by Delaware law. We also maintain directors' and officers' liability insurance and have entered into indemnification agreements with all of our directors and our NEOs.

Certain Relationships

In accordance with our Audit Committee charter, our Audit Committee is responsible for reviewing and approving the terms and conditions of all related party transactions. This would encompass all transactions with directors, immediate family members of our directors and executive officers, or any entities that such persons may have ownership or employment relationships with. A report is made annually to our Audit Committee disclosing all related parties that are employed by us or any related party transactions or relationships that occurred during the year, if any. There were no reportable related party transactions or relationships during 2014.

PROPOSAL TWO: NON-BINDING ADVISORY VOTE TO APPROVE EXECUTIVE OFFICER COMPENSATION

We are providing our stockholders with the opportunity to cast an advisory vote to approve the compensation of our named executive officers as disclosed in the Compensation Discussion and Analysis section and accompanying tables in this Proxy Statement. We believe that it is appropriate to seek the views of our stockholders on the design and effectiveness of our executive compensation program.

Our goal for our executive compensation program is to attract and retain exceptional individuals as executive officers who will provide leadership for our success in dynamic, competitive markets. We seek to accomplish this goal in a way that is aligned with the long-term interests of our stockholders and suitably rewards our executives based on performance. We believe that our executive compensation program achieves this goal with its emphasis on long-term equity awards and performance-based compensation, which has to date, enabled us to sufficiently motivate and reward our named executive officers.

We encourage our stockholders to approve the compensation of our named executive officers as disclosed above in the Compensation Discussion and Analysis, the compensation tables and the related narrative discussion.

Accordingly, the following resolution will be submitted to our stockholders for approval at the Annual Meeting:

“RESOLVED, that the compensation paid to our named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion contained in this proxy statement, is hereby approved.”

As an advisory vote, this proposal is not binding upon us. However, the Compensation Committee, which is responsible for designing and administering our executive compensation program, values the opinions expressed by stockholders, and to the extent that a significant percentage of votes are cast against the compensation of our Named Executive Officers, the Compensation Committee will determine whether any actions are necessary to address the concerns reflected in such votes.

This proposal will be approved upon the affirmative vote of the holders of a majority of the Votes Cast on the proposal at the Annual Meeting. Broker non-votes and abstentions will not be considered “Votes Cast” with respect to this proposal and will have no effect.

THE BOARD UNANIMOUSLY RECOMMENDS A VOTE “FOR” THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS, AS DISCLOSED IN THE COMPENSATION DISCUSSION AND ANALYSIS, AND THE ACCOMPANYING COMPENSATION TABLES AND NARRATIVE DISCUSSION CONTAINED IN THIS PROXY STATEMENT.

PROPOSAL THREE: RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

As disclosed in its charter, the Audit Committee is responsible for selecting the Company's independent registered public accounting firm, reviewing that selection with the Board of Directors, approving all related fees and compensation for the accounting firm, and overseeing the work of the firm. In accordance with its charter, the Audit Committee has appointed Grant Thornton LLP as our independent registered public accounting firm for the fiscal year ended December 31, 2015. The Audit Committee is asking the stockholders to ratify this appointment. Grant Thornton LLP has served in this capacity since their appointment in 2010.

In the event the stockholders fail to ratify the appointment, our Audit Committee will reconsider its selection. Even if the selection is ratified, the Audit Committee in its discretion may direct the appointment of a different independent auditing firm at any time during the year if the Audit Committee believes that such a change would be in the best interests of Active Power and our stockholders.

A representative of Grant Thornton LLP is expected to be present at the Annual Meeting, where he or she will have the opportunity to make a statement if he or she desires to do so and will be available to respond to appropriate questions.

Fees incurred by Grant Thornton LLP

The following table presents fees for professional services rendered by Grant Thornton LLP and billed to us for the audit of our annual financial statements and review of our interim quarterly financial statements for the years ended December 31, 2014 and 2013, respectively, and fees for other services billed by Grant Thornton LLP during those periods

Fees	2014	2013
Audit fees	\$282,725	\$251,000
Audit-related fees	\$ —	\$ 87,500
Tax fees	\$ 25,236	\$ —
All other fees	<u>\$ —</u>	<u>\$ —</u>
Total	<u>\$307,961</u>	<u>\$338,500</u>

Audit Fees. Annual audit fees relate to services rendered in connection with the audit of the annual financial statements included in our Form 10-K, the quarterly reviews of financial statements included in our Forms 10-Q, Form S-8 and Form S-3 consent procedures and audit and testing of our internal controls in accordance with Section 404 of the Sarbanes-Oxley Act of 2002.

Audit-Related Fees. Audit-related services include fees for consultations concerning financial accounting and reporting matters and responding to SEC comments. Audit-related fees are disclosed as those audit-related fees paid during the specified fiscal year.

Tax Fees. We used Grant Thornton LLP for tax-related activities in foreign jurisdictions in 2014 and 2013.

All Other Fees. All other fees include amounts billed by Grant Thornton LLP in connection with consultation on accounting matters addressed during the audit or interim reviews.

Pre-Approval Policies

The Audit Committee pre-approves all audit and non-audit services provided by our independent auditors prior to the engagement of the independent auditors with respect to such services, including those set forth in the table above. The Chairman of the Audit Committee has the authority to approve any additional audit services and permissible non-audit services, provided the Chairman informs the Audit Committee of such approval at its next regularly scheduled meeting. Our independent registered public accounting firm and management are required to report to the Audit Committee periodically regarding the extent of services provided by the independent registered public accounting firm in accordance with this pre-approval, and the fees for the services performed to date.

Required Vote and Recommendation of the Board

The affirmative vote of the holders of a majority of the Votes Cast on the proposal at the Annual Meeting is required to ratify the appointment of Grant Thornton LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2015. Abstentions will not be considered “Votes Cast” with respect to this proposal and will have no effect.

THE BOARD UNANIMOUSLY RECOMMENDS A VOTE “FOR” THE RATIFICATION OF APPOINTMENT OF GRANT THORNTON LLP AS OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE FISCAL YEAR ENDING DECEMBER 31, 2015.

**PROPOSAL FOUR: APPROVAL OF AMENDMENT AND RESTATEMENT OF THE COMPANY'S
AMENDED AND RESTATED 2010 EQUITY INCENTIVE PLAN AND THE MATERIAL TERMS OF
THE PERFORMANCE GOALS THEREUNDER**

The stockholders are being asked to approve the amendment and restatement of the Company's amended and restated 2010 Equity Incentive Plan (the "Plan") to add 3 million shares to the total number of shares of the Company's common stock reserved for issuance under the Plan and to make certain technical and administrative changes. Our stockholders initially authorized us to issue under the Plan a total of (i) 420,000 shares, plus (ii) any shares which have been reserved but not issued pursuant to any awards granted under the 2000 Plan and (iii) any shares subject to outstanding awards under the 2000 Plan expire or otherwise terminate without having been exercised in full, or are forfeited to or repurchased by the Company, up to a maximum of 1,127,888 shares pursuant to this subsection (iii). The Plan was amended and restated by the stockholders on May 17, 2012 to add 1,700,000 shares to the total number of shares of the Company's common stock reserved for issuance under the Plan. As of March 2, 2015, a total of 3,208,690 shares of our common stock were subject to awards currently outstanding under the Plan and 253,218 shares of our common stock were available for future issuance. If this proposal is approved by our stockholders, an additional 3 million shares of our common stock will be available for issuance on the date of such approval. All common stock numbers described in this proposal and that are reflected in the amended and restated plan have been adjusted to reflect the five-for-one reverse stock split that occurred on December 21, 2012.

The Board believes that the Company must offer a competitive equity incentive program if it is to continue to successfully attract and retain the best possible candidates for positions of substantial responsibility within the Company. The Board believes that stockholder approval of the amendment is essential to the Company's continued success as the additional shares will be an important factor in attracting, retaining and rewarding highly capable employees, directors, and consultants and in providing incentive to these individuals to promote the success of the Company. If our stockholders approve the amendments, we estimate that the shares reserved for issuance under the Plan, as amended and restated, would be sufficient for several additional years of awards, depending on projected new employee growth and turnover, and assuming we continue to grant awards consistent with our historical usage and current practices. However, the share reserve under the Plan, as amended and restated, could last for a longer or shorter period of time.

In connection with the approval of the amendment and restatement, stockholders are also being asked to approve the material terms of the performance goals for performance awards that may be granted under the Plan. Under Section 162(m) of the Internal Revenue Code of 1986, as amended ("Code"), the federal income tax deductibility of compensation paid to our chief executive officer and three other most highly compensated officers other than our chief executive officer or chief financial officer (each, a "Covered Employee") may be limited to the extent such Covered Employee's compensation exceeds \$1,000,000 in any taxable year. However, we may deduct compensation paid to a Covered Employee in excess of that amount if it qualifies as "performance-based compensation" as defined in Section 162(m). For awards under the Plan to constitute "performance-based compensation," among other things, the material terms of the performance goals under the Plan must be disclosed to, and approved by, the Company's stockholders. Under the Treasury regulations issued under Section 162(m), the "material terms" of the performance goals under the Plan ("Performance Goal Terms") are (i) the maximum amount of compensation that may be paid to an individual participant under the Plan pursuant to awards intended to qualify as "performance-based compensation" under Section 162(m) in any specified period, (ii) the employees eligible to receive compensation under the Plan, and (iii) the business criteria on which the performance goals may be based, each of which is described in the summary of the material features of the Plan below. Stockholder approval of this Proposal Four will constitute approval of the material terms of the performance goals under the Plan for purposes of Section 162(m). Nevertheless, there can be no guarantee that compensation under the Plan will ultimately be treated as qualified "performance-based compensation" under Section 162(m). The Company may also elect to grant awards under the Plan that are not intended to qualify as "performance-based compensation" under Section 162(m).

If this Proposal Four is not approved by our stockholders, the proposed amendment and restatement to the Plan will not become effective, but the Plan will remain in effect in accordance with its present terms. Please see the section titled "Summary of the Plan" below for a summary of the principal features of the Plan and its operation, including a description of the amended and restated Plan if stockholders approve Proposal Four.

Summary of the Plan (including proposed amendments)

The essential features of the Plan, as amended in accordance with the proposed amendment, are summarized below. The summary is qualified in its entirety by reference to the Plan set forth in Appendix A.

General

The purposes of the Plan are to attract and retain the best available personnel for positions of substantial responsibility, to provide incentives to individuals who perform services to the Company, and to promote the success of the Company's business. These incentives are provided through the grant of stock options, stock appreciation rights, restricted stock awards, restricted stock units, performance shares and performance units.

Authorized Shares

As amended, the total number of authorized shares under the Plan will include (i) the 2,120,000 shares previously authorized, (ii) the 3,000,000 newly authorized shares, (iii) any shares which have been reserved but not issued pursuant to any awards granted under the Company's 2000 Stock Incentive Plan, as amended (the "Old Plan") as of the date of the initial stockholder approval of the Plan, plus (iv) the number of shares subject to outstanding awards under the Old Plan that expire or otherwise terminate without having been exercised in full, or are forfeited to or repurchased by the Company (up to a maximum of 1,127,888 shares pursuant to this subsection (iv)). If any award granted under the Plan expires, lapses or becomes unexercisable without having been exercised in full, or if shares subject to forfeiture or repurchase are forfeited or repurchased by the Company due to failure to vest, any such shares that are reacquired or subject to such a terminated award will again become available for issuance under the Plan.

Shares subject to awards of restricted stock, restricted stock units, performance shares and performance units (collectively, "Full Value Awards") will count against the Plan's share reserve as 1.25 shares for each share subject to such award. If shares acquired pursuant to Full Value Awards are forfeited or repurchased by the Company and would otherwise return to the share reserve as described above, then 1.25 times the number of shares forfeited or repurchased will return to the share reserve.

Upon the exercise of a stock appreciation right settled in shares, the gross number of shares covered by the portion of the award exercised will cease to be available under the Plan. If shares issued pursuant to restricted stock, restricted stock units, performance shares or performance units are repurchased by or forfeited to the Company due to failure to vest, such shares will become available for future grant under the Plan. Shares used to pay the exercise price or purchase price of an award and/or to satisfy the tax withholding obligations of an award will not remain available for issuance under the Plan. Payment of cash rather than shares pursuant to an award will not result in reducing the number of shares available for issuance under the Plan.

Adjustments to Shares Subject to the Plan

In the event of any dividend or other distribution (whether in the form of cash, shares, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase, exchange of shares or other securities of the Company, or other change in the corporate structure affecting the Company's common stock, the Administrator (as defined below), in order to prevent diminution or enlargement of the benefits or potential benefits intended to be made available under the Plan, will adjust the number and class of shares that may be delivered under the Plan, and/or the number, class and price of shares of stock subject to outstanding awards, and the award grant limitations.

Administration

The Plan will be administered by the Board or a committee of individuals satisfying applicable laws appointed by the Board (the "Committee"). To make grants to certain officers and key employees of the Company, the members of the Committee must qualify as "non-employee directors" under Rule 16b-3 of the Securities Exchange Act of 1934. In the case of awards intended to qualify for the performance-based compensation exemption under Section 162(m), administration must be by a compensation committee comprised solely of two or more "outside directors" within the meaning of Section 162(m). (For purposes of this summary of the Plan, the term "Administrator" will refer to either the Committee or the Board.)

Subject to the terms of the Plan, the Administrator has the sole discretion to select the employees, consultants, and directors who will receive awards, to determine the terms and conditions of awards, to modify or amend each award (subject to the restrictions of the Plan), including to accelerate vesting or waive forfeiture restrictions, and to interpret the provisions of the Plan and outstanding awards. The Administrator cannot (x) modify or amend an option or a stock appreciation right to reduce the exercise price of such option or stock appreciation right after it has been

granted (other than pursuant to certain changes in the Company's capitalization), or (y) cancel any outstanding option or stock appreciation right and immediately replace it with a new option or stock appreciation right with a lower exercise price, unless such action is approved by the Company's stockholders before such action is taken. The Administrator may allow a participant to defer the receipt of payment of cash or delivery of shares that otherwise would be due to such participant. The Administrator may make rules and regulations relating to sub-plans established for the purpose of satisfying applicable foreign laws or qualifying for favorable tax treatment under applicable foreign laws and may make all other determinations deemed necessary or advisable for administering the Plan.

Eligibility

Awards may be granted to employees, directors and consultants of the Company and employees and consultants of any affiliate of the Company. Incentive stock options may be granted only to employees who, as of the time of grant, are employees of the Company or any parent or subsidiary corporation of the Company. As of January 31, 2015, the Company had approximately 209 employees, five directors, and three consultants who would be eligible to participate in the Plan.

Stock Options

Each option granted under the Plan will be evidenced by a written agreement between the Company and a participant specifying the number of shares subject to the option and the other terms and conditions of the option, consistent with the requirements of the Plan.

The exercise price per share of each option may not be less than the fair market value of a share of on the date of grant except for certain substitute awards that may be granted in connection with a corporate transaction. However, any incentive stock option granted to a person who at the time of grant owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Company or any parent or subsidiary corporation of the Company (a "Ten Percent Stockholder") must have an exercise price per share equal to at least 110% of the fair market value of a share on the date of grant. Generally, the fair market value of the common stock is the closing sales price per share on the date of grant as quoted on The Nasdaq Stock Market. On March 2, 2015, the closing price of the Company's common stock on The Nasdaq Stock Market was \$2.13 per share.

The Plan provides that the option exercise price may be paid, as determined by the Administrator, in cash, by check, by tender of shares having a fair market value equal to the exercise price, by the assignment of the proceeds of a sale with respect to some or all of the shares being acquired upon the exercise of the option (a "cashless exercise"), by a net exercise, by a reduction in any Company liability to the participant, by any combination of the foregoing, or by such other consideration and method of payment for the issuance of shares to the extent permitted by applicable laws. An option will be deemed exercised when the Company receives the notice of exercise and full payment for the shares to be exercised, together with applicable tax withholdings.

Options will be exercisable at such times or under such conditions as determined by the Administrator and set forth in the award agreement. The maximum term of an option will be specified in the award agreement, provided that options will have a maximum term of 10 years, and provided further that an incentive stock option granted to a Ten Percent Stockholder must have a term not exceeding five years.

The Administrator will determine and specify in each written award agreement, and solely in its discretion, the period of post-termination exercise applicable to each option. In the absence of such a determination by the Administrator, the participant generally will be able to exercise his or her option for (i) three months following his or her termination for reasons other than death, disability or misconduct, and (ii) 12 months following his or her termination due to disability or following his or her death while holding the option. If a participant is terminated for misconduct (as defined in the Plan) or engages in misconduct while holding an option, the option will terminate immediately. An award agreement may also provide that if exercising an option following termination of a participant's service (other than upon death or disability) would result in liability under Section 16(b) of the Securities Exchange Act of 1934, as amended ("Section 16(b)"), then the option will terminate 10 days after the last date on which exercise would result in liability under Section 16(b). An award agreement may also provide that if exercising an option following termination of a participant's service (other than upon death or disability) would be prohibited solely due to a violation of registration requirements under the Securities Act of 1933, as amended, then the option will terminate three months after termination of the participant's service during which exercising the option would not violate such registration requirements. However, in no event can an option be exercised after the expiration of the term of the option.

Stock Appreciation Rights

A stock appreciation right gives a participant the right to receive the appreciation in the fair market value of Company common stock between the date of grant of the award and the date of its exercise. Each stock appreciation right granted under the Plan will be evidenced by a written agreement between the Company and the participant specifying the exercise price and the other terms and conditions of the award, consistent with the requirements of the Plan.

The exercise price per share of each stock appreciation right may not be less than the fair market value of a share on the date of grant except for certain substitute awards that may be granted in connection with a corporate transaction. The Company may pay the appreciation in cash, in shares, or in some combination thereof. The term of a stock appreciation right will be no more than 10 years from the date of grant. A stock appreciation right will be deemed exercised when the Company receives the notice of exercise and full payment for the shares to be exercised, together with applicable tax withholdings. Additionally, the terms and conditions relating to the period of post-termination exercise with respect to options described above also apply to stock appreciation rights.

Restricted Stock Awards

Awards of restricted stock are shares of common stock subject to restrictions which lapse in accordance with the terms and conditions established by the Administrator in its sole discretion. Each restricted stock award granted will be evidenced by a written agreement between the Company and the participant specifying the number of shares granted and the other terms and conditions of the award, consistent with the requirements of the Plan. Restricted stock awards may be subject to vesting conditions as the Administrator specifies, and the shares acquired may not be transferred by the participant until vested. Unless otherwise provided by the Administrator, a participant will forfeit any shares of restricted stock as to which the restrictions have not lapsed prior to the participant's termination of service. Participants holding restricted stock will have the right to vote the shares and, unless otherwise determined by the Administrator, to receive any dividends paid, except that dividends or other distributions paid in shares will be subject to the same restrictions as the original award. The Administrator may, in its sole discretion, reduce or waive any restrictions and may accelerate the time at which any restrictions will lapse or be removed.

Restricted Stock Units

The Administrator may grant restricted stock units which represent a right to receive shares or a cash payment at a future date as set forth in the participant's award agreement. Each restricted stock unit granted under the Plan will be evidenced by a written agreement between the Company and the participant specifying the number of shares subject to the award and other terms and conditions of the award, consistent with the requirements of the Plan. Unless otherwise determined by the Administrator, Restricted stock units will result in a payment to a participant only if the performance goals or other vesting criteria the Administrator may establish are achieved or the awards otherwise vest. Earned restricted stock units will be paid, in the sole discretion of the Administrator, in the form of cash, shares, or in a combination thereof. The Administrator may establish vesting criteria in its discretion, which may be based on company-wide, divisional or individual goals, or any other basis and which may include the performance goals listed below, and which, depending on the extent to which they are met, will determine the number of restricted stock units to be paid out to participants.

After the grant of a restricted stock unit award, the Administrator, in its sole discretion, may reduce or waive any vesting criteria that must be met to receive a payout and may accelerate the time at which any restrictions will lapse or be removed. A participant will forfeit any unearned restricted stock units as of the date set forth in the award agreement.

Performance Units and Performance Shares

Performance units and performance shares may also be granted under the Plan. Each award of performance shares or units granted under the Plan will be evidenced by a written agreement between the Company and the participant specifying the performance period and other terms and conditions of the award, consistent with the requirements of the Plan. Performance units and performance shares will result in a payment to a participant only if the performance goals or other vesting criteria the Administrator may establish are achieved or the awards otherwise vest. Earned performance units and performance shares will be paid, in the sole discretion of the Administrator, in the form of cash, shares, or in a combination thereof. The Administrator may establish performance objectives in its discretion, which may be based on company-wide, divisional or individual goals, applicable federal or state securities

laws, or any other basis determined by the Administrator in its discretion, and which may include the performance goals listed below, and which, depending on the extent to which they are met, will determine the number and/or the value of performance units and performance shares to be paid out to participants.

After the grant of a performance unit or performance share, the Administrator, in its sole discretion, may reduce or waive any performance objectives or other vesting provisions for such performance units or shares and accelerate the time at which any restrictions will lapse or be removed. Performance units will have an initial value established by the Administrator on or before the date of grant. Performance shares will have an initial value equal to the fair market value of a share on the grant date. A participant will forfeit any performance shares or units that are unearned or unvested as of the date set forth in the award agreement.

Performance Goals

Awards of restricted stock, restricted stock units, performance shares, performance units and other incentives under the Plan intended to constitute “performance-based compensation” under Code Section 162(m) may be made subject to the attainment of performance goals relating to one or more business criteria within the meaning of Code Section 162(m) and may provide for a targeted level or levels of achievement including: cash flow, cash position, earnings (which may include earnings before interest and taxes, earnings before taxes and net earnings), earnings per share, growth in stockholder value relative to the moving average of the S&P 500 Index or another index, net income, net profit, net sales, operating cash flow, operating income, revenue, revenue growth, stock price and working capital. The performance goals may differ from participant to participant and from award to award, may be used to measure the performance of the Company as a whole or a business unit or other segment of the Company, or one or more product lines or specific markets and may be measured relative to a peer group or index. Any criteria used may be measured in absolute terms or in terms of growth, compared to other companies, measured against the market as a whole or and/or according to applicable market indices, measured against the Company as a whole or a segment of the Company, and/or measured on a pre-tax or post-tax basis, if applicable. In all other respects, such performance goals will be calculated in accordance with the Company’s financial statements, generally accepted accounting principles, or under a methodology established by the Administrator prior to issuance of an award and applied consistently with respect to the performance goal for the relevant period. Awards not intended to constitute “performance-based compensation” under Code Section 162(m) may be subject to such performance criteria as determined by the Administrator.

Individual Award Limitations

The Plan contains annual grant limits intended to satisfy Section 162(m). Specifically, the maximum number of shares which could be issued to any one individual in any fiscal year (i) pursuant to options is 300,000 shares, (ii) pursuant to stock appreciation rights is 300,000 shares, (iii) pursuant to restricted stock intended to constitute “performance-based compensation” under Code Section 162(m) is 100,000 shares, (iv) pursuant to restricted stock units intended to constitute “performance-based compensation” under Code Section 162(m) is 100,000 shares, and (v) pursuant to performance shares intended to constitute “performance-based compensation” under Code Section 162(m) is 100,000 shares, and (vi) the maximum dollar value which could be issued to any one individual in any fiscal year pursuant to the grant of performance units intended to constitute “performance-based compensation” under Code Section 162(m) is \$1,000,000. In addition, in connection with his or her initial hiring with the Company, an individual may be granted additional awards of up to a maximum of (a) 500,000 shares covering options, (b) 500,000 shares covering stock appreciation rights, (c) 150,000 shares covering restricted stock intended to constitute “performance-based compensation” under Code Section 162(m), (d) 150,000 shares covering restricted stock units intended to constitute “performance-based compensation” under Code Section 162(m), (e) 150,000 shares covering performance shares intended to constitute “performance-based compensation” under Code Section 162(m), and (f) \$1,500,000 covering performance units intended to constitute “performance-based compensation” under Code Section 162(m).

The Administrator will adjust the share limitations described in the above paragraph in the event of any adjustment to the Company’s shares discussed above (under “*Adjustments to Shares Subject to the Plan*”).

Transferability of Awards

Awards granted under the Plan generally are not transferable, and all rights with respect to an award granted to a participant generally will be available during a participant’s lifetime only to the participant.

Dissolution or Liquidation

In the event of the Company's proposed dissolution or liquidation, the Administrator will notify each participant in writing as soon as practicable prior to the effective date of such proposed transaction. An award will terminate immediately prior to consummation of such proposed action to the extent the award has not been previously exercised.

Change in Control

The Plan provides that, in the event of a merger or our "change in control" (as defined in the Plan), the Administrator will have authority to determine the treatment of outstanding awards in its discretion, including, without limitation, that:

- awards be assumed or substantially equivalent award substituted by the acquiring or succeeding corporation or its affiliate;
- awards will terminate upon or immediately prior to consummation of such transaction, upon providing written notice to the participant;
- outstanding awards will vest and become exercisable, realizable, or payable, or restrictions applicable to an award will lapse, in whole or in part prior to or upon such transaction and, to the extent the Administrator determines, terminate upon or immediately prior to the effectiveness of the transaction;
- an award will terminate in exchange for an amount of cash and/or property, if any, equal to the amount that would have been attained upon exercise of the award or realization of the participant's rights as of the date of the transaction, or an award be replaced with other rights or property selected by the Administrator in its sole discretion; or
- any combination of the foregoing.

If the successor corporation does not assume or substitute outstanding awards, the options and stock appreciation rights will become fully vested and exercisable, all restrictions on restricted stock, restricted stock units, performance shares and performance units will lapse, and, with respect to awards with performance-based vesting, all performance goals or other vesting criteria will be deemed achieved at 100% of target levels and all other terms and conditions met. The Administrator will not be required to treat all outstanding awards the same in the transaction. In addition, if an option or stock appreciation right is not assumed or substituted for in the event of a change in control, the Administrator will notify the participant in writing or electronically that the option or stock appreciation right will be fully vested and exercisable for a period of time determined by the Administrator in its sole discretion, and the option or stock appreciation right will terminate upon the expiration of such period.

Termination or Amendment

The Plan will automatically terminate 10 years from the date of its adoption by the Board of Directors, unless terminated at an earlier time by the Administrator. The Administrator may terminate or amend the Plan at any time, provided that no amendment may be made without stockholder approval to the extent approval is necessary or desirable to comply with any applicable laws. No termination or amendment may impair the rights of any participant unless mutually agreed otherwise between the participant and the Administrator.

Summary of U.S. Federal Income Tax Consequences

The following summary is intended only as a general guide to the material U.S. federal income tax consequences of participation in the Plan. The summary is based on existing U.S. laws and regulations, and there can be no assurance that those laws and regulations will not change in the future. The summary does not purport to be complete and does not discuss the tax consequences upon a participant's death, or the provisions of the income tax laws of any municipality, state or foreign country in which the participant may reside. As a result, tax consequences for any particular participant may vary based on individual circumstances.

Incentive Stock Options

An optionee recognizes no taxable income for regular income tax purposes as a result of the grant or exercise of an incentive stock option qualifying under Section 422 of the Code. Optionees who neither dispose of their shares within two years following the date the option was granted nor within one year following the exercise of the option

normally will recognize a capital gain or loss equal to the difference, if any, between the sale price and the purchase price of the shares. If an optionee satisfies such holding periods upon a sale of the shares, the Company will not be entitled to any deduction for federal income tax purposes. If an optionee disposes of shares within two years after the date of grant or within one year after the date of exercise (a “disqualifying disposition”), the difference between the fair market value of the shares on the exercise date and the option exercise price (not to exceed the gain realized on the sale if the disposition is a transaction with respect to which a loss, if sustained, would be recognized) will be taxed as ordinary income at the time of disposition. Any gain in excess of that amount will be a capital gain. If a loss is recognized, there will be no ordinary income, and such loss will be a capital loss. Any ordinary income recognized by the optionee upon the disqualifying disposition of the shares generally should be deductible by the Company for federal income tax purposes, except to the extent such deduction is limited by applicable provisions of the Code.

The difference between the option exercise price and the fair market value of the shares on the exercise date is treated as an adjustment in computing the optionee’s alternative minimum taxable income and may be subject to an alternative minimum tax which is paid if such tax exceeds the regular tax for the year. Special rules may apply with respect to certain subsequent sales of the shares in a disqualifying disposition, certain basis adjustments for purposes of computing the alternative minimum taxable income on a subsequent sale of the shares and certain tax credits which may arise with respect to optionees subject to the alternative minimum tax.

Nonstatutory Stock Options

Options not designated or qualifying as incentive stock options will be nonstatutory stock options having no special tax status. An optionee generally recognizes no taxable income as the result of the grant of such an option. Upon exercise of a nonstatutory stock option, the optionee normally recognizes ordinary income equal to the amount that the fair market value of the shares on such date exceeds the exercise price. If the optionee is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of stock acquired by the exercise of a nonstatutory stock option, any gain or loss, based on the difference between the sale price and the fair market value on the exercise date, will be taxed as capital gain or loss. No tax deduction is available to the Company with respect to the grant of a nonstatutory stock option or the sale of the stock acquired pursuant to such grant.

Stock Appreciation Rights

In general, no taxable income is reportable when a stock appreciation right is granted to a participant. Upon exercise, the participant will recognize ordinary income in an amount equal to the fair market value of any shares of our common stock received. Any additional gain or loss recognized upon any later disposition of the shares would be capital gain or loss.

Restricted Stock Awards

A participant acquiring restricted stock generally will recognize ordinary income equal to the fair market value of the shares on the vesting date. If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. The participant may elect, pursuant to Section 83(b) of the Code, to accelerate the ordinary income tax event to the date of acquisition by filing an election with the Internal Revenue Service no later than 30 days after the date the shares are acquired. Upon the sale of shares acquired pursuant to a restricted stock award, any gain or loss, based on the difference between the sale price and the fair market value on the date the ordinary income tax event occurs, will be taxed as capital gain or loss.

Restricted Stock Unit Awards

There are no immediate tax consequences of receiving an award of restricted stock units. A participant who is awarded restricted stock units will be required to recognize ordinary income in an amount equal to the fair market value of shares or cash issued to such participant upon settlement. Any additional gain or loss recognized upon any later disposition of any shares received would be capital gain or loss.

Performance Shares and Performance Unit Awards

A participant generally will recognize no income upon the grant of a performance share or a performance unit award. Upon the settlement of such awards, participants normally will recognize ordinary income in the year of receipt in an amount equal to the cash received and the fair market value of any cash or nonrestricted shares received.

If the participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of any shares received, any gain or loss, based on the difference between the sale price and the fair market value on the date the ordinary income tax event occurs, will be taxed as capital gain or loss.

Section 409A

Section 409A of the Code provides certain requirements for non-qualified deferred compensation arrangements with respect to an individual's deferral and distribution elections and permissible distribution events. Awards granted under the Plan with a deferral feature will be subject to the requirements of Section 409A of the Code. If an award is subject to and fails to satisfy the requirements of Section 409A of the Code, the recipient of that award may recognize ordinary income on the amounts deferred under the award, to the extent vested, which may be prior to when the compensation is actually or constructively received. Also, if an award that is subject to Section 409A fails to comply with Section 409A's provisions, Section 409A imposes an additional 20% federal income tax on compensation recognized as ordinary income, as well as interest on such deferred compensation.

Tax Effect for the Company

The Company generally will be entitled to a tax deduction in connection with an award under the Plan in an amount equal to the ordinary income realized by a participant and at the time the participant recognizes such income (for example, the exercise of a nonstatutory stock option). Special rules limit the deductibility of compensation paid to our Chief Executive Officer and other "covered employees" as determined under Section 162(m) and applicable guidance.

Number of Awards Granted to Employees, Consultants, and Directors

The number of awards that an employee, director or consultant may receive under the Plan is in the discretion of the Administrator and therefore cannot be determined in advance. Because all awards under the Plan are discretionary, other than the director awards described under "Director Compensation," it is not possible to determine which awards would have been granted during the prior fiscal year had the Plan been in effect at that time. Therefore, a "New Plan Benefits Table" is not provided in this proxy. The following table sets forth, as of March 2, 2015, (i) the aggregate number of shares of common stock subject to outstanding awards granted under the Plan, and (ii) the average per share exercise price of such options. No shares were issued pursuant to awards of stock appreciation rights under the Plan during the last fiscal year.

Name of Individual or Group	Number of Options Granted	Average Per Share Exercise Price
Mark A. Ascolese	640,000	\$2.46
Randall J. Adleman	250,000	\$2.46
James A. Powers, CFO and VP of Finance	275,000	\$2.70
Jason P. Rubin, Vice President Manufacturing	0	\$ 0
All executive officers, as a group	1,165,000	\$2.54
All directors who are not executive officers, as a group	198,900	\$4.66
All employees who are not executive officers, as a group	1,375,934	\$2.97

Required Vote and Board of Directors Recommendation

The affirmative vote of the holders of a majority of the Votes Cast at the Annual Meeting is required to approve the adoption of the amended and restated Plan. Abstentions and broker non-votes are not considered "Votes Cast" with respect to this proposal and will have no effect. The Board of Directors believes that the adoption of the Plan is in the best interests of the Company and its stockholders for the reasons stated above.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE "FOR" APPROVAL OF THE AMENDMENT AND RESTATMENT OF THE PLAN AND APPROVAL OF THE MATERIAL TERMS OF THE PERFORMANCE GOALS THEREUNDER.

PROPOSAL FIVE: TO AMEND OUR RESTATED CERTIFICATE OF INCORPORATION TO DECLASSIFY OUR BOARD OF DIRECTORS

We are asking you to approve an amendment to our Restated Certificate of Incorporation (“Restated Certificate”) to declassify our Board such that each director will be elected annually. Our current Restated Certificate provides that our Board be divided into three classes, with each class elected every three years. Our Board has unanimously approved and declared advisable, and recommends that our stockholders approve, the proposed amendment to our Restated Certificate eliminating the classified structure of the Board and making certain conforming changes (“Declassified Board Amendment”). The complete text of the Declassified Board Amendment is attached to this Proxy Statement as Appendix B and incorporated into this Proxy Statement by reference.

Background of Proposal

The Board’s consideration of whether to maintain its classified Board structure was undertaken as part of the efforts of our Board and our Nominating and Corporate Governance Committee to improve and enhance our corporate governance practices. Our Board and Nominating and Corporate Governance Committee considered the advantages and disadvantages of maintaining the classified Board structure compared to providing for an annual election of directors. In particular, our Board and our Nominating and Corporate Governance Committee considered the view of some that classified boards reduce the accountability of directors to stockholders because stockholders are unable to evaluate and elect all directors on an annual basis. Director elections are a primary means for stockholders to express their views on the performance of individual directors, and a classified board structure affords stockholders this opportunity only once every three years for any particular director.

Our Board and our Nominating and Corporate Governance Committee also considered the benefits of retaining the classified Board structure, which has a long history in corporate law. A classified structure is considered by some to provide continuity and stability in the management of the business and affairs of a company because a majority of directors will have prior experience as directors of a company. In some circumstances, classified boards may enhance stockholder value by forcing an entity seeking control of a company to initiate discussions at arm’s-length with the board of the company, because the entity cannot replace the entire board in a single election.

After deliberating the considerations noted above, upon the recommendation of our Nominating and Corporate Governance Committee, our Board unanimously determined that it is in the best interests of Active Power and its stockholders to eliminate the classified Board structure as proposed.

Declassification of our Board of Directors

If the stockholders approve this proposal, each of the four directors (comprising all of the Class III Directors and one Class II Director) who are elected this year will be elected for a one-year term that will expire at the 2016 Annual Meeting. In addition, the Class II Director whose term would otherwise expire in 2017 has agreed to voluntarily relinquish the third year of his existing three-year term upon approval of this proposal. Consequently, if this proposal is approved by the stockholders, the entire Board of Directors will be subject to election at the 2016 Annual Meeting and at every annual meeting thereafter.

If the stockholders do not approve this proposal, the Board will remain classified and the Company’s directors will continue to be subject to the current classifications pursuant to the Company’s governing documents.

Text of the Amendment

The proposed Declassified Board Amendment is set forth in Appendix B to this Proxy Statement. If this proposal is approved by our stockholders, we will amend our Restated Certificate to reflect the revisions contemplated by this proposal as set forth in Appendix B and the resulting amended Restated Certificate will become effective upon its filing with the Secretary of State of the State of Delaware, which is anticipated to occur promptly after the Annual Meeting. Additionally, the Board has resolved to amend the bylaws of the Company if this proposal is approved by our stockholders, by deleting Section 4.1(b) in order to eliminate the classified board provisions contained in the Bylaws and by making certain conforming changes.

Required Vote and Recommendation of the Board

The affirmative vote of the holders of at least two-thirds of the outstanding shares of our common stock is needed to approve this proposal. Therefore, the failure to vote, either by proxy or in person, will have the same effect as a vote against this proposal. Abstentions and broker non-votes will have the same effect as a vote against this proposal.

THE BOARD UNANIMOUSLY RECOMMENDS A VOTE “FOR” THE DECLASSIFIED BOARD AMENDMENT TO DECLASSIFY THE BOARD AND PROVIDE FOR THE ANNUAL ELECTION OF DIRECTORS.

OTHER MATTERS

We know of no other matters that will be presented for consideration at the Annual Meeting. If any other matters properly come before the Annual Meeting, it is the intention of the persons named in the enclosed form of proxy to vote the shares they represent as our Board may recommend. Discretionary authority with respect to such other matters is granted by the execution of the enclosed proxy.

OWNERSHIP OF SECURITIES

The following table sets forth certain information known to us with respect to the beneficial ownership of our common stock as of February 2, 2015 (unless otherwise indicated), by:

- each person known by us to be a beneficial owner of five percent (5%) or more of our common stock;
- each current director;
- each named executive officer; and
- all current directors and executive officers as a group.

Our common stock is the only class of voting securities outstanding. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and includes voting and investment power with respect to the securities. Except as indicated in the notes following the table, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them. The percentage of beneficial ownership is based on 23,157,509 shares of common stock outstanding as of February 2, 2015. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of our common stock subject to options held by that person that are currently exercisable or will become exercisable within 60 days following February 2, 2015 are deemed outstanding. However, these shares are not deemed outstanding for the purpose of computing the percentage ownership of any other person or entity.

Beneficial Owner	Shares Beneficially Owned	Percentage of Shares Beneficially Owned
<i>Named Executive Officers and Directors</i>		
Mark A. Ascolese	115,400	*
James A. Powers	57,749	*
Randall J. Adleman	80,000	*
Ake Almgren	133,300	*
Robert S. Greenberg	59,760	*
Peter Gross	—	*
James E. J. deVenny III	89,000	*
T. Patrick Kelly	45,666	*
Stephen J. Clearman	3,530,597	15.3%
Jan H. Lindelow (until May 28, 2014)	6,200	*
 All current directors and executives as a group (9 persons)	 4,117,672	 17.8%
<i>Other 5% stockholders:</i>		
Kinderhook Partners, L.P.	3,526,597	15.2%
Laurence W. Lytton	2,111,293	9.1%
Pacific View Asset Management (UK) LLP	1,933,549	8.4%
Joshua Ruch	1,286,429	5.6%

* Less than one percent of the outstanding common stock

Notes Regarding Beneficial Ownership Table:

- The address for all officers and directors is c/o Active Power, Inc., 2128 W. Braker Lane, BK 12, Austin, Texas 78758.
- **Mark A. Ascolese.** Includes 30,400 shares of outstanding common stock and 85,000 shares of common stock issuable upon exercise of options within 60 days of February 2, 2015.
- **James A. Powers.** Includes 14,000 shares of outstanding common stock and 43,750 shares of common stock issuable upon exercise of options within 60 days of February 2, 2015.
- **Randall J. Adleman.** Includes 30,000 shares of outstanding common stock and 50,000 shares of common stock issuable upon exercise of options within 60 days of February 2, 2015.
- **Ake Almgren.** Includes 70,300 shares of outstanding common stock and 63,000 shares of common stock issuable upon exercise of options within 60 days of February 2, 2015.
- **Robert S. Greenberg.** Includes 23,760 shares of outstanding common stock and 36,000 shares of common stock issuable upon exercise of options within 60 days of February 2, 2015.
- **Peter Gross.** Does not own any shares of outstanding common stock as of February 2, 2015, or shares of common stock subject to options that are currently exercisable or will become exercisable within 60 days following February 2, 2015.
- **James E. J. deVenny III.** Includes 32,000 shares of outstanding common stock held directly, 12,000 shares held of record indirectly by JD Investments Defined Benefit Plan, 3,000 shares held by his spouse, and 42,000 shares of common stock issuable upon exercise of options within 60 days of February 2, 2015.
- **T. Patrick Kelly.** Includes 35,000 shares of outstanding common stock and 6,666 shares of common stock issuable upon exercise of options within 60 days of February 2, 2015.
- **Stephen J. Clearman.** Consists of 3,526,597 shares of common stock held of record by Kinderhook Partners, LP (“Kinderhook”) and 4,000 shares of outstanding common stock held by Mr. Clearman. Mr. Clearman agreed to remit any proceeds from the sale of the 4,000 shares to Kinderhook. Accordingly, Mr. Clearman disclaims beneficial ownership of all shares except to the extent of his pecuniary interest, if any, therein.
- **All current directors and executive officers as a group.** Includes 3,767,057 shares of outstanding common stock and 326,416 shares of common stock issuable upon exercise of options within 60 days after February 2, 2015.
- **Kinderhook Partners, LP.** Based on a Schedule 13D/A filed with the SEC on February 26, 2013, reported that it had shared voting power and shared dispositive power over 3,526,597 shares of common stock as of January 3, 2013, and that its address was 2 Executive Drive, Suite 585, Fort Lee, NJ 07024. Mr. Clearman is the chief principal at Kinderhook Partners, LP and therefore his shares shown also include these shares in his total.
- **Laurence W. Lytton.** Based on a Schedule 13G/A filed with the SEC on February 13, 2015 Mr. Lytton reported that he had (i) sole voting power and sole dispositive power over 2,042,705 shares of common stock, and (ii) shared voting power and shared dispositive power over 68,588 shares of common stock, as of December 31, 2014, and that his address is 262 Harbor Drive, Stamford, Connecticut 06902.
- **Pacific View Asset Management (UK) LLP.** Based on a Schedule 13G/A filed with the SEC on February 13, 2015, reported that it had shared voting power and shared dispositive power over 1,933,549 shares of common stock as of December 31, 2014, and that its address is North Hall Farm Road, North Hall Road, Quendon, Essex, United Kingdom CB113XP.
- **Joshua Ruch.** Pursuant to a Schedule 13G/A filed with the SEC on February 5, 2013, Mr. Ruch reported that he had that he had sole voting power and sole dispositive power over 1,286,429 shares of common stock as of February 5, 2013. Mr. Ruch is a citizen of the United States and of the Republic of South Africa, with his business address at 4 Dune Road, East Quogue, New York 11942.

CERTAIN TRANSACTIONS

Employment agreements. For information regarding the employment agreements we have with our named executive officers, please see the “Employment Arrangements with Executive Officers” section of our Compensation Discussion and Analysis, above.

Stock options granted to executive officers and directors. For more information regarding the grant of stock options to executive officers and directors in 2014, please see the table “Fiscal 2014 Grants of Plan-based Awards” and the footnotes thereto included in our Compensation Discussion and Analysis, above.

Termination of employment and change in control arrangements. For information regarding the employment agreements we have with our named executive officers, please see the “Employment Arrangements with Executive Officers” section of our Compensation Discussion and Analysis, above.

Indemnification and insurance. Our bylaws require us to indemnify our directors and executive officers to the fullest extent permitted by Delaware law. We have entered into indemnification agreements with all of our directors and executive officers and have purchased directors’ and officers’ liability insurance. In addition, our certificate of incorporation limits the personal liability of our Board members for breaches of their fiduciary duties.

EQUITY COMPENSATION PLAN INFORMATION

The following table provides information about our common stock that, as of December 31, 2014, may be issued upon the exercise of options and rights under the following existing equity compensation plans (which are all of our equity compensation plans as of December 31, 2014):

<u>Plan Category</u>	<u>Number of Securities to be Issued Upon Exercise of Outstanding Options</u>	<u>Weighted Average Exercise Price of Outstanding Options</u>	<u>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column A)</u>
Equity Compensation Plans Approved by			
Stockholders	2,409,590	\$4.30	1,052,318
Equity Compensation Plans Not Approved by			
Stockholders	—	—	—
Total	2,409,590	\$4.30	1,052,318

NO INCORPORATION BY REFERENCE OF CERTAIN PORTIONS OF THIS PROXY STATEMENT

Notwithstanding anything to the contrary set forth in any of our previous filings made under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, that might incorporate future filings made by us under those statutes, neither the preceding Audit Committee Report nor the Compensation Committee Report is to be incorporated by reference into any such prior filings, nor shall such reports be incorporated by reference into any future filings made by us under those statutes.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires Active Power's directors, executive officers, and 10% or greater stockholders to file forms with the SEC to report their ownership of Active Power shares and any changes in ownership. Anyone required to file forms with the SEC must also send copies of the forms to Active Power. We have reviewed all such forms provided to us and based solely on that review, Active Power believes that all reports for our executive officers and directors that were required to be filed under Section 16 of the Securities Exchange Act of 1934 were timely filed.

ANNUAL REPORT

A copy of our Annual Report to Stockholders for 2014 has been mailed concurrently with this proxy statement to all stockholders entitled to notice of and to vote at the Annual Meeting. The Annual Report is not incorporated into this proxy statement and is not considered proxy solicitation material.

ANNUAL REPORT ON FORM 10-K

We filed an Annual Report on Form 10-K with the Securities and Exchange Commission on February 27, 2015. Stockholders may obtain a copy of this report, without charge, by writing to the attention of Investor Relations, at our principal executive offices, located at 2128 W. Braker Lane, BK 12, Austin, Texas 78758.

APPENDIX A

ACTIVE POWER, INC.

AMENDED AND RESTATED 2010 EQUITY INCENTIVE PLAN

1. Purposes of the Plan. The purposes of this Plan are:

- to attract and retain the best available personnel for positions of substantial responsibility,
- to provide incentives to individuals who perform services to the Company, and
- to promote the success of the Company's business.

The Plan permits the grant of Incentive Stock Options, Nonstatutory Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Units and Performance Shares.

2. Definitions. As used herein, the following definitions will apply:

(a) "Administrator" means the Board or any of its Committees as will be administering the Plan, in accordance with Section 4 of the Plan.

(b) "Affiliate" means any corporation or any other entity (including, but not limited to, partnerships and joint ventures) controlling, controlled by, or under common control with the Company.

(c) "Applicable Laws" means the requirements relating to the administration of equity-based awards under U.S. state corporate laws, U.S. federal and state securities laws, the Code, any stock exchange or quotation system on which the Common Stock is listed or quoted and the applicable laws of any foreign country or jurisdiction where Awards are, or will be, granted under the Plan.

(d) "Award" means, individually or collectively, a grant under the Plan of Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Units or Performance Shares.

(e) "Award Agreement" means the written or electronic agreement setting forth the terms and provisions applicable to each Award granted under the Plan. The Award Agreement is subject to the terms and conditions of the Plan.

(f) "Board" means the Board of Directors of the Company.

(g) "Change in Control" means the occurrence of any of the following events:

(i) Change in Ownership of the Company. A change in the ownership of the Company which occurs on the date that any one person, or more than one person acting as a group ("Person"), acquires ownership of the stock of the Company that, together with the stock held by such Person, constitutes more than 50% of the total voting power of the stock of the Company; provided, however, that for purposes of this subsection (i), the acquisition of additional stock by any one Person, who is considered to own more than 50% of the total voting power of the stock of the Company will not be considered a Change in Control; or

(ii) Change in Effective Control of the Company. If the Company has a class of securities registered pursuant to Section 12 of the Exchange Act, a change in the effective control of the Company which occurs on the date that a majority of members of the Board is replaced during any 12-month period by Directors whose appointment or election is not endorsed by a majority of the members of the Board prior to the date of the appointment or election. For purposes of this subsection (ii), if any Person is considered to be in effective control of the Company, the acquisition of additional control of the Company by the same Person will not be considered a Change in Control; or

(iii) Change in Ownership of a Substantial Portion of the Company's Assets. A change in the ownership of a substantial portion of the Company's assets which occurs on the date that any Person acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from the Company that have a total gross fair market value equal to or more than 50% of the total gross fair market value of all of the assets of the Company immediately prior to such acquisition or acquisitions; provided, however, that for purposes of this subsection (iii), the following will not constitute a change in the ownership of a substantial portion of the Company's assets: (A) a transfer to an entity that is controlled by the Company's stockholders immediately after the transfer, or (B) a transfer of assets by the Company to: (1) a stockholder of the Company (immediately

before the asset transfer) in exchange for or with respect to the Company's stock, (2) an entity, 50% or more of the total value or voting power of which is owned, directly or indirectly, by the Company, (3) a Person, that owns, directly or indirectly, 50% or more of the total value or voting power of all the outstanding stock of the Company, or (4) an entity, at least 50% of the total value or voting power of which is owned, directly or indirectly, by a Person described in this subsection (iii)(B)(3). For purposes of this subsection (iii), gross fair market value means the value of the assets of the Company, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

For purposes of this Section 2(g), persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the Company.

Notwithstanding the foregoing, a transaction shall not be deemed a Change in Control unless the transaction qualifies as a change in control event within the meaning of Section 409A of the Code, as it has been and may be amended from time to time, and any proposed or final Treasury Regulations and Internal Revenue Service guidance that has been promulgated or may be promulgated thereunder from time to time.

Further and for the avoidance of doubt, a transaction shall not constitute a Change in Control if: (i) its sole purpose is to change the state of the Company's incorporation, or (ii) its sole purpose is to create a holding company that shall be owned in substantially the same proportions by the persons who held the Company's securities immediately before such transaction.

(h) "Code" means the Internal Revenue Code of 1986, as amended. Reference to a specific section of the Code or Treasury Regulation thereunder will include such section or regulation, any valid regulation or other official applicable guidance promulgated under such section, and any comparable provision of any future legislation or regulation amending, supplementing or superseding such section or regulation.

(i) "Committee" means a committee of Directors or of other individuals satisfying Applicable Laws appointed by the Board in accordance with Section 4 hereof.

(j) "Common Stock" means the common stock of the Company.

(k) "Company" means Active Power, Inc., a Delaware corporation, or any successor thereto.

(l) "Consultant" means any person, including an advisor, engaged by the Company or its Affiliates to render services to such entity other than as an Employee.

(m) "Determination Date" means the latest possible date that will not jeopardize the qualification of an Award granted under the Plan as "performance-based compensation" under Section 162(m) of the Code.

(n) "Director" means a member of the Board.

(o) "Disability" means total and permanent disability as defined in Section 22(e)(3) of the Code, provided that in the case of Awards other than Incentive Stock Options, the Administrator in its discretion may determine whether a permanent and total disability exists in accordance with uniform and non-discriminatory standards adopted by the Administrator from time to time.

(p) "Employee" means any person, including Officers and Directors, employed by the Company or its Affiliates. Neither service as a Director nor payment of a director's fee by the Company will be sufficient to constitute "employment" by the Company.

(q) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(r) "Fair Market Value" means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the Nasdaq Global Market, the Nasdaq Global Select Market or the Nasdaq Capital Market, its Fair Market Value shall be the closing sales price for such stock (or, if no closing sales price was reported on that date, as applicable, on the last trading date such closing sales price is reported) as quoted on such exchange or system on the day of determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, its Fair Market Value shall be the mean between the high bid and low asked prices for the Common Stock on the day of determination (or, if no bids and asks were reported on that date, as applicable, on the last trading date such bids and asks are reported); or

(iii) In the absence of an established market for the Common Stock, the Fair Market Value will be determined in good faith by the Administrator.

(s) “Fiscal Year” means the fiscal year of the Company.

(t) “Incentive Stock Option” means an Option that by its terms qualifies and is otherwise intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder.

(u) “Misconduct” means the commission of any act of fraud, embezzlement or dishonesty by the Participant, any unauthorized use or disclosure by such person of confidential information or trade secrets of the Company (or any Parent or Subsidiary), or any intentional wrongdoing by such person, whether by omission or commission, which adversely affects the business or affairs of the Company (or any Parent or Subsidiary) in a material manner. This shall not limit the grounds for the dismissal or discharge of any person in the service of the Company (or any Parent or Subsidiary).

(v) “Nonstatutory Stock Option” means an Option that by its terms does not qualify or is not intended to qualify as an Incentive Stock Option.

(w) “Officer” means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

(x) “Option” means a stock option granted pursuant to the Plan.

(y) “Parent” means a “parent corporation,” whether now or hereafter existing, as defined in Section 424(e) of the Code.

(z) “Participant” means the holder of an outstanding Award.

(aa) “Performance Goals” will have the meaning set forth in Section 11 of the Plan.

(bb) “Performance Period” means any Fiscal Year of the Company or such longer or shorter period as determined by the Administrator in its sole discretion.

(cc) “Performance Share” means an Award denominated in Shares which may be earned in whole or in part upon attainment of performance goals or other vesting criteria as the Administrator may determine pursuant to Section 10.

(dd) “Performance Unit” means an Award which may be earned in whole or in part upon attainment of performance goals or other vesting criteria as the Administrator may determine and which may be settled for cash, Shares or other securities or a combination of the foregoing pursuant to Section 10.

(ee) “Period of Restriction” means the period during which the transfer of Shares of Restricted Stock are subject to restrictions and therefore, the Shares are subject to a substantial risk of forfeiture. Such restrictions may be based on the passage of time, the achievement of target levels of performance, or the occurrence of other events as determined by the Administrator.

(ff) “Plan” means this 2010 Equity Incentive Plan, as amended from time to time.

(gg) “Restricted Stock” means Shares issued pursuant to a Restricted Stock award under Section 8 of the Plan, or issued pursuant to the early exercise of an Option.

(hh) “Restricted Stock Unit” means a bookkeeping entry representing an amount equal to the Fair Market Value of one Share, granted pursuant to Section 9. Each Restricted Stock Unit represents an unfunded and unsecured obligation of the Company.

(ii) “Rule 16b-3” means Rule 16b-3 of the Exchange Act or any successor to Rule 16b-3, as in effect when discretion is being exercised with respect to the Plan.

(jj) “Section 16(b)” means Section 16(b) of the Exchange Act.

(kk) “Service Provider” means an Employee, Director or Consultant.

(ll) “Share” means a share of the Common Stock, as adjusted in accordance with Section 15 of the Plan.

(mm) “Stock Appreciation Right” means an Award, granted alone or in connection with an Option, that pursuant to Section 7 is designated as a Stock Appreciation Right.

(nn) “Subsidiary” means a “subsidiary corporation”, whether now or hereafter existing, as defined in Section 424(f) of the Code.

3. Stock Subject to the Plan.

(a) Subject to the provisions of Section 15 of the Plan, the maximum aggregate number of Shares that may be issued under the Plan is equal to the sum of (i) 5,120,000 Shares, (ii) any Shares which have been reserved but not issued pursuant to any awards granted under the Company’s 2000 Stock Incentive Plan (the “2000 Plan”) as of the date of stockholder approval of this Plan, plus (iii) any Shares subject to stock options or similar awards granted under 2000 Plan that expire or otherwise terminate without having been exercised in full and Shares issued pursuant to awards granted under the 2000 Plan that are forfeited to or repurchased by the Company (up to a maximum of 1,127,888) Shares pursuant to this subsection (iii)). The Shares may be authorized, but unissued, or reacquired Common Stock.

(b) Full Value Awards. Any Shares subject to Awards of Restricted Stock, Restricted Stock Units, Performance Units, and Performance Shares will be counted against the numerical limits of this Section 3 as 1.25 Shares for every one Share subject thereto. Further, if Shares acquired pursuant to any such Award are forfeited or repurchased by the Company and would otherwise return to the Plan pursuant to Section 3(c), 1.25 times the number of Shares so forfeited or repurchased will return to the Plan and will again become available for issuance.

(c) Lapsed Awards. If an Award expires or becomes unexercisable without having been exercised in full or, with respect to an Award of Restricted Stock Units, Performance Units or Performance Shares, is terminated due to failure to vest, the unpurchased Shares (or for Awards other than Options or Stock Appreciation Rights, the unissued Shares) which were subject thereto will become available for future grant or sale under the Plan (unless the Plan has terminated). Upon the exercise of a Stock Appreciation Right settled in Shares, the gross number of Shares covered by the portion of the Award so exercised will cease to be available under the Plan. Shares that have actually been issued under the Plan under any Award will not be returned to the Plan and will not become available for future distribution under the Plan; provided, however, that if Shares issued pursuant to Awards of Restricted Stock, Restricted Stock Units, Performance Shares or Performance Units are repurchased by the Company or are forfeited to the Company due to failure to vest, such Shares will become available for future grant under the Plan. Shares used to pay the exercise or purchase price of an Award and/or to satisfy the tax withholding obligations related to an Award will not become available for future grant or sale under the Plan. To the extent an Award under the Plan is paid out in cash rather than Shares, such cash payment will not result in reducing the number of Shares available for issuance under the Plan. Notwithstanding the foregoing and, subject to adjustment as provided in Section 15, the maximum number of Shares that may be issued upon the exercise of Incentive Stock Options will equal the aggregate Share number stated in Section 3(a), plus, to the extent allowable under Section 422 of the Code and the Treasury Regulations promulgated thereunder, any Shares that become available for issuance under the Plan under this Section 3(c).

(d) Share Reserve. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as will be sufficient to satisfy the requirements of the Plan.

4. Administration of the Plan.

(a) Procedure.

(i) Multiple Administrative Bodies. Different Committees with respect to different groups of Service Providers may administer the Plan.

(ii) Section 162(m). To the extent that the Administrator determines it to be desirable to qualify Awards granted hereunder as “performance-based compensation” within the meaning of Section 162(m) of the Code, the Plan will be administered by a Committee of two (2) or more “outside directors” within the meaning of Section 162(m) of the Code.

(iii) Rule 16b-3. To the extent desirable to qualify transactions hereunder as exempt under Rule 16b-3, the transactions contemplated hereunder will be structured to satisfy the requirements for exemption under Rule 16b-3.

(iv) Other Administration. Other than as provided above, the Plan will be administered by (A) the Board or (B) a Committee, which committee will be constituted to satisfy Applicable Laws.

(b) Powers of the Administrator. Subject to the provisions of the Plan, and in the case of a Committee, subject to the specific duties delegated by the Board to such Committee, the Administrator will have the authority, in its discretion:

(i) to determine the Fair Market Value;

(ii) to select the Service Providers to whom Awards may be granted hereunder;

(iii) to determine the number of Shares to be covered by each Award granted hereunder;

(iv) to approve forms of Award Agreements for use under the Plan;

(v) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any Award granted hereunder. Such terms and conditions include, but are not limited to, the exercise price, the time or times when Awards may be exercised (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions, and any restriction or limitation regarding any Award or the Shares relating thereto, based in each case on such factors as the Administrator will determine;

(vi) to construe and interpret the terms of the Plan and Awards granted pursuant to the Plan;

(vii) to prescribe, amend and rescind rules and regulations relating to the Plan, including rules and regulations relating to sub-plans established for the purpose of satisfying applicable foreign laws or for qualifying for favorable tax treatment under applicable foreign laws;

(viii) to modify or amend each Award (subject to Section 20(c) of the Plan), including but not limited to the discretionary authority to extend the post-termination exercisability period of Awards and to extend the maximum term of an Option (subject to Section 6(e) regarding Incentive Stock Options). Notwithstanding the previous sentence, the Administrator may not modify or amend an Option or Stock Appreciation Right to reduce the exercise price of such Option or Stock Appreciation Right after it has been granted (except for adjustments made pursuant to Section 15), and neither may the Administrator cancel any outstanding Option or Stock Appreciation Right and immediately replace it with a new Option or Stock Appreciation Right with a lower exercise price, unless such action is approved by stockholders prior to such action being taken. Further, the Administrator may not offer to buy out for a payment in cash an Option or Stock Appreciation Right after it has been granted (except with respect to any payments made pursuant to Section 15), unless approved by the Company's stockholders prior to making any such offer;

(ix) to allow Participants to satisfy withholding tax obligations in such manner as prescribed in Section 16;

(x) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Award previously granted by the Administrator;

(xi) to allow a Participant to defer the receipt of the payment of cash or the delivery of Shares that would otherwise be due to such Participant under an Award pursuant to such procedures as the Administrator may determine; and

(xii) to make all other determinations deemed necessary or advisable for administering the Plan.

(c) Effect of Administrator's Decision. The Administrator's decisions, determinations and interpretations will be final and binding on all Participants and any other holders of Awards.

(d) No Liability. Under no circumstances shall the Company, its Affiliates, the Administrator, or the Board incur liability for any indirect, incidental, consequential or special damages (including lost profits) of any form incurred by any person, whether or not foreseeable and regardless of the form of the act in which such a claim may be brought, with respect to the Plan or the Company's, its Affiliates', the Administrator's or the Board's roles in connection with the Plan.

5. Eligibility. Nonstatutory Stock Options, Restricted Stock, Restricted Stock Units, Stock Appreciation Rights, Performance Units, and Performance Shares may be granted to Service Providers. Incentive Stock Options may be granted only to employees of the Company or any Parent or Subsidiary of the Company.

6. Stock Options.

(a) Grant of Stock Options. Subject to the terms and conditions of the Plan, an Option may be granted to Service Providers at any time and from time to time as will be determined by the Administrator, in its sole discretion. Each Option will be designated in the Award Agreement as either an Incentive Stock Option or a Nonstatutory Stock Option. However, notwithstanding such designation, to the extent that the aggregate Fair Market Value of the Shares with respect to which Incentive Stock Options are exercisable for the first time by the Participant during any calendar year (under all plans of the Company and any Parent or Subsidiary) exceeds \$100,000, such Options will be treated as Nonstatutory Stock Options. For purposes of this Section 6(a), Incentive Stock Options will be taken into account in the order in which they were granted. The Fair Market Value of the Shares will be determined as of the time the Option with respect to such Shares is granted.

(b) Number of Shares. The Administrator will have complete discretion to determine the number of Shares subject to an Option granted to any Participant, provided that during any Fiscal Year, no Participant will be granted Options covering more than 300,000 Shares. Notwithstanding the limitation in the previous sentence, in connection with his or her initial service as an Employee, an Employee may be granted Options covering up to an additional 500,000 Shares. The foregoing limitations will be adjusted proportionately in connection with any change in the Company's capitalization as described in Section 15.

(c) Exercise Price and Other Terms. The Administrator, subject to the provisions of the Plan, will have complete discretion to determine the terms and conditions of Options granted under the Plan, provided, however, that the exercise price will not be less than one hundred percent (100%) of the Fair Market Value of a Share on the date of grant. In addition, in the case of an Incentive Stock Option granted to an employee of the Company or any Parent or Subsidiary of the Company who, at the time the Incentive Stock Option is granted, owns stock representing more than 10% of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the per Share exercise price will be no less than 110% of the Fair Market Value per Share on the date of grant. Notwithstanding the foregoing provisions of this Section 6(c), Options may be granted with a per Share exercise price of less than 100% of the Fair Market Value per Share on the date of grant pursuant to a transaction described in, and in a manner consistent with, Section 424(a) of the Code and the Treasury Regulations thereunder.

(d) Option Agreement.

(i) Terms and Conditions. Each Option grant will be evidenced by an Award Agreement that will specify the exercise price, the term of the Option, the acceptable forms of consideration for exercise (which may include any form of consideration permitted by Section 6(d)(ii), the conditions of exercise, and such other terms and conditions as the Administrator, in its sole discretion, will determine.

(ii) Form of Consideration. The Administrator will determine the acceptable form(s) of consideration for exercising an Option, including the method of payment, to the extent permitted by Applicable Laws. In the case of an Incentive Stock Option, the Administrator will determine the acceptable form of consideration at the time of grant. Such consideration to the extent permitted by Applicable Laws may include, but is not limited to:

(1) cash;

(2) check;

(3) other Shares which have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option will be exercised and provided that accepting such Shares, in the sole discretion of the Administrator, will not result in any adverse accounting consequences to the Company;

(4) by net exercise;

(5) consideration received by the Company under a cashless exercise program implemented by the Company in connection with the Plan;

(6) a reduction in the amount of any Company liability to the Participant, including any liability attributable to the Participant's participation in any Company-sponsored deferred compensation program or arrangement;

(7) such other consideration and method of payment for the issuance of Shares to the extent permitted by Applicable Laws; or

(8) any combination of the foregoing methods of payment.

(e) Term of Option. An Option granted under the Plan will expire upon the date determined by the Administrator, in its sole discretion, and set forth in the Award Agreement; provided, however, that the term will be no more than ten years from the date of grant thereof or such shorter period as may be required to avoid additional taxes under Section 409A of the Code. In the case of an Incentive Stock Option granted to a Participant who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or any Parent or Subsidiary, the term of the Incentive Stock Option will be five years from the date of grant or such shorter term as may be provided in the Award Agreement.

(f) Exercise of Option.

(i) Procedure for Exercise; Rights as a Stockholder. Any Option granted hereunder will be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Administrator and set forth in the Award Agreement. An Option may not be exercised for a fraction of a Share.

An Option will be deemed exercised when the Company receives: (i) notice of exercise (in such form as the Administrator specifies from time to time) from the person entitled to exercise the Option, and (ii) full payment for the Shares with respect to which the Option is exercised (together with applicable tax withholdings). Full payment may consist of any consideration and method of payment authorized by the Administrator and permitted by the Award Agreement and the Plan. Shares issued upon exercise of an Option will be issued in the name of the Participant or, if requested by the Participant, in the name of the Participant and his or her spouse. Until the Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a stockholder will exist with respect to the Shares subject to an Option, notwithstanding the exercise of the Option. The Company will issue (or cause to be issued) such Shares promptly after the Option is exercised. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Shares are issued, except as provided in Section 15 of the Plan.

Exercising an Option in any manner will decrease the number of Shares thereafter available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

(ii) Termination of Relationship as a Service Provider. If a Participant ceases to be a Service Provider, other than upon the Participant's termination as the result of the Participant's death, Disability or Misconduct, the Participant may exercise his or her Option within such period of time as is specified in the Award Agreement to the extent that the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Award Agreement). In the absence of a specified time in the Award Agreement, the Option will remain exercisable for three months following the Participant's termination. Unless otherwise provided by the Administrator, if on the date of termination the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option will revert to the Plan. If after termination the Participant does not exercise his or her Option within the time specified by the Administrator, the Option will terminate, and the Shares covered by such Option will revert to the Plan.

(iii) Misconduct of Participant. If a Participant's termination occurs as a result of Misconduct or if a Participant engages in Misconduct while his or her Options are outstanding, then all such Options shall terminate immediately and cease to be outstanding.

(iv) Disability of Participant. If a Participant ceases to be a Service Provider as a result of the Participant's Disability, the Participant may exercise his or her Option within such period of time as is specified in the Award Agreement to the extent the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Award Agreement). In the absence of a specified time in the Award Agreement, the Option will remain exercisable for twelve months following the Participant's termination. Unless otherwise provided by the Administrator, if on the date of termination the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option will revert to the Plan. If after termination the Participant does not exercise his or her Option within the time specified herein, the Option will terminate, and the Shares covered by such Option will revert to the Plan.

(v) Death of Participant. If a Participant dies while a Service Provider, the Option may be exercised following the Participant's death within such period of time as is specified in the Award Agreement to the extent that the Option is vested on the date of death (but in no event may the Option be exercised later than the expiration of the term of such Option as set forth in the Award Agreement), by the Participant's designated beneficiary, provided such beneficiary has been designated prior to Participant's death in a form acceptable to the Administrator. If no such beneficiary has been designated by the Participant, then such Option may be exercised by the personal representative of the Participant's estate or by the person(s) to whom the Option is transferred pursuant to the Participant's will or in accordance with the laws of descent and distribution. In the absence of a specified time in the Award Agreement, the Option will remain exercisable for 12 months following Participant's death. Unless otherwise provided by the Administrator, if at the time of death Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option will immediately revert to the Plan. If the Option is not so exercised within the time specified herein, the Option will terminate, and the Shares covered by such Option will revert to the Plan.

(vi) Other Termination. A Participant's Award Agreement also may provide that if the exercise of the Option following the termination of Participant's status as a Service Provider (other than upon the Participant's death or Disability) would result in liability under Section 16(b), then the Option will terminate on the earlier of (A) the expiration of the term of the Option set forth in the Award Agreement, or (B) the tenth (10th) day after the last date on which such exercise would result in such liability under Section 16(b). Finally, a Participant's Award Agreement may also provide that if the exercise of the Option following the termination of the Participant's status as a Service Provider (other than upon the Participant's death or Disability) would be prohibited at any time solely because the issuance of Shares would violate the registration requirements under the Securities Act, then the Option will terminate on the earlier of (A) the expiration of the term of the Option, or (B) the expiration of a period of three months after the termination of the Participant's status as a Service Provider during which the exercise of the Option would not be in violation of such registration requirements.

7. Stock Appreciation Rights.

(a) Grant of Stock Appreciation Rights. Subject to the terms and conditions of the Plan, a Stock Appreciation Right may be granted to Service Providers at any time and from time to time as will be determined by the Administrator, in its sole discretion.

(b) Number of Shares. The Administrator will have complete discretion to determine the number of Stock Appreciation Rights granted to any Participant, provided that during any Fiscal Year, no Participant will be granted Stock Appreciation Rights covering more than 300,000 Shares. Notwithstanding the limitation in the previous sentence, in connection with his or her initial service as an Employee, an Employee may be granted Stock Appreciation Rights covering up to an additional 500,000 Shares. The foregoing limitations will be adjusted proportionately in connection with any change in the Company's capitalization as described in Section 15.

(c) Exercise Price and Other Terms. The Administrator, subject to the provisions of the Plan, will have complete discretion to determine the terms and conditions of Stock Appreciation Rights granted under the Plan, provided, however, that the exercise price will not be less than one hundred percent (100%) of the Fair Market Value of a Share on the date of grant. Notwithstanding the foregoing provisions of this Section 7(c), Stock Appreciation Rights may be granted with a per Share exercise price of less than one hundred percent (100%) of the Fair Market Value per Share on the date of grant pursuant to a transaction described in, and in a manner consistent with, Section 424(a) of the Code and the Treasury Regulations thereunder.

(d) Stock Appreciation Right Agreement. Each Stock Appreciation Right grant will be evidenced by an Award Agreement that will specify the exercise price, the term of the Stock Appreciation Right, the conditions of exercise, and such other terms and conditions as the Administrator, in its sole discretion, will determine.

(e) Expiration of Stock Appreciation Rights. A Stock Appreciation Right granted under the Plan will expire upon the date determined by the Administrator, in its sole discretion, and set forth in the Award Agreement; provided, however, that the term will be no more than ten years from the date of grant thereof. Notwithstanding the foregoing, the rules of Section 6(f) relating to exercise also will apply to Stock Appreciation Rights.

(f) Payment of Stock Appreciation Right Amount. Upon exercise of a Stock Appreciation Right, a Participant will be entitled to receive payment from the Company in an amount determined by multiplying:

(i) The difference between the Fair Market Value of a Share on the date of exercise over the exercise price; times

- (ii) The number of Shares with respect to which the Stock Appreciation Right is exercised.

At the discretion of the Administrator, the payment upon Stock Appreciation Right exercise may be in cash, in Shares of equivalent value, or in some combination thereof.

8. Restricted Stock.

(a) Grant of Restricted Stock. Subject to the terms and provisions of the Plan, the Administrator, at any time and from time to time, may grant Shares of Restricted Stock to Service Providers in such amounts as the Administrator, in its sole discretion, will determine.

(b) Restricted Stock Agreement. Each Award of Restricted Stock will be evidenced by an Award Agreement that will specify the Period of Restriction, the number of Shares granted, and such other terms and conditions as the Administrator, in its sole discretion, will determine. Unless the Administrator determines otherwise, the Company as escrow agent will hold Shares of Restricted Stock until the restrictions on such Shares have lapsed. Notwithstanding the foregoing sentence, for restricted stock intended to qualify as “performance-based compensation” within the meaning of Section 162(m) of the Code, during any Fiscal Year no Participant will receive more than an aggregate of 100,000 Shares of Restricted Stock. Notwithstanding the foregoing limitation, in connection with his or her initial service as an Employee, for restricted stock intended to qualify as “performance-based compensation” within the meaning of Section 162(m) of the Code, an Employee may be granted an aggregate of up to an additional 150,000 Shares of Restricted Stock. The foregoing limitations will be adjusted proportionately in connection with any change in the Company’s capitalization as described in Section 15.

(c) Transferability. Except as provided in this Section 8, Shares of Restricted Stock may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated until the end of the applicable Period of Restriction.

(d) Other Restrictions. The Administrator, in its sole discretion, may impose such other restrictions on Shares of Restricted Stock as it may deem advisable or appropriate.

(e) Removal of Restrictions. Except as otherwise provided in this Section 8, Shares of Restricted Stock covered by each Restricted Stock grant made under the Plan will be released from escrow as soon as practicable after the last day of the Period of Restriction or at such other time as the Administrator may determine. The Administrator, in its sole discretion, may reduce or waive any restrictions for such Award and may accelerate the time at which any restrictions will lapse or be removed.

(f) Voting Rights. During the Period of Restriction, Service Providers holding Shares of Restricted Stock granted hereunder may exercise full voting rights with respect to those Shares, unless the Administrator determines otherwise.

(g) Dividends and Other Distributions. During the Period of Restriction, Service Providers holding Shares of Restricted Stock will be entitled to receive all dividends and other distributions paid with respect to such Shares, unless the Administrator provides otherwise. If any such dividends or distributions are paid in Shares, the Shares will be subject to the same restrictions on transferability and forfeitability as the Shares of Restricted Stock with respect to which they were paid.

(h) Return of Restricted Stock to Company. On the date set forth in the Award Agreement, the Restricted Stock for which restrictions have not lapsed will revert to the Company and again will become available for grant under the Plan.

(i) Section 162(m) Performance Restrictions. For purposes of qualifying grants of Restricted Stock as “performance-based compensation” under Section 162(m) of the Code, the Administrator, in its discretion, may set restrictions based upon the achievement of Performance Goals. The Performance Goals will be set by the Administrator on or before the Determination Date. In granting Restricted Stock which is intended to qualify under Section 162(m) of the Code, the Administrator will follow any procedures determined by it from time to time to be necessary or appropriate to ensure qualification of the Award under Section 162(m) of the Code (e.g., in determining the Performance Goals).

9. Restricted Stock Units.

(a) Grant. Restricted Stock Units may be granted at any time and from time to time as determined by the Administrator. After the Administrator determines that it will grant Restricted Stock Units under the Plan, it will advise the Participant in an Award Agreement of the terms, conditions, and restrictions related to the grant, including the number of Restricted Stock Units. Notwithstanding anything to the contrary in this subsection (a), for Restricted

Stock Units intended to qualify as “performance-based compensation” within the meaning of Section 162(m) of the Code, during any Fiscal Year of the Company, no Participant will receive more than an aggregate of 100,000 Restricted Stock Units. Notwithstanding the limitation in the previous sentence, for Restricted Stock Units intended to qualify as “performance-based compensation” within the meaning of Section 162(m) of the Code, in connection with his or her initial service as an Employee, an Employee may be granted an aggregate of up to an additional 150,000 Restricted Stock Units. The foregoing limitations will be adjusted proportionately in connection with any change in the Company’s capitalization as described in Section 15.

(b) Vesting Criteria and Other Terms. The Administrator will set vesting criteria in its discretion, which, depending on the extent to which the criteria are met, will determine the number of Restricted Stock Units that will be paid out to the Participant. The Administrator may set vesting criteria based upon the achievement of Company-wide, business unit, or individual goals (including, but not limited to, continued employment), or any other basis determined by the Administrator in its discretion.

(c) Earning Restricted Stock Units. Upon meeting the applicable vesting criteria, the Participant will be entitled to receive a payout as determined by the Administrator. Notwithstanding the foregoing, at any time after the grant of Restricted Stock Units, the Administrator, in its sole discretion, may reduce or waive any vesting criteria that must be met to receive a payout and may accelerate the time at which any restrictions will lapse or be removed.

(d) Form and Timing of Payment. Payment of earned Restricted Stock Units will be made as soon as practicable after the date(s) set forth in the Award Agreement or as otherwise provided in the applicable Award Agreement or as required by Applicable Laws. The Administrator, in its sole discretion, may pay earned Restricted Stock Units in cash, Shares, or a combination thereof. Shares represented by Restricted Stock Units that are fully paid in cash again will not reduce the number of Shares available for grant under the Plan.

(e) Cancellation. On the date set forth in the Award Agreement, all unearned Restricted Stock Units will be forfeited to the Company.

(f) Section 162(m) Performance Restrictions. For purposes of qualifying grants of Restricted Stock Units as “performance-based compensation” under Section 162(m) of the Code, the Administrator, in its discretion, may set restrictions based upon the achievement of Performance Goals. The Performance Goals will be set by the Administrator on or before the Determination Date. In granting Restricted Stock Units which are intended to qualify under Section 162(m) of the Code, the Administrator will follow any procedures determined by it from time to time to be necessary or appropriate to ensure qualification of the Award under Section 162(m) of the Code (e.g., in determining the Performance Goals).

10. Performance Units and Performance Shares.

(a) Grant of Performance Units/Shares. Performance Units and Performance Shares may be granted to Service Providers at any time and from time to time, as will be determined by the Administrator, in its sole discretion. The Administrator will have complete discretion in determining the number of Performance Units and Performance Shares granted to each Participant provided that during any Fiscal Year, for Performance Units or Performance Shares intended to qualify as “performance-based compensation” within the meaning of Section 162(m) of the Code, (i) no Participant will receive Performance Units having an initial value greater than \$1,000,000, and (ii) no Participant will receive more than 100,000 Performance Shares. Notwithstanding the foregoing limitation, for Performance Shares intended to qualify as “performance-based compensation” within the meaning of Section 162(m) of the Code, in connection with his or her initial service, a Service Provider may be granted up to an additional 150,000 Performance Shares and additional Performance Units having an initial value up to \$1,500,000. The foregoing limitations will be adjusted proportionately in connection with any change in the Company’s capitalization as described in Section 15.

(b) Value of Performance Units/Shares. Each Performance Unit will have an initial value that is established by the Administrator on or before the date of grant. Each Performance Share will have an initial value equal to the Fair Market Value of a Share on the date of grant.

(c) Performance Objectives and Other Terms. The Administrator will set performance objectives or other vesting provisions (including, without limitation, continued status as a Service Provider) in its discretion which, depending on the extent to which they are met, will determine the number or value of Performance Units/Shares that will be paid out to the Service Providers. The time period during which the performance objectives or other vesting provisions must be met will be called the “Performance Period.” Each Award of Performance Units/Shares will be evidenced by an Award Agreement that will specify the Performance Period, and such other terms and conditions as the

Administrator, in its sole discretion, will determine. The Administrator may set performance objectives based upon the achievement of Company-wide, divisional, or individual goals, applicable federal or state securities laws, or any other basis determined by the Administrator in its discretion.

(d) Earning of Performance Units/Shares. After the applicable Performance Period has ended, the holder of Performance Units/Shares will be entitled to receive a payout of the number of Performance Units/Shares earned by the Participant over the Performance Period, to be determined as a function of the extent to which the corresponding performance objectives or other vesting provisions have been achieved. After the grant of a Performance Unit/Share, the Administrator, in its sole discretion, may reduce or waive any performance objectives or other vesting provisions for such Performance Unit/Share and may accelerate the time at which any restrictions will lapse or be removed.

(e) Form and Timing of Payment of Performance Units/Shares. Payment of earned Performance Units/Shares will be made as soon as practicable after the expiration of the applicable Performance Period, or as otherwise provided in the applicable Award Agreement or as required by Applicable Laws. The Administrator, in its sole discretion, may pay earned Performance Units/Shares in the form of cash, in Shares (which have an aggregate Fair Market Value equal to the value of the earned Performance Units/Shares at the close of the applicable Performance Period) or in a combination thereof.

(f) Cancellation of Performance Units/Shares. On the date set forth in the Award Agreement, all unearned or unvested Performance Units/Shares will be forfeited to the Company, and again will be available for grant under the Plan.

(g) Section 162(m) Performance Restrictions. For purposes of qualifying grants of Performance Units/Shares as “performance-based compensation” under Section 162(m) of the Code, the Administrator, in its discretion, may set restrictions based upon the achievement of Performance Goals. The Performance Goals will be set by the Administrator on or before the Determination Date. In granting Performance Units/Shares which are intended to qualify under Section 162(m) of the Code, the Administrator will follow any procedures determined by it from time to time to be necessary or appropriate to ensure qualification of the Award under Section 162(m) of the Code (e.g., in determining the Performance Goals).

11. Performance-Based Compensation Under Code Section 162(m).

(a) General. If the Administrator, in its discretion, decides to grant an Award intended to qualify as “performance-based compensation” under Section 162(m) of the Code, the provisions of this Section 11 will control over any contrary provision in the Plan; provided, however, that the Administrator may in its discretion grant Awards that are not intended to qualify as “performance-based compensation” under Section 162(m) of the Code to such Participants that are based on Performance Goals or other specific criteria or goals but that do not satisfy the requirements of this Section 11.

(b) Performance Goals. The granting and/or vesting of Awards of Restricted Stock, Restricted Stock Units, Performance Shares and Performance Units and other incentives under the Plan may be made subject to the attainment of performance goals relating to one or more business criteria within the meaning of Section 162(m) of the Code and may provide for a targeted level or levels of achievement (“Performance Goals”) including: (i) cash flow, (ii) cash position, (iii) earnings (which may include earnings before interest and taxes, earnings before taxes and net earnings), (iv) earnings per Share, (v) growth in stockholder value relative to the moving average of the S&P 500 Index or another index, (vi) net income, (vii) net profit, (viii) net sales, (ix) operating cash flow, (x) operating income, (xi) revenue, (xii) revenue growth, (xiii) stock price, and (xiv) working capital. Any criteria used may be (A) measured in absolute terms, (B) measured in terms of growth, (C) compared to another company or companies, (D) measured against the market as a whole and/or according to applicable market indices, (E) measured against the performance of the Company as a whole or a segment of the Company and/or (F) measured on a pre-tax or post-tax basis (if applicable). Further, any Performance Goals may be used to measure the performance of the Company as a whole or a business unit or other segment of the Company, or one or more product lines or specific markets and may be measured relative to a peer group or index. The Performance Goals may differ from Participant to Participant and from Award to Award. Prior to the Determination Date, the Administrator will determine whether any significant element(s) will be included in or excluded from the calculation of any Performance Goal with respect to any Participant. In all other respects, Performance Goals will be calculated in accordance with the Company’s financial statements, generally accepted accounting principles, or under a methodology established by the Administrator prior to the issuance of an Award and which is consistently applied with respect to a Performance Goal in the relevant

Performance Period. The Administrator will adjust any performance criteria, Performance Goal or other feature of an Award that relates to or is wholly or partially based on the number of, or the value of, any stock of the Company, to reflect any stock dividend or split, repurchase, recapitalization, combination, or exchange of shares or other similar changes in such stock.

(c) Procedures. To the extent necessary to comply with the performance-based compensation provisions of Section 162(m) of the Code, with respect to any Award granted subject to Performance Goals and intended to qualify as “performance-based compensation” under Section 162(m) of the Code, on or before the Determination Date (i.e., within the first twenty-five percent (25%) of the Performance Period, but in no event more than ninety (90) days following the commencement of any Performance Period or such other time as may be required or permitted by Section 162(m) of the Code), the Administrator will, in writing, (i) designate one or more Participants to whom an Award will be made, (ii) select the Performance Goals applicable to the Performance Period, (iii) establish the Performance Goals, and amounts of such Awards, as applicable, which may be earned for such Performance Period, and (iv) specify the relationship between Performance Goals and the amounts of such Awards, as applicable, to be earned by each Participant for such Performance Period.

(d) Additional Limitations. Notwithstanding any other provision of the Plan, any Award which is granted to a Participant and is intended to constitute qualified performance-based compensation under Section 162(m) of the Code will be subject to any additional limitations set forth in the Code (including any amendment to Section 162(m)) or any regulations and ruling issued thereunder that are requirements for qualification as qualified performance-based compensation as described in Section 162(m) of the Code, and the Plan will be deemed amended to the extent necessary to conform to such requirements.

(e) Determination of Amounts Earned. Following the completion of each Performance Period, the Administrator will certify in writing whether the applicable Performance Goals have been achieved for such Performance Period. A Participant will be eligible to receive payment pursuant to an Award intended to qualify as “performance-based compensation” under Section 162(m) of the Code for a Performance Period only if the Performance Goals for such period are achieved. In determining the amounts earned by a Participant pursuant to an Award intended to qualified as “performance-based compensation” under Section 162(m) of the Code, the Committee will have the right to (a) reduce or eliminate (but not to increase) the amount payable at a given level of performance to take into account additional factors that the Committee may deem relevant to the assessment of individual or corporate performance for the Performance Period, (b) determine what actual Award, if any, will be paid in the event of a termination of employment as the result of a Participant’s death or disability or upon a Change in Control or in the event of a termination of employment following a Change in Control prior to the end of the Performance Period, and (c) determine what actual Award, if any, will be paid in the event of a termination of employment other than as the result of a Participant’s death or disability prior to a Change of Control and prior to the end of the Performance Period to the extent an actual Award would have otherwise been achieved had the Participant remained employed through the end of the Performance Period. A Participant will be eligible to receive payment pursuant to an Award intended to qualify as “performance-based compensation” under Section 162(m) of the Code for a Performance Period only if the Performance Goals for such period are achieved.

12. Compliance With Code Section 409A. Awards will be designed and operated in such a manner that they are either exempt from the application of, or comply with, the requirements of Code Section 409A such that the grant, payment, settlement or deferral will not be subject to the additional tax or interest applicable under Code Section 409A, except as otherwise determined in the sole discretion of the Administrator. The Plan and each Award Agreement under the Plan is intended to meet the requirements of Code Section 409A and will be construed and interpreted in accordance with such intent, except as otherwise determined in the sole discretion of the Administrator. To the extent that an Award or payment, or the settlement or deferral thereof, is subject to Code Section 409A the Award will be granted, paid, settled or deferred in a manner that will meet the requirements of Code Section 409A, such that the grant, payment, settlement or deferral will not be subject to the additional tax or interest applicable under Code Section 409A.

13. Leaves of Absence/Transfer Between Locations. Unless the Administrator provides otherwise and except as required by Applicable Laws, vesting of Awards granted hereunder will be suspended during any unpaid leave of absence. A Participant will not cease to be an Employee in the case of (i) any leave of absence approved by the Company or (ii) transfers between locations of the Company or between the Company, its Parent, or any Subsidiary. For purposes of Incentive Stock Options, no such leave may exceed three months, unless reemployment upon

expiration of such leave is guaranteed by statute or contract. If reemployment upon expiration of a leave of absence approved by the Company is not so guaranteed, then six months following the first (1st) day of such leave, any Incentive Stock Option held by the Participant will cease to be treated as an Incentive Stock Option and will be treated for tax purposes as a Nonstatutory Stock Option.

14. Transferability of Awards. Unless determined otherwise by the Administrator, an Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Participant, only by the Participant.

15. Adjustments; Dissolution or Liquidation; Merger or Change in Control.

(a) Adjustments. In the event that any dividend or other distribution (whether in the form of cash, Shares, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase, or exchange of Shares or other securities of the Company, or other change in the corporate structure of the Company affecting the Shares occurs, the Administrator, in order to prevent diminution or enlargement of the benefits or potential benefits intended to be made available under the Plan, will adjust the number and class of Shares that may be delivered under the Plan and/or the number, class, and price of Shares covered by each outstanding Award, the numerical Share limits set forth in Sections 3, 6, 7, 8, 9 and 10 of the Plan.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, the Administrator will notify each Participant as soon as practicable prior to the effective date of such proposed transaction. To the extent it has not been previously exercised, an Award will terminate immediately prior to the consummation of such proposed action.

(c) Change in Control. In the event of a merger or Change in Control, each outstanding Award will be treated as the Administrator determines without a Participant's consent, including, without limitation, that (i) Awards will be assumed, or substantially equivalent Awards will be substituted, by the acquiring or succeeding corporation (or an affiliate thereof) with appropriate adjustments as to the number and kind of shares and prices; (ii) upon written notice to a Participant, that the Participant's Awards will terminate upon or immediately prior to the consummation of such merger or Change in Control; (iii) outstanding Awards will vest and become exercisable, realizable, or payable, or restrictions applicable to an Award will lapse, in whole or in part prior to or upon consummation of such merger or Change in Control, and, to the extent the Administrator determines, terminate upon or immediately prior to the effectiveness of such merger or Change in Control; (iv) (A) the termination of an Award in exchange for an amount of cash and/or property, if any, equal to the amount that would have been attained upon the exercise of such Award or realization of the Participant's rights as of the date of the occurrence of the transaction (and, for the avoidance of doubt, if as of the date of the occurrence of the transaction the Administrator determines in good faith that no amount would have been attained upon the exercise of such Award or realization of the Participant's rights, then such Award may be terminated by the Company without payment), or (B) the replacement of such Award with other rights or property selected by the Administrator in its sole discretion; or (v) any combination of the foregoing. In taking any of the actions permitted under this subsection 15(c), the Administrator will not be obligated to treat all Awards, all Awards held by a Participant, or all Awards of the same type, similarly.

In the event that the successor corporation does not assume or substitute for the Award (or portion thereof), the Participant will fully vest in and have the right to exercise all of his or her outstanding Options and Stock Appreciation Rights that are not assumed or substituted for, including Shares as to which such Awards would not otherwise be vested or exercisable, all restrictions on Restricted Stock, Restricted Stock Units, and Performance Shares/Units not assumed or substituted for will lapse, and, with respect to Awards with performance-based vesting not assumed or substituted for, all performance goals or other vesting criteria will be deemed achieved at 100% of target levels and all other terms and conditions met. In addition, if an Option or Stock Appreciation Right is not assumed or substituted for in the event of a Change in Control, the Administrator will notify the Participant in writing or electronically that the Option or Stock Appreciation Right will be fully vested and exercisable for a period of time determined by the Administrator in its sole discretion, and the Option or Stock Appreciation Right will terminate upon the expiration of such period.

For the purposes of this subsection (c), an Award will be considered assumed if, following the merger or Change in Control, the Award confers the right to purchase or receive, for each Share subject to the Award immediately prior to the Change in Control, the consideration (whether stock, cash, or other securities or property) or, in the case of a Stock Appreciation Right upon the exercise of which the Administrator determines to pay cash or a Restricted Stock

Unit, Performance Share or Performance Unit which the Administrator can determine to pay in cash, the fair market value of the consideration received in the merger or Change in Control by holders of Common Stock for each Share held on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the merger or Change in Control is not solely common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of an Option or Stock Appreciation Right or upon the payout of a Restricted Stock Unit, Performance Unit or Performance Share, for each Share subject to such Award (or in the case of an Award settled in cash, the number of implied shares determined by dividing the value of the Award by the per share consideration received by holders of Common Stock in the merger or Change in Control), to be solely common stock of the successor corporation or its Parent equal in fair market value to the per share consideration received by holders of Common Stock in the merger or Change in Control.

Notwithstanding anything in this Section 15(c) to the contrary, an Award that vests, is earned or paid-out upon the satisfaction of one or more performance objectives (including any Performance Goals) will not be considered assumed if the Company or its successor modifies any of such performance objectives without the Participant's consent; provided, however, a modification to such performance objectives only to reflect the successor corporation's post-Change in Control corporate structure will not be deemed to invalidate an otherwise valid Award assumption.

Notwithstanding anything in this Section 15(c) to the contrary, if a payment under an Award Agreement is subject to Section 409A of the Code and if the change in control definition contained in the Award Agreement or other agreement related to the Award does not comply with the definition of "change in control" for purposes of a distribution under Section 409A of the Code, then any payment of an amount that is otherwise accelerated under this Section will be delayed until the earliest time that such payment would be permissible under Section 409A of the Code without triggering any penalties applicable under Section 409A of the Code.

16. Tax Withholding.

(a) Withholding Requirements. Prior to the delivery of any Shares or cash pursuant to an Award (or exercise thereof), the Company will have the power and the right to deduct or withhold, or require a Participant to remit to the Company, an amount sufficient to satisfy federal, state, local, foreign or other taxes (including the Participant's FICA obligation) required to be withheld with respect to such Award (or exercise thereof).

(b) Withholding Arrangements. The Administrator, in its sole discretion and pursuant to such procedures as it may specify from time to time, may permit a Participant to satisfy such tax withholding obligation, in whole or in part by (without limitation) (a) paying cash, (b) electing to have the Company withhold otherwise deliverable cash or Shares having a Fair Market Value equal to the amount required to be withheld, (c) delivering to the Company already-owned Shares having a Fair Market Value equal to the amount required to be withheld, provided the delivery of such Shares will not result in any adverse accounting consequences as the Administrator determines in its sole discretion, (d) selling a sufficient number of Shares otherwise deliverable to the Participant through such means as the Administrator may determine in its sole discretion (whether through a broker or otherwise) equal to the amount required to be withheld, or (e) retaining from salary or other amounts payable to the Participant cash having a sufficient value to satisfy the amount required to be withheld. The amount of the withholding requirement will be deemed to include any amount which the Administrator agrees may be withheld at the time the election is made, not to exceed the amount determined by using the maximum federal, state or local marginal income tax rates applicable to the Participant with respect to the Award on the date that the amount of tax to be withheld is to be determined. The Fair Market Value of the Shares to be withheld or delivered will be determined as of the date that the taxes are required to be withheld.

17. No Effect on Employment or Service. Neither the Plan nor any Award will confer upon a Participant any right with respect to continuing the Participant's relationship as a Service Provider with the Company, nor will they interfere in any way with the Participant's right or the Company's right to terminate such relationship at any time, with or without cause, to the extent permitted by Applicable Laws.

18. Date of Grant. The date of grant of an Award will be, for all purposes, the date on which the Administrator makes the determination granting such Award, or such other later date as is determined by the Administrator. Notice of the determination will be provided to each Participant within a reasonable time after the date of such grant.

19. Term of Plan. Subject to Section 23 of the Plan, the Plan will become effective upon its adoption by the Board. It will continue in effect for a term of ten years from the date adopted by the Board, unless terminated earlier under Section 20 of the Plan.

20. Amendment and Termination of the Plan.

(a) Amendment and Termination. The Administrator may at any time amend, alter, suspend or terminate the Plan.

(b) Stockholder Approval. The Company will obtain stockholder approval of any Plan amendment to the extent necessary and desirable to comply with Applicable Laws.

(c) Effect of Amendment or Termination. No amendment, alteration, suspension or termination of the Plan will impair the rights of any Participant, unless mutually agreed otherwise between the Participant and the Administrator, which agreement must be in writing and signed by the Participant and the Company. Termination of the Plan will not affect the Administrator's ability to exercise the powers granted to it hereunder with respect to Awards granted under the Plan prior to the date of such termination.

21. Conditions Upon Issuance of Shares.

(a) Legal Compliance. Shares will not be issued pursuant to the exercise of an Award unless the exercise of such Award and the issuance and delivery of such Shares will comply with Applicable Laws and will be further subject to the approval of counsel for the Company with respect to such compliance.

(b) Investment Representations. As a condition to the exercise of an Award, the Company may require the person exercising such Award to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required.

22. Inability to Obtain Authority. The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, will relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority will not have been obtained.

23. Stockholder Approval. The Plan will be subject to approval by the stockholders of the Company within 12 months after the date the Plan is adopted by the Board. Such stockholder approval will be obtained in the manner and to the degree required under Applicable Laws.

APPENDIX B

**CERTIFICATE OF AMENDMENT OF
RESTATED CERTIFICATE OF INCORPORATION OF
ACTIVE POWER, INC.**

Active Power, Inc., a corporation organized and existing under the laws of the State of Delaware, DOES HEREBY CERTIFY:

FIRST: The name of this corporation is Active Power, Inc.

SECOND: The original Certificate of Incorporation of this corporation was filed with the Secretary of State of the State of Delaware on March 29, 2000. A Restated Certificate of Incorporation was filed with the Secretary of State of the State of Delaware on June 7, 2006 and a Certificate of Amendment of Restated Certificate of Incorporation was filed with the Secretary of State of the State of Delaware on December 21, 2012.

THIRD: Pursuant to Section 242 of the General Corporate Law of the State of Delaware (the "DGCL"), this Certificate of Amendment of Restated Certificate of Incorporation amends and restates Article IX of the Restated Certificate of Incorporation of this corporation to read in its entirety as follows:

"A. Commencing with the 2016 annual meeting of the stockholders of the Company, the directors of the Company shall be elected annually at each annual meeting of stockholders of the Company to hold office for a term expiring at the next succeeding annual meeting of stockholders. Each director shall hold office until his or her successor shall have been duly elected and qualified, subject to prior death, resignation or removal from office.

B. Vacancies occurring on the Board of Directors for any reason may be filled by vote of a majority of the remaining members of the Board of Directors, although less than a quorum, at a meeting of the Board of Directors. A person so elected by the Board of Directors to fill a vacancy shall hold office until the next succeeding annual meeting of stockholders of the Company and until his or her successor shall have been duly elected and qualified, subject to prior death, resignation or removal from office."

FOURTH: This Certificate of Amendment of Restated Certificate of Incorporation has been duly adopted by the board of directors and stockholders of this corporation in accordance with the provisions of Section 242 of the DGCL.

IN WITNESS WHEREOF, Active Power, Inc. has caused this Certificate of Amendment of Restated Certificate of Incorporation to be signed by Mark A. Ascolese, its President and Chief Executive Officer, this ____ day of April, 2015.

ACTIVE POWER, INC.

By: _____
Mark A. Ascolese,
President and Chief Executive Officer



Board of Directors

Dr. Ake Almgren, Chairman
Mark A. Ascolese
Stephen J. Clearman
James E. deVenny III

Robert S. Greenberg
Peter Gross
T. Patrick Kelly

Officers

Mark A. Ascolese
President and Chief Executive Officer

James A. Powers
Chief Financial Officer and Vice President of Finance

Randall J. Adleman
Vice President of Global Sales and Marketing

Stock Listing

Active Power is listed on The Nasdaq Capital Market under the symbol ACPW.

Investor Relations

Active Power invites stockholders, security analysts, portfolio managers, and other interested parties to contact:

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To obtain a free copy of Active Power's annual report on Form 10-K, quarterly reports on Form 10-Q, earnings releases, to access other SEC filings, or to listen to past earnings calls, please visit www.activepower.com.

Transfer Agent

Communications concerning stock transfer requirements and change of address should be sent to our transfer agent:

American Stock Transfer & Trust Company
59 Maiden Lane Plaza Level
New York, NY 10038
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