

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

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, BK12, Austin, Texas
(Address of principal executive offices)

78758
(Zip Code)

(512) 836-6464
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 such shorter period that the registrant was required to submit and post such files). Yes No

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 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

(Do not check if a smaller reporting company)

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

The number of shares of common stock, par value of \$0.001 per share, outstanding at July 30, 2012 was 95,407,631.

ACTIVE POWER, INC.
FORM 10-Q
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PART I – FINANCIAL INFORMATION**Item 1. Condensed Consolidated Financial Statements.**

Active Power, Inc.
Condensed Consolidated Balance Sheets
(in thousands)

	<u>June 30,</u> <u>2012</u>	<u>December 31,</u> <u>2011</u>
	<u>(unaudited)</u>	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,624	\$ 10,357
Restricted cash	1,380	389
Accounts receivable, net of allowance for doubtful accounts of \$399 and \$337 at June 30, 2012 and December 31, 2011, respectively	17,088	11,163
Inventories	8,925	9,439
Prepaid expenses and other	2,317	414
Total current assets	44,334	31,762
Property and equipment, net	3,048	2,861
Deposits and other	405	404
Total assets	<u>\$ 47,787</u>	<u>\$ 35,027</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 7,127	\$ 4,757
Accrued expenses	4,428	5,351
Deferred revenue	3,722	2,366
Revolving line of credit	5,535	5,535
Total current liabilities	20,812	18,009
Long-term liabilities	834	726
Stockholders' equity:		
Common stock	95	80
Treasury stock	(125)	(115)
Additional paid-in capital	287,835	277,023
Accumulated deficit	(261,552)	(260,895)
Other accumulated comprehensive income (loss)	(112)	199
Total stockholders' equity	26,141	16,292
Total liabilities and stockholders' equity	<u>\$ 47,787</u>	<u>\$ 35,027</u>

See accompanying notes.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Revenues:				
Product revenue	\$ 17,481	\$ 16,156	\$ 33,887	\$ 30,894
Service and other revenue	4,178	3,059	7,570	5,650
Total revenue	21,659	19,215	41,457	36,544
Cost of goods sold:				
Cost of product revenue	11,358	11,991	23,354	22,513
Cost of service and other revenue	2,529	2,591	5,024	4,688
Total cost of goods sold	13,887	14,582	28,378	27,201
Gross profit	7,772	4,633	13,079	9,343
Operating expenses:				
Research and development	1,432	1,086	2,720	2,007
Selling and marketing	3,897	3,400	7,444	6,870
General and administrative	1,940	1,435	3,484	2,803
Total operating expenses	7,269	5,921	13,648	11,680
Operating profit (loss)	503	(1,288)	(569)	(2,337)
Interest expense, net	(52)	(48)	(166)	(81)
Other income (expense), net	39	(58)	78	(42)
Net income (loss)	\$ 490	\$ (1,394)	\$ (657)	\$ (2,460)
Net income (loss) per share, basic	\$ 0.01	\$ (0.02)	\$ (0.01)	\$ (0.03)
Net income (loss) per share, diluted	\$ 0.01	\$ (0.02)	\$ (0.01)	\$ (0.03)
Shares used in computing net income (loss) per share, basic	95,470	80,045	90,179	79,934
Shares used in computing net income (loss) per share, diluted	95,965	80,045	90,179	79,934
Comprehensive income (loss):				
Net income (loss)	\$ 490	\$ (1,394)	\$ (657)	\$ (2,460)
Translation gain (loss) on subsidiaries denominated in foreign currencies	(347)	299	(311)	609
Comprehensive income (loss)	\$ 143	\$ (1,095)	\$ (968)	\$ (1,851)

Active Power, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2012	2011
Operating activities		
Net loss	\$ (657)	\$ (2,460)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation expense	647	700
Change to allowance for doubtful accounts	62	(28)
Unrealized gain on marketable securities	—	(11)
(Gain) Loss on disposal of fixed assets	27	(2)
Stock-based compensation	773	722
Changes in operating assets and liabilities:		
Restricted cash	(991)	—
Accounts receivable	(5,987)	(3,069)
Inventories	514	(5,621)
Prepaid expenses and other assets	(1,904)	16
Accounts payable	2,370	4,973
Accrued expenses	(923)	(2,194)
Deferred revenue	1,356	(193)
Long-term liabilities	108	133
Net cash used in operating activities	(4,605)	(7,034)
Investing activities		
Purchases of property and equipment	(861)	(1,284)
Net cash used in investing activities	(861)	(1,284)
Financing activities		
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	3,000
Payments on revolving line of credit	(2,017)	—
Proceeds from employee stock purchases	491	258
Purchases of treasury stock	(10)	(12)
Net cash provided by financing activities	10,044	3,246
Translation gain (loss) on subsidiaries in foreign currencies	(311)	609
Change in cash and cash equivalents	4,267	(4,463)
Cash and cash equivalents, beginning of period	10,357	15,416
Cash and cash equivalents, end of period	<u>\$ 14,624</u>	<u>\$ 10,953</u>

See accompanying notes.

Active Power, Inc.
Notes to Condensed Consolidated Financial Statements
June 30, 2012
(unaudited)

1. Significant Accounting Policies

Organization and Basis of presentation

Active Power, Inc. and its subsidiaries (hereinafter referred to as “we”, “us”, “Active Power” or the “Company”) manufacture and provide critical power quality and infrastructure solutions that provide business continuity and protect customers in the event of an electrical power disturbance. Our products and solutions are designed to deliver continuous clean power, protecting customers from voltage fluctuations, such as surges and sags, and frequency fluctuations, and also to provide ride-through, or temporary, power to bridge the gap between a power outage and the restoration of utility power. Our target customers are those global enterprises requiring “power insurance” because they have zero tolerance for downtime in their mission critical operations. The Uninterruptible Power Supply (“UPS”) products we manufacture use kinetic energy to provide short-term power as a cleaner alternative to electro-chemical battery-based energy. We sell stand-alone UPS products as well as complete continuous power and infrastructure solutions, including containerized continuous power systems that we brand as PowerHouse. We sell our products globally through direct, manufacturer’s representatives, Original Equipment Manufacturer (“OEM”) channels and IT partners. Our current principal markets are Europe, Middle East and Africa (“EMEA”), Asia and North America.

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles and include the accounts of the Company and its consolidated subsidiaries. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring items) necessary to present fairly the consolidated financial position of the Company and its consolidated results of operations and cash flows. These interim financial statements should be read in conjunction with the financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

2. Supplemental Balance Sheet Information

Restricted Cash

Restricted cash balance of \$1.4 million as of June 30, 2012 consists of secured performance and deposit guarantees given to customers. Upon satisfaction of these guarantees, the restriction on these funds will be released.

Receivables

Accounts receivable consist of the following (in thousands):

	June 30, 2012	December 31, 2011
Trade receivables	\$ 17,487	\$ 11,500
Allowance for doubtful accounts	(399)	(337)
	<u>\$ 17,088</u>	<u>\$ 11,163</u>

Inventory

We state inventories at the lower of cost or market, using the first-in-first-out-method (in thousands):

	June 30, 2012	December 31, 2011
Raw materials	\$ 7,566	\$ 6,493
Work in process	1,751	3,085
Finished goods	838	1,680
Allowances for obsolescence	(1,230)	(1,819)
	<u>\$ 8,925</u>	<u>\$ 9,439</u>

Property and Equipment

Property and equipment consist of the following (in thousands):

	June 30, 2012	December 31, 2011
Equipment	\$ 9,996	\$ 9,980
Demonstration units	2,123	1,345
Computers and purchased software	4,148	4,029
Furniture and fixtures	370	369
Leasehold improvements	7,623	7,425
Construction in progress	602	1,107
	<u>24,862</u>	<u>24,255</u>
Accumulated depreciation	(21,814)	(21,394)
	<u>\$ 3,048</u>	<u>\$ 2,861</u>

Accrued Expenses

Accrued expenses consist of the following (in thousands):

	June 30, 2012	December 31, 2011
Compensation and benefits	\$ 2,446	\$ 3,037
Warranty liability	554	583
Property, income, state, sales and franchise tax	229	529
Professional fees	405	463
Other	794	739
	<u>\$ 4,428</u>	<u>\$ 5,351</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 to Caterpillar. 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 our warranty liability are presented in the following table (in thousands):

Balance at December 31, 2011	\$	613
Warranty expense		607
Warranty charges incurred		(617)
Balance at June 30, 2012	\$	603
Warranty liability included in accrued expenses	\$	554
Long-term warranty liability		49
Balance at June 30, 2012	\$	603

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. Revenue-generating transactions generally fall into one of the following categories of revenue recognition:

- We recognize product revenue at the time of shipment for substantially 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 recognize installation and 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 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”). Arrangements to sell products to customers frequently include multiple deliverables. Our most significant MEAs include the sale of one or more of our CleanSource UPS or 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 delivery of product and commissioning and installation typically takes 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 stand-alone value and the four criteria for revenue recognition have been met for each element. 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 stand-alone 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.

3. Net Income (Loss) Per Share

The following table sets forth the computation of basic and diluted net income (loss) per share (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Numerator:				
Net income (loss)	\$ 490	\$ (1,394)	\$ (657)	\$ (2,460)
Denominator:				
Weighted-average shares of common stock outstanding	95,470	80,045	90,179	79,934
Dilutive effect of employee stock options and restricted stock awards	495	—	—	—
Weighted average shares for diluted net income per share	95,965	80,045	90,179	79,934
Basic net income (loss) per share	\$ 0.01	\$ (0.02)	\$ (0.01)	\$ (0.03)
Diluted income (loss) per share:	\$ 0.01	\$ (0.02)	\$ (0.01)	\$ (0.03)
Common stock equivalents that were not included in the calculation because the option or restricted stock unit price was greater than the average market price of the common shares or the net loss would cause the effect of the options to be anti-dilutive:				
Employee stock options	9,672	10,135	9,672	10,135
Restricted stock units	1,066	-	1,066	-
	10,738	10,135	10,738	10,135

There were no restricted stock unit awards outstanding at June 30, 2011. As of June 30, 2012 and 2011, respectively, there was no common stock subject to repurchase.

4. Fair Value of Financial Instruments

Investments in marketable securities consist of money-market funds, commercial paper and debt securities with readily determinable fair values. Active Power accounts for investments that are reasonably expected to be realized in cash, sold or consumed during the year as short-term investments. We classify investments in marketable securities as available-for-sale and all reclassifications made from unrealized gains/losses to realized gains/losses are determined based on the specific identification method.

In accordance with our investment policy and guidelines, our short-term investments are diversified among and limited to high quality securities with a minimum of investment grade ratings. We actively monitor our investment portfolio to ensure compliance with our investment objective to preserve capital, meet liquidity requirements and maximize return on our investments. We do not require collateral or enter into master netting arrangements to mitigate our credit risk.

Effective October 1, 2008, we adopted an accounting standard that defines fair value, establishes a framework for measuring fair value as well as expands on required disclosures regarding fair value measurements. This standard applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances.

Level 1—uses quoted prices in active markets for identical assets or liabilities we have the ability to access.

Level 2—uses 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—uses one or more significant inputs that are unobservable and supported by little or no market activity, and that reflect the use of significant management judgment.

Inputs are referred to as assumptions that market participants would use in pricing the asset or liability. The uses of inputs in the valuation process are categorized into a three-level fair value hierarchy.

Our Level 1 assets and liabilities consist of cash equivalents and short-term investments, 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 of our cash equivalents, which are primarily invested in money-market funds, was determined using the following inputs as of June 30, 2012 and December 31, 2011 (in thousands):

June 30, 2012				
	Fair Value Measurements at Reporting Date Using			
	Level 1	Level 2	Level 3	Total
Money-market funds	\$ 3,092	\$ —	\$ —	\$ 3,092
Total	<u>\$ 3,092</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,092</u>
Amounts included in:				
Cash and cash equivalents	\$ 3,092	\$ —	\$ —	\$ 3,092
Short-term investments	—	—	—	—
Total	<u>\$ 3,092</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,092</u>

December 31, 2011				
	Fair Value Measurements at Reporting Date Using			
	Level 1	Level 2	Level 3	Total
Money-market funds	\$ 3,093	\$ —	\$ —	\$ 3,093
Total	<u>\$ 3,093</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,093</u>
Amounts included in:				
Cash and cash equivalents	\$ 3,093	\$ —	\$ —	\$ 3,093
Short-term investments	—	—	—	—
Total	<u>\$ 3,093</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,093</u>

For cash and cash equivalents, marketable securities, accounts receivable, and accounts payable, the carrying amount approximates fair value because of the relative short maturity of those instruments.

5. Guarantees

In certain geographical regions, particularly Europe and Africa, 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 product warranty obligations. We secure these guarantees with standby letters of credit through our bank. At June 30, 2012 and December 31, 2011, we had \$2,286 and \$446, respectively, of performance guarantees outstanding to customers that were secured with letters of credit.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with, and is qualified in its entirety by reference to, the financial statements and notes thereto included in Item 1 of this Form 10-Q and the financial statements and notes thereto and our Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2011 included in our 2011 Annual Report on Form 10-K. This report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, 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 such forward-looking statements. In addition, please see the "Risk Factors" in Part 1, Item 1A of our 2011 Annual Report on Form 10-K and in Part II, Item 1A of this Form 10-Q for a discussion of items that may affect our future results.

Overview

Active Power designs and manufactures continuous power and infrastructure solutions. These solutions 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 ("clean") power during power disturbances and outages, voltage sags and surges, and provide ride-through power in the event of 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 power density (less space) and energy efficiency, total cost of ownership, system reliability, modular design, and the economically green benefits of our solutions.

We have sold our patented flywheel-based uninterruptible power supply ("UPS") systems since 1999. As of June 30, 2012, we have shipped more than 3,400 flywheels in UPS system installations, delivering more than 825 megawatts of power to customers in 42 countries around the world with more than 131 million runtime hours of operation.

In addition to selling stand alone UPS systems, we also manufacture and sell continuous power systems ("CPS") that integrate our UPS products with other related equipment such as switchgear and backup diesel generators, and that are sold as a complete power solution for customers. Our CPS systems can be sold in a containerized format, or as individual components, and offer the same customer benefits with regard to operating efficiency, reliability and cost as our UPS products.

We have leveraged our success with containerized CPS solutions to work with our partners to develop and manufacture containerized infrastructure solutions. These solutions serve as the infrastructure for containerized data center products which are self-contained fully functioning data centers. We design and build enclosures that have a fully built out interior – including electrical, cooling, monitoring and other elements – ready for the customer to add their IT racks and servers. Once the customer adds their IT equipment to our infrastructure solution, they have a functional modular data center. These industry emerging products can be deployed rapidly and at a lower cost than traditional brick-and-mortar solutions and are optimally suited for hyper-scale IT and cloud applications.

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

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

- sales made directly by us;
- manufacturer's representatives;
- distributors;
- OEM partners; and
- strategic IT partners.

We believe a number of underlying macroeconomic trends place Active Power in a strong position to be one of the leading providers of critical power protection. These trends include:

- increasing business costs of downtime;
- a rapidly expanding need for data center infrastructure
- ever-increasing demands placed on the public utility infrastructure;

- an inadequate investment in global utility infrastructure;
- rising costs of energy worldwide driven by volume of energy used; and
- an increasing demand for economically green solutions.

We have evolved significantly since the company was founded in 1992. Our early focus was on research and development of the core products that continue to enable the business today. Over the past several years, we have focused our efforts on brand, markets, and channels of distribution. The technological foundation of Active Power has yielded more than 100 worldwide patents and a highly differentiated, cost-efficient product platform that we have evolved into an expanding suite of infrastructure solutions. As we go forward, it is critical for us to focus on both developing technology to maintain and grow our leadership position and building channels of distribution to have more avenues into the market.

Active Power has developed and implemented a go-to-market strategy to set the direction for our sales and marketing initiatives and plans around the following components:

- Customer: Data Center Applications Across Vertical Markets
- Distribution: Partner Enabled Distribution Strategy Transacted Locally
- Geography: 9 Global Markets around 4 Centers of Operation
- Products: Continuous Power and Infrastructure Solutions
- Value: Ingenious Efficient, Reliable, Green Solutions

As a result of this strategy, we have been successful in growing our revenue, improving our operating performance, broadening our global footprint, diversifying our customer base, broadening our sales channels and partners, and moving higher up the customer value chain with innovative developments of our core underlying product technology.

In line with our ongoing efforts to improve margins and operational efficiency, we have been evaluating ways to fine tune our fixed cost position. As a result, we have recently executed cost savings measures that we expect to yield annualized savings of about \$1.8 million, with a one-time restructuring charge of approximately \$350,000 in the third quarter of 2012. We believe these prudent measures will ensure we are making appropriate investments for the future while also aligning our overhead to support consistent and profitable growth.

Results of Operations

(\$ in thousands)	Three Months ended June 30,				Variance 2012 vs. 2011	
	2012	% of total revenue	2011	% of total revenue	\$	%
	Product revenue	\$ 17,481	81%	\$ 16,156	84%	\$ 1,325
Service and other revenue	4,178	19%	3,059	16%	1,119	37%
Total revenue	21,659	100%	19,215	100%	2,444	13%
Cost of product revenue	11,358	52%	11,991	63%	(633)	(5)%
Cost of service and other revenue	2,529	12%	2,591	13%	(62)	(2)%
Total cost of goods sold	13,887	64%	14,582	76%	(695)	(5)%
Gross profit	7,772	36%	4,633	24%	3,139	68%
Operating expenses:						
Research and development	1,432	7%	1,086	6%	346	32%
Selling and marketing	3,897	18%	3,400	18%	497	15%
General and administrative	1,940	9%	1,435	7%	505	35%
Total operating expenses	7,269	34%	5,921	31%	1,348	23%
Operating profit (loss)	503	2%	(1,288)	(7)%	1,791	139%
Interest expense, net	(52)	—	(48)	—	(4)	(8)%
Other income (expense), net	39	—	(58)	—	97	167%
Net income (loss)	\$ 490	2%	\$ (1,394)	(7)%	\$ 1,884	135%

(\$ in thousands)	Six months ended June 30,				Variance 2012 vs. 2011	
	2012	% of total revenue	2011	% of total revenue	\$	%
	Product revenue	\$ 33,887	82%	\$ 30,894	85%	\$ 2,993
Service and other revenue	7,570	18%	5,650	15%	1,920	34%
Total revenue	41,457	100%	36,544	100%	4,913	13%
Cost of product revenue	23,354	56%	22,513	61%	841	4%
Cost of service and other revenue	5,024	12%	4,688	13%	336	7%
Total cost of revenue	28,378	68%	27,201	74%	1,177	4%
Gross profit	13,079	32%	9,343	26%	3,736	40%
Operating expenses:						
Research and development	2,720	7%	2,007	5%	713	36%
Selling and marketing	7,444	18%	6,870	19%	574	8%
General and administrative	3,484	8%	2,803	8%	681	24%
Total operating expenses	13,648	33%	11,680	32%	1,968	17%
Operating loss	(569)	(1)%	(2,337)	(6)%	1,768	76%
Interest expense, net	(166)	—	(81)	—	(85)	(105)%
Other income (expense), net	78	—	(42)	—	120	286%
Net loss	\$ (657)	(1)%	\$ (2,460)	(6)%	\$ 1,803	73%

Product revenue. Product revenue primarily consists of sales of our CleanSource power quality products, CPS and other data center infrastructure solutions. Our CleanSource power quality products are comprised of both UPS and DC product lines and our CPS are comprised of our UPS systems and some combination of third party ancillary equipment, such as engine generators and switchgear. The CPS products may be sold in a containerized solution that we call PowerHouse, or as separate equipment. Our infrastructure solutions provide power distribution, cooling capabilities, security systems, fire suppression and monitoring capabilities for our IT channel partners. Our product revenue was derived from the following sources:

(\$ in thousands)	Three Months Ended		Variance	
	June 30,		\$	%
	2012	2011		
Product revenue:				
UPS product revenue	\$ 9,553	\$ 5,458	\$ 4,095	75%
Continuous Power Systems	-	8,399	(8,399)	(100)%
Infrastructure solutions	7,928	2,299	5,629	245%
Total product revenue	\$ 17,481	\$ 16,156	\$ 1,325	8%

(\$ in thousands)	Six Months Ended		Variance	
	June 30,		\$	%
	2012	2011		
Product revenue:				
UPS product revenue	\$ 13,769	\$ 14,773	\$ (1,004)	(7)%
Continuous Power Systems	4,931	13,071	(8,140)	(62)%
Infrastructure solutions	15,187	3,050	12,137	398%
Total product revenue	\$ 33,887	\$ 30,894	\$ 2,993	10%

Product revenue for the three-month period ended June 30, 2012 increased by approximately \$1.3 million, or 8%, compared to the same period of 2011. This increase is primarily attributable to an increase in sales of data center infrastructure solutions, as our solutions have gained market acceptance, and from an increase in sales of our UPS products. Sales related to our infrastructure solutions comprised 45% of our product revenue for the second quarter of 2012, compared to 14% for the second quarter of 2011. Due to timing of customer projects, there were no sales of our CPS products in the second quarter of 2012 as compared to CPS product sales of \$8.4 million, or 52%, of our product revenue in the second quarter of 2011. Due to the small number of customers and large order values, the amount of revenue from our CPS and infrastructure solutions can fluctuate materially between quarters based on the timing of product shipments and we would expect continued large fluctuations in quarterly revenue from each of these product lines. UPS product sales comprised 55% of our product revenue for the second quarter of 2012, as compared to 34% for the second quarter of 2011. Sales of our UPS products for the second quarter of 2012 increased by 75% from the second quarter of 2011. This increase was primarily due to large UPS installations in the second quarter of 2012 in Europe, the Middle East and Africa (“EMEA”) and a broader increase in the number of UPS customers as we have re-focused our sales activities on improving UPS product sales after several quarters of lower than expected sales of our UPS products.

Product revenue for the six-month period ended June 30, 2012 increased by \$3.0 million, or 10%, compared to the same period in 2011. This increase was driven primarily by an increase of \$12.1 million in sales of our infrastructure solutions, particularly in North America. Sales related to our infrastructure solutions comprised 45% of product revenue in the first half of 2012, compared to 10% of product revenue in the same period of 2011. The \$8.4 million decrease in CPS product revenue was due primarily to timing of customer projects and compared to 2011, we had lower CPS sales in Europe and Asia. UPS product revenues for the first half of 2012 decreased by approximately \$1.0 million, or 7%, as compared to the first half of 2011, primarily due to decreased megawatt class UPS sales in Europe.

Product revenue from Active Power branded products through our direct and manufacturer’s representative channels was \$7.9 million, or 45% of our product revenue, for the three-month period ended June 30, 2012, compared to \$9.9 million, or 61%, in the same period of 2011, and \$6.3 million, or 39% of our product revenue, for the first quarter of 2012. For the six-month period ended June 30, 2012, product sales of Active Power branded products through our direct and manufacturer’s representative channels were \$14.2 million, or 42% of our product revenue, compared to \$17.3 million, or 56%, for the same period of 2011. As direct sales typically have higher profit margins than sales through our OEM and IT channels, we will continue to focus on our direct sales channel to increase revenue and improve profit margins and to decrease our dependency upon our OEM and IT channels.

Product revenue from our OEM channels for the three-month period ended June 30, 2012 was \$1.7 million, a decrease of approximately \$132,000, or 7%, compared to \$1.8 million for the second quarter of 2011. For the six-month period ended June 30, 2012, product revenue from our OEM channel was \$2.7 million, a decrease of \$4.4 million, or 62%, as compared to \$7.1 million for the same period in 2011. Product revenue from our OEM channels for the three-month period ended June 30, 2012 increased by \$607,000, or 58%, compared to \$1.0 million for the first quarter of 2012. The second quarter of 2011 included several multi-megawatt UPS installations in Europe that resulted in significant OEM channel revenue that period. The size and volume of orders from our OEM channels can fluctuate significantly on a quarterly basis and in 2012 we have seen fewer, but larger value transactions from our OEM channel. 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 systems as a total solution. If our OEM partners are successful with this strategy, we believe that it will help drive an increase in our UPS product revenue. However, as our OEM partners sell more solutions, the quarterly volume of revenue becomes more variable. Sales to Caterpillar, our primary OEM channel, represented \$1.7 million and \$2.7 million, or 9% and 8% of our product revenue, for the three-month and six-month periods ended June 30, 2012, respectively, compared to \$1.8 million and \$7.1 million, or 11% and 23% of our product revenue, in the comparable periods of 2011. Caterpillar remains one of our largest customers as well as our largest OEM customer.

Product revenue from our IT channel for the second quarter of 2012 was \$7.9 million, as compared to \$4.5 million for the second quarter of 2011, which represents a \$3.4 million, or 76%, increase. This increase was primarily due to the sale of infrastructure solutions to HP, our largest IT channel partner, for them to re-sell to end users in conjunction with sales of such partner's IT and computing products. Sales to HP accounted for 45% of our product revenue for the second quarter of 2012.

Our CPS and infrastructure solutions transactions tend to be larger in value and from a smaller number of customers compared to sales of our UPS products. This smaller number of customers with greater transaction value can contribute to large quarterly fluctuations in revenue from each product family, due to the timing of orders or shipments in any particular accounting period and as evidenced by no CPS shipments in the second quarter of 2012. Generally, the size of these transactions has been increasing and individual CPS and infrastructure transactions have been as high as \$6 million in 2011. A small number of transactions can therefore lead to significant revenue, but cause greater volatility in our quarterly results and increase liquidity risk for us as these orders require much larger amounts of working capital to fulfill, which we attempt to manage through customer and vendor payment terms as part of our working capital management.

North America product revenue was \$12.1 million, or 69% of our product revenue for the three-month period ended June 30, 2012, compared to \$8.5 million, or 52%, for the same period in 2011 and \$10.6 million, or 65% of product revenue, in the first quarter of 2012. For the six-month period ended June 30, 2012, our North America product revenue was \$22.7 million, or 67% of our total product revenue, which compared to \$16.2 million, or 53%, for the same period in 2011. The increase in North American sales has been driven by an increase in sales to HP.

We also sell products directly to customers in Asia and Western Europe and we have a network of international distributors in other territories that sell products for us. In these markets, customers are more likely to purchase a total power solution from us rather than a stand-alone UPS system. This usually results in a longer selling cycle and makes quarterly results from these regions more volatile. Thus the amount of revenue from our international markets can fluctuate significantly on a quarterly basis. Product sales to customers in Asia were \$1.0 million, or 6% of our total product revenue, in the three-month period ended June 30, 2012, compared to \$4.0 million, or 25%, for the same period in 2011 and \$1.5 million, or 9%, for the first quarter of 2012. Product revenue in EMEA was \$4.4 million, or 25% of product revenue, in the three-month period ended June 30, 2012, compared to \$3.7 million, or 23%, for the same period of 2011 and \$4.3 million, or 26%, for the first quarter of 2012. These fluctuations are primarily attributable to variations in sales of our CPS products in each region in the relevant periods and illustrate the impact of larger orders from fewer customers on quarterly revenue for each of these regions.

Our products perform well in harsh environments where power quality or reliability is particularly poor, which makes them a good fit for countries with a poor power infrastructure or in harsh manufacturing or process environments, or situations where reliability is paramount, such as mission-critical business applications. Therefore, we will continue to focus our direct sales efforts on these types of customer situations.

Service and other revenue. Service and other revenue primarily relates to revenue generated from both traditional (after-market) service work and from customer-specific system engineering. This includes revenue from design, installation, startup, repairs or reconfigurations of our products and the sale of spare or replacement parts to our OEM and end-user customers. It also includes revenue associated with the costs of travel of our service personnel and revenues or fees received upon contract deferment or cancellation. Revenue from extended maintenance contracts with our customers is also included in this revenue category.

Service and other revenue increased by approximately \$1.1 million, or 37%, for the three-month period ended June 30, 2012, compared to the same period of 2011. These increases reflect higher levels of service and contract work from direct product sales and from higher professional fees associated with increased PowerHouse and other CPS and infrastructure sales. For our CPS customers, we provide a full power solution, including design services, site preparation, installation of an entire power solution and provision of all products required to provide a turnkey product to the end user, often including maintenance services. We had increased service revenues from maintenance contracts and repair-related activities as our increasing installed base of UPS customers provides greater opportunities to generate such revenues. Where we make sales through our OEM channel, it is typical for the OEM to provide these types of services to their end-user customers, so these revenue opportunities do not typically exist for us on our OEM sales. We anticipate that service and other revenue will continue to grow with product revenue, particularly as our PowerHouse system revenue grows and as our installed base of UPS product expands, because as more units are sold to customers, more installation, startup and maintenance services will be required.

Cost of product revenue. Cost of product revenue includes the cost of component parts of our products, ancillary equipment that is sourced from external suppliers, personnel, equipment and other costs associated with our assembly and test operations, depreciation of our manufacturing property and equipment, shipping costs, warranty costs, and the costs of manufacturing support functions such as logistics and quality assurance. The cost of product revenue as a percentage of total product revenue was 65% for the three-month period ended June 30, 2012, compared to 74% for the same period in 2011, and was 69% in the six-month period ended June 30, 2012 as compared to 73% in the same period of 2011. These decreases in costs as a percentage of revenue reflect higher levels of absorbed overhead costs attributable to a higher level of UPS system production. We continue to operate a manufacturing facility that has a manufacturing and testing capacity significantly greater than our current product revenue levels. A large portion of the costs involved in operating this manufacturing facility are fixed in nature and we have incurred unabsorbed overhead each quarter depending on the level of UPS system production. We continue to work on reducing our product costs through design enhancements and modifications, vendor management programs and increasing our sales volume to absorb these expenses. We have also improved our capabilities and efficiency in manufacturing and managing our infrastructure solutions which have reduced our total cost of production for these products and further contributed to the decrease in cost of product revenue as a percentage of revenue.

Cost of service and other revenue. Cost of service and other revenue includes the cost of component parts that we use in service or sell as spare parts, as well as labor and overhead costs of our service organization, including travel and related costs incurred in fulfilling our service obligations to our customers. Costs paid to third parties in fulfillment of service and design or installation services are also included in costs of service and other revenue. The cost of service and other revenue decreased to 61% of service and other revenue in the three-month period ended June 30, 2012, compared to 85% for the same period of 2011, and decreased to 66% in the six-month period ended June 30, 2012 as compared to 83% in the same period of 2011. These percentage decreases in the second quarter of 2012 reflect higher utilization of our service personnel and improved revenues on the professional service work we perform for CPS and infrastructure systems installation. We have had higher costs relative to the increase in service and other revenues as we have continued to expand our service team and broaden the geographic regions where we have service capability as our total business grows. The utilization of our service personnel will also be affected by the number of PowerHouse and infrastructure solution products implemented in a particular period, and in periods where we have a low number of installation projects we would expect our costs as a percentage of revenue to increase. A large portion of the costs involved in operating our service organization are fixed in nature and depending upon the revenues for the quarter, we may incur unabsorbed overhead each quarter. We continue to work on reducing our service overhead through better utilization of our service employees and cost control measures. This infrastructure also means that we can leverage this investment and grow our service capabilities substantially by adding direct technical labor only as required.

Gross profit. For the three-month period ended June 30, 2012, our gross profit was 36% of revenue, compared to a 24% gross profit margin for the second quarter of 2011 and a 27% gross profit margin for the first quarter of 2012. The improvement from the previous quarter reflects improved margins on our UPS business as a result of better selling prices and higher manufacturing efficiency, and from improved margins on our infrastructure solutions, due to improved execution and pricing on delivery of our CPS and infrastructure solutions. Historically, sales of our CPS and infrastructure products have generated lower margins for us than sales of our UPS product because they include a higher proportion of third party ancillary equipment. Our ability to improve our gross profit from these product lines has come from our ability to continue to reduce material costs and our efforts to improve our service margins through pricing and operational efficiency. Our ability to further improve margins will depend, in part, on our ability to further improve our sales channel mix, increase sales of higher margin products such as our UPS products, increase product prices, improve our professional service margins through further pricing and operating efficiency, and increase our total revenues to a level that will allow us to improve the utilization of our manufacturing and service operations.

Research and development. Research and development expense primarily consists of compensation and related costs for employees engaged in research, development and engineering activities, third party consulting and product development activities, as well as an allocated portion of our occupancy costs. Overall, our research and development expenses were approximately \$346,000, or 32%, higher in the second quarter of 2012 compared to the second quarter of 2011 and were \$144,000, or 11%, lower than the first quarter of 2012. We are currently developing a new generation of UPS product that we believe will offer greater power modularity and space efficiencies especially as we target the larger power market segments, which we expect to release later this year. We have increased headcount and prototyping expenses to support this new product development and meet our delivery deadline and to support new infrastructure and UPS products that we believe will contribute to future revenue growth. We believe research and development expenses in the third quarter of 2012 will remain at similar levels to those recorded in the second quarter of 2012.

Selling and marketing. Selling and marketing expense primarily consists of compensation, including variable sales compensation, and related costs for sales and marketing personnel, and related travel, selling and marketing expenses, as well as an allocated portion of our occupancy costs and the cost of our foreign sales operations. Selling and marketing costs were approximately \$497,000, or 15%, higher in the second quarter of 2012 compared to the second quarter of 2011 and increased approximately \$350,000, or 10%, from the first quarter of 2012 primarily from continued investment in our sales organization size. We believe that quarterly sales and marketing expenses during the remainder of 2012 will remain at similar levels to those recorded in the second quarter of 2012, except for changes in variable selling expenses that are based on fluctuations in total revenue and gross profit margins.

General and administrative. General and administrative expense is primarily comprised of compensation and related costs for executive and administrative personnel, professional fees, and taxes, including sales, property and franchise taxes. General and administrative expenses for the second quarter of 2012 increased approximately \$505,000, or 35%, compared to the same period in 2011 due to higher compensation, legal, recruiting and other professional services fees, and increased by approximately \$396,000, or 26%, as compared to the first quarter of 2012 due to higher compensation and professional fees and an increase in our provision for doubtful accounts. We anticipate our level of general and administrative expenses to decrease in the third quarter.

Interest expense, net. Net interest expense has increased from approximately \$48,000 in the second quarter of 2011 to approximately \$52,000 in the second quarter of 2012, or by 8%. We incurred higher interest expense as we had a larger average outstanding balance on our revolving credit facility. Our average cash and investments balance over the three-month period ending June 30, 2012 has increased by \$5.2 million, or 42%, compared to the average balance over the same period ending June 30, 2011. This higher average cash balance resulted in higher interest income, which offset a portion of the higher interest expense.

Other income (expense), net. Other income (expense) in the second quarter of 2012 and 2011 reflects foreign exchange gains (losses) on a bank account held in foreign currencies by our subsidiary company.

Liquidity and Capital Resources

Our primary sources of liquidity at June 30, 2012 are our cash and investments on hand, our bank credit facilities and projected cash flows from operating activities. If we meet our cash flow projections in our current business plan, we expect that we have adequate capital resources in order to continue operating our business for at least the next 12 months. Our business plan and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, there are potential risks 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 the remainder of 2012 and beyond or significantly affect our level of liquidity, which may limit our opportunity to pursue certain opportunities to grow our business.

A substantial increase in sales of our PowerHouse or our infrastructure solutions products or a substantial increase in UPS sales may materially impact the amount of liquidity required to fund our operations. The amount of time between our expenditures for raw materials, manufacturing and shipment of products and our receipt of payments from our customers (the cash cycle) for sales of our CleanSource UPS product can be as short as 45 days, and is typically 60 days. However, the cash cycle on a PowerHouse sale can be as much as 210 days, depending upon customer payment terms. We intend to mitigate the financial impact of this longer cash cycle by requiring customer deposits and periodic payments where possible from our customers. This is not always commercially feasible, and in order to increase our PowerHouse sales, we may be required to make larger investments in inventory and receivables. These larger investments may require us to obtain additional sources of working capital, debt or equity financing in order to fund this business.

Should additional funding be required, 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 debt or equity securities, the ownership of our 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.

The following table summarizes the quarterly changes in cash used in operating activities:

(\$ in thousands)	Six months ended		Variance	
	June 30,		2012 vs. 2011	
	2012	2011	\$	%
Cash used in operating activities	\$ (4,605)	\$ (7,034)	\$ (2,429)	(35)%

Cash used in operating activities decreased by \$2.4 million in the six-month period ended June 30, 2012 compared to the same period of 2011. This was primarily due to a \$1.8 million decrease in our level of operating losses and from changes in our working capital requirements caused by the timing of product shipments to our customers. This timing of large orders can cause large fluctuations in the amount of cash required for operations on a quarterly basis.

The fluctuations in working capital are impacted by the timing of product order and shipment. In the six-month period ended June 30, 2012 we saw a decrease of approximately \$514,000 in inventory as inventory levels declined primarily due to timing of product delivery on infrastructure and CPS projects. Our receivables increased by \$6.0 million since December 31, 2011, reflecting the higher revenue levels and a higher proportion of revenues that were recognized toward the end of the reporting period compared to the same period in 2011. Restricted cash increased by \$1.0 million over the six-month period ended June 30, 2012, due to a secured performance guarantee given to a customer in connection with a future order. Upon delivery of product to the customer in the third quarter of 2012, the guarantee will lapse and the restriction on these funds will be released. Our prepaid expenses and other assets increased by \$1.9 million since December 31, 2011, due to prepayments required on supplier purchase orders for inventory required to fulfill infrastructure solutions sales orders. These uses of funds were offset by an increase in accounts payable of \$2.4 million and an increase in deferred revenue of \$1.4 million since December 31, 2011. These increases reflect timing of payables due on large inventory purchases received at the end of the quarter and the receipt of customer deposits and advance payments related to the timing of our large CPS and infrastructure projects. We anticipate that cash provided by (used in) operations will fluctuate significantly based upon the volume and size of our CPS and infrastructure solutions sold and by the timing of product delivery relative to our reporting periods, and that such volatility in sources and uses of funds will continue based upon growth of our CPS and infrastructure solutions businesses.

The following table summarizes the quarterly changes in cash used in investing activities:

(\$ in thousands)	Six months ended		Variance	
	June 30,		2012 vs. 2011	
	2012	2011	\$	%
Cash used in investing activities	\$ (861)	\$ (1,284)	\$ (423)	(33)%

Investing activities primarily consist of purchases of property and equipment. Capital expenditures were \$423,000, or 33% lower in the six-month period ending June 30, 2012, compared to the same period of 2011, which is attributable to the fact that we invested in multiple demonstration CPS systems in Asia and Europe, and as we commenced tooling for our next generation UPS product.

The following table summarizes the quarterly changes in cash provided by financing activities:

(\$ in thousands)	Six months ended		Variance	
	June 30,		2012 vs. 2011	
	2012	2011	\$	%
Cash provided by financing activities	\$ 10,044	\$ 3,246	\$ 6,798	209%

Funds provided by financing activities during the six-months ended June 30, 2012 primarily reflect the sale of common stock in the first quarter of 2012 pursuant to which we sold approximately 14.3 million shares of common stock at a purchase price of \$0.68 per share, for proceeds, net of fees and expenses, of approximately \$9.6 million, and also reflects proceeds from the exercise of employee stock options.

The shares that were sold in the first quarter of 2012 were sold pursuant to a prospectus included in our shelf registration statement on Form S-3 dated November 24, 2009, as amended on December 17, 2009 (Registration No. 333-163301), which was declared effective by the Securities and Exchange Commission (the "SEC") on December 21, 2009, as supplemented by a prospectus supplement dated March 7, 2012 filed with the SEC pursuant to Rule 424(b) under the Securities Act of 1933, as amended (the "Offering"). No discounts or placement agent fees were payable in connection with the Offering.

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In connection with the Offering, we also entered into a Side Letter Agreement with Kinderhook, LP (formerly known as Kinderhook Partners, LP) (“Kinderhook”) pursuant to which Kinderhook was granted the right to designate one member of our board of directors. Pursuant to this Side Letter Agreement, in June 2012 Kinderhook appointed a designee, Mr. Stephen Clearman, to the Company’s board of directors.

We also entered into a Resale Registration Rights Agreement (the “Rights Agreement”) pursuant to which we were obligated to prepare promptly and file with the SEC a Registration Statement on Form S-3 covering the resale of shares of Common Stock held by Kinderhook. The registration statement covering such shares was declared effective on July 18, 2012 in accordance with the terms of the Rights Agreement. All expenses incurred by us in connection with registrations, filings or qualifications pursuant to the Rights Agreement have been borne by us.

We are currently renegotiating our credit facility with Silicon Valley Bank. We believe these negotiations will enable us to extend and better utilize this credit facility and provide us greater flexibility in our working capital management as a result.

We believe that our cash and investments and our sources of available liquidity, including our bank credit facility, will be sufficient to fund our operations for at least the next 12 months. Our sales cycle is such that we generally have visibility two to three quarters in advance for future orders that allows us to predict revenues over this period of time with some degree of confidence. 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 could significantly impact our expected revenues. The recent global economic downturn has reduced our confidence at predicting future revenues, and even with improving economic conditions, there is still uncertainty and risk in our forecasting. This two to three quarter 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 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 PowerHouse or our infrastructure solutions business, would likely increase our working capital requirements, due to the longer production time and cash cycle of sales of these products.

Item 3. 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 allow and in terms of the credit quality of the investments we hold. 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 interest income or their fair value.

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, British pounds and Chinese Renminbi. 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 increasing the 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.

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 4. Controls and Procedures.

Evaluation 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 Securities Exchange Act of 1934, as amended (the "Exchange Act")) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, have concluded that, as of June 30, 2012, 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 Securities and Exchange Commission 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.

Changes in internal control over financial reporting.

During the three months ended June 30, 2012, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and Rule 15d-15(d) under the Exchange Act that have materially affected, or that we believe are reasonably likely to materially affect, our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

We are, from time to time, subject to various legal proceedings, claims and litigation arising in the ordinary course of business. We do not believe we are party to any currently pending legal proceedings the outcome of which may have a material effect on our operations or consolidated financial position. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our financial position, results of operations or cash flows.

Item 1A. Risk Factors.

You should carefully consider the risks described below and in Item 1A of our 2011 Annual Report on Form 10-K before making a decision to invest in our common stock or in evaluating Active Power and our business. The risks and uncertainties described below and in our 2011 Annual Report on Form 10-K 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 report is qualified in its entirety by these risk factors.

The actual occurrence of any of the risks described below and in our 2011 Annual Report on Form 10-K could materially harm our business, financial condition and results of operations. In that case, the trading price of our common stock could decline.

Our increased emphasis on larger and more complex system solutions and customer concentration may affect our ability to accurately predict the timing of revenues and to meet short-term expectations of operating results and may adversely impact our liquidity.

Our increased emphasis on larger and more complex system solutions has increased the effort and time required by us to complete sales to customers. Further, a larger portion of our quarterly revenue is derived from relatively few large transactions with relatively few customers. For example, during the three months ended June 30, 2012, our three largest customers contributed an aggregate of 69% of our revenue. Any delay in completing these large sales transactions or reduction in business volume from these large customers, may result in significant fluctuations in our quarterly revenue. In addition, 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. Further, we may purchase inventory and enter into commitments with our suppliers based on purchase orders we receive from our customers, which orders subsequently may be cancelled or deferred. While our customers are typically legally obligated to take delivery against a purchase order, any such cancellation or deferral may extend the amount of time between our expenditures for inventory and supplier commitments and our receipt of payment from our customers. The occurrence of any of these events would likely materially adversely affect our results of operations, and could adversely impact our liquidity, which would likely cause the market price of our common stock to decline.

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

Caterpillar including its dealer network is our primary OEM customer and our largest single customer for our flywheel-based products. Caterpillar and its dealer network accounted for 19%, 16%, and 8% of our revenue in 2010, 2011 and the six months ended June 30, 2012, respectively. HP is our largest IT channel partner and accounted for 25%, 36%, and 48% of our revenue in 2010, 2011 and the six months ended June 30, 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 or securing other sources for the products that we manufacture, cancellations or deferrals by their customers, or developing such products internally. If our relationships with HP or with Caterpillar are not successful or suffers a material adverse change, such as a material reduction in the level of orders or their failure to timely pay us, our business and operating results would likely suffer.

The transition to a new Chief Executive Officer and new Chief Financial Officer may limit our ability to effectively execute on our business plan.

Effective March 1, 2012, Douglas Milner became our President and Chief Executive Officer. Because he is new to Active Power, his experience with our management team and knowledge of our operations is limited. While Jan Lindelow, who had been serving as our Interim Chief Executive Officer, is assisting Mr. Milner as he transitions into the position, this leadership change may result in disruptions to our business or operations or otherwise limit the ability of our management team to effectively execute on our business plan, which could have an adverse effect on our results of operations and financial condition.

In addition, on June 13, 2012, John Penver delivered his resignation as our Vice President of Finance, Chief Financial Officer and Secretary, to be effective as of October 31, 2012. We are currently in the process of identifying a new Chief Financial Officer. We may not be able to attract or retain a new Chief Financial Officer due to the intense competition for qualified personnel for this position. In addition, once a qualified candidate is hired, the transition to a new Chief Financial Officer will require time and expense, may cause disruptions in our finance and accounting function and may limit the ability of our management team to effectively execute on our business plan. If we are unsuccessful in hiring a replacement for Mr. Penver quickly, or if we are unable to manage this transition efficiently and effectively, our business and operating results may be adversely affected.

Our common stock could be delisted from The Nasdaq Capital Market if our stock price continues to trade below \$1.00 per share.

Prior to June 21, 2012, our common stock was listed on The Nasdaq Global Market. On December 19, 2011, we received a Staff Deficiency Letter from The NASDAQ OMX Group, or Nasdaq, notifying us that we were not in compliance with Nasdaq's Marketplace Rule 5450(a)(1), because the bid price for our common stock had, for the preceding 30 consecutive business days, closed below the minimum \$1.00 per share requirement for continued listing. In accordance with Marketplace Rule 5810(c)(3)(A), we were provided a period of 180 calendar days, or until June 18, 2012, to regain compliance.

We applied to transfer the listing of our common stock from The Nasdaq Global Market to The Nasdaq Capital Market. Upon transfer to The Nasdaq Capital Market, we are still required under Rule 5550(a)(2) to maintain a minimum bid price of \$1.00. On June 19, 2012, we received approval from Nasdaq of our application for the transfer of the listing of our common stock from The Nasdaq Global Market to The Nasdaq Capital Market, effective at the market open on June 21, 2012, and granting us an additional 180 days pursuant to Marketplace Rule 5810(c)(3)(A)(ii) to regain compliance with the minimum \$1.00 per share bid price requirement for continued listing on The Nasdaq Capital Market. If at any time before December 17, 2012, the bid price of our common stock closes at or above \$1.00 per share for a minimum of 10 consecutive business days, Nasdaq will provide written confirmation that we have achieved compliance. If compliance with Marketplace Rule 5550(a)(2) cannot be demonstrated by December 17, 2012, our common stock will be subject to delisting from The Nasdaq Capital Market.

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In the event that we receive notice that our common stock is being delisted from The Nasdaq Capital Market, Nasdaq rules permit us to appeal any delisting determination by the Nasdaq staff to a Nasdaq Hearings Panel.

We will continue to monitor the bid price for our common stock and consider various options available to us if our common stock does not trade at a level that is likely to regain compliance.

Delisting from The Nasdaq Capital Market could have an adverse effect on our business and on the trading of our common stock. If a delisting of our common stock from The Nasdaq Stock Market were to occur, our common stock would trade on the OTC Bulletin Board or on the “pink sheets” maintained by the National Quotation Bureau, Inc. Such alternatives are generally considered to be less efficient markets, and our stock price, as well as the liquidity of our common stock, may be adversely impacted as a result.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

The following documents are filed as exhibits to this report:

- 3.1* Restated Certificate of Incorporation, dated June 7, 2006 (filed as Exhibit 3.1 to Active Power's Quarterly Report on Form 10-Q filed on April 30, 2012)
- 3.2* Second Amended and Restated Bylaws as adopted February 1, 2007 (filed as Exhibit 3.2 to Active Power's Quarterly Report on Form 10-Q filed on April 30, 2012)
- 3.3* Amendment to Second Amended and Restated Bylaws as adopted December 6, 2007 (filed as Exhibit 3.3 to Active Power's Quarterly Report on Form 10-Q filed on April 30, 2012)
- 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))
- 4.2* See Exhibits 3.1, 3.2 and 3.3 for provisions of the Certificate of Incorporation and Bylaws of the registrant defining the rights of holders of common stock
- [10.1](#) Active Power, Inc. 2010 Equity Incentive Plan as amended effective May 17, 2012
- [10.2](#) Transition Agreement and Release, dated June 13, 2012, between Active Power, Inc. and John Penver
- [10.3](#) First Amendment to Second Amended and Restated Loan and Security Agreement, dated March 5, 2012, between Active Power, Inc. and Silicon Valley Bank
- [31.1](#) Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
- [31.2](#) Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
- [32.1](#) Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003
- [32.2](#) Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003
- 101 The following financial statements from the Active Power's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, formatted in XBRL:
(i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations and Comprehensive Loss, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) Notes to Condensed Consolidated Financial Statements.

* Incorporated by reference to the indicated filing.

SIGNATURES

Pursuant to the requirements 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.

(Registrant)

August 3, 2012

(Date)

/s/ J. Douglas Milner

J. Douglas Milner

President and Chief Executive Officer

(Principal Executive Officer)

August 3, 2012

(Date)

/s/ John K. Penver

John K. Penver

Vice President of Finance, Chief Financial Officer and Secretary

(Principal Financial and Accounting Officer)

ACTIVE POWER, INC.

2010 EQUITY INCENTIVE PLAN

(as amended effective May 17, 2012)

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 fifty percent (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 fifty percent (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 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 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 twelve (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 fifty percent (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, fifty percent (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, fifty percent (50%) or more of the total value or voting power of all the outstanding stock of the Company, 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 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.

(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) 10,600,000 shares 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 5,639,442) 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) 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 one hundred thousand U.S. dollars (\$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 1,500,000 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 2,500,000 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 ten percent (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 one hundred ten percent (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 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) 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 seven (7) years from the date of grant thereof. 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 (5) 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 (3) 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 (12) 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 twelve (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 (3) 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 1,500,000 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 2,500,000 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 seven (7) 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 500,000 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 750,000 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 500,000 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 750,000 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 500,000 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 750,000 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.

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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 (3) 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 (6) 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 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.

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 (10) 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 twelve (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.

TRANSITION AGREEMENT AND RELEASE

This Transition Agreement and Release (“Agreement”) is made by and between **John K. Penver** (“Employee”) and Active Power, Inc. (the “Company”) (collectively referred to as the “Parties” or individually referred to as a “Party”).

RECITALS

WHEREAS, Employee and the Company entered into a Severance Benefits Agreement dated April 14, 2012 (the “Severance Agreement”), which superseded and replaced the Severance Benefits Agreement dated October 29, 2008 between Employee and the Company;

WHEREAS, Employee and the Company entered into a Proprietary Information and Nondisclosure Agreement dated February 1, 2005 (the “Confidentiality Agreement”);

WHEREAS, Employee and the Company entered into Stock Option Agreements with the Company dated February 28, 2005, February 3, 2006, February 7, 2007, February 28, 2008, February 4, 2009, February 25, 2010, February 24, 2011, February 28, 2011 and February 17, 2012 and a Restricted Stock Unit Agreement with the Company dated February 17, 2012, under the Company’s 2000 Stock Incentive Plan and 2010 Equity Incentive Plan, as applicable (collectively, the “Stock Agreements”);

WHEREAS, Employee is employed as the Chief Financial Officer and Vice President, Finance of the Company and wishes to resign his position with the Company effective as of the Separation Date;

WHEREAS, the Company and Employee wish to provide for an orderly transition of Employee’s duties prior to Employee’s employment with the Company terminating no later than October 31, 2012 (the “Separation Date,” and the period of time between the Effective Date of this Agreement and the Separation Date referred to as the “Transition Period”). The Parties agree that Employee’s separation will be considered a “termination without Cause,” as defined in the Severance Agreement;

WHEREAS, the Parties wish to resolve any and all disputes, claims, complaints, grievances, charges, actions, petitions, and demands that the Employee may have against the Company and any of the Releasees as defined below, including, but not limited to, any and all claims arising out of or in any way related to Employee’s employment with or separation from the Company;

NOW, THEREFORE, in consideration of the mutual promises made herein, the Company and Employee hereby agree as follows:

COVENANTS

1. Consideration.

- a. Payment. The Company agrees to provide the following to Employee in consideration for Employee entering into this Agreement:

- (i) The Company will continue to retain Employee as an employee of the Company until the Separation Date, during which time Employee shall remain an at-will employee.
- (ii) During the Transition Period, Employee will continue to receive his regular base salary as in effect as of the Effective Date.
- (iii) Following the Separation Date, provided that this Agreement is in effect and Employee is in compliance with this Agreement (and any agreements incorporated herein) the Company will provide Employee with the following benefits (the "Separation Benefits"), subject to Employee's compliance with Section 1(b) below and this Agreement:
 - a. Salary continuation at the rate in effect on the Effective Date of this Agreement, nine (9) months following the Separation Date (the "Salary Continuation Period"). All such payments, if any, will be less applicable withholding, and will be made in accordance with the Company's regular payroll practices and schedule.
 - b. Reimbursement of Employee for insurance continuation premiums made by Employee pursuant to COBRA for the shorter of (i) nine (9) months after the Separation Date, (ii) the date Employee has secured other employment, or (iii) the date Employee is no longer eligible to receive continuation coverage pursuant to COBRA, subject to Employee's providing evidence of payment to the Company within thirty (30) days of Employee making such payments.
 - c. All stock options and restricted stock held by Employee in which Employee would have vested if Employee had remained employed with the Company for a period of nine (9) months following the Separation Date will immediately vest and become exercisable.
 - d. Employee will remain eligible to participate in the Company's management incentive plan, and should any bonus be earned prior to the Separation Date, Employee will be paid according to the formula set forth in section 2(d) of the Severance Agreement. All determinations of the amount of the achievement of such objectives and the amounts of such bonuses shall be made by the Board of Directors of the Company in its sole discretion.
 - e. Employee agrees that the Company may, at its sole discretion, assign Employee to alternate duties of the Company's choice during the remainder of his employment period, provided Employee's pay rate does not decrease.

b. Supplemental Release. Employee agrees to sign the Supplemental Release attached hereto as Exhibit A within three (3) business days of the Separation Date or Employee's actual termination date, whichever is earlier. Subject to Employee's signing the Supplemental Release, the Company agrees to provide Employee with a lump sum payment of \$50,000, less applicable withholding, within ten (10) days of Employee's signing the Supplemental Release (the "Supplemental Consideration"). **For the avoidance of doubt, Employee acknowledges and understands that he must remain employed through the entire Transition Period in order to receive the Supplemental Consideration.** No partial or pro rata Supplemental Consideration will be paid if Employee resigns or is terminated with Cause (as defined in the Severance Agreement) prior to the Separation Date. If Employee is terminated without Cause prior to the Separation Date, the Company will pay the Supplemental Consideration as well as the Separation Benefits set forth in Section 1(a) above.

c. Payment in Full. Employee further specifically acknowledges and agrees that the consideration provided to him hereunder fully satisfies any obligation that the Company had to pay Employee wages or any other compensation for any of the services that Employee rendered to the Company, any severance or other benefits pursuant to the Severance Agreement, including but not limited to any bonus entitlement or any severance due to Employee in accordance with his Severance Agreement. Employee further agrees that the amount paid is in excess of any disputed wage claim that Employee may have, that the consideration paid shall be deemed to be paid first in satisfaction of any disputed wage claim with the remainder sufficient to act as consideration for the release of claims set forth herein, and that Employee has not earned and is not entitled to receive any additional wages or other form of compensation from the Company up through the Effective Date.

2. Benefits. Employee's health, dental and vision insurance benefits shall cease on the last day of the month in which the Separation Date or effective employment termination date occurs, subject to Employee's COBRA insurance continuation rights. Except as otherwise specifically stated in this Agreement, Employee's participation in all benefits and incidents of employment, including, but not limited to, vesting in stock options as a result of employment, and the accrual of vacation and paid time off, will cease as of the Separation Date or the effective employment termination date, whichever is earlier.

3. Payment of Salary and Receipt of All Benefits. Employee acknowledges and represents that, other than the consideration set forth in this Agreement, the Company has paid or provided all salary, wages, bonuses, accrued vacation/paid time off, leave, housing allowances, relocation costs, interest, severance, outplacement costs, fees, reimbursable expenses, commissions, stock, stock options, vesting, and any and all other benefits and compensation due to Employee through the Effective Date.

4. Release of Claims. Employee agrees that the foregoing consideration represents settlement in full of all outstanding obligations owed to Employee by the Company and its current and former officers, directors, employees, agents, investors, attorneys, shareholders, administrators, affiliates, benefit plans, plan administrators, insurers, divisions, and subsidiaries, and predecessor and successor corporations and assigns (collectively, the "Releasees"). Employee, on his own behalf and on behalf of his respective heirs, family members, executors, agents, and assigns, hereby and forever releases the Releasees from, and agrees not to sue concerning, or in any manner to institute, prosecute, or pursue, any claim, complaint, charge, duty, obligation, or cause of action relating to any matters of any kind, whether presently known or unknown, suspected or unsuspected, that Employee may possess against any of the Releasees arising from any omissions, acts, facts, or damages that have occurred up until and including the Effective Date of this Agreement, including, without limitation:

- a. any and all claims relating to or arising from Employee's employment relationship with the Company and the decision to terminate that relationship;
- b. any and all claims relating to, or arising from, Employee's right to purchase, or actual purchase of shares of stock of the Company, including, without limitation, any claims for fraud, misrepresentation, breach of fiduciary duty, breach of duty under applicable state corporate law, and securities fraud under any state or federal law;
- c. any and all claims for wrongful discharge of employment; termination in violation of public policy; discrimination; harassment; retaliation; breach of contract, both express and implied; breach of covenant of good faith and fair dealing, both express and implied; promissory estoppel; negligent or intentional infliction of emotional distress; fraud; negligent or intentional misrepresentation; negligent or intentional interference with contract or prospective economic advantage; unfair business practices; defamation; libel; slander; negligence; personal injury; assault; battery; invasion of privacy; false imprisonment; conversion; and disability benefits;
- d. any and all claims for violation of any federal, state, or municipal statute, including, but not limited to, Title VII of the Civil Rights Act of 1964; the Civil Rights Act of 1991; the Rehabilitation Act of 1973; the Americans with Disabilities Act of 1990; the Equal Pay Act; the Fair Labor Standards Act, except as prohibited by law; the Fair Credit Reporting Act; the Age Discrimination in Employment Act of 1967; the Older Workers Benefit Protection Act; the Employee Retirement Income Security Act of 1974; the Worker Adjustment and Retraining Notification Act; the Family and Medical Leave Act, except as prohibited by law; the Sarbanes-Oxley Act of 2002; the Texas Payday Act; Texas Workers' Compensation Act; and Chapter 21 of the Texas Labor Code (also known as the Texas Commission on Human Rights Act); and any other laws of the states of Texas or any other state, except as prohibited by law;
- e. any and all claims for violation of the federal or any state constitution;
- f. any and all claims arising out of any other laws and regulations relating to employment or employment discrimination;
- g. any claim for any loss, cost, damage, or expense arising out of any dispute over the non-withholding or other tax treatment of any of the proceeds received by Employee as a result of this Agreement; and
- h. any and all claims for attorneys' fees and costs.

Employee agrees that the release set forth in this section shall be and remain in effect in all respects as a complete general release as to the matters released. This release does not extend to any obligations incurred under this Agreement. This release does not release claims that cannot be released as a matter of law, including, but not limited to Employee's right to file a charge with or participate in a charge by the Equal Employment Opportunity Commission, or any other local, state, or federal administrative body or government agency that is authorized to enforce or administer laws related to employment, against the Company (with the understanding that any such filing or participation does not give Employee the right to recover any monetary damages against the Company; Employee's release of claims herein bars Employee from recovering such monetary relief from the Company).

5. Acknowledgment of Waiver of Claims under ADEA. Employee acknowledges that he is waiving and releasing any rights he may have under the Age Discrimination in Employment Act of 1967 ("ADEA"), and that this waiver and release is knowing and voluntary. Employee agrees that this waiver and release does not apply to any rights or claims that may arise under the ADEA after the Effective Date of this Agreement. Employee acknowledges that the consideration given for this waiver and release is in addition to anything of value to which Employee was already entitled. Employee further acknowledges that he has been advised by this writing that: (a) he should consult with an attorney prior to executing this Agreement; (b) he has twenty-one (21) days within which to consider this Agreement; (c) he has seven (7) days following his execution of this Agreement to revoke this Agreement; (d) this Agreement shall not be effective until after the revocation period has expired; and (e) nothing in this Agreement prevents or precludes Employee from challenging or seeking a determination in good faith of the validity of this waiver under the ADEA, nor does it impose any condition precedent, penalties, or costs for doing so, unless specifically authorized by federal law. In the event Employee signs this Agreement and returns it to the Company in less than the 21-day period identified above, Employee hereby acknowledges that he has freely and voluntarily chosen to waive the time period allotted for considering this Agreement.

Employee acknowledges and understands that revocation must be accomplished by a written notification to Doug Milner that is received prior to the Effective Date. The Parties agree that any changes to this Agreement, whether material or immaterial, do not restart the running of the 21- day consideration period.

6. Unknown Claims. Employee acknowledges that he has been advised to consult with legal counsel and that he is familiar with the principle that a general release does not extend to claims which the releasor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the releasee. Employee, being aware of said principle, agrees to expressly waive any rights Employee may have to that effect, as well as under any other statute or common law principles of similar effect.

7. No Pending or Future Lawsuits. Employee represents that he has no lawsuits, claims, or actions pending in his name, or on behalf of any other person or entity, against the Company or any of the other Releasees. Employee also represents that he does not intend to bring any claims on his own behalf or on behalf of any other person or entity against the Company or any of the other Releasees.

8. Confidentiality. Employee agrees to maintain in complete confidence the existence of this Agreement, the contents and terms of this Agreement, and the consideration for this Agreement (hereinafter collectively referred to as "Separation Information"). Except as required by law, Employee may disclose Separation Information only to his immediate family members, the Court in any proceedings to enforce the terms of this Agreement, Employee's undersigned counsel, and Employee's accountant and any professional tax advisor to the extent that they need to know the Separation Information in order to provide advice on tax treatment or to prepare tax returns, and must prevent disclosure of any Separation Information to all other third parties. Employee agrees that he will not publicize, directly or indirectly, any Separation Information.

Employee acknowledges and agrees that the confidentiality of the Separation Information is of the essence. The Parties agree that if the Company proves that Employee breached this Confidentiality provision, the Company shall be entitled to an award of its costs spent enforcing this provision, including all reasonable attorneys' fees associated with the enforcement action, without regard to whether the Company can establish actual damages from Employee's breach, except to the extent that such breach constitutes a legal action by Employee that directly pertains to the ADEA. Any such individual breach or disclosure shall not excuse Employee from his obligations hereunder, nor permit him to make additional disclosures. Employee warrants that he has not disclosed, orally or in writing, directly or indirectly, any of the Separation Information to any unauthorized party.

9. Trade Secrets and Confidential Information/Noncompete/Company Property. Employee reaffirms and agrees to observe and abide by the surviving terms of the Confidentiality Agreement and the Severance Agreement, specifically including the provisions therein regarding non-competition, nondisclosure of the Company's trade secrets and confidential and proprietary information, and non-solicitation of Company employees. Employee's signature below constitutes his certification under penalty of perjury that he will return all documents and other items provided to Employee by the Company, developed or obtained by Employee in connection with his employment with the Company, or otherwise belonging to the Company on or before the Separation Date. Employee acknowledges and agrees that the Company is relying on Employee's compliance with the Confidentiality Agreement and the Severance Agreement **as an essential term of this Agreement**, and that if Employee violates either such agreement, that the Company will be entitled to cease and/or recover any payments made pursuant to Section 1, in addition to any seeking remedies it may have under the Confidentiality Agreement, the Severance Agreement or otherwise. All other provisions of this Agreement shall remain in full force and effect.

10. No Cooperation. Employee agrees not to act in any manner that might damage the business of the Company. Employee further agrees that he will not knowingly encourage, counsel, or assist any attorneys or their clients in the presentation or prosecution of any disputes, differences, grievances, claims, charges, or complaints by any third party against any of the Releasees, unless under a subpoena or other court order to do so or as related directly to the ADEA waiver in this Agreement. Employee agrees both to immediately notify the Company upon receipt of any such subpoena or court order, and to furnish, within three (3) business days of its receipt, a copy of such subpoena or other court order. If approached by anyone for counsel or assistance in the presentation or prosecution of any disputes, differences, grievances, claims, charges, or complaints against any of the Releasees, Employee shall state no more than that he cannot provide counsel or assistance.

11. Communications and Transition of Duties. The Parties agree to work together in good faith with regard to all communications made to customers, vendors, employees or other individuals or entities regarding Employee's separation from employment. Employee further agrees that any statement made by Employee to customers, vendors, employees or other individuals or entities regarding his separation from employment must be consistent in all respects with the terms of this Agreement. Employee further agrees to cooperate with the Company with regard to the transition of Employee's job duties and business relationships. Employee agrees to sign and return a resignation letter substantially in the form attached as Exhibit B within one (1) day following the Effective Date of this Agreement.

12. Non-Disparagement. Employee agrees to refrain from any disparaging statements about the Company or any of the other Releasees (including but not limited to the Company's employees and/or members of the Board of Directors) including, without limitation, the business, products, intellectual property, financial standing, future, or employment/compensation/benefit practices of the Company. For purposes of clarity, this paragraph applies to statements made in writing, orally, or by any other means, and includes internal statements to Company employees as well as external statements to third parties.

13. Non-Solicitation. Employee agrees that for a period of twenty four (24) months immediately following the Separation Date, Employee shall not directly or indirectly solicit any of the Company's employees to leave their employment at the Company.

14. Breach. Employee acknowledges and agrees that any material breach of this Agreement, unless such breach constitutes a legal action by Employee challenging or seeking a determination in good faith of the validity of the waiver herein under the ADEA, or of the Employment Agreement shall entitle the Company immediately to recover and/or cease providing the consideration provided to Employee under this Agreement, except as provided by law. Except as provided by law, Employee shall also be responsible to the Company for all costs, attorneys' fees, and any and all damages incurred by the Company in (a) enforcing Employee's obligations under this Agreement or the Employment Agreement, including the bringing of any action to recover the consideration, and (b) defending against a claim or suit brought or pursued by Employee in violation of the terms of this Agreement.

15. No Admission of Liability. Employee understands and acknowledges that this Agreement constitutes a compromise and settlement of any and all actual or potential disputed claims by Employee. No action taken by the Company hereto, either previously or in connection with this Agreement, shall be deemed or construed to be (a) an admission of the truth or falsity of any actual or potential claims or (b) an acknowledgment or admission by the Company of any fault or liability whatsoever to Employee or to any third party.

16. Costs. The Parties shall each bear their own costs, attorneys' fees, and other fees incurred in connection with the preparation of this Agreement.

17. ARBITRATION. THE PARTIES AGREE THAT ANY AND ALL DISPUTES ARISING OUT OF THE TERMS OF THIS AGREEMENT, THEIR INTERPRETATION, AND ANY OF THE MATTERS HEREIN RELEASED, SHALL BE SUBJECT TO ARBITRATION IN DALLAS COUNTY, TEXAS BEFORE JAMS, THE RESOLUTION EXPERTS (“JAMS”), PURSUANT TO ITS EMPLOYMENT ARBITRATION RULES & PROCEDURES (“JAMS RULES”). THE ARBITRATOR MAY GRANT INJUNCTIONS AND OTHER RELIEF IN SUCH DISPUTES. THE ARBITRATOR SHALL ADMINISTER AND CONDUCT ANY ARBITRATION IN ACCORDANCE WITH TEXAS LAW, AND THE ARBITRATOR SHALL APPLY SUBSTANTIVE AND PROCEDURAL TEXAS LAW TO ANY DISPUTE OR CLAIM, WITHOUT REFERENCE TO ANY CONFLICT-OF-LAW PROVISIONS OF ANY JURISDICTION. TO THE EXTENT THAT THE JAMS RULES CONFLICT WITH TEXAS LAW, TEXAS LAW SHALL TAKE PRECEDENCE. THE DECISION OF THE ARBITRATOR SHALL BE FINAL, CONCLUSIVE, AND BINDING ON THE PARTIES TO THE ARBITRATION. THE PARTIES AGREE THAT THE PREVAILING PARTY IN ANY ARBITRATION SHALL BE ENTITLED TO INJUNCTIVE RELIEF IN ANY COURT OF COMPETENT JURISDICTION TO ENFORCE THE ARBITRATION AWARD. THE PARTIES TO THE ARBITRATION SHALL EACH PAY AN EQUAL SHARE OF THE COSTS AND EXPENSES OF SUCH ARBITRATION, AND EACH PARTY SHALL SEPARATELY PAY FOR ITS RESPECTIVE COUNSEL FEES AND EXPENSES; PROVIDED, HOWEVER, THAT THE ARBITRATOR SHALL AWARD ATTORNEYS’ FEES AND COSTS TO THE PREVAILING PARTY, EXCEPT AS PROHIBITED BY LAW. THE PARTIES HEREBY AGREE TO WAIVE THEIR RIGHT TO HAVE ANY DISPUTE BETWEEN THEM RESOLVED IN A COURT OF LAW BY A JUDGE OR JURY. NOTWITHSTANDING THE FOREGOING, THIS SECTION WILL NOT PREVENT EITHER PARTY FROM SEEKING INJUNCTIVE RELIEF (OR ANY OTHER PROVISIONAL REMEDY) FROM ANY COURT HAVING JURISDICTION OVER THE PARTIES AND THE SUBJECT MATTER OF THEIR DISPUTE RELATING TO THIS AGREEMENT AND THE AGREEMENTS INCORPORATED HEREIN BY REFERENCE. SHOULD ANY PART OF THE ARBITRATION AGREEMENT CONTAINED IN THIS PARAGRAPH CONFLICT WITH ANY OTHER ARBITRATION AGREEMENT BETWEEN THE PARTIES, THE PARTIES AGREE THAT THIS ARBITRATION AGREEMENT SHALL GOVERN.

18. Tax Consequences. The Company makes no representations or warranties with respect to the tax consequences of the payments and any other consideration provided to Employee or made on his behalf under the terms of this Agreement. Employee agrees and understands that he is responsible for payment, if any, of local, state, and/or federal taxes on the payments and any other consideration provided hereunder by the Company and any penalties or assessments thereon. Employee further agrees to indemnify and hold the Company harmless from any claims, demands, deficiencies, penalties, interest, assessments, executions, judgments, or recoveries by any government agency against the Company for any amounts claimed due on account of (a) Employee’s failure to pay or the Company’s failure to withhold, or Employee’s delayed payment of, federal or state taxes, or (b) damages sustained by the Company by reason of any such claims, including attorneys’ fees and costs.

19. Section 409(A). If the Company determines that any cash severance benefits, health continuation coverage, or additional benefits provided under this Agreement shall fail to satisfy the distribution requirement of Section 409A(a)(2)(A) or the Internal Revenue Code of 1986, as amended (the “Code”) as result of Section 409A(a)(2)(B)(i) of the Code, the payment of such benefit shall be accelerated to the minimum extent necessary so that the benefit is not subject to the provisions of Section 409(a)(1) of the Code. (It is the intention of the preceding sentence to apply the short-term deferral provisions of Section 409A of the Code, and the regulations and other guidance thereunder, to such payments, and the payment schedule as revised after the application of the preceding sentence shall be referred to as the “Revised Payment Schedule.”) However, if there is no Revised Payment Schedule that would avoid the application of Section 409A(a)(1) of the Code, the payment of such benefits shall not be paid pursuant to a Revised Payment Schedule and instead shall be delayed to the minimum extent necessary so that such benefits are not subject to the provisions of section 409A(a)(1) of the Code. The Company may attach conditions to or adjust the amounts paid pursuant to this paragraph to preserve, as closely as possible, the economic consequences that would have applied in the absence of this paragraph; *provided, however*, that no such condition or adjustment shall result in the payments being subject to Section 409A(a)(1) of the Code.

20. Successors and Assigns. Employee understands and acknowledges that this Agreement is personal in its nature and agrees that he shall not assign or transfer his rights under this Agreement. The provisions of this Agreement shall inure to the benefit of, and shall be binding on, each successor of the Company whether by merger, consolidation, transfer of all or substantially all assets, or otherwise, and the heirs and legal representatives of Employee.

21. Authority. The Company represents and warrants that the undersigned has the authority to act on behalf of the Company and to bind the Company and all who may claim through it to the terms and conditions of this Agreement. Employee represents and warrants that he has the capacity to act on his own behalf and on behalf of all who might claim through him to bind them to the terms and conditions of this Agreement. Each Party warrants and represents that there are no liens or claims of lien or assignments in law or equity or otherwise of or against any of the claims or causes of action released herein.

22. No Representations. Employee represents that he has had an opportunity to consult with an attorney, and has carefully read and understands the scope and effect of the provisions of this Agreement. Employee has not relied upon any representations or statements made by the Company that are not specifically set forth in this Agreement.

23. Severability. In the event that any provision or any portion of any provision hereof or any surviving agreement made a part hereof becomes or is declared by a court of competent jurisdiction or arbitrator to be illegal, unenforceable, or void, this Agreement shall continue in full force and effect without said provision or portion of provision.

24. Attorneys' Fees. Except with regard to a legal action challenging or seeking a determination in good faith of the validity of the waiver herein under the ADEA, in the event that either Party brings an action to enforce or effect its rights under this Agreement, the prevailing Party shall be entitled to recover its costs and expenses, including the costs of mediation, arbitration, litigation, court fees, and reasonable attorneys' fees incurred in connection with such an action.

25. Entire Agreement. This Agreement represents the entire agreement and understanding between the Company and Employee concerning the subject matter of this Agreement and Employee's employment with and separation from the Company and the events leading thereto and associated therewith, and supersedes and replaces any and all prior agreements and understandings concerning the subject matter of this Agreement and Employee's relationship with the Company, with the exception of the surviving portions of the Severance Agreement, the Confidentiality Agreement and the Stock Agreements.

26. No Oral Modification. This Agreement may only be amended in a writing signed by Employee and the Company's Chief Executive Officer.

27. Governing Law. This Agreement shall be governed by the laws of the State of Texas, without regard for choice-of-law provisions. Employee consents to personal and exclusive jurisdiction and venue in the State of Texas.

28. Effective Date. Each Party has seven (7) days after that Party signs this Agreement to revoke it. This Agreement will become effective on the eighth (8th) day after Employee signed this Agreement, so long as it has been signed by the Parties and has not been revoked by either Party before that date (the "Effective Date").

29. Counterparts. This Agreement may be executed in counterparts and by facsimile, and each counterpart and facsimile shall have the same force and effect as an original and shall constitute an effective, binding agreement on the part of each of the undersigned.

30. Voluntary Execution of Agreement. Employee understands and agrees that he executed this Agreement voluntarily, without any duress or undue influence on the part or behalf of the Company or any third party, with the full intent of releasing all of his claims against the Company and any of the other Releasees. Employee acknowledges that:

- (a) he has read this Agreement;
- (b) he has been represented in the preparation, negotiation, and execution of this Agreement by legal counsel of his own choice or has elected not to retain legal counsel;
- (c) he understands the terms and consequences of this Agreement and of the releases it contains; and
- (d) he is fully aware of the legal and binding effect of this Agreement.

IN WITNESS WHEREOF, the Parties have executed this Agreement on the respective dates set forth below.

JOHN K. PENVER, an individual

Dated: June 13, 2012

/s/ John K. Penver
John K. Penver

ACTIVE POWER, INC.

Dated: June 13, 2012

By: /s/ J. Douglas Milner

Name: J. Douglas Milner

Title: Chief Executive Officer

EXHIBIT A

SUPPLEMENTAL RELEASE

The undersigned, hereby verifies that he has chosen not to revoke the Transition Agreement and Release, dated ____, 2012, and confirms his renewed agreement to the terms of that Agreement, as well as the release and waiver of any and all claims relating to his employment with the Company, any employment-related claims arising prior to the Effective Date of the Agreement, including but not limited to claims under any local ordinance or state or federal employment law, including laws prohibiting discrimination in employment on the basis of race, sex, age (in particular, any claim under the Age Discrimination in Employment Act or any similar state law), disability, national origin, or religion, as well as any claims for wrongful discharge, breach of contract, attorneys' fees, costs, or any claims of amounts due for fees, commissions, stock options, expenses, salary, bonuses, profit sharing or fringe benefits. The undersigned further acknowledges that the terms of Sections 5, 6, 7 and 8 of the Transition Agreement and Release shall also apply to this Supplemental Release and are incorporated herein.

JOHN K. PENVER, an individual

Dated: _____

By: _____
John K. Penver

EXHIBIT B
RESIGNATION LETTER

To Whom it May Concern:

This letter confirms that I am resigning my employment position at Active Power, Inc., effective as of October 31, 2012.

Sincerely,

John K. Penver

FIRST AMENDMENT

TO

SECOND AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT

THIS FIRST AMENDMENT to Second Amended and Restated Loan and Security Agreement (this “Amendment”) is entered into this 5th day of March, 2012, by and between Silicon Valley Bank (“Bank”) and ACTIVE POWER, INC., a Delaware corporation (“Borrower”), with its principal place of business at 2128 W Braker Lane BK 12, Austin, TX 78758.

Recitals

- A.** Bank and Borrower have entered into that certain Second Amended and Restated Loan and Security Agreement dated as of August 5, 2010 (as the same may from time to time be amended, modified, supplemented or restated, the “Loan Agreement”).
- B.** Bank has extended credit to Borrower for the purposes permitted in the Loan Agreement.
- C.** Borrower has requested that Bank amend the Loan Agreement to consent to a transaction with an Affiliate of Borrower.
- D.** Bank has agreed to so amend certain provisions of the Loan Agreement, but only to the extent, in accordance with the terms, subject to the conditions and in reliance upon the representations and warranties set forth below.

Agreement

Now, Therefore, in consideration of the foregoing recitals and other good and valuable consideration, the receipt and adequacy of which is hereby acknowledged, and intending to be legally bound, the parties hereto agree as follows:

- 1. Definitions.** Capitalized terms used but not defined in this Amendment shall have the meanings given to them in the Loan Agreement.
- 2. Amendments to Loan Agreement.**

2.1 Section 7.7 (Transactions with Affiliates). Section 7.7 is amended in its entirety and replaced with the following:

“**7.7 Transactions with Affiliates.** Enter into or permit to exist any material transaction with any Affiliate of Borrower, except for transactions that are in the ordinary course of Borrower’s business, upon fair and reasonable terms that are no less favorable to Borrower than would be obtained in an arm’s length transaction with a non-affiliated Person; provided that the foregoing restriction shall not apply to (i) any transaction between Borrower and any of its Subsidiaries or between any Subsidiaries that is not otherwise prohibited by this Agreement, (ii) reasonable and customary fees paid to members of the board of directors of Borrower and its Subsidiaries, (iii) compensation arrangements and benefit plans for officers and other employees of Borrower and its Subsidiaries entered into or maintained in the ordinary course of business and (iv) transactions pursuant to the Securities Purchase Agreement.

2.2 Section 13 (Definitions). The following term and its definition are hereby added to **Section 13.1**:

“Securities Purchase Agreement” is that certain Securities Purchase Agreement by and among Borrower and the Purchasers party thereto dated as of March 5, 2012.

2.3 Bank hereby agrees that any Letters of Credit or Cash Management Services that are currently required to be cash secured pursuant to the terms of the Agreement may remain not cash secured until March 23, 2012, at which time any such Letters of Credit or Cash Management Services that are required to be cash secured pursuant to the terms of the Agreement at such time shall be immediately cash secured.

3. Limitation of Amendments.

3.1 The amendments set forth in **Section 2**, above, are effective for the purposes set forth herein and shall be limited precisely as written and shall not be deemed to (a) be a consent to any amendment, waiver or modification of any other term or condition of any Loan Document, or (b) otherwise prejudice any right or remedy which Bank may now have or may have in the future under or in connection with any Loan Document.

3.2 This Amendment shall be construed in connection with and as part of the Loan Documents and all terms, conditions, representations, warranties, covenants and agreements set forth in the Loan Documents, except as herein amended, are hereby ratified and confirmed and shall remain in full force and effect.

4. Representations and Warranties. To induce Bank to enter into this Amendment, Borrower hereby represents and warrants to Bank as follows:

4.1 Immediately after giving effect to this Amendment (a) the representations and warranties contained in the Loan Documents are true, accurate and complete in all material respects as of the date hereof (except to the extent such representations and warranties relate to an earlier date, in which case they are true and correct as of such date), and (b) no Event of Default has occurred and is continuing;

4.2 Borrower has the power and authority to execute and deliver this Amendment and to perform its obligations under the Loan Agreement, as amended by this Amendment;

4.3 The organizational documents of Borrower delivered to Bank on the Effective Date remain true, accurate and complete and have not been amended, supplemented or restated and are and continue to be in full force and effect;

4.4 The execution and delivery by Borrower of this Amendment and the performance by Borrower of its obligations under the Loan Agreement, as amended by this Amendment, have been duly authorized;

4.5 The execution and delivery by Borrower of this Amendment and the performance by Borrower of its obligations under the Loan Agreement, as amended by this Amendment, do not and will not contravene (a) any law or regulation binding on or affecting Borrower, (b) any contractual restriction with a Person binding on Borrower, (c) any order, judgment or decree of any court or other governmental or public body or authority, or subdivision thereof, binding on Borrower, or (d) the organizational documents of Borrower;

4.6 The execution and delivery by Borrower of this Amendment and the performance by Borrower of its obligations under the Loan Agreement, as amended by this Amendment, do not require any order, consent, approval, license, authorization or validation of, or filing, recording or registration with, or exemption by any governmental or public body or authority, or subdivision thereof, binding on either Borrower, except as already has been obtained or made; and

4.7 This Amendment has been duly executed and delivered by Borrower and is the binding obligation of Borrower, enforceable against Borrower in accordance with its terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization, liquidation, moratorium or other similar laws of general application and equitable principles relating to or affecting creditors' rights.

5. Counterparts. This Amendment may be executed in any number of counterparts and all of such counterparts taken together shall be deemed to constitute one and the same instrument.

6. Effectiveness. This Amendment shall be deemed effective upon the due execution and delivery to Bank of this Amendment by each party hereto.

[Signature page follows.]

In Witness Whereof, the parties hereto have caused this Amendment to be duly executed and delivered as of the date first written above.

BANK

Silicon Valley Bank

By:

Name: /s/ Priya Iyer

Title: Relationship Manager

BORROWER

Active Power, Inc.

By:

Name: /s/ John K. Penver

Title: Chief Financial Officer

CERTIFICATIONS

I, J. Douglas Milner, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Active Power, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2012

/s/ J. Douglas Milner
J. Douglas Milner
President and Chief Executive Officer
(Principal Executive Officer)

CERTIFICATIONS

I, John K. Penver, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Active Power, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2012

/s/ John K. Penver
John K. Penver
Vice President of Finance, Chief Financial
Officer and Secretary
(Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Active Power, Inc. (the "Company") for the period ending June 30, 2012, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, J. Douglas Milner, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ J. Douglas Milner

J. Douglas Milner
President and Chief Executive Officer
August 3, 2012

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Active Power, Inc. (the "Company") for the period ending June 30, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John K. Penver, Vice President of Finance, Chief Financial Officer and Secretary of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ John K. Penver

John K. Penver
Vice President of Finance,
Chief Financial Officer and Secretary
August 3, 2012
