

# ACTIVE POWER INC (ACPW)

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
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Form 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the fiscal year ended December 31, 2000

Commission file number 000-30939  
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ACTIVE POWER, INC.  
(Exact name of registrant as specified in its charter)

Delaware	74-2961657
State or other jurisdiction of incorporation or organization	(I.R.S. Employer Identification No.)

11525 Stonehollow Drive, Suite 110, Austin, Texas 78758  
(Address of principal executive offices, including Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock, par value \$0.001 per share  
(Title of each class)

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. [X] Yes [ ] No

Indicated by a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of March 1, 2001, based upon the closing sale price of Common Stock on such date, as reported on the Nasdaq National Market, was approximately \$581.3 million (affiliates being, for these purposes only, directors, executive officers and holders of more than 5% of the Registrant's Common Stock).

As of March 1, 2001, the Registrant had 39,257,420 outstanding shares of Common Stock.

Documents Incorporated by Reference:  
(Specific pages incorporated are indicated under the applicable Item herein)

Incorporated  
by Reference  
in Part No.  
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Our proxy statement filed in connection with our 2001 Annual  
Meeting of Stockholders..... III

Active Power, Inc.

Unless otherwise indicated, "we," "us," "our," and "Active Power" mean Active Power, Inc., including our predecessor Texas corporation. We own the trademarks CLEANSOURCE(R) and MAKING ELECTRICITY BETTER(R). All other trademarks, tradenames or service marks referred to in this document are the property of their respective owners. References in this document to "\$" or "dollars" are to United States of America currency.

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Table of Contents

Table of Contents.....	i
Special Note Regarding Forward-Looking Statements.....	ii
PART I.....	1
ITEM 1. Business.....	1
ITEM 2. Properties.....	19
ITEM 3. Legal Proceedings.....	19
ITEM 4. Submission of Matters to a Vote of Security Holders.....	19
PART II.....	20
ITEM 5. Market for Registrant's Common Equity and Related Stockholder Matters.....	20
ITEM 6. Selected Financial Data.....	21
ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	22
ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk.....	25
ITEM 8. Financial Statements and Supplementary Data.....	25
ITEM 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.....	25
PART III.....	26
ITEM 10. Executive Officers of the Registrant.....	26
ITEM 11. Executive Compensation.....	27
ITEM 12. Security Ownership of Certain Beneficial Owners and Management..	27
ITEM 13. Certain Relationships and Related Transactions.....	27
PART IV.....	28
ITEM 14. Exhibits, Financial Statement Schedules, and Reports on Form 8- K.....	28

Note on Incorporation by Reference

Throughout this report, various information and data are incorporated by reference to portions of our 2001 Proxy Statement. Any reference in this report to disclosures in our 2001 Proxy Statement shall constitute incorporation by reference of that specific material into this Form 10-K.

## Special Note Regarding Forward-Looking Statements

This document contains forward-looking statements that involve substantial risks and uncertainties, such as statements concerning:

- . industry trends;
- . customer demand for our products;
- . growth and future operating results;
- . developments in our markets and strategic focus;
- . expansion of and enhancements to our manufacturing and engineering facilities and product offerings;
- . customer benefits attributable to our products;
- . potential acquisitions and joint ventures and the integration of acquired businesses;
- . technologies and operations;
- . strategic relationships with third parties; and
- . future economic, business and regulatory conditions.

You can identify these statements by forward-looking words such as "may," "will," "expect," "intend," "anticipate," "believe," "estimate," "continue" and other similar words. You should read statements that contain these words carefully because they discuss our future expectations, make projections of our future results of operations or financial condition, or state other "forward-looking" information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to accurately predict or control. The factors listed in the sections captioned "Additional Factors That May Affect Future Results" in Item 1 of this report and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this report, as well as any cautionary language in this annual report, provide examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we described in our forward-looking statements.

PART I

ITEM 1. Business.

Overview

We design, manufacture and market battery-free power quality products that provide the consistent, reliable electric power required by today's digital economy. We believe that we are the first company to commercialize a flywheel energy storage system that provides a highly reliable, low-cost and non-toxic replacement for lead-acid batteries used in conventional power quality installations. Leveraging our expertise in this technology and in conjunction with Caterpillar, the leading maker of engine generators for the power reliability market, we have developed a battery-free power quality system that is marketed under the Caterpillar brand name. As an extension of these existing product lines, we are developing a fully integrated continuous power system. The initial target market for this product is the rapidly growing telecommunications industry.

Industry Background

Power Requirements of the New Economy

The worldwide demand for high quality electricity has been increasing rapidly in recent years, driven in large part by growth in the use of computers, the Internet, on-line transactions and the telecommunications infrastructure. Industry sources have estimated that the share of all U.S. electricity consumed by computer-based microprocessors is 13% and that within the next two decades up to 50% of the nation's electricity supply may support the direct and indirect needs of the Internet.

As the proliferation of sophisticated digital electronics grows and the dependence on high performance computing and networked systems increases, the need for very high levels of quality power and reliable power becomes paramount. However, despite this increasingly dramatic change in the mix of electricity demand, the distribution system used to provide power has not changed. The power delivered over the electric utility grid today is subject to power disturbances, such as voltage sags and surges, and power outages. These disturbances, while typically lasting less than two seconds, can have significant financial and operational effects on companies doing business in the digital economy.

[GRAPHIC APPEARS HERE]

[Description of Graphic: This graphic depicts sine waves representing both the types of problems with power supplied from the electric utility grid and the desired sine wave for "Reliable, Quality Electric Power". The first graphic on the far left is titled "Reliability Problem" and shows a steady sine wave that turns into a straight line. Above the straight line is the word "Outage" with an arrow pointing at the straight line. In the middle of the graphic under "Power Quality Problems" are two sine waves. The top sine wave has smaller peaks and valleys in the middle of the sine wave. Above the middle of the sine wave are the words "Voltage Sag" with an arrow pointing at the center of the sine wave. The bottom sine wave has larger peaks and valleys in the middle of the sine wave. Above the middle of the sine wave are the words "Voltage Surges" with an arrow pointing at the center of the sine wave. On the right side of the diagram is a smooth, continuous sine wave which is labeled "Reliable, Quality Electric Power".]

The highly publicized recent power outages in California, as well as in a number of major cities in the U.S., has highlighted the increasing likelihood of costly interruptions and the need to seek continuous electric power protection. Power disturbances are a significant concern for everything from the computers used in modern commercial and industrial processes to telecommunications equipment. Leaving these devices unprotected from disturbances can have significant and negative impacts on the power user. A 1999 study by the Electric Power Research Institute estimated that electric power problems annually cost U.S. industry more than \$30 billion in lost data, material and productivity. Even the loss of quality power for one second at a semiconductor manufacturing plant can result in the loss of millions of dollars. As the digital economy grows, avoiding network and equipment downtime due to power-related problems will become even more important.

Electric utilities are dependent on the existing utility grid for transmission and distribution of electric power. The electric utility grid is unable to provide high quality, uninterrupted power due in large part to being

exposed to severe weather, animals, accidents and other external events. While substantial upgrades and other investment could improve overall utility grid reliability, the absolute level of power quality required for these sophisticated electronic applications remains difficult to achieve without local uninterrupted power protection close to the point of use.

#### Power Quality Systems: Uninterruptible Power Supplies and Continuous Power Systems

Currently, there are a variety of approaches that attempt to address the deficiencies of power delivered by the electric utility grid. Conventional power quality systems have been constructed from an array of devices, including batteries for short-term power disturbances, engine generators, commonly referred to as "gensets," for longer-term outages, and control electronics to bridge the two. A short-term (seconds to minutes) energy storage device with control electronics is referred to as an uninterruptible power supply, or UPS. A UPS coupled with a genset to protect against longer-term outages (minutes to hours or days) is referred to as a continuous power system, or CPS.

A UPS protects sensitive systems from sags, surges and other temporary interruptions in utility-supplied power. A UPS consists of solid-state switches and electronics that are connected to both the electric utility grid and a back-up power source, typically lead-acid batteries. The UPS electronics monitor the power from the electric utility grid. If the UPS determines that the power being supplied from the grid is unacceptable or that insufficient power is being supplied, it will draw power from the back-up power source to ensure uninterrupted, quality power. These systems typically provide 5 to 15 minutes of back-up power before the batteries are depleted.

A CPS provides back-up power indefinitely. As described above, if the UPS determines that there is a power quality or power reliability problem, it initially turns to the back-up power source. If, however, the disturbance lasts for an extended period (typically, more than 5 to 10 seconds), the CPS genset is activated and begins to provide back-up power. Internet service providers, data processing centers, semiconductor plants, cellular phone sites and fiber nodes all use CPS to keep critical business equipment operating when electric utility grid power falters.

The following diagrams depict a conventional UPS and CPS:

[GRAPHIC APPEARS HERE]

[Description of graphic: The graphic on the left depicts a "Conventional UPS System". From the left side of the graphic is an arrow pointed to the center of the graphic with the caption "Electric Power from Utility" beneath the arrow. The arrow points to a box in the center of the graphic with the caption "Uninterruptible Power Supply Electronics" inside the box. Beneath the box and connected to the box with a line is another box with the caption "Lead Acid Battery for short term power (seconds to minutes)" inside the box. From the center box is an arrow pointed to the right side of the graphic with the caption "Uninterruptible Power to Customer" beneath the arrow. Beneath this graphic is the following text "Electric power from the electric utility passes through the UPS to the customer. If this power is interrupted or is disturbed, the UPS immediately draws power from the battery to supply uninterrupted power to customer".

The graphic on the right depicts a "Conventional CPS System". From the left side of the graphic is an arrow pointed to the center of the graphic with the caption "Electric Power from Utility" beneath the arrow. The arrow points to a box in the center of the graphic with the caption "Uninterruptible Power Supply Electronics" inside the box. Above the box and connected to the center box with a line is an oval with the caption "Generator" inside the oval and the caption "long term power (minutes to days)" to the left of the oval. Beneath the center box and connected to the center box with a line is another box with the caption "Lead Acid Battery for short term power (seconds to minutes)" inside the box. From the center box is an arrow pointed to the right side of the graphic with the caption "Uninterruptible Power to customer" beneath the arrow. Beneath this graphic is the following text: "In a CPS configuration, if the power disturbance lasts longer than a few seconds, the standby generator is started to provide electric power for as long as required."]

Electric power from the electric utility passes through the UPS to the customer. If this power is interrupted or is disturbed, the UPS immediately draws power from the battery to supply uninterrupted power to the customer.

In a CPS configuration, if the power disturbance lasts longer than a few seconds, the standby generator is started to provide electric power for as long as required.





## Limitations of Conventional UPS and CPS

Conventional battery-based UPS and CPS devices have evolved out of a makeshift combination of diesel engines, generators, automobile batteries and UPS electronics. We believe that this patchwork approach to UPS and CPS has resulted in systems that are less efficient, less reliable and more expensive than they otherwise could be. The lead-acid batteries that provide ride-through, or temporary, power for the UPS and CPS, are viewed as the most unreliable and most costly element of conventional power quality and reliability solutions. Lead-acid batteries have numerous problems, including:

### Reliability

- . Relatively high failure rate--Batteries are prone to heat buildup and acid leaks that lead to battery failure.
- . Limited life based on usage--When batteries are repeatedly used at close to their maximum power output, their power output capacity can rapidly decrease, reducing the batteries' effectiveness over time.

### Cost

- . High maintenance--Batteries must be regularly inspected, generally every three months, to detect problems. Batteries also require periodic testing to determine their power output capacity, which degrades over time.
- . Bulky--Generally, multiple batteries forming banks or strings must be used to support UPS functions. They also must be spaced apart to prevent uncontrolled heating. Batteries therefore consume valuable space which otherwise could be allocated to revenue generating equipment.
- . Frequent replacement required--Regardless of usage, batteries have a limited useful life and must be replaced every 2 to 6 years, depending upon the type of use, environment and other factors.
- . Temperature sensitivity--Unless cooled by costly air conditioning systems, battery life will rapidly degrade.

### Environmental

- . Toxicity--Batteries contain toxic materials such as lead and sulfuric acid.
- . Disposal--State and federal environmental regulations governing battery disposal are rigorous and costly.

Beyond the specific problems associated with lead-acid batteries, existing UPS and CPS contain inefficiencies inherent in any system that was not designed as an integrated solution. Specifically, the major components of these systems do not come from a single reliable source. This lack of a single-source supplier makes installation, maintenance and failure analysis more difficult, costly and complex. Typically, separate companies manufacture, market and service the genset, UPS electronics and batteries. The end user must often assume the responsibility to integrate and monitor the system.

### Active Power's Products--Making Electricity Better

Rather than adopt conventional approaches to power quality systems, we design new solutions specifically for the power quality market. As a result, we believe that we create products that are less expensive, more efficient and more reliable than other systems presently available.

### CleanSource DC

CleanSource DC is the first commercially viable, non-chemical replacement for lead-acid batteries used for short-term power in power quality installations. As opposed to the chemical energy stored by batteries, our

patented flywheel energy storage system stores kinetic energy by spinning constantly in a patented low-friction environment. When the UPS electronics detect a power disturbance, CleanSource DC draws upon the power stored as kinetic energy to generate back-up power. Our CleanSource flywheel energy storage system is compact, quiet and has demonstrated field proven reliability.

CleanSource DC can run in conjunction with or can replace battery strings used in UPS and CPS systems and can replace the batteries now used with fuel cells and microturbines to meet peak power demands. This system is available in a variety of delivered power ratings up to 480 kW per flywheel system. We also can configure the units in parallel to achieve higher power. CleanSource DC has been designed for much longer service intervals and more extreme environments than typical lead-acid battery installations. Our first CleanSource DC unit was placed in service in March 1997. Our installed CleanSource DC units have accumulated over 400,000 hours of field operation.

#### CleanSource UPS

Building on the technological success of CleanSource DC, we created a battery-free UPS, CleanSource UPS, which is the primary focus of our current sales efforts. Historically, a UPS is created by coupling together two components--a string or strings of batteries and control electronics. CleanSource UPS integrates UPS electronics and our flywheel energy storage system into a single power quality solution. CleanSource UPS is contrasted with a conventional battery-based system in the illustration below.

[GRAPHIC APPEARS HERE]

[Description of graphic: This graphic depicts a comparison of a "Conventional Battery-Based UPS" and a "CleanSource UPS". The Traditional Battery-Based UPS is pictured on the left side of the graphic. The left portion of the Traditional Battery-Based UPS is labeled "battery cabinets" and the right side of the Traditional Battery-Based UPS is labeled "UPS electronics". Beneath the picture of the Traditional Battery-Based UPS is the following information: "240 KW UPS with minimum battery cabinet; Footprint - 37.5 sq. ft., Weight - 13,000 lbs., Electrical Efficiency - 92%". The CleanSource UPS is pictured on the right side of the graphic. Beneath the picture of the CleanSource UPS is the following information: "250 KW UPS with energy storage; Footprint - 10 sq. ft., Weight - 3,250 lbs., Electrical Efficiency - 98%".]

The CleanSource UPS design takes advantage of the many component similarities between CleanSource DC and standard UPS electronics. Each system requires power conversion electronics, fans for cooling, a frame for structural support, a user display and data reporting capability, and other overlapping functions. By combining these functions into a single system, as shown in the figure below, we can provide a highly reliable power quality solution while achieving significant cost savings.

[GRAPHIC APPEARS HERE]

[Description of graphic: This graphic depicts "CleanSource UPS System Efficiencies". The graphic is a ven diagram consisting of two circles which partially overlap in the middle of the graphic. The circle on the left side of the graphic is labeled "Energy Storage" at the bottom left. Inside the left circle on the left side of the circle are the words "flywheel puck". In the middle of the left circle is the caption "Flywheel Electronics". In the middle of the graphic where the circles overlap from top to bottom are the words "heat sinks & fans", "cabinet frame & skins" and "monitoring & display". Above the overlapping portion of the circles is the caption "System Efficiencies" with an arrow pointed toward the overlapping portion of the diagram. The circle on the right side of the graphic is labeled "UPS" at the bottom right. Inside the right circle on the right side of the circle are the words "bypass switch contactors". In the middle of the right circle is the caption "UPS Electronics".]

Due to its unique design, CleanSource UPS can typically match the installed cost of a conventional battery-based UPS. Due to its high efficiency and long service life, we believe that the total cost of ownership of CleanSource UPS, which includes the purchase price, installation, maintenance and energy costs accumulated over a ten year period, is less than half of that of conventional battery-free systems. In conjunction with Caterpillar, we designed CleanSource UPS to be compatible with new and installed standby generators, extending their application to CPS. As of the end of 2000, we are currently delivering CleanSource UPS units that span the power range from 250kVA up to 900kVA. We have plans to further expand the power range of the CleanSource UPS product up to 3000kVA. Availability of these higher power systems is targeted for the third quarter of 2001.

#### Future Products--Fully Integrated Continuous Power System

We are developing an advanced continuous power system for the distributed telecommunications market that combines short and long-term energy storage and power electronics functionality into one fully integrated system. We believe the benefits of this fully integrated CPS product will include increased reliability, lower cost and less maintenance relative to the piecemeal systems in use today. We anticipate commercial availability of our first CPS product by the end of 2001.

#### Our Business Strategy

Our goal is to become the leading supplier of battery-free power quality and reliability equipment. Key elements of our strategy include:

##### Design, Manufacture And Market Optimal Solutions For Targeted Markets

We design products for specific markets. Our first products, CleanSource DC and CleanSource UPS, put this principle into practice. With CleanSource DC, we created a flywheel product to meet the specific needs of the UPS market. In so doing, we overcame the design constraints that had hampered preceding flywheel programs to produce the first commercially viable alternative to lead-acid batteries. Building on that success, we developed our second product, the CleanSource UPS, the world's most efficient and compact UPS to specifically address the market's growing desire for compact and reliable power protection. We intend to continue to identify market needs for the power industry and design products to address those specific needs.

##### Leverage Our Core Technologies to Develop Next Generation Products

We intend to continue to use our expertise in advanced electromechanical technologies, combined with an integrated solutions approach, to create innovative products that lower the cost and increase the quality of

electric power. We are designing a fully integrated CPS with applications in the distributed telecommunications power quality and reliability market.

#### Distribute and Market our Products through Established OEM Channels

We believe that working with leading original equipment manufacturers, or OEMs, enables us to rapidly introduce our products into established customer and dealer networks and promote the adoption of new technologies. To date, our most important OEM relationship is with Caterpillar, a worldwide distributor of the CleanSource UPS product line. Additionally, we have established distributor relationships with leading UPS OEMs Liebert, Powerware and MGE UPS Systems for our CleanSource DC product. We intend to continue to use development and distribution relationships for our future products to achieve rapid market penetration.

#### Leverage Our Relationship with Caterpillar to Achieve Rapid Market Penetration

We believe that our distribution agreement with Caterpillar allows us to rapidly penetrate the power quality and reliability market through Caterpillar's worldwide network of over 200 dealers and over 1,500 branch outlets. A portion of Caterpillar's large installed base of over 300,000 gensets also provides a significant retrofit opportunity by converting installed standby systems to CPS with the addition of our CleanSource UPS. Our relationship with Caterpillar should enhance our credibility among the generally conservative customers within the power quality and reliability market. We will continue to examine additional ways to leverage our relationship with Caterpillar.

#### Outsource Components to Rapidly Scale Manufacturing

We intend to continue to outsource all non-proprietary hardware and electronics by maintaining and building on multiple supplier relationships so that we can respond quickly to significant quantity increases. We intend to focus on the final assembly and testing of our products, decreasing production cycle times and increasing volume production capability.

#### Aggressively Protect Our Intellectual Property

We seek to aggressively identify and protect our key intellectual property, primarily through the use of patents. We believe that a policy of actively protecting intellectual property is an important component of our strategy to serve as a leading innovator in power quality technology and will provide us with a long-term competitive advantage.

#### Market Opportunities

The Electric Power Research Institute estimates that power disturbances cost U.S. businesses more than \$30 billion each year. According to industry sources, in 1999 businesses spent in excess of \$11.0 billion globally on power quality and reliability products in an attempt to reduce these losses. Our current products, CleanSource DC and CleanSource UPS, are targeted at the \$5.5 billion market for UPS. We believe that our products are superior alternatives to conventional UPS and CPS products and should be able to rapidly penetrate this growing segment of the power quality industry. With future products, we anticipate that we will be able to compete in most segments of this market.

With our current and future products we intend to focus on the following market opportunities:

##### Internet Data Center Market

A 1999 study conducted by the University of Texas and released by Cisco Systems, Inc. found that the U.S. Internet economy grew at an estimated average annual rate of 175% from 1995 to 1998. The June 2000 update to this study also projected that the Internet economy would grow to \$850 billion in 2000, up 62% from 1999. To support this growth, businesses must construct new advanced data centers to house the computers and

communications systems required to provide around-the-clock service to their customers. To ensure continuous 24 x 7 service, power quality equipment protection is essential.

#### Telecommunications Market

To ensure uninterrupted service, reliable backup power is critical for wireless base stations, remote switching centers and broadband communications such as fiber-to-cable and DSL distribution. This market for back-up telecommunications power systems represented approximately \$4.0 billion of the \$11.0 billion power quality market in 1999. Conventional CPS systems currently satisfy market demand using a patchwork of gensets, lead-acid batteries and power electronics. We are designing our next generation product, a fully integrated CPS, to service the specific needs of this market, although we expect broader market applications in the future. We believe that our fully integrated CPS will be well positioned to serve this market and will achieve rapid market penetration.

#### Other Power Quality and Reliability Markets

**Industrial.** An Electric Power Research Institute study on recurring U.S. power problems estimated that the average U.S. manufacturing facility experienced in excess of 20 power disturbances annually. Exacerbating this problem, manufacturing organizations are employing increasing levels of automation, especially process and machine control, communications and computerized optimization of material flow. Even brief power disturbances, which result in lost material, lost data and worker and plant down time, can be very expensive. Industries with the potential to suffer significant loss from power disturbances include semiconductor and pharmaceutical manufacturing, textiles and precision machining.

**Commercial Facilities.** Many commercial facilities such as office buildings, hotels and university facilities now have a large number of computers or servers. Historically, these businesses and their personal computer networks have been unprotected from power disturbances or have only been spot-protected with a small PC UPS under each person's desk. A single CleanSource UPS system can protect as few as 200 PCs more cost effectively than many small PC UPS products.

**Retrofit Market.** Caterpillar has the largest installed base of standby generators, or generators that are not coupled with a UPS, in the world. As even a brief power outage can cause an extended shutdown of sensitive electronic equipment, many of the customers that rely on standby generators for long-term power outages can no longer afford the five to ten second outage while the generator starts and therefore need to add a UPS for short-term protection. While a lead-acid battery based UPS can be used to upgrade a standby generator into a CPS, Caterpillar sells our CleanSource UPS and does not offer a battery-based UPS. We believe that upgrading, or retrofitting, a portion of Caterpillar's approximately 300,000 installed gensets worldwide by adding our CleanSource UPS, thereby creating a CPS, represents a significant market opportunity.

#### Distributed Generation

Fuel cells and microturbines, which allow users to bypass the electric utility grid by generating power locally, represent potential markets for our CleanSource products. These distributed generation technologies currently cannot respond effectively to rapid changes in electric power demands, or loads, due to their slow response capability. CleanSource DC can absorb sharp peaks in electrical demand, allowing a relatively expensive microturbine or fuel cell to be sized for the average power requirement of the customer. This combination provides a cost competitive alternative to sizing the fuel cell or microturbine to handle both peak and average electrical demands. In addition, CleanSource UPS can seamlessly transfer a customer load from electric utility grid power to fuel cell or microturbine standby power in the event of a utility outage.

## Our Relationship with Caterpillar

We have established a strategic relationship with Caterpillar, granting Caterpillar the world wide right to distribute CleanSource UPS, which is marketed as "Cat UPS." Caterpillar is a market leader in new genset sales and has the largest installed base of existing standby generators in the world. By offering the Cat UPS with a standby genset, Caterpillar can transform a standby power system into a CPS. The combined solution reduces maintenance cost and increases reliability relative to traditional CPS products. Moreover, because Caterpillar's product line now includes both a UPS and a genset, Caterpillar is now selling, installing and servicing a complete CPS under a single brand name. We believe that this total solution gives both Caterpillar and us a significant competitive advantage in the power quality market. Through Caterpillar's worldwide dealership and sales force network and its market reputation, we believe that we will be able to rapidly penetrate the market for our products.

**UPS Development Agreement.** We entered into a development agreement with Caterpillar in January 1999 for the creation and distribution of Cat UPS marketed under the Caterpillar brand name. Under the development agreement, Caterpillar provided \$5.0 million in funding to support the development of Cat UPS.

While we retained sole ownership of the underlying flywheel energy storage technology, we jointly own with Caterpillar intellectual property associated with the integration of UPS electronics with CleanSource DC. Either we or Caterpillar may license to other entities the intellectual property that we jointly own without seeking the consent of the other and all licensing revenue generated by licensing the joint intellectual property will be solely retained by the licensing party. However, we may not license the joint intellectual property to specifically identified competitors of Caterpillar until January 1, 2005.

**Distribution Agreement.** We also have a distribution agreement with Caterpillar. During 2000, we received approximately \$4.7 million, or 96% of our product revenue, from Caterpillar and its dealer network under this agreement. The principal provisions of this agreement are summarized below:

- . Caterpillar has semi-exclusive worldwide rights to distribute Cat UPS under the Caterpillar brand name;
- . As long as Caterpillar meets minimum annual sales requirements, we will not sell Cat UPS to specifically identified competitors of Caterpillar until January 1, 2005 or the termination of the distribution agreement; and
- . We will provide Caterpillar the same warranty Caterpillar provides its customers procuring electric power generation products (one year from delivery).

Caterpillar may continue to distribute Cat UPS until January 1, 2005. At such time the agreement will continue for additional six-month periods unless either party provides written notice to the other within ninety days of the end of the current period of its decision not to renew the agreement. The agreement may also be terminated by Caterpillar for any uncured material breach by us, if Cat UPS consistently and materially fails to meet our published specifications, or if we substantially and continuously fail to meet agreed shipment dates for products ordered by Caterpillar. Finally, either party may terminate in the event of a change in control of the other.

## Sales, Marketing and Support

### Sales and Marketing

In the power quality industry, we believe that partnering with established companies with significant relationships and service capabilities enables us to promote the adoption of new technology that otherwise would take significantly longer for wide application. Our sales activity has focused principally on OEM adoption of our products through extensive OEM testing, product qualification and early product placement with select end users. We intend to continue to sell through OEMs to gain acceptance of our proprietary and innovative power technologies. We believe that focusing on product acceptance and support from OEMs

provides the greatest opportunity for market penetration and sales growth with minimal resources. We are also expanding our international sales activities through our multinational OEM sales channels. We employ a small, geographically dispersed sales force to develop leads and educate our OEM customers in their sales efforts.

Our marketing efforts are geared toward developing and sustaining key relationships with OEMs, participating in tradeshow to promote and launch our products, and training for the salespeople within the OEM channels. We also work with OEM partners on promotional activities such as advertising development, direct mail and telemarketing strategies. We use our marketing resources to stimulate end user sales through trade press articles, participation in industry conferences and limited direct mail to specific power quality customers.

#### Service and Support

We continue to transition the primary service and maintenance of our products from our own service personnel to the OEMs who sell our products. We believe that this will reduce the need for a large end user support organization by enabling our OEMs to provide installation, service and primary support to their customers. Our service personnel will remain as a back-up for difficult situations or where no trained personnel are immediately available and will support initial applications of the products. Our customer service and support organization also provides comprehensive training programs to our OEM customers.

#### Our Customers

Our primary customers are OEMs. To date, our most significant OEM is Caterpillar, which distributes CleanSource UPS under its brand name. We intend to continue to use selected development and distribution partnerships to develop and distribute our future products into selected markets and achieve rapid market penetration.

End use industries for our products include advanced data centers, semiconductor manufacturers, telecommunication providers, pharmaceutical manufacturers, hospitals, electric utilities and broadcasters.

During 2000, Caterpillar and its dealer network accounted for 96% of our total revenue. No other customer accounted for more than 1% of our revenue during 2000. Due to Caterpillar's semi-exclusive CleanSource UPS distribution rights, we anticipate that revenue from Caterpillar will comprise a majority of our revenue in 2001.

#### Technology

##### Flywheel Energy Storage System

Our patented flywheel energy storage system stores kinetic energy -- energy produced by motion -- by spinning a compact rotor constantly in a low-friction environment. When the user requires short-term back-up power -- i.e. when the electric power used to spin the flywheel fluctuates or is lost -- the wheel's inertia causes it to continue spinning. The resulting kinetic energy of the spinning flywheel generates electricity for short periods. We believe that relative to other energy storage alternatives, our system provides high quality, reliable power at the lowest cost.

Over the past 20 years, attempts at commercializing flywheel systems have been based on technology used in aerospace applications, such as satellite momentum control, that attempt to maximize the amount of stored energy with the absolute minimum system weight. Cost has been a secondary concern for such applications. As a result of these design goals, these flywheel designs require extremely high rotational speeds in excess of 50,000 rotations per minute. In order to achieve such high speeds, the flywheel must be made of expensive materials, such as composite carbon fiber. As a result, high-speed flywheel concepts require a number of

expensive safety systems, including extensive inertial containment and "active" magnetic bearing systems that use sophisticated computer controls to continuously monitor the position and balance of the flywheel.

Rather than rely on the flywheel concepts developed for other applications, we focused our development efforts on providing products that meet the specific needs of the power quality and reliability market. Users requiring back-up power products want products that can deliver high quality, reliable power at the lowest cost. As a result of these needs, we developed a flywheel system that operates at significantly lower speeds, under 8,000 rotations per minute. These speeds are comparable to those of automobile engines and industrial machinery. This lower flywheel speed has allowed us to develop a lower cost design by using an inexpensive bearing system and conventional steel in place of expensive composite materials.

The design of our flywheel system, which is displayed below, integrates the function of a motor (which utilizes electric current from the electric utility grid to provide the energy to rotate the flywheel), flywheel rotor (which spins constantly to maintain a ready source of kinetic energy) and generator (which converts the kinetic energy of the flywheel into electricity) into a single integrated system. This integration further reduces the cost of our product and increases its efficiency.

[GRAPHIC APPEARS HERE]

[Description of graphic: This graphic depicts "The CleanSource Flywheel Technology" and lists the patents we have obtained or filed on the specific parts of the flywheel system. From the top of the left side of the flywheel to the bottom, we have listed the following patents: "Magnetic bearing integrated into field circuit, Patent# US5920138", "Constant voltage regulation, Patent# US5932935", "Smooth air-gap armature, Patent Pending", High-Power motor-generator, Patent# US5905321". From the top of the right side of the flywheel to the bottom, we have listed the following patents: "Ball bearing cartridge for easy replacement, Patent# US6029538", High inertia motor-generator rotor, Patent# US5929548" and "Slotless motor-generator stator, Patent# US5731654, Patent# 5969457".]

The flywheel rotor is designed to spin in a near frictionless environment by the use of a low-cost, combination magnetic and mechanical bearing system. The friction in the spinning chamber is further reduced by the creation of a partial vacuum, which reduces the amount of air in the chamber that otherwise creates drag on the flywheel rotor. The flywheel rotor stores energy in the form of kinetic energy by constantly rotating within the vacuum container. As the flywheel rotor slows down when a user requires power, the rotor's magnetism is increased as it rotates past copper coils contained in the armature to generate constant output power. This enables the flywheel system to provide between ten and sixty seconds of electricity during power disturbances. While a lead-acid battery can typically provide back-up power for a much longer period, this capability usually is not required. Our flywheel-based system can provide ride-through, or temporary, power for the majority of power disturbances, such as voltage sags and surges, and can bridge the gap between a power outage and the time required to switch to generator power.

We have verified our flywheel design with both internal and external three-dimensional finite element analysis, as well as tests designed to determine the flywheel's safety at varying speeds. We test each flywheel rotor with stringent quality control methods. These tests have demonstrated a factor of safety consistent with common industrial machines such as large motors and generators.



## The CleanSource Family of Products

Our unique flywheel energy storage system device is being used in our two currently offered products: CleanSource DC and CleanSource UPS. The CleanSource UPS design takes advantage of the many component similarities between the CleanSource DC and a traditional UPS system. Both products require power conversion electronics, fans for cooling, a frame for structural support, telemetry, data reporting, a user display and other overlapping functions. By combining these functions into a single system, we achieved significant cost efficiencies.

The UPS electronics we use in the CleanSource UPS product line are the latest in power semiconductor devices using highly reliable and efficient insulated gate bipolar transistors. This results in an efficient, highly responsive power conditioning system that can protect sensitive customer power requirements from even the briefest of electric power anomalies. Tightly integrating these power electronics with our flywheel energy storage system results in an efficient, compact and cost effective UPS system.

## Generator Start Enhancement

To enhance the overall system reliability of CleanSource UPS, we have patented a method to draw power from the flywheel to supply 24 volts of starting power to a genset to augment or replace the typical starter battery, which is the cause of most generator start failures. When taking advantage of this flywheel-sourced starting power, the reliability of the entire CPS solution is significantly enhanced.

## Research and Development

We believe that our research and development efforts are essential to our ability to successfully deliver innovative products that address the needs of our customers as the market for power quality products evolves. Our research and development team works closely with our marketing and sales team and OEMs to define product requirements to address the specific needs of the power quality market. Our research and development expenses were \$4.0 million, \$4.4 million and \$9.9 million in 1998, 1999 and 2000, respectively. We anticipate maintaining significant levels of research and development expenditures in the future. At December 31, 2000, our research, development and engineering team consisted of 54 engineers and technicians.

## Manufacturing

We source all of our components from contract manufacturers to enhance our ability to scale our operations and minimize cost. This approach allows us to respond quickly to customer orders while maintaining high quality standards.

Our internal manufacturing process consists of assembly, functional testing and quality control of our products. We also test components, parts and subassemblies obtained from suppliers for quality control purposes.

We are in the process of implementing long-term agreements with our suppliers, but currently purchase most of our components on a purchase order basis. Although we use standard parts and components for our products where possible, we purchase a particular type of power module from Semikron International and a microprocessor from Motorola, both of whom are single source suppliers. If we were unable to obtain these components, we believe it would take approximately six months to develop a substitute power module and approximately four months to develop a substitute microprocessor. The power module from Semikron International is now covered by a long-term agreement and requires the supplier to maintain a safety stock of power modules in the United States. We further maintain a two month inventory of such component. Our requirements for the Motorola microprocessor are covered by purchase orders into the third quarter of 2001. We further maintain approximately three months of inventory of the Motorola microprocessor.

We plan to substantially expand our manufacturing facilities and capacity in order to support projected volume demand for our products.

#### Proprietary Rights

We rely on a combination of patents and trademarks, as well as confidentiality agreements and other contractual restrictions with employees and third parties, to establish and protect our proprietary rights. We have filed over 30 patent applications before the United States Patent and Trademark Office, 26 of which have issued into patents. Additionally, we have made a concerted effort to obtain patent protection abroad for Active Power's technology by continuing to file patent applications in Europe and Asia. Our patent strategy is critical for preserving our rights in and to the intellectual property embodied in our CleanSource product line. As a manufactured, tangible device that is sold rather than licensed, the CleanSource product line does not qualify for copyright or trade secret protection. To enforce our ownership of such technology, we principally rely on the protection obtained through the patents we own, as well as state unfair competition laws. We intend to aggressively protect our patents, including by bringing legal actions if we deem it necessary.

We own the registered trademarks CLEANSOURCE(R) and MAKING ELECTRICITY BETTER(R) in the United States and have applied for a trademark on our logo. All other trademarks, service marks or trade names referred to in this report are the property of their respective owners.

#### Competition

The power quality and power reliability markets are intensely competitive. The principal bases of competition are system reliability, availability, cost, including initial cost and total cost of ownership, and OEM endorsement and brand recognition.

Our CleanSource DC product competes with makers of lead-acid batteries and groups that are developing their own battery-free technologies. Industry sources estimate that the U.S. UPS lead-acid battery market was approximately \$400 million in 2000, substantially all of which will be comprised of sales of lead-acid batteries rather than battery-free technologies designed to replace lead-acid batteries, such as CleanSource DC. Of the makers of battery-free products, Piller and International Computer Power are the only companies currently offering flywheel energy storage systems that directly compete with the CleanSource DC. The Piller flywheel is only available with Piller's proprietary UPS system. In the 500 kW and under power range, we believe that we have a substantial majority of the installed base of flywheel products. In the overall flywheel market, we believe that we and Piller each have approximately half of the installed flywheel units. The CleanSource DC is the only flywheel system that is sold and serviced by the major UPS manufacturers--Powerware, Liebert and MGE UPS Systems. Examples of other technologies potentially competitive with CleanSource DC include high-speed composite flywheels, ultra capacitors and superconducting magnetic energy storage. To date, however, we believe that none of these technologies has achieved a sufficient presence in our market to be considered a competitor.

The CleanSource UPS as distributed by Caterpillar competes with UPS manufacturers such as Powerware, Liebert and MGE UPS Systems, who also are CleanSource DC distributors. When sold in conjunction with a standby generator, the CleanSource UPS competes with battery-free systems from Piller, Hitec and EuroDiesel. While CleanSource UPS is a new product and we therefore have not sold a significant number of units, we believe that the high efficiency, broad power range and compact footprint of the CleanSource UPS, coupled with Caterpillar's brand recognition and support, will allow us to compete successfully with these alternatives.

We expect our future CPS product to compete with batteries, flywheels and gensets that are used in the telecommunications market from such companies as C&D Technologies, Beacon, Yuasa, Panasonic, the Hawker division of Invensys and Generac. While we believe that our future CPS product will offer the telecommunications market a superior technology to what currently exists, we may have difficulty competing with the existing product offerings in this market and may never develop a competitive product offering.

## Employees

At December 31, 2000, we had 167 employees, with 54 engaged in research, development and engineering, 64 in manufacturing, 19 in sales, 4 in marketing and customer support, and 26 in administration, information technology and finance. None of our employees are represented by a labor union. We have not experienced any work stoppages and consider our relations with our employees to be good.

### Additional Factors That May Affect Future Results

You should carefully consider the following risks and all other information contained in this prospectus before deciding to invest in our common stock. Additional risks and uncertainties that we are unaware of or that we currently deem immaterial also may become important factors that affect us.

We have incurred significant losses and anticipate losses for the next several years.

We have incurred operating losses since our inception and expect to continue to incur losses in the foreseeable future. As of December 31, 2000, we had an accumulated deficit of \$52.7 million. To date, our product revenue has been insignificant, and we have funded our operations through sales of our stock and a \$5.0 million development funding payment from Caterpillar. We will need to generate significant revenue to achieve profitability, and we cannot assure you that we will ever realize sufficient revenue to achieve profitability. We also expect to incur significant product development, sales and marketing and administrative expenses and, as a result, we expect to continue to incur losses.

Due to our limited operating history and the uncertain market acceptance of our products, we may never achieve significant revenue and may have difficulty accurately predicting revenue for future periods and appropriately budgeting for expenses.

We have generated a total of \$6.8 million in product revenue over the past three years, and we have sold fewer than 160 CleanSource DC and CleanSource UPS products. We are uncertain whether our products will achieve market acceptance such that our revenues will increase or whether we will be able to achieve significant revenue. Therefore, we have a very limited ability to predict future revenue. Our limited operating experience, the uncertain market acceptance for our products, and other factors that are beyond our control make it difficult for us to accurately forecast our quarterly and annual revenue. However, we use our forecasted revenue to establish our expense budget. Most of our expenses are fixed in the short term or incurred in advance of anticipated revenue. As a result, we may not be able to decrease our expenses in a timely manner to offset any revenue shortfall. Further, we are expanding our staff and facilities and increasing our expense levels in anticipation of future revenue growth. If our revenue does not increase as anticipated, we will incur significant losses.

Our business is subject to fluctuations in operating results, which could negatively impact the price of our stock.

Our product revenue, expense and operating results have varied in the past and may fluctuate significantly in the future due to a variety of factors, many of which are outside of our control. These factors include, among others:

- . the timing of orders from our customers and the possibility that these customers may change their order requirements with little or no advance notice to us;
- . the rate of adoption of our flywheel-based energy storage system as an alternative to lead-acid batteries;
- . the deferral of customer orders in anticipation of new products from us or other providers of power quality systems;
- . the ongoing need for short-term power outage protection in traditional UPS systems;
- . the uncertainty regarding the adoption of our current and future products, including our recently introduced CleanSource UPS product and our fully integrated CPS, which we expect to commercially introduce by the end of 2001; and
- . the rate of growth of the markets for our products.

Our business is dependent on the market for power quality products, and if this market does not expand as we anticipate, or if alternatives to our products are successful, our business will suffer.

The market for power quality products is rapidly evolving and it is difficult to predict its potential size or future growth rate. Most of the organizations that may purchase our products have invested substantial resources in their existing power systems and, as a result, may be reluctant or slow to adopt a new approach. Moreover, our products are alternatives to existing UPS and CPS systems and may never be accepted by our customers or may be made obsolete by other advances in power quality technologies. Improvements may also be made to the existing alternatives to our products that could render them less desirable or obsolete.

We have limited product offerings, and our success depends on our ability to develop in a timely manner new and enhanced products that achieve market acceptance.

We have only one principal product that has any significant operating history at customer sites, CleanSource DC, and we have only recently introduced our CleanSource UPS product. To grow our revenue, we must rely on Caterpillar to successfully market our CleanSource UPS product, and we must develop and introduce to market new products and product enhancements in a timely manner. Even if we are able to develop and commercially introduce new products and enhancements, they may not achieve market acceptance. This would substantially impair our revenue prospects.

Failure to expand our distribution channels and manage our distribution relationships could impede our future growth.

The future growth of our business will depend in part on our ability to expand our existing relationships with OEMs, to identify and develop additional channels for the distribution and sale of our products and to manage these relationships. As part of our growth strategy, we intend to expand our relationships with OEMs and to develop relationships with new OEMs. We will also look to identify and develop relationships with additional partners that could serve as distributors for our products. Our inability to successfully execute this strategy and to reduce our reliance on Caterpillar could impede our future growth.

We are heavily dependent on our relationship with Caterpillar. If our relationship is unsuccessful, our business and revenue will suffer.

If our relationship with Caterpillar is not successful, or if Caterpillar's distribution of our CleanSource UPS product is not successful, our business and revenue will suffer. Pursuant to a development agreement, Caterpillar provided us with \$5.0 million in funding to support the development of our CleanSource UPS product. In exchange for this payment, Caterpillar received co-ownership of the proprietary rights in this product. Either we or Caterpillar may license to other entities the intellectual property that we jointly own without seeking the consent of the other and all licensing revenue generated by licensing this intellectual property will be solely retained by the licensing party. However, we may not license the joint intellectual property to specifically identified competitors of Caterpillar until January 1, 2005. Caterpillar may terminate this agreement at any time by giving us 90 days' advance written notice. We also have a distribution agreement with Caterpillar. During 2000, we received approximately \$4.7 million, or 96% of our product revenue from Caterpillar. Pursuant to the distribution agreement with Caterpillar, they are the exclusive distributor, subject to limited exceptions, of our CleanSource UPS product. Caterpillar is not obligated to purchase any CleanSource UPS units.

We depend on a limited number of OEM customers for the vast majority of our revenue and service and support functions. The loss or significant reduction in orders, or the failure to provide adequate service and support to the end users of our products, from any key OEM customer, particularly Caterpillar, would significantly reduce our revenue.

We rely on OEMs as a primary distribution channel because they are able to sell our products to a large number of end user organizations. We further rely on our OEMs to provide service and support to the end users

of our products because they have the experience and personnel to perform such activities. We believe that the use of OEM channels will enable our products to achieve broad market penetration, while we devote a limited amount of our resources to sales, marketing and customer service and support. Our operating results in the foreseeable future will continue to depend on sales to a relatively small number of OEM customers, primarily Caterpillar. For example, in 2000, sales to Caterpillar and its dealer network accounted for 96% of our revenue. Therefore, the loss of our key OEM customer, Caterpillar, or a significant reduction in sales to Caterpillar and its dealers, would significantly reduce our revenue. We also have granted Caterpillar semi-exclusive worldwide rights to distribute our CleanSource UPS product, provided that they meet minimum annual sales requirements. These restrictions will further increase our dependence upon Caterpillar. However, Caterpillar is not obligated to purchase any CleanSource UPS units under this agreement.

We may have difficulty managing the expansion of our operations.

We are undergoing rapid growth in the number of our employees, the size of our physical facilities and the scope of our operations. For example, we had 38 employees on January 1, 1998, 126 employees on June 30, 2000 and 167 employees on December 31, 2000. Such rapid expansion is likely to place a significant strain on our senior management team and other resources. Our business, prospects, results of operations or financial condition could be harmed if we encounter difficulties in effectively managing the budgeting, forecasting and other process control issues presented by such a rapid expansion.

We have no experience manufacturing our products in the quantities we expect to sell in the future.

To be financially successful, we will have to manufacture our products in commercial quantities at acceptable costs while also preserving the quality levels achieved in manufacturing these products in more limited quantities. This presents a number of technological and engineering challenges for us. We cannot assure you that we will be successful in executing the planned expansion of our manufacturing activities. We have not previously manufactured our products in high volume. We do not know whether or when we will be able to develop efficient, low-cost manufacturing capability and processes that will enable us to meet the quality, price, engineering, design and product standards or production volumes required to successfully manufacture large quantities of our products. Even if we are successful in developing our manufacturing capability and processes, we do not know whether we will do so in time to meet our product commercialization schedule or to satisfy the requirements of our customers.

We are subject to increased inventory risks and costs because we outsource the manufacturing of components of our products in advance of binding commitments from our customers to purchase our products.

To assure the availability of our products to our OEM customers, we outsource the manufacturing of components prior to the receipt of purchase orders from OEM customers based on their forecasts of their product needs. However, these forecasts do not represent binding purchase commitments, and we do not recognize revenue for such products until the product is shipped to the OEM. As a result, we incur inventory and manufacturing costs in advance of anticipated revenue. As demand for our products may not materialize, this product delivery method subjects us to increased risks of high inventory carrying costs and obsolescence and may increase our operating costs. In addition, we may from time to time make design changes to our products, which could lead to obsolescence of inventory.

We depend on sole source and limited source suppliers for certain key components, and if we are unable to buy these components on a timely basis, our delayed ability to deliver our products to our customers may result in reduced revenue and lost sales.

We purchase a power module and a microprocessor for our products from sole sources. We do not have long-term contracts with most of our suppliers, and to date most of our component purchases have been made in relatively small volumes. As a result, if our suppliers receive excess demand for their products, we may

receive a low priority for order fulfillment as large volume customers will receive priority. If we are delayed in acquiring components for our products, the manufacture and shipment of our products also will be delayed. We generally use a twelve-month forecast of our future product sales to determine our component requirements. Lead times for ordering materials and components vary significantly and depend on factors such as specific supplier requirements, contract terms, the extensive production time required and current market demand for such components. Some of these delays may be substantial. As a result, we purchase these components in large quantities to protect our ability to deliver finished products. If we overestimate our component requirements, we may have excess inventory, which will increase our costs. If we underestimate our component requirements, we will have inadequate inventory, which will delay our manufacturing and render us unable to deliver products to customers on scheduled delivery dates. If we are unable to obtain a component from a supplier or if the price of a component has increased substantially, we will be required to manufacture the component internally, which will result in delays. Manufacturing delays could negatively impact our ability to sell our products and could damage our customer relationships.

We depend on key personnel to manage our business and develop new products in a rapidly changing market, and if we are unable to retain our current personnel and hire additional personnel, our ability to develop and sell our products could be impaired.

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering and sales and marketing personnel. In particular, due to the relatively early stage of our business, we believe that our future success is highly dependent on Joseph F. Pinkerton, III, our founder, chief executive officer and president, to provide continuity in the execution of our growth plans. While we have severance arrangements in place with Mr. Pinkerton and with David S. Gino, our chief financial officer, we do not have long-term employment agreements in place with any of our employees. The loss of the services of any of our key employees, the inability to attract or retain qualified personnel in the future or delays in hiring required personnel, particularly engineers and sales personnel, could delay the development and introduction of, and negatively impact our ability to sell, our products.

We are a relatively small company with limited resources compared to some of our current and potential competitors, and competition within our markets may limit our sales growth.

The markets for power quality and power reliability are intensely competitive. There are many companies engaged in all areas of traditional and alternative UPS and CPS systems in the United States, Canada and abroad, including, among others, major electric and specialized electronics firms, as well as universities, research institutions and foreign government-sponsored companies. There are many companies located in the United States, Canada and abroad that are developing flywheel-based energy storage systems and flywheel-based power quality systems. We also compete indirectly with companies that are developing other types of power technologies, such as superconducting magnetic energy storage, ultra-capacitors and dynamic voltage restorers.

Many of our current and potential competitors have longer operating histories, significantly greater resources, broader name recognition and a larger customer base than we have. As a result, these competitors may have greater credibility with our existing and potential customers. They also may be able to adopt more aggressive pricing policies and devote greater resources to the development, promotion and sale of their products than we can to ours, which would allow them to respond more quickly than us to new or emerging technologies or changes in customer requirements. In addition, some of our current and potential competitors have established supplier or joint development relationships with our current or potential customers. These competitors may be able to leverage their existing relationships to discourage these customers from purchasing products from us or to persuade them to replace our products with their products. Increased competition could decrease our prices, reduce our sales, lower our margins, or decrease our market share. These and other competitive pressures could prevent us from competing successfully against current or future competitors and could materially harm our business.

If we are unable to protect our intellectual property, we may be unable to compete.

Our products rely on our proprietary technology, and we expect that future technological advancements made by us will be critical to sustain market acceptance of our products. Therefore, we believe that the protection of our intellectual property rights is, and will continue to be, important to the success of our business. We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We also enter into confidentiality or license agreements with our employees, consultants and business partners and control access to and distribution of our software, documentation and other proprietary information. Despite these efforts, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our products is difficult, and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where applicable laws may not protect our proprietary rights as fully as in the United States. In addition, the measures we undertake may not be sufficient to adequately protect our proprietary technology and may not preclude competitors from independently developing products with functionality or features similar to those of our products.

Our efforts to protect our intellectual property may cause us to become involved in costly and lengthy litigation, which could seriously harm our business.

In recent years, there has been significant litigation in the United States involving patents, trademarks and other intellectual property rights. Although we have not been involved in intellectual property litigation, we may become involved in litigation in the future to protect our intellectual property or defend allegations of infringement asserted by others. Legal proceedings could subject us to significant liability for damages or invalidate our intellectual property rights. Any litigation, regardless of its outcome, would likely be time consuming and expensive to resolve and would divert management's time and attention. Any potential intellectual property litigation also could force us to take specific actions, including:

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

Any acquisitions we make could disrupt our business and harm our financial condition.

Although we are not currently negotiating any material business or technology acquisitions, as part of our growth strategy, we intend to review opportunities to acquire other businesses or technologies that would complement our current products, expand the breadth of our markets or enhance our technical capabilities. We have no experience in making acquisitions. Acquisitions entail a number of risks that could materially and adversely affect our business and operating results, including:

- . problems integrating the acquired operations, technologies or products with our existing business and products;
- . potential disruption of our ongoing business and distraction of our management;
- . difficulties in retaining business relationships with suppliers and customers of the acquired companies;
- . difficulties in coordinating and integrating overall business strategies, sales and marketing, and research and development efforts;
- . the maintenance of corporate cultures, controls, procedures and policies;
- . risks associated with entering markets in which we lack prior experience; and
- . potential loss of key employees.



We may require substantial additional funds in the future to finance our product development and commercialization plans.

Our product development and commercialization schedule could be delayed if we are unable to fund our research and development activities or the development of our manufacturing capabilities with our revenue, cash on hand and proceeds from our initial public offering. We expect that our current cash and investments, together with our other available sources of working capital, will be sufficient to fund development activities for at least 24 months. However, unforeseen delays or difficulties in these activities could increase costs and exhaust our resources prior to the full commercialization of our products under development. We do not know whether we will be able to secure additional funding, or funding on terms acceptable to us, to continue our operations as planned. If financing is not available, we may be required to reduce, delay or eliminate certain activities or to license or sell to others some of our proprietary technology.

Our stock price may be volatile.

During 2000, we experienced significant volatility in our stock price. The market price of our common stock may fluctuate significantly in response to numerous factors, some of which are beyond our control, including the following:

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

#### ITEM 2. Properties.

As of December 31, 2000, our corporate headquarters facility, which houses our administrative, advanced development, engineering, information systems, marketing, sales and service and support groups, consists of approximately 27,550 square feet in Austin, Texas. We lease our corporate headquarters facility pursuant to an agreement that expires in March 2003. Our current manufacturing facility of approximately 42,300 square feet is also located in Austin, Texas; however, the lease on this facility will expire in September 2001. The total monthly lease payments due for these facilities is approximately \$61,000. Additionally, we have recently signed a lease, which will be effective in May 2001, for an additional 86,000 square feet of manufacturing space to replace our existing manufacturing facility. The size of this facility will increase to approximately 127,000 square feet by the end of the lease term in May 2005. Our total monthly lease payments will increase by \$40,800 when the lease for this new facility becomes effective.

#### ITEM 3. Legal Proceedings.

We are not party to any legal proceedings.

#### ITEM 4. Submission of Matters to a Vote of Security Holders.

None.

PART II

ITEM 5. Market for Registrant's Common Equity and Related Stockholder Matters.

Our common stock has been quoted on the Nasdaq National Market under the symbol "ACPW" since our initial public offering on August 7, 2000. Prior to the initial public offering, there had been no public market for our common stock. The following table lists the high and low per share sales price for our common stock as reported by the Nasdaq National Market for the periods indicated:

	High	Low
	-----	-----
Year Ended December 31, 2000		
Third Quarter (from August 7, 2000.....)	\$79.75	\$17.00
Fourth Quarter.....	\$63.50	\$12.75

As of March 1, 2001, there were 39,257,420 shares of our common stock outstanding held by 771 stockholders of record.

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

Our registration statement (Registration No. 333-36946) under the Securities Act of 1933, as amended, relating to our initial public offering of our common stock became effective on August 7, 2000. A total of 9,200,000 shares of common stock were registered. We sold a total of 8,900,000 shares of our common stock and a selling shareholder sold 300,000 shares to an underwriting syndicate. The managing underwriters were Goldman, Sachs & Co., Merrill Lynch, Pierce Fenner & Smith Incorporated, Morgan Stanley & Co. Incorporated and CIBC World Markets Corp. The offering commenced and was completed on August 8, 2000, at a price to the public of \$17.00 per share. The initial public offering resulted in net proceeds to us of \$139.0 million after deducting underwriting commissions of \$10.6 million and offering expenses of \$1.6 million. As of January 31, 2001, we have used \$12 million of our available funds. The remaining proceeds from the IPO were invested in government securities and other short-term, investment-grade, interest bearing instruments.

ITEM 6. Selected Financial Data.

SELECTED FINANCIAL DATA

The following tables set forth our selected financial data. The data for the three years ended December 31, 2000, 1999 and 1998 has been derived from the audited financial statements appearing elsewhere in this document. The data for the years ended December 31, 1997 and 1996 has been derived from audited financial statements not appearing in this document. You should read the selected financial data set forth below in conjunction with our financial statements and the notes thereto, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and other financial information appearing elsewhere in this document.

Results of Operations:

	Year ended December 31,				
	2000	1999	1998	1997	1996
	(In thousands, except per share data)				
Product revenue.....	\$ 4,872	\$ 1,047	\$ 915	\$ 138	--
Cost of goods sold.....	7,966	3,006	1,238	158	--
Product margin.....	\$ (3,094)	\$ (1,959)	\$ (323)	\$ (20)	--
Development funding.....	--	5,000	--	--	--
Operating expenses:					
Research and development.....	9,864	4,441	4,045	2,598	\$ 968
Selling, general & administrative.....	6,205	3,972	1,925	1,264	483
Amortization of deferred stock compensation.....	6,692	1,631	--	--	--
Total operating expenses.....	22,761	10,044	5,970	3,862	1,451
Operating loss.....	(25,855)	(7,003)	(6,294)	(3,882)	(1,451)
Interest income/expense, net.....	4,363	421	305	144	109
Change in fair value of warrants with redemption rights.....	(1,562)	(3,614)	--	--	--
Other income.....	(50)	8	10	--	--
Net loss.....	\$ (23,104)	\$ (10,188)	\$ (5,979)	\$ (3,738)	\$ (1,342)
Preferred stock dividends, accretion, & conversion.....	19,079	29,660	2,789	826	293
Net loss to common stockholders.....	\$ (42,183)	\$ (39,848)	\$ (8,767)	\$ (4,564)	\$ (1,635)
Net loss per share, basic and diluted.....	\$ (1.92)	\$ (3.98)	\$ (0.90)	\$ (0.48)	\$ (0.17)
Shares used in computing net loss per share, basic and diluted.....	21,928,874	10,009,554	9,789,407	9,589,462	9,426,456

Balance Sheet Data:

	As of December 31,				
	2000	1999	1998	1997	1996
	(thousands)				
Cash, cash equivalents and investments.....	\$146,209	\$ 26,265	\$ 7,536	\$ 4,340	\$ 2,434
Working capital.....	136,972	26,394	8,008	4,565	2,470
Total assets.....	156,132	28,366	9,734	5,921	3,002
Long-term obligations, less current portion.....	--	--	55	170	--
Redeemable convertible preferred stock.....	--	54,235	24,575	11,786	4,960
Total stockholders' equity (deficit).....	152,389	(30,338)	(15,524)	(6,742)	(2,167)

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

The following discussion should be read in conjunction with the financial statements appearing elsewhere in this 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 actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this report, particularly under the heading "Risk Factors." Please also see "Special Note Regarding Forward Looking Statements."

Overview

We design, manufacture and market power quality products that provide the consistent, reliable electric power required by today's digital economy. We believe that we are the first company to commercialize a flywheel energy storage system that provides a highly reliable, low-cost and non-toxic replacement for lead-acid batteries used in conventional power quality installations. Leveraging our expertise in this technology and in conjunction with Caterpillar, the leading maker of engine generators for the power reliability market, we have developed a battery-free power quality system, which is marketed under the Caterpillar brand name (Cat UPS). Our products are sold for use in the facilities of companies in many different industries that all share a critical need for reliable, high-quality power, such as Internet service providers, semiconductor manufacturers, telecommunications providers, hospitals, electric utilities and broadcasters. As an extension of these existing product lines, we are developing a fully integrated continuous power system. The initial target market for this product is the rapidly growing telecommunications industry.

Since 1996, we have focused our efforts and financial resources primarily on the design and development of our CleanSource line of power quality products and on establishing effective OEM channels to market our products. As of December 31, 2000, we had generated an accumulated deficit of \$52.7 million and expect to continue to sustain operating losses for the next several years. We initially funded our operations primarily through sales of shares of our preferred stock, which have resulted in gross proceeds of approximately \$42.6 million. We believe the proceeds from our August 2000 initial public offering, approximately \$139.0 million net of commissions and issuance costs, together with cash balances on hand prior to August 2000 will be sufficient to meet our capital requirements through at least the next 24 months. Our cash and investments position at December 31, 2000 was \$146.2 million.

Since our inception, a small number of customers have accounted for the majority of our annual sales. During 1999, our four largest customers accounted for 89% of our sales, with our largest customer, Caterpillar and its dealer network, accounting for 39%. In 2000, our business level with Caterpillar and its dealer network grew substantially accounting for 96% of our revenue due to the commercial introduction of the CleanSource UPS product line. We expect to continue to be dependent on a few OEM customers, primarily Caterpillar, for the majority of our sales for the foreseeable future.

With the commercial release of our second generation product line, CleanSource UPS, in May 2000 under the Caterpillar brand name, and a growing market demand for power quality equipment, we believe the demand for our products will increase significantly. To prepare for this anticipated growth in demand and to position us for future growth, we have increased and expect to continue to increase the scale of our operations in the following ways:

- . expand our manufacturing facilities and add manufacturing personnel to address anticipated increases in product demand;
- . increase our personnel levels in product development and engineering to accelerate time to market on new products and enhance existing product lines; and
- . add sales and marketing personnel to support our OEM customers.

We believe that although these efforts will increase our operating expenses, they will also enable us to realize significant revenue growth.

## Results of Operations

### Comparison of 2000, 1999 and 1998

**Product Revenue.** Product revenue primarily consists of sales of our CleanSource power quality products. Sales increased \$3.9 million, or 365%, to \$4.9 million in 2000 from \$1.0 million in 1999. Sales increased \$131,000, or 14%, to \$1.05 million in 1999 from \$915,000 in 1998. Both the 2000 and 1999 increases are attributable to an increase in the sales of our recently launched CleanSource UPS product line, with initial sales of this new product line beginning in the fourth quarter of 1999. During 2000 we sold 118 of our quarter-megawatt flywheel units, compared to 24 in 1999 and 23 in 1998.

**Cost of goods sold.** Cost of goods sold includes the cost of component parts of our product that are sourced from suppliers, personnel, equipment and other costs associated with our assembly and test operations, shipping costs, and the costs of manufacturing support functions such as logistics and quality assurance. Cost of goods sold increased \$5.0 million, or 165%, to \$8.0 million in 2000 from \$3.0 million in 1999. Cost of goods sold increased \$1.8 million, or 143%, to \$3.0 million in 1999 from \$1.2 million in 1998. Both the 2000 and 1999 increases were primarily attributable to increases in manufacturing capacity to support an increase in sales volume and an anticipated increase in demand for our products. We expect that as our product volumes increase over time, unit production costs will tend to decrease as we achieve greater economies of scale in production and in purchasing component parts.

**Development funding.** Development funding consists of funds received from Caterpillar to support the development of the CleanSource UPS product. In 1999, we received \$5.0 million in development funding from Caterpillar. We did not receive any development funding in 2000 or 1998. We do not currently have any other development funding contracts.

**Research and development.** Research and development expense primarily consists of compensation and related costs of employees engaged in research, development and engineering activities, third party consulting and development activities, as well as an allocated portion of our occupancy costs. Research and development expense increased \$5.5 million, or 122%, to \$9.9 million in 2000 from \$4.4 million in 1999. Research and development expense increased \$396,000, or 10%, to \$4.4 million in 1999 from \$4.0 million in 1998. The increase in research and development expense was primarily due to the increased product development of CleanSource UPS and other products including our 6 kilowatt continuous power system. We believe that research and development expense will continue to increase significantly in 2001 and thereafter as we continue to develop new products and enhance existing product lines.

**Selling, general and administrative.** Selling, general and administrative expense is primarily comprised of compensation and related costs for sales, marketing and administrative personnel, selling and marketing expenses, professional fees and reserves for bad debt. Selling, general and administrative expense increased approximately \$2.2 million, or 56%, to \$6.2 million in 2000 from \$4.0 million in 1999. Selling, general and administrative expense increased approximately \$2.0 million, or 106%, to \$4.0 million in 1999 from \$1.9 million in 1998. The 1999 increase in selling, general and administrative expense was principally due to a charge of \$1.4 million related to warrants we issued to stockholders in conjunction with strategic alliance agreements we entered into with them relating to their use, evaluation and feedback of products they agreed to purchase and other business assistance. In 2000, we increased personnel in our sales organization in order to support our OEM channel partners and to address opportunities for sales of our CleanSource UPS product line. We believe that selling, general and administrative expense will increase in future periods as we add sales, marketing and administrative personnel to position us for future sales growth and to assist in the administration of an expanding work force and the additional activities associated with becoming a public company.

Amortization of deferred stock compensation. Deferred stock compensation is a non-cash expense that reflects the difference between the exercise price of option grants to employees and the estimated fair value determined subsequently by us of our common stock at the date of grant. We are amortizing deferred stock compensation as an operating expense over the vesting periods of the applicable options, which resulted in amortization expense of \$1.6 million in 1999. No amortization of deferred stock compensation occurred in 1998 as, prior to 1999, we believe that all options were granted at exercise prices equal to the fair value of the underlying stock on the date of grant. This amortization expense increased in 2000 to \$6.7 million due to the vesting of options that were granted in 1999 and 2000. However, we expect the amortization expense to decrease after 2000, as the options on which we are amortizing deferred stock compensation become fully vested.

Interest income/expense. Interest income net of interest expense increased \$3.9 million, or 936%, to \$4.4 million in 2000 from approximately \$421,000 in 1999. Net interest income/expense increased \$116,000, or 38%, to \$421,000 in 1999 from \$305,000 in 1998. The significant increase in 2000 is primarily due to increases in our average cash, cash equivalent and investment balances associated with the approximately \$139.0 million raised as part of our August 2000 initial public offering.

Change in fair value of warrants. Due to the redemption feature of warrants we had outstanding until the initial public offering, we recorded a liability associated with the fair value of the warrants on the balance sheet and recorded changes in fair value of the warrants in earnings. We calculated the fair value of the warrants using a Black-Scholes pricing model. In 1999 and 2000 the fair value of the underlying common stock increased substantially, resulting in an increase in the warrant value and corresponding non-cash expense.

Preferred stock dividends, accretion and conversion. We recorded non-cash charges of \$19.1 million in 2000 and \$7.7 million in 1999 associated with our redeemable preferred stock to reflect dividend rights and accretion to redemption value. In 1999, we issued Series E convertible preferred stock at a lower price than the price which was subsequently determined by the board of directors to be the fair market value totaling a \$22.0 million discount. All of our preferred stock was converted to common at the time of our initial public offering.

Income Tax Expense. As of December 31, 2000, our accumulated net operating loss carryforward was \$30 million. We anticipate that all of this loss carryforward amount will remain available for offset against any future tax liabilities that we may incur. However, because of uncertainty regarding our ability to use these carryforwards, we have established a valuation allowance for the full amount of our deferred tax assets.

#### Liquidity and Capital Resources

Our principal sources of liquidity as of December 31, 2000 consisted of \$146 million of cash and investments. We have primarily funded our operations through our initial public offering in August 2000, resulting in net proceeds of \$139 million, sales of shares of our preferred stock, which have resulted in gross proceeds of approximately \$43 million, as well as \$5 million in development funding received from Caterpillar in 1999. Cash used in operating activities in 2000 was \$15.3 million, a \$12.7 million increase from the \$2.6 million used in 1999. The increased level of cash usage is primarily attributable to a higher level of product development, and the expansion of our manufacturing operations and sales activities.

Capital expenditures were \$4.4 million in 2000 and \$598,000 and \$793,000 in 1999 and 1998, respectively. We made these expenditures to acquire engineering test equipment, to develop market demonstration units, and to purchase manufacturing equipment to facilitate production testing, as well as for general computer equipment and software for administrative purposes, and for the buildout of additional office, engineering lab and manufacturing space. We expect to incur \$8.0 to \$10.0 million in capital expenditures in 2001 primarily on manufacturing facility improvements, including product test and assembly equipment, to increase our manufacturing capacity.

We believe our existing cash balances at December 31, 2000 will be sufficient to meet our capital requirements through at least the next 24 months, although we may elect to seek additional funding prior to that time. Beyond the next 24 months, our capital requirements will depend on many factors, including the rate of sales growth, the market acceptance of our products, the rate of expansion of our sales and marketing activities, the rate of expansion of our manufacturing facilities, and the timing and extent of research and development projects. Although we are not a party to any agreement or letter of intent with respect to a potential acquisition, we may enter into acquisitions or strategic arrangements in the future which could also require us to seek additional equity or debt financing.

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

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. We estimate that a 1% decrease in market interest rates would decrease our interest income by \$1.5 million. Because of the short-term nature of the majority of our investments, we do not believe a 1% decline in interest rates would have a material effect on their fair value.

We invest our cash in a variety of financial instruments, including bank time deposits, and taxable and tax-advantaged 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.

ITEM 8. Financial Statements and Supplementary Data.

The financial statements and supplementary data required by this item is included in Part IV, Item 14(a) on this Form 10-K and are presented beginning on page F-1.

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

None.

PART III

ITEM 10. Executive Officers of the Registrant.

The following table sets forth, as of December 31, 2000, certain information concerning our executive officers:

Name	Age	Position(s)
----	---	-----
Eric L. Jones.....	65	Chairman of the Board of Directors
Joseph F. Pinkerton, III....	37	President and Chief Executive Officer
David S. Gino.....	42	Vice President of Finance, Chief Financial Officer, Treasurer, and Secretary
James A. Balthazar.....	47	Vice President of Marketing
William E. Ott, II.....	45	Vice President of Sales and Service

Eric L. Jones has served as the Chairman of our Board of Directors since March 1995. Since April 1994, he has been a partner with SSM Venture Partners, L.P., an Austin, Texas-based venture capital firm. Mr. Jones is currently a director/chairman of several private companies including Motive Communications, 360 Commerce, eTopware and NetBotz. He is also the past chairman of the board of directors of VTEL Corporation and Tivoli Systems, both of whom became public corporations during his tenure. During a 25-year career at Texas Instruments, Mr. Jones managed a Fortune 500-sized business units as a corporate vice president and Group president. Mr. Jones holds a Ph.D. in mechanical engineering from the University of Texas at Austin.

Joseph F. Pinkerton, III, our founder, has served as our Chief Executive Officer, President and director since August 1992. Mr. Pinkerton formed Active Power in 1992. Shortly after founding the company, Mr. Pinkerton patented the world's first room temperature magnetic bearing capable of operating without electronic controls. Since then, he has brought together a team of experienced engineers, developed a revolutionary flywheel device and filed over 30 patent applications covering magnetic bearings, flywheel systems and rotating electric machinery. From June 1989 to June 1992, Mr. Pinkerton was a principal with Fundamental Research Company, in Walled Lake, Michigan. While at FRC, Mr. Pinkerton completed two joint research projects with the University of Texas at Austin and was awarded a patent for a novel electrical generator. Mr. Pinkerton received a Bachelor of Arts degree in Physics from Albion College, Albion, MI in association with Columbia University, New York, N.Y.

David S. Gino has served as Chief Financial Officer, Vice President of Finance and Secretary since joining Active Power in December 1999. From August 1995 to November 1999, Mr. Gino was the Chief Financial Officer and Executive Vice President of Finance of DuPont Photomasks, Inc. (DPI), a public semiconductor component manufacturer. Mr. Gino led DPI through a period of rapid growth, numerous acquisitions, its initial public offering and secondary public financing. Prior to joining DPI, Mr. Gino held a number of financial and business management positions with The DuPont Company's semiconductor materials, imaging systems and printing and publishing businesses. Mr. Gino holds a Bachelor of Arts degree in economics from the University of California at Santa Barbara and an M.B.A. from the University of Phoenix.

James A. Balthazar has served as our Vice President of Marketing since October 1996. Mr. Balthazar is responsible for worldwide marketing activities at Active Power, including market development, channel development and product marketing activities. Prior to joining Active Power, Mr. Balthazar held various management positions, including Vice President of Marketing, during his 12-year tenure at Convex Computer Corporation, a public supercomputer manufacturer in Richardson, Texas. He joined Convex as an early employee, prior to the company becoming public, and assisted in its growth to an over \$250 million company before being purchased by Hewlett Packard in 1995. Before that, he worked as a consulting engineer for Structural Dynamics Research Corp. (SDRC), Cincinnati, Ohio, and for University Computing Co. (UCC),



Dallas, Texas. The Maryland native has a Bachelor of Science degree from the University of Maryland, College Park and a Master's of Science degree in theoretical and applied mechanics from Cornell University, Ithaca, New York.

William E. Ott, II has served as our Vice President of Sales and Service since September 1997. Before Active Power, Mr. Ott held several senior field management positions in the high technology arena including over nine years with Convex Computer Corporation, which was acquired in 1995 by Hewlett Packard. Most recently, Mr. Ott served as General Manager for Eastern United States, Canada and Latin America at US Data Corp., a public manufacturer of automation software. From August 1995 to July 1996, he was the Southeastern Sales Director for Pyramid Technology Corp., a public high performance UNIX server manufacturer, and from July 1994 to June 1995, he was the Southeastern United States Sales Manager for Sybase, Inc. Mr. Ott holds a Bachelor of Science degree in electrical engineering and an M.B.A. from the University of Missouri at Columbia.

Further information required by this Item is incorporated by reference to our Proxy Statement under the sections captioned "Matters to be Considered at Annual Meeting--Proposal One: Election of Directors" and "Compliance with Section 16(a) of the Securities Exchange Act of 1934."

ITEM 11. Executive Compensation.

The information required by this Item is incorporated by reference to our Proxy Statement under the sections captioned "Executive Compensation and Other Information" and "Certain Transactions."

ITEM 12. Security Ownership of Certain Beneficial Owners and Management.

The information required by this Item is incorporated by reference to our Proxy Statement under the section captioned "Ownership of Securities."

ITEM 13. Certain Relationships and Related Transactions.

The information required by this Item is incorporated by reference to our Proxy Statement under the section captioned "Certain Transactions."

PART IV

ITEM 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.

(a) The following documents are filed as part of this 10-K:

1. Financial Statements. The following financial statements of Active Power, Inc. are filed as a part of this Form 10-K on the pages indicated:

	Page
	----
Report of Independent Auditors.....	F-1
Financial Statements:	
Balance Sheets.....	F-2
Statements of Operations.....	F-3
Statements of Stockholders' Equity (Deficit).....	F-4
Statements of Cash Flows.....	F-5
Notes to Financial Statements.....	F-6

2. Schedules.

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

3. Exhibits.

Exhibit	
Number	Description
-----	
3.1*	Form of Amended and Restated Certificate of Incorporation (filed as Exhibit 3.1 to the Company's IPO Registration Statement on Form S-1 (SEC File No. 333-36946) (the "IPO Registration Statement")
3.2*	Form of Amended and Restated Bylaws (filed as Exhibit 3.2 to the IPO Registration Statement)
4.1*	Specimen certificate for shares of Common Stock (filed as Exhibit 4.1 to the IPO Registration Statement)
4.2*	Warrant to Purchase Common Stock issued to Enron North America Corp. (filed as Exhibit 4.2 to the IPO Registration Statement)
4.3*	Warrant to Purchase Common Stock issued to Stephens Group, Inc. (filed as Exhibit 4.3 to the IPO Registration Statement)
10.1*	Form of Indemnity Agreement (filed as Exhibit 10.1 to the IPO Registration Statement)
10.2*	Active Power, Inc. 2000 Stock Incentive Plan (filed as Exhibit 10.2 to the IPO Registration Statement)
10.3*	Active Power, Inc. 2000 Employee Stock Purchase Plan (filed as Exhibit 10.3 to the IPO Registration Statement)
10.4*	Second Amended and Restated Investors' Rights Agreement by and between Active Power, Inc. and certain of its stockholders (filed as Exhibit 10.4 to the IPO Registration Statement)
10.5*	Consulting Services Agreement by and between Active Power and Eric L. Jones (filed as Exhibit 10.5 to the IPO Registration Statement)

Exhibit

Number Description

- 
- 10.6+\* Phase II Development and Phase III Feasibility Agreement by and between Active Power, Inc. and Caterpillar Inc. (filed as Exhibit 10.6 to the IPO Registration Statement)
  
  - 10.7\* Credit Terms and Conditions by and between Active Power, Inc. and Imperial Bank (filed as Exhibit 10.7 to the IPO Registration Statement)
  
  - 10.8\* Security and Loan Agreement by and between Active Power, Inc. and Imperial Bank (filed as Exhibit 10.8 to the IPO Registration Statement)
  
  - 10.9\* Lease Agreement by and between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.9 to the IPO Registration Statement)
  
  - 10.10\* First Amendment to Lease Agreement by and between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.10 to the IPO Registration Statement)
  
  - 10.11\* Second Amendment to Lease Agreement by and between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.11 to the IPO Registration Statement)
  
  - 10.12\* Third Amendment to Lease Agreement by and between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.12 to the IPO Registration Statement)
  
  - 10.13\* Fourth Amendment to Lease Agreement by and between Active Power, Inc. and Metropolitan Life Insurance Company (filed as Exhibit 10.13 to the IPO Registration Statement)
  
  - 10.14\* Fifth Amendment to Lease Agreement by and between Active Power, Inc. and Metropolitan Life Insurance Company (filed as Exhibit 10.14 to the IPO Registration Statement)
  
  - 10.15\* Sublease Agreement by and between Active Power, Inc. and Video Associates Laboratories, Inc. (filed as Exhibit 10.15 to the IPO Registration Statement)
  
  - 10.16\* Employee offer letter (including severance arrangements) from Active Power, Inc. to David S. Gino (filed as Exhibit 10.16 to the IPO Registration Statement)
  
  - 10.17 Lease Agreement by and between Active Power, Inc. and BC12 99, Ltd.
  
  - 10.18 Sixth Amendment to Lease Agreement by and between Active Power, Inc. and Metropolitan Life Insurance Company
  
  - 10.19 Seventh Amendment to Lease Agreement by and between Active Power, Inc. and Metropolitan Life Insurance Company
  
  - 23.1 Consent of Ernst & Young LLP
  
  - 24.1 Power of Attorney, pursuant to which amendments to this Form 10-K may be filed, is included on the signature page contained in Part IV of this Form 10-K

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\* Incorporated by reference to the indicated filing  
+ Confidential treatment previously granted

SIGNATURES

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

Active Power, Inc.

/s/ Joseph F. Pinkerton, III,  
By: \_\_\_\_\_  
Joseph F. Pinkerton, III,  
President and Chief Executive  
Officer

POWER OF ATTORNEY

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

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

Name -----	Title -----	Date -----
/s/ Joseph F. Pinkerton, III ----- Joseph F. Pinkerton, III	President, Chief Executive Officer and Director (principal executive officer)	March 15, 2001
/s/ David S. Gino ----- David S. Gino	Vice President of Finance and Chief Financial Officer (principal financial and accounting officer)	March 15, 2001
/s/ Eric L. Jones ----- Eric L. Jones	Chairman of the Board of Directors	March 15, 2001
/s/ Richard E. Anderson ----- Richard E. Anderson	Director	March 15, 2001
/s/ Rodney S. Bond ----- Rodney S. Bond	Director	March 15, 2001
/s/ Jan H. Lindelow ----- Jan H. Lindelow	Director	March 15, 2001
/s/ Terrence L. Rock ----- Terrence L. Rock	Director	March 15, 2001

REPORT OF INDEPENDENT AUDITORS

The Board of Directors  
Active Power, Inc.

We have audited the accompanying balance sheets of Active Power, Inc. (the Company) as of December 31, 2000 and 1999, and the related statements of operations, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Active Power, Inc. at December 31, 2000 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

/s/ Ernst & Young LLP

Austin, Texas  
January 18, 2001

ACTIVE POWER, INC.

BALANCE SHEETS  
(Thousands, except share and per share amounts)

	Year ended December 31,	
	2000	1999
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 92,720	\$ 24,856
Short-term investments.....	42,541	1,409
Accounts receivable, net.....	1,934	38
Inventories, net.....	2,343	934
Prepaid expenses and other.....	1,177	5
	-----	-----
Total current assets.....	140,715	27,242
Property and equipment, net.....	4,469	1,124
Long-term investments.....	10,948	--
	-----	-----
Total assets.....	\$ 156,132	\$ 28,366
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable.....	\$ 2,133	\$ 196
Accrued expenses.....	1,610	597
Notes payable.....	--	55
	-----	-----
Total current liabilities.....	3,743	848
Other non-current liabilities.....	--	7
Warrants with redemption rights.....	--	3,614
	-----	-----
Total liabilities.....	3,743	4,469
Redeemable convertible preferred stock, zero and 7,732,084 shares issued and outstanding in 2000 and 1999, respectively.....	--	54,235
Stockholders' equity (deficit):		
1992 Preferred Stock--\$.001 par value, \$.50 redemption value: 420,000 shares designated, issued and outstanding; \$210,000 liquidation value.....	--	--
Preferred Stock, par value \$.001 per share; 25,000,000 shares authorized, none issued and outstanding.....	--	--
Common Stock--\$.001 par value; 400,000,000 shares authorized; 39,043,166 and 10,787,126 shares issued and outstanding in 2000 and 1999, respectively.....	39	11
Treasury stock, at cost; 34,599 shares.....	(2)	(2)
Deferred stock compensation.....	(7,519)	(5,430)
Additional paid-in capital.....	212,601	803
Accumulated deficit.....	(52,730)	(25,720)
	-----	-----
Total stockholders' equity (deficit).....	152,389	(30,338)
	-----	-----
Total liabilities and stockholders' equity (deficit).....	\$ 156,132	\$ 28,366
	=====	=====

See accompanying notes.

ACTIVE POWER, INC.

STATEMENTS OF OPERATIONS  
(Thousands, except share and per share amounts)

	Year ended December 31,		
	2000	1999	1998
Product revenue.....	\$ 4,872	\$ 1,047	\$ 915
Cost of goods sold (excludes deferred stock compensation amortization of \$698 in 2000 and \$195 in 1999).....	7,966	3,006	1,238
Product margin (loss).....	(3,094)	(1,959)	(323)
Development funding.....	--	5,000	--
Operating expenses:			
Research and development (excludes deferred stock compensation amortization of \$1,636 in 2000 and \$910 in 1999).....	9,864	4,441	4,045
Selling, general and administrative (excludes deferred stock compensation amortization of \$4,358 in 2000 and \$526 in 1999).....	6,205	3,972	1,925
Amortization of deferred stock compensation.....	6,692	1,631	--
Total operating expenses.....	22,761	10,044	5,970
Operating loss.....	(25,855)	(7,003)	(6,294)
Interest income.....	4,365	439	339
Interest expense.....	(2)	(18)	(34)
Change in fair value of warrants with redemption rights.....	(1,562)	(3,614)	--
Other income.....	(50)	8	10
Net loss.....	\$ (23,104)	\$ (10,188)	\$ (5,979)
Cumulative undeclared dividends on preferred stock.....	(2,053)	(1,820)	(1,283)
Accretion on redeemable convertible preferred stock to redemption amounts..	(17,026)	(5,886)	(1,505)
Beneficial conversion feature on preferred stock issuance.....	--	(21,953)	--
Net loss to common stockholders.....	\$ (42,183)	\$ (39,848)	\$ (8,767)
Net loss per share, basic and diluted...	\$ (1.92)	\$ (3.98)	\$ (0.90)
Shares used in computing net loss per share, basic and diluted.....	21,928,874	10,009,554	9,789,407
Pro forma loss per share, basic and diluted, assuming conversion of convertible preferred stock to common stock (unaudited).....	\$ (0.71)		
Shares used in computing pro forma loss per share, basic and diluted, assuming conversion of convertible preferred stock to common stock (unaudited).....	32,462,945		

See accompanying notes.

ACTIVE POWER, INC.

STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)  
(Thousands)

	1992		Common Stock		Treasury Stock		Deferred Stock Compensation	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Preferred Stock	Par	Number of Shares	Par Value	Number of Shares	At Cost				
	Number of Shares	Value	Shares	Value	Shares	Cost				
Balance at December 31, 1997.....	420	\$--	9,932	\$10	35	\$ (2)	\$ --	\$ --	\$ (6,750)	\$ (6,742)
Exercise of stock options.....	--	--	115	--	--	--	--	11	--	11
Preferred stock issuance costs.....	--	--	--	--	--	--	--	(11)	(14)	(25)
Accretion of redeemable convertible preferred stock to redemption amount...	--	--	--	--	--	--	--	--	(1,505)	(1,505)
Cumulative dividends on redeemable convertible preferred stock.....	--	--	--	--	--	--	--	--	(1,283)	(1,283)
Net loss.....	--	--	--	--	--	--	--	--	(5,979)	(5,979)
Balance at December 31, 1998.....	420	--	10,047	10	35	(2)	--	--	(15,531)	(15,523)
Exercise of stock options.....	--	--	740	1	--	--	--	134	--	135
Warrants issued for services.....	--	--	--	--	--	--	--	1,380	--	1,380
Preferred stock issuance costs.....	--	--	--	--	--	--	--	(66)	--	(66)
Deferred stock compensation.....	--	--	--	--	--	--	(7,061)	7,061	--	--
Amortization of deferred stock compensation.....	--	--	--	--	--	--	1,631	--	--	1,631
Accretion of redeemable convertible preferred stock to redemption amount...	--	--	--	--	--	--	--	(5,886)	--	(5,886)
Cumulative dividends on redeemable convertible preferred stock.....	--	--	--	--	--	--	--	(1,820)	--	(1,820)
Net loss.....	--	--	--	--	--	--	--	--	(10,189)	(10,189)
Balance at December 31, 1999.....	420	--	10,787	11	35	(2)	(5,430)	803	(25,720)	(30,338)
Exercise of stock options.....	--	--	1,497	2	--	--	--	554	--	556
Exercise of warrants.....	--	--	432	--	--	--	--	5,206	--	5,206
Deferred stock compensation.....	--	--	--	--	--	--	(8,781)	8,781	--	--
Amortization of deferred stock compensation.....	--	--	--	--	--	--	6,692	--	--	6,692
Accretion of redeemable convertible preferred stock to redemption amount...	--	--	--	--	--	--	--	(13,712)	(3,314)	(17,026)
Cumulative dividends on redeemable convertible preferred stock.....	--	--	--	--	--	--	--	(1,461)	(592)	(2,053)
Conversion of redeemable convertible preferred stock to common stock.....	--	--	17,462	17	--	--	--	73,296	--	73,313
Net proceeds from initial public offering.....	--	--	8,900	9	--	--	--	139,134	--	139,143
Net loss.....	--	--	--	--	--	--	--	--	(23,104)	(23,104)



Balance at December										
31, 2000.....	420	\$--	39,078	\$39	35	\$ (2)	\$(7,519)	\$212,601	\$(52,730)	\$152,389
	===	====	=====	===	===	====	=====	=====	=====	=====

See accompanying notes.

ACTIVE POWER, INC.

STATEMENTS OF CASH FLOWS  
(Thousands)

	Year ended December 31,		
	2000	1999	1998
Operating activities			
Net loss.....	\$(23,104)	\$(10,188)	\$(5,979)
Adjustment to reconcile net loss to cash used in operating activities:			
Depreciation expense.....	1,066	629	342
Loss on disposal of assets.....	--	1	--
Warrants issued for services.....	--	1,380	--
Amortization of deferred stock compensation....	6,692	1,631	--
Changes in fair value of warrants with redemption rights.....	1,562	3,614	--
Changes in operating assets and liabilities:			
Accounts receivable, net.....	(1,896)	181	(193)
Inventories, net.....	(1,409)	(126)	18
Prepaid expenses and other assets.....	(1,172)	11	7
Accounts payable.....	1,937	(57)	(253)
Accrued expenses.....	1,013	394	157
Other non-current liabilities.....	(7)	(51)	--
Net cash used in operating activities.....	(15,318)	(2,581)	(5,899)
Investing activities			
Net maturity (purchase) of short-term investments.....	(52,080)	3,327	(965)
Purchases of property and equipment.....	(4,411)	(598)	(793)
Net cash provided by (used in) investing activities.....	(56,491)	2,729	(1,758)
Financing activities			
Payments on notes payable.....	(55)	(114)	(98)
Net proceeds from issuance of common stock.....	139,698	136	11
Proceeds from issuance of convertible preferred stock, net of issuance costs.....	--	21,887	9,975
Net proceeds from exercise of warrants.....	30	--	--
Net cash provided by financing activities.....	139,673	21,909	9,888
Increase in cash and cash equivalents.....	67,864	22,056	2,231
Cash and cash equivalents, beginning of period...	24,856	2,800	569
Cash and cash equivalents, end of period.....	\$ 92,720	\$ 24,856	\$ 2,800
Supplemental disclosure of cash flow information:			
Interest paid.....	\$ 2	\$ 18	\$ 33

See accompanying notes.

ACTIVE POWER, INC.

NOTES TO FINANCIAL STATEMENTS  
December 31, 2000

1. Organization

Active Power, Inc. was founded in 1992 for the purpose of developing and commercializing advances in the field of electromechanics. Since inception, Active Power has devoted its efforts principally to research and development, production and marketing of flywheel-based power-quality and storage products that provide consistent, reliable electric power required by today's digital economy. These efforts have included pursuing patent protection for intellectual property, successful production of initial prototypes and limited production volumes, development of manufacturing processes, raising capital and pursuing markets for Active Power's products.

2. Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Revenue Recognition

Active Power recognizes revenue when title transfers and its obligations are complete, usually when a unit is shipped. Active Power recognizes revenue related to units shipped for evaluation by the customer at the time of customer acceptance of the unit.

Shipping and Handling Costs

The Company classifies shipping and handling costs as cost of goods sold.

Cash Equivalents

Active Power considers liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Short-Term and Long-Term Investments

Short-term and long-term investments consist of debt securities with readily determinable fair values. Active Power accounts for highly liquid investments with maturities greater than three months but less than one year at date of acquisition as short-term investments. Active Power classifies short-term and long-term investments as available-for-sale. The carrying amount of Active Power's short-term and long-term investments approximates fair value.

Short term and long term investments at December 31, 2000 consist of the following:

	Carrying Value
Corporate Notes.....	\$ 4,627,296
Medium Term Notes.....	11,948,466
Commercial Paper.....	36,913,429
	-----
	\$53,489,191
	=====

ACTIVE POWER, INC.

NOTES TO FINANCIAL STATEMENTS

The carrying value by contractual maturity, is shown below:

Due in one year or less.....	\$42,540,812
Due after one year through five years.....	10,948,379
	-----
	\$53,489,191
	=====

Inventories

Active Power states inventories at the lower of cost or replacement cost, with cost being determined on a standard cost basis which does not differ materially from actual cost.

Inventories, before reserves, consist of the following:

	December 31,		
	2000	1999	1998
Raw materials.....	\$2,902,224	\$1,287,031	\$ 662,436
Work in process.....	310,330	135,324	197,607
Finished goods.....	4,981	295,315	26,381
Evaluation units.....	--	27,771	183,323
	-----	-----	-----
	\$3,217,535	\$1,745,441	\$1,069,747
	=====	=====	=====

The following table summarizes the changes in inventory reserves:

Balance at December 31, 1997.....	\$198,475
Additions charged to costs and expenses.....	105,000
Write-off of inventory.....	(41,001)
	-----
Balance at December 31, 1998.....	262,474
Additions charged to costs and expenses.....	549,275
Write-off of inventory.....	--
	-----
Balance at December 31, 1999.....	811,749
Additions charged to costs and expenses.....	63,118
Write-off of inventory.....	--
	-----
Balance at December 31, 2000.....	\$874,867
	=====

Property and Equipment

Active Power carries property and equipment at cost, less accumulated depreciation. Active Power depreciates property and equipment using the straight-line method over the estimated useful lives of the assets (generally three to eight years).

Other Liabilities

The Company's other liabilities are made up of the following significant components at December 31:

	2000	1999
Compensation and Benefits Accruals.....	\$ 917,001	\$270,552
Accrued Warranty Liability.....	167,725	95,214
Other Accrued Expenses.....	525,567	231,236
	-----	-----
	\$1,610,293	\$597,002
	=====	=====

ACTIVE POWER, INC.

NOTES TO FINANCIAL STATEMENTS

Patent Application Costs

Active Power has not capitalized patent application fees and related costs because of uncertainties regarding net realizable value of the technology represented by the existing patent applications and ultimate recoverability. All patent costs have been expensed through December 31, 2000.

Accounting for Stock-Based Compensation

As allowed by the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, Active Power accounts for its stock compensation arrangements with employees under the provisions of the Accounting Principles Board's Opinion No. 25, Accounting for Stock Issued to Employees. Deferred stock-based compensation is amortized utilizing the accelerated method prescribed in FASB Interpretation No. 28 over the vesting period which is generally four years.

Income Taxes

Active Power accounts for income taxes in accordance with the FASB's Statement No. 109, Accounting for Income Taxes. Statement No. 109 prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Segment Reporting

Active Power's chief operating decision maker allocates resources and assesses the performance of its power management product development and sales activities as one segment.

Concentration of Credit Risk

Financial instruments which potentially subject Active Power to concentrations of credit risk consist of short-term investments and trade receivables. Active Power's short-term investments are placed with high credit quality financial institutions and issuers. Active Power performs limited credit evaluations of its customers' financial condition and generally does not require collateral. Active Power estimates an allowance for doubtful accounts based on factors related to the credit risk of each customer. Credit losses have not been significant to date.

The following table summarizes the changes in the allowance for doubtful accounts receivable:

Balance at December 31, 1997.....	\$ 463
Additions charged to costs and expenses.....	4,577
Write-off of uncollectible accounts.....	--
	-----
Balance at December 31, 1998.....	5,040
Additions charged to costs and expenses.....	20,936
Write-off of uncollectible accounts.....	--
	-----
Balance at December 31, 1999.....	25,976
Additions charged to costs and expenses.....	29,514
Write-off of uncollectible accounts.....	--
	-----
Balance at December 31, 2000.....	\$55,490
	=====

ACTIVE POWER, INC.

NOTES TO FINANCIAL STATEMENTS

The following customers accounted for a significant percentage of Active Power's total revenue as follows:

Customer	2000	1999	1998
A.....	96%	39%	17%
B.....	1	21	--
C.....	--	16	--
D.....	1	13	--
E.....	--	--	24
F.....	--	--	20

Economic Dependence

The Company is heavily dependent on its relationship with Caterpillar. If this relationship is unsuccessful, the business and revenue will suffer. The loss or significant reduction in orders from Caterpillar, or the failure to provide adequate service and support to the end-users of our products by Caterpillar, would significantly reduce our revenue. Our operating results in the foreseeable future will continue to depend on sales to a relatively small number of OEM customers, primarily Caterpillar.

Advertising Costs

Active Power expenses advertising costs as incurred. These expenses were not material in 2000, 1999 or 1998.

Net Loss Per Share

Active Power computes loss per share in accordance with the FASB's Statement No. 128, Earnings Per Share, and SEC Staff Accounting Bulletin No. 98 ("SAB 98"). Under Statement No. 128 and SAB 98, basic loss per share is computed by dividing net loss by the weighted average number of shares outstanding. Diluted loss per share is computed by dividing net loss by the weighted average number of common shares and dilutive common share equivalents outstanding. Active Power's calculation of diluted loss per share excludes shares of common stock issuable upon exercise of warrants and employee stock options because inclusion would be antidilutive.

The following table sets forth the computation of basic and diluted net loss per share:

	Year Ended December 31,		
	2000	1999	1998
Net loss to common stockholders.....	\$(42,183,272)	\$(39,848,010)	\$(8,767,391)
Basic and diluted:			
Weighted-average shares of common stock outstanding.....	22,366,656	10,150,138	9,978,796
Weighted-average shares of common stock subject to repurchase.....	(437,782)	(140,584)	(189,389)
Shares used in computing basic and diluted net loss per share.....	21,928,874	10,009,554	9,789,407
Basic and diluted net loss per share..	\$ (1.92)	\$ (3.98)	\$ (0.90)

ACTIVE POWER, INC.

NOTES TO FINANCIAL STATEMENTS

3. Property and Equipment

Property and equipment consist of the following at December 31:

	2000	1999	1998
Equipment.....	\$ 3,440,102	\$ 1,391,233	\$1,036,883
Demonstration units.....	171,252	107,321	107,321
Computers and purchased software.....	943,248	424,525	319,131
Furniture and fixtures.....	66,977	63,037	63,037
Leasehold improvements.....	2,092,050	316,541	179,825
	6,713,629	2,302,657	1,706,197
Accumulated depreciation.....	(2,244,392)	(1,178,934)	(550,368)
	\$4,469,237	\$ 1,123,723	\$1,155,829

4. Stockholders' Equity and Preferred Stocks

At December 31, 1999, Active Power had 10,420,000 shares of \$.001 par value preferred stock authorized and 8,152,084 shares outstanding. Upon closing of the initial public offering in August 2000, all outstanding shares of Series A, B, C, D and E redeemable convertible preferred stock were converted into an aggregate of 17,461,883 shares of the Company's common stock. At December 31, 2000 Active Power has 25,420,000 shares of preferred stock authorized and 420,000 shares outstanding.

1992 Preferred Stock

Holders of the 1992 Preferred Stock are not entitled to dividends. The 1992 Preferred Stock shall be redeemed by Active Power at such time as the Board of Directors determines, in its sole discretion, that Active Power has available funds in excess of anticipated needs. No dividends may be declared or paid on Common Stock so long as any shares of 1992 Preferred Stock are issued and outstanding. The redemption price of the 1992 Preferred Stock is \$0.50 per share.

Stock Split

In March 2000, Active Power reincorporated in Delaware. In conjunction with the reincorporation, all of the \$0.01 par value shares held by the common and preferred stockholders were automatically converted into two \$0.001 par value shares of the corresponding common or preferred stock of the Delaware corporation. On July 13, 2000, Active Power's Board of Directors approved a 2.16-for-1 common stock split in the form of a dividend of 1.16 shares of common stock for each share of common stock outstanding on July 20, 2000. All share and per share amounts in the financial statements and accompanying notes have been restated to reflect the reincorporation and stock split as if they had taken place at the inception of Active Power.

Warrants

In November 1999, Active Power issued warrants to purchase 432,000 shares of Common Stock to two purchasers of the Series E Preferred Stock in conjunction with the placement of preferred stock and strategic alliance agreements with those stockholders. The warrants have exercise prices of \$5.25 per share. The warrants were fully vested, non-forfeitable and exercisable upon issuance and expire in November 2006. Active Power estimated the fair value of the warrants using the Black-Scholes pricing model with the following assumptions: expected volatility of 50%, expected life of 1 year, expected dividend yield of 0%, and risk-free rate of 6%. Active Power expensed the estimated fair value of these warrants of approximately \$1.4 million in 1999. The exercise prices of the warrants is to be adjusted only for capital restructures and stock splits, and not for subsequent sales of Common Stock. The weighted average exercise price of warrants outstanding at December 31, 2000 was \$5.25 per share. The weighted average fair value of warrants granted during the year ended December 31, 1999 was \$3.19.

ACTIVE POWER, INC.

NOTES TO FINANCIAL STATEMENTS

Stock Option Agreements

Active Power has reserved 5,636,178 shares of its Common Stock for issuance under its 2000 Stock Incentive Plan. The options are immediately exercisable upon grant and vest over periods ranging from immediate to four years. Active Power has repurchase rights for unvested shares purchased by optionees. At December 31, 2000, 1999 and 1998, 321,245, 217,957 and 149,066 shares, respectively, that were purchased by optionees remained unvested and subject to repurchase.

A summary of Common Stock option activity during the years ended December 31, 2000, 1999 and 1998 is as follows:

	Number of Shares	Range of Exercise Prices	Weighted-Average Exercise Prices
Outstanding at December 31,			
1997.....	2,371,680	\$ .07 -- 1.97	\$ .15
Granted.....	699,840	.16 -- .28	.23
Exercised.....	(114,912)	.07 -- .28	.10
Canceled.....	(56,160)	.09 -- .16	.16
-----			
Outstanding at December 31,			
1998.....	2,900,448	\$ .07 -- 1.97	\$ .18
Granted.....	1,276,560	.42 -- 1.04	.65
Exercised.....	(739,735)	.07 -- .83	.19
Canceled.....	(89,346)	.09 -- 1.97	.29
-----			
Outstanding at December 31,			
1999.....	3,347,927	\$ .07 -- 1.97	\$ .35
Granted.....	1,294,785	1.04 -- 68.50	5.04
Exercised.....	(1,496,745)	.07 -- 6.94	.37
Canceled.....	(102,637)	.28 -- 6.94	1.65
-----			
Outstanding at December 31,			
2000.....	3,043,330	\$ .07 -- 68.50	\$2.42
=====			

At December 31, 2000, 2,592,848 shares were available for future grants.

The following is a summary of options outstanding and exercisable as of December 31, 2000:

Range of Exercise Prices	Number	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
\$ .07--\$ .09.....	242,404	5.5	.08
\$ .16--\$ .42.....	1,147,623	7.3	.23
\$ .56--\$ 1.39.....	1,124,721	8.9	.95
\$ 1.85--\$ 1.97.....	30,240	2.9	\$ 1.90
\$ 4.17--\$ 6.94.....	385,401	9.4	\$ 5.39
\$17.00--\$68.50.....	112,941	9.8	\$34.46
-----			
	3,043,330	8.1	\$ 2.42
=====			

Stock options vested as of December 31, 2000, 1999, and 1998 were 1,274,526, 1,458,112, and 1,090,645 respectively.



ACTIVE POWER, INC.

NOTES TO FINANCIAL STATEMENTS

Of the stock options granted to employees during the year ended December 31, 1999, 1,275,480 had exercise prices below the fair value determined subsequently by the board of directors of the underlying shares of Common Stock on the date of grant. As a result, Active Power recorded unearned stock compensation of \$7,061,267 of which \$1,631,068 was amortized to non-cash compensation during the year ended December 31, 1999. The remaining unearned compensation will be recognized as non-cash compensation over the remaining vesting period of the options of approximately 3 years.

During 2000, Active Power granted 1,101,924 stock options to employees with exercise prices below the fair value determined subsequently by the board of directors of the underlying shares and, accordingly, recorded \$8,781,404 additional unearned stock compensation of which \$6,692,173 was amortized to non-cash compensation during the year ended December 31, 2000. The remaining unearned compensation will be recognized as non-cash compensation over the options' vesting period of four years.

Pro forma information regarding net loss is required by Statement No. 123, and has been determined as if Active Power had accounted for its employee stock options under the fair value method of Statement No. 123. The fair value for these options was estimated at the date of grant using a minimum value option pricing model until the date of the initial public offering and the Black-Scholes option pricing model thereafter, with the following assumptions:

	Year ended December 31,		
	2000	1999	1998
Risk-free interest rate.....	6.5%	6.5%	6.5%
Weighted-average expected life of the options... 7 years	7 years	7 years	7 years
Dividend rate.....	0%	0%	0%
Assumed volatility.....	150%	0%	0%
Weighted average fair value of options granted:			
Exercise price equal to fair value of stock on date of grant.....	\$ 32.52	--	\$ .06
Exercise price less than fair value of stock on date of grant.....	\$ 8.90	\$5.77	--

For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the options' vesting period. Active Power's pro forma information under Statement No. 123 follows:

	Year ended December 31,		
	2000	1999	1998
Pro forma stock-based compensation expense.....	\$ 8,619,884	\$ 1,712,263	\$ 35,726
Pro forma net loss.....	\$(25,032,060)	\$(10,269,539)	\$(6,014,504)
Pro forma net loss to common stockholders.....	\$(44,110,982)	\$(39,929,205)	\$(8,803,117)
Pro forma basic and diluted loss per share.....	\$ (2.01)	\$ (3.99)	\$ (.90)

Option valuation models incorporate highly subjective assumptions. Because changes in the subjective assumptions can materially affect the fair value estimate, the existing models do not necessarily provide a reliable single measure of the fair value of Active Power's employee stock options. Because the determination of fair value of all employee stock options granted after such time as Active Power becomes a public entity will include an expected volatility factor and because, for pro forma disclosure purposes, the estimated fair value of Active Power's employee stock options is treated as if amortized to expense over the options' vesting period, the effects of applying Statement No. 123 for pro forma disclosures are not necessarily indicative of future amounts.

ACTIVE POWER, INC.

NOTES TO FINANCIAL STATEMENTS

Common stock reserved at December 31, 2000 consists of the following:

For exercise of Common Stock Warrants.....	432,000
For issuance under the 1993/2000 Stock Option Plan.....	5,636,178

5. Income Taxes

At December 31, 2000, Active Power has net operating loss carryforwards of approximately \$30 million for federal tax reporting purposes and research and development credit carryforwards of approximately \$563,000. The net operating loss and research and development credit carryforwards begin to expire in 2007 if not utilized.

Utilization of the net operating losses and credits may be subject to a substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986. The annual limitation may result in the expiration of net operating losses and credits before utilization.

Significant components of Active Power's deferred tax liabilities and assets as of December 31 are as follows:

	2000	1999
Deferred tax assets:		
Capital expenses.....	164,000	71,000
Warrants.....	511,000	511,000
Reserves and allowances.....	628,000	461,000
Net operating loss and tax credit carryforwards.....	11,587,000	5,730,000
Other.....	--	34,000
Total deferred tax assets.....	12,890,000	6,807,000
Valuation allowance for net deferred tax assets.....	(12,890,000)	(6,807,000)
Net deferred taxes.....	\$ --	\$ --

Active Power has established a valuation allowance equal to the net deferred tax assets due to uncertainties regarding the realization of deferred tax assets based on the Company's lack of earnings history. The valuation allowance increased by approximately \$6,083,000 during 2000. Approximately \$438,000 of the valuation allowance for deferred tax assets relates to benefits for stock option deductions, which when realized, will be allocated directly to contributed capital.

Active Power's benefit for income taxes differs from the expected tax benefit amount computed by applying the statutory federal income tax rate of 34% to loss before taxes due to the following:

	Year Ended December 31,		
	2000	1999	1998
Federal statutory rate.....	(34.0)%	(34.0)%	(34.0)%
Non-cash compensation expense.....	12.1	17.4	--
State taxes, net of federal benefit.....	(1.9)	(1.5)	(3.0)
Permanent items and other.....	(2.5)	(.6)	(1.8)
Change in valuation allowance.....	26.3	18.7	38.8
	0.0%	0.0%	0.0%

ACTIVE POWER, INC.

NOTES TO FINANCIAL STATEMENTS

6. Commitments

Active Power leases its office and manufacturing facilities under operating lease agreements. The office space and manufacturing facilities leases are noncancelable and obligate Active Power to pay taxes and maintenance costs. In addition, Active Power leases certain equipment such as copiers and phone systems under noncancelable leases.

Future minimum payments under these leases at December 31, 2000 are as follows:

2001.....	1,184,974
2002.....	1,383,264
2003.....	1,073,781
2004.....	815,892
2005.....	334,795
	-----
Total future minimum lease payments.....	\$4,792,706
	=====

Rent expense for the years ended December 31, 2000, 1999, and 1998 was \$489,597, \$353,502, and \$276,637 respectively.

Active Power has a consulting services agreement with the Chairman of the board of directors. In accordance with the consulting agreement, the Chairman receives \$6,250 in consulting fees monthly. During 2000, 1999, and 1998 Active Power paid \$75,000 in fees per year under this agreement.

7. Employee Benefit Plan

In 1996, Active Power established a 401(k) Plan that covers substantially all full-time employees. Company contributions to the plan are determined at the discretion of the Board of Directors and vest ratably over five years of service starting after the first year of employment. Active Power did not contribute to this plan in 1998, 1999, and 2000.

8. Development Funding

During January 1999, Active Power entered into a contract development agreement with a third party. In accordance with the agreement, the third party provided funding to allow Active Power to accelerate development of its products in a certain market application in exchange for the third party obtaining exclusive marketing rights for the product in that application. The exclusive marketing rights are subject to the third party meeting specified minimum orders of the product. The two companies share ownership of the resulting intellectual property. Active Power completed the contract in 1999 and collected the full \$5,000,000 development funding specified in the contract, which it recognized as it achieved the product performance milestones specified in the agreement. Active Power does not separately account for efforts spent by its engineers on research and development by the various project. Because this project involved development of Active Power's product already contemplated by management and for which Active Power co-owns the resulting intellectual property, all of the costs associated with this contract are classified in research and development expense.

ACTIVE POWER, INC.

NOTES TO FINANCIAL STATEMENTS

9. Geographic Information

Revenues for the year ended December 31 were as follows:

	2000	1999	1998
United States.....	\$3,392,607	\$1,014,411	\$867,775
Foreign countries.....	1,479,526	32,400	47,543
Total.....	\$4,872,133	\$1,046,811	\$915,318

Revenues from foreign countries above represent shipments to customers located primarily in Europe. Active Power has no property, plant or equipment located outside the United States.

Supplementary Financial Information (Unaudited)

	Year Ended December 31, 2000			
	First	Second	Third	Fourth
	Quarter	Quarter	Quarter	Quarter
Product revenue.....	\$ 182	\$ 679	\$ 1,343	\$ 2,668
Product margin (loss).....	(339)	(497)	(742)	(1,516)
Net loss.....	(4,857)	(6,208)	(5,789)	(6,250)
Cumulative undeclared dividends on preferred stock.....	(849)	(849)	(355)	--
Accretion on redeemable convertible preferred stock to redemption amounts.....	(6,383)	(7,329)	(3,314)	--
Net loss to common stockholders.....	\$(12,089)	\$(14,386)	\$(9,458)	\$(6,250)
Net loss per share, basic and diluted.....	\$ (1.15)	(1.26)	(0.35)	(0.16)

Non-cash charges associated with redeemable preferred stock were recorded to reflect dividend rights and accretion to redemption value prior to conversion to common stock which occurred immediately prior to the Company's initial



LEASE AGREEMENT

Between

BC12 99, Ltd.,  
as Landlord,

and

Active Power, Inc.  
as Tenant,

Covering approximately 126,750 gross square feet  
of the Building known as

Braker 12

located at

2128 Braker Lane

Austin, Texas, 78758

STANDARD INDUSTRIAL LEASE AGREEMENT  
TRAMMELL CROW COMPANY - (AUS/91)

Approximately 126,750 gross square feet  
2128 Braker Lane  
Austin, Texas 78758  
(Braker 12)

LEASE AGREEMENT

THIS LEASE AGREEMENT is made and entered into by and between BC12 99, Ltd., a Texas limited partnership hereinafter referred to as "Landlord," and Active Power, Inc., a Delaware corporation hereinafter referred to as "Tenant."

1. PREMISES AND TERM. In consideration of the mutual obligations of Landlord and Tenant set forth herein, Landlord leases to Tenant, and Tenant hereby takes from Landlord, approximately 126,750 square feet of space (the "Premises") shown on Exhibit "A" attached hereto and incorporated herein, located in the building known as Braker 12, which building has an address of 2128 Braker Lane, Austin, Travis County, Texas 78750 (the "Building"). The Building is located on the real property described on Exhibit "A-1" attached hereto and incorporated herein. The term of this Lease shall commence on the Commencement Date hereinafter set forth and shall end on the last day of the month that is forty-eight (48) months after the Commencement Date (the "Expiration Date"). Notwithstanding anything to the contrary contained herein, on the Commencement Date, Tenant shall lease only that portion of the Premises containing 85,000 square feet and shown on Exhibit "A-2" attached hereto and incorporated herein (the "Initial Premises"). Tenant shall lease approximately 20,875 square feet of the Premises shown on Exhibit "A-3" attached hereto and incorporated herein (the "First Additional Premises") not later than the date which is the sixth month anniversary of the Commencement Date and Tenant shall lease the remaining approximately 20,875 square feet of the Premises shown on Exhibit "A-4" attached hereto and incorporated herein (the "Second Additional Premises") not later than the first annual anniversary of the Commencement Date. In the event Tenant elects to lease the First Additional Premises prior to the six month anniversary of the Commencement Date or Tenant elects to lease the Second Additional Premises prior to the first annual anniversary of the Commencement Date, the commencement date for such space shall be the date Tenant actually occupies the First Additional Premises and/or the Second Additional Premises, as the case may be, for the conduct of Tenant's business. Further, notwithstanding anything to the contrary set forth herein, Tenant shall have no obligations with respect to or liability for the First Additional Premises or the Second Additional Premises until the applicable commencement date for such space, except for the obligation to pay one-half (1/2) of the Operating Expenses attributable to such space as provided in Paragraph 2C below.

A. Existing Building and Improvements. The "Commencement Date" shall be May

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1, 2001, provided that the Commencement Date shall be delayed to the extent that Landlord fails to deliver possession of the Initial Premises to Tenant for any reason, including but not limited to, holding over by prior occupants. However, Landlord shall within fifteen (15) days after the execution of this Lease by Landlord and Tenant, notify the existing tenant in the Premises that such tenant shall not be permitted to hold over after the expiration of its lease and that the Premises have been rented to a third party effective as of May 1, 2001. If the Commencement Date is delayed, the Expiration Date under the Lease shall be similarly extended. Notwithstanding the foregoing, if the Commencement Date does not occur by July 1, 2001, Tenant shall be entitled to terminate this Lease by giving Landlord written notice of termination on or before the occurrence of the Commencement Date. Landlord shall use its best efforts to deliver the Initial Premises on May 1, 2001. Upon Landlord's delivery of the Premises, Landlord shall, at Landlord's sole cost and expense, re-key the Premises. In the event of holding over or retention of any third party tenant, tenants or occupants of the Premises by the current tenant after April 30, 2001, Landlord shall take all commercially reasonable steps necessary to evict such tenant as soon as possible, including without limitation, the employment of legal counsel to take steps required to evict such third party tenant, tenants or occupants. Upon Tenant's occupancy of the Premises, Tenant shall be deemed to acknowledge that subject to Paragraphs 4.B below, (i) it has inspected and accepts the Premises in its "as is" condition, (ii) the buildings and improvements comprising the same are suitable for the purpose for which the Premises are leased, (iii) the Premises are in good and satisfactory condition, and (iv) no representations as to the repair of the Premises nor promises to alter, remodel or improve the Premises have been made by Landlord (unless otherwise expressly set forth in this Lease).

2. BASE RENT, SECURITY DEPOSIT AND ESCROW DEPOSITS.

A. Base Rent. Tenant agrees to pay Landlord base rent ("Base Rent") for the

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Premises, in advance, without demand, deduction or set off, except as otherwise provided herein, at the rates set forth below for the following periods:



Months	Base Rental Rate PSF/Mo.	Square Feet	Base Monthly Rent
1-6	\$0.48	85,000	\$40,800.00
7-12	\$0.48	105,875	\$50,820.00
13-24	\$0.48	126,750	\$60,840.00
25-48	\$0.50	126,750	\$63,375.00

per month during the Term hereof. One monthly installment of \$40,800.00, shall be due and payable on the date hereof and shall be applied to the first monthly installment of Base Rent due hereunder, and the foregoing described monthly installments shall be due and payable on or before the first day of each calendar month succeeding the Commencement Date, except that all payments due hereunder for any fractional calendar month shall be prorated. In the event Tenant elects to lease the First Additional Premises or the Second Additional Premises prior to the sixth month anniversary of the Commencement Date and the first annual anniversary of the Commencement Date, respectively, the Base Rent Schedule set forth above shall be adjusted accordingly.

**B. Security Deposit.** In addition, Tenant agrees to deposit with Landlord on

the date hereof the sum of Seventy Nine Thousand Two Hundred Eighteen and 75/100 Dollars (\$79,218.75) which shall be held by Landlord, without obligation for interest, as security for the performance of Tenant's obligations under this Lease (the "Security Deposit"), it being expressly understood and agreed that the Security Deposit is not an advance rental deposit or a measure of Landlord's damages in case of Tenant's default. Upon occurrence of an Event of Default, Landlord may use all or part of the Security Deposit to pay past due rent or other payments due Landlord under this Lease or the cost of any other damage, injury, expense or liability caused by such Event of Default, without prejudice to any other remedy provided herein or provided by law. The Security Deposit shall be deemed the property of Landlord, but any remaining balance of the Security Deposit shall be returned by Landlord to Tenant when all of Tenant's obligations under this Lease have been fulfilled.

**C. Operating Expenses.** Without limiting in any way Tenant's other

obligations under this Lease, Tenant agrees to pay to Landlord its Proportionate Share (as defined in this Paragraph 2C below) of Operating Expenses (hereinafter defined) for the Project (hereinafter defined). Operating Expenses shall mean (i) Taxes (hereinafter defined) payable by Landlord pursuant to Paragraph 3A below, and the cost of any tax consultant to assist Landlord in determining the fair tax valuation of the Building and land upon which it is located (ii) the cost of utilities for the common areas of the Project payable by Landlord pursuant to Paragraph 8 below, (iii) Landlord's cost of maintaining any insurance or insurance related expense applicable to the Building and Landlord's personal property used in connection therewith including, but not limited to, insurance pursuant to Paragraph 9A below, and (iv) Landlord's cost of maintaining the Project which include but are not limited to (a) maintenance and repairs, (b) landscaping, (c) common area utilities, (d) water and sewer, (e) roof repairs, (f) reasonable and customary management fees, (g) exterior painting, and (h) parking lot maintenance and repairs. Operating Expenses shall not include the following expenses: (a) any costs for interest, amortization, or other payments on loans to Landlord, (b) expenses incurred in leasing or procuring tenants, (c) legal expenses other than those incurred for the general benefit of the Building's tenants, (d) allowances, concessions, and other costs of renovating or otherwise improving space for occupants of the Building or other buildings in the Project or vacant space in the Building or other buildings in the Project, (e) rents under ground leases, (f) costs incurred in selling, syndicating, financing, mortgaging, or hypothecating any of Landlord's interests in the Building or the Project, (g) expenses for which Landlord is actually reimbursed by another source (excluding tenant reimbursement for Operating Expenses) including repair or replacement of any item covered by warranty as well as insurance proceeds received by Landlord or paid by a tenant or other third parties, (h) alterations attributable solely to individual tenants of the Project, (i) the cost of capital improvements, depreciation, interest, lease commissions, advertising and marketing costs, and principal payments on mortgage and other non-operating debts of Landlord, (j) depreciation of the Building or other buildings in the Project, (k) salaries paid to employees above the Building manager level, commission to brokers, advertising and promotion costs, and wages, salaries, fees and benefits paid to executive personnel or officers or partners of Landlord, (l) the cost of tools and equipment used initially in the construction of the Project, (m) costs incurred in connection with the original construction of the Project or with any major changes to same, including, but not limited to, additions or deletions of corridor extensions, renovations and improvements of the common areas beyond the costs caused by normal wear and tear, and upgrades or replacement of major

Project systems, (n) costs of correcting defects (including latent defects), including any allowances for same, in the construction of the Project or its related facilities; (o) expenses for the defense of Landlord's title to the premises or the Building, (p) the cost of overtime or other expenses of Landlord in performing work expressly provided in this Lease to be performed by Landlord, at Landlord's expense and not as part of Operating Expenses, (q) any amounts expended by Landlord as environmental response costs for removal, enclosure, encapsulation, clean-up, remediation or other activities regarding Landlord's compliance with federal, state, municipal or local hazardous waste and environmental laws, regulations or ordinances, (r) any fines or penalties incurred as a result of Landlord's violation or failure to comply with any governmental regulations and rules or any court order, decree or judgment, (s) costs of initially bringing the Building or Project into compliance with applicable laws as of the date of this Lease, (t) attorneys fees incurred in connection with negotiations or disputes with other tenants or occupants of the Project, (u) any charge for Landlord's income taxes, excess profit taxes, or franchise taxes, (v) any Operating Expenses representing an amount paid to a related corporation, entity or person which is in excess of the amount which would be paid in the absence of such relationship, (w) expenses paid directly by Tenant for any reason (such as Tenant's electricity use), and (x) all costs for which Tenant or any other tenant in the Project is being directly or separately billed other than as a component of Operating Expenses. Prior to the Commencement Date and prior to January 1 of each calendar year during the Term, Landlord shall make a good faith estimate of Operating Expenses for the upcoming calendar year and Tenant's Proportionate Share of such expenses. During each month of the Term of this Lease, on the same day that Base Rent is due hereunder, Tenant shall deposit in escrow with Landlord an amount equal to one-twelfth (1/12) of the estimated amount of Tenant's Proportionate Share of the Operating Expenses. Tenant authorizes Landlord to use the funds deposited with Landlord under this Paragraph 2C to pay such Operating Expenses. The initial monthly escrow payments are based upon the estimated amounts for the year in question and shall be increased or decreased annually to reflect the projected actual amount of all Operating Expenses. As soon as is practical following the end of each calendar year during the Term Landlord shall furnish to Tenant a statement of Landlord's actual Operating Expenses for the previous calendar year. If the Tenant's total escrow deposits for any calendar year are less than Tenant's actual Proportionate Share of the Operating Expenses for such calendar year, Tenant shall pay the difference to Landlord within thirty (30) days after receipt of the statement of Actual Operating Expenses. If the total escrow deposits of Tenant for any calendar year are more than Tenant's actual Proportionate Share of the Operating Expenses for such calendar year, Landlord shall retain such excess and credit it against Tenant's Proportionate Share of Operating Expenses escrow deposits next maturing after such determination, except in connection with the last calendar year of the Term, in which case Landlord shall refund to Tenant any overpayment. The Premises and the Building are a part of a project or business park owned, managed or leased by Landlord or an affiliate of Landlord (the "Project"). Tenant's "Proportionate Share" of the Project, as used in this Lease, shall mean a fraction, the numerator of which is the gross rentable area contained in the Premises and the denominator of which is the gross rentable area contained in the Building, which is 126,750 square feet. Notwithstanding that the First Additional Premises and the Second Additional Premises are not initially part of the Premises, Tenant shall pay, commencing on the Commencement Date, one-half (1/2) of Tenant's Proportionate Share of Operating Expenses attributable to such space.

Tenant at its sole expense, shall have the right no more frequently than once per calendar year, following thirty (30) days prior written notice to Landlord, which notice must be given within one hundred eighty (180) days after Tenant's receipt of Landlord's statement of actual Operating Expenses pursuant to this Paragraph 2.C, to audit Landlord's books and records relating to Operating Expenses at Landlord's office during Landlord's normal business hours. Tenant shall be solely responsible for all costs, expenses and fees incurred for the audit; provided, that if an audit by Tenant establishes that Landlord has overstated Tenant's Proportionate Share of Operating Expenses by more than five percent (5%) in any one calendar year, Landlord shall reimburse Tenant for the reasonable costs of the audit. Within sixty (60) days after the books and records are made available to Tenant, Tenant shall have the right to give Landlord written notice (an "Objection Notice") stating in reasonable detail any objection to Landlord's statement of Operating Expenses for that year. If Tenant provides Landlord with a timely Objection Notice, Landlord and Tenant shall work together in good faith to resolve any issues raised by Tenant's Objection Notice. The records obtained by Tenant shall be treated as confidential.

### 3. TAXES

#### A. Real Property Taxes. Subject to reimbursement under Paragraph 2C

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herein, Landlord agrees to pay all taxes, assessments and governmental charges of any kind and nature (collectively referred to herein as "Taxes") that accrue against the Premises, the Building and/or the land of which the Premises or the Building are a part. If at any time during the term of this Lease there shall be levied, assessed or imposed on Landlord a tax directly on the rents received

therefrom and/or a franchise tax, assessment, levy or charge measured by or based, in whole or in part, upon such rents from the Premises and/or improvements of which the Premises are a part, then all such taxes, assessments, levies or charges, or the part thereof so measured or based shall be deemed to be included within the term "Taxes" for the purposes hereof.

B. Personal Property Taxes. Tenant shall be liable for all taxes levied

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or assessed against any personal property or fixtures placed in or on the Premises. If any such taxes are levied or assessed against Landlord or Landlord's property and (i) Landlord pays the same or (ii) the assessed value of Landlord's property is increased by inclusion of such personal property and fixtures and Landlord pays the increased taxes, then Tenant shall pay to Landlord, within thirty (30) days after receipt of an invoice therefor, together with documentation substantiating that such taxes were solely attributable to Tenant's personal property and fixtures, the amount of such taxes.

4. LANDLORD'S REPAIRS AND MAINTENANCE.

A. Structural Repairs. Landlord, at its own cost and expense, shall

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maintain the foundation and the structural soundness of the exterior walls of the Building in good repair, reasonable wear and tear excluded. The term "walls" as used herein shall not include windows, glass or plate glass, any doors, special store fronts or office entries, and the term "foundation" as used herein shall not include loading docks. Landlord shall further, at its sole cost and expense (subject to inclusion as a component of Operating Expenses to the extent such costs qualify as an Operating Expenses), repair, replace (as necessary) and maintain in good working order, condition and repair, the roof, landscaping, drainage, common area lighting facilities, parking lots and driveways of the Project, sanitary sewers and water main in the Building, concealed plumbing serving the Premises, all exterior common areas of the Project, and the exterior of the Building. With respect to the foregoing areas of repair and maintenance, Landlord shall maintain the Building in a manner reasonably consistent with comparable industrial buildings in the North Austin submarket ("Comparable Buildings"). Notwithstanding any other provision hereof, if the lack of such maintenance and repair materially impairs Tenant's use of or access to the Premises, and Landlord fails to make any required repairs within thirty (30) days after the receipt of Tenant's written notice or, in the event the nature of Landlord's obligation is such that more than thirty (30) days are required for its performance and Landlord fails to commence performance with the thirty (30) day period and thereafter diligently pursue the completion of same using commercially reasonable efforts, Tenant may, at its option, make such repair or replacement on Landlord's behalf and Landlord shall reimburse to Tenant, within thirty (30) days of Tenant's written request therefor, Tenant's reasonable costs and expenses in connection with the exercise of such right. Tenant shall immediately give Landlord written notice of defect or need for repairs.

B. Delivery of Premises. Landlord shall deliver the Premises to Tenant

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in a "broom clean" condition with all systems in good working order, including without limitation, all lights and lighting fixtures, plumbing fixtures and systems, and with all dock doors and levelers in good working order. Landlord shall also deliver the Premises with those installations which are currently in the Premises that are identified by Landlord and Tenant prior to the Commencement Date. Upon the request of either party, the other party shall confirm in writing of such installations agreed to between Landlord and Tenant. Landlord shall warranty the HVAC systems serving the Premises for a period of thirty (30) days after the Commencement Date with respect to the Initial Premises and for a period of thirty (30) days after the applicable commencement date therefor, for the First Additional Premises and the Second Additional Premises. On or before the Commencement Date, Landlord shall provide Tenant with a copy of the existing tenant's exit inspection of the Premises, including an inspection report by a licensed engineer, evidencing that the HVAC and electrical systems serving the Premises are in good working order. On or before the Commencement Date, Landlord shall also provide Tenant with a copy of Landlord's most current roof inspecting evidencing that the roof of the Building is in good condition and repair. If the roof inspection reflects any condition needing repair, Landlord shall provide Tenant with evidence that such repair was performed, or Landlord shall promptly make the necessary repair.

C. Repainting of Building Exterior. Prior to the Commencement Date,

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Landlord shall, at its sole cost and expense (and not as a component of Operating Expenses), repaint the exterior of the Building in a color mutually approved by Landlord and Tenant.

5. TENANT'S REPAIRS.

A. Maintenance of Premises. Tenant, at its own cost and expense, shall

(i) maintain all parts of the interior of the Premises and promptly make all necessary repairs and replacements to the interior of the Premises (except those for which Landlord is expressly responsible hereunder), and (ii) keep the parking areas, driveways, alleyways and areas surrounding the loading docks free of trash, debris and inventory, including but not limited to pallets, barrels, and equipment from tenant use. If Tenant fails to make any required repairs within thirty (30) days after receipt of a written request from Landlord, or in the event the nature of Tenant's obligation is such that more than thirty (30) days is required for performance, and Tenant fails to commence performance within the thirty (30) day period and thereafter diligently pursue the completion of same using commercially reasonable efforts, then the Landlord may (but shall not be obligated to) perform such duties and the Tenant shall reimburse Landlord within thirty (30) days of presentation of appropriate statement. Tenant's obligation to maintain, repair and make replacements to the Premises shall cover, but not be limited to, pest control (including termites), trash removal and the maintenance, repair and replacement of all HVAC, electrical, plumbing, (but only to the extent it is not concealed), sprinkler and other mechanical systems.

B. Parking. Tenant and its employees, customers and licensees shall

have the right to use all of the parking areas that have been designated as parking areas (which parking areas for the common use of tenants of the Project are shown on the site plan attached as Exhibit "A-5" attached hereto and incorporated herein), subject to (i) all reasonable rules and regulations promulgated by Landlord, and (ii) rights of ingress and egress of other lessees of the Project. Except in connection with Tenant's parking spaces in the Adjacent Parking Facility, Landlord shall not be responsible for enforcing Tenant's parking rights against any third parties. Tenant shall have the right to take commercially reasonable efforts to enforce its parking rights with respect to the parking spaces not located in the Adjacent Parking Facility, including without limitation, the use of parking stickers and the right to tow or obstruct improperly parked vehicles. Tenant agrees not to park on any public streets or private roadways adjacent to or in the vicinity of the Premises. Landlord shall make available to Tenant on the Commencement Date the use of forty (40) parking spaces in the parking lot adjacent to the Project (the "Adjacent Parking Facility") on an unreserved basis. The location of the Adjacent Parking Facility is shown on Exhibit "A-6" attached hereto and incorporated herein. Landlord shall use reasonable efforts to insure that such spaces in the Adjacent Parking Facility shall be available for use by Tenant, including without limitation, the towing of unauthorized vehicles. Additionally, Landlord shall make available to Tenant in the Adjacent Parking Facility additional parking spaces in accordance with the following schedule :

Months	Total Parking Spaces in Adjacent Parking Facility
Months 6 - 12	80 Spaces
Months 13 - 24	120 spaces
Months 25 - 48	160 Spaces

Landlord has not and will not grant any other tenant of the Project the right to use the parking spaces being made available to Tenant hereunder situated in the Adjacent Parking Facility during the term of this Lease (including any renewal thereof). In consideration of Landlord's provision of the parking spaces in the Adjacent Parking Facility, Tenant shall pay to Landlord, in addition to Base Rent, the sum of \$19.00 per parking space per month plus Tenant's proportionate share of taxes, insurance and maintenance expenses applicable to the Adjacent Parking Facility. Such payments shall be due and payable at the same time as Base Rent is due hereunder.

C. System Maintenance. Landlord shall service HVAC equipment serving the

Premises within thirty (30) days of Tenant's occupancy (and within thirty (30) days of Tenant's occupancy of the First Additional Premises and the Second Additional Premises, as applicable) to ensure such HVAC equipment is in good working order. Tenant, at its own cost and expense, shall enter into a regularly scheduled preventive maintenance/service contract with a maintenance contractor reasonably approved by Landlord for servicing all hot water, heating and air conditioning systems and equipment within the Premises. The service contract must include the replacement of filters on a regular basis and all services suggested by the equipment manufacturer in its operations/maintenance manual and must become effective within ninety (90) days of the date Tenant takes possession of the applicable portion of the Premises.

6. ALTERATIONS.

A. Approval of Alterations. Except as set forth below, Tenant shall not

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make any alterations, additions or improvements to the Premises without the prior written consent of Landlord, which consent shall not be unreasonably withheld or delayed for alterations or improvements which do not affect the structure of the Building or which do not adversely affect the mechanical, electrical or plumbing systems of the Building. Landlord shall not be required to notify Tenant of whether it consents to any alteration, addition or improvement until it (a) has received plans and specifications therefor which are sufficiently detailed to allow construction of the work depicted thereon to be performed in a good and workmanlike manner (and if Landlord has provided Tenant with a CAD disk with existing improvements, Tenant shall have updated such CAD disk), and (b) has had fifteen (15) business days to review such plans. If the alteration, addition or improvement will affect the Building's structure, HVAC system, or mechanical, electrical, or plumbing systems, then the plans and specifications therefor must be prepared by a licensed engineer reasonably acceptable to Landlord and, in the event Landlord has delivered to Tenant a CAD disk with all existing improvements and systems shown thereon, then Tenant shall update such CAD disk with such plans and specifications. Landlord shall notify Tenant whether it consents to any alteration, addition or improvement within fifteen (15) business days after Landlord has received the foregoing described plans. If Landlord fails to notify Tenant of its approval or disapproval of such alteration, addition or improvement within the foregoing described fifteen (15) business day period, Landlord shall be deemed to have approved such requested alteration, addition or improvement. Landlord's approval of any plans and specifications shall not be a representation that the plans or the work depicted thereon will comply with law or be adequate for any purpose, but shall merely be Landlord's consent to performance of the work. Upon completion of any alteration, addition, or improvement, Tenant shall deliver to Landlord accurate, reproducible as-built plans therefor and in the event Tenant has received a CAD disk from Landlord with all existing improvements, Tenant shall update the CAD disk to show such improvements. Tenant may erect shelves, bins, machinery and trade fixtures provided that such items (1) do not alter the basic character of the Premises or the Building; (2) do not overload the same; and (3) may be removed without material damage to the Premises. Unless Landlord specifies in writing otherwise, all alterations, additions, and improvements shall be Landlord's property when installed in the Premises. All shelves, bins, machinery and trade fixtures installed by Tenant shall be removed on or before the earlier to occur of the day of termination or expiration of this Lease or vacating the Premises, at which time Tenant shall repair any damage caused by such removal. Additionally, subject to paragraph (a) of the Tenant Improvement section of Exhibit C, Landlord shall have the right to require Tenant to remove any

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alterations made to the Premises by Tenant during the term of this Lease. In the event Landlord requires Tenant to remove any such alterations, Landlord shall provide Tenant written notice of such removal requirement prior to the expiration of the term of this Lease, and Tenant shall be afforded a reasonable time to accomplish such removal after the Expiration Date and Tenant shall repair any damage caused by such removal. All work performed by a Tenant in the Premises (including that relating to the installations, repair replacement, or removal of any item) shall be performed in accordance with all applicable governmental laws, ordinances, regulations, in a good and workmanlike manner, and so as not to damage or alter the Building's structure or the Premises. Tenant shall be responsible for compliance with The Americans With Disabilities Act of 1990 (the "ADA") with respect to any alterations, additions or improvements to the Premises made by Tenant; provided that in no event shall Tenant be required to make any alterations to the Premises or make any structural alterations or alterations to the base Building (including restrooms located within the Premises) in order to comply with the ADA or any other federal or state law related to handicap or disabled persons unless compliance is necessary solely as a result of Tenant's specific use of the Premises (and not as a result of Tenant's use of the Premises for the purposes set forth in Paragraph 12.A below) and not merely due to the fact that Tenant is making alterations.

B. Permitted Alterations. Notwithstanding the foregoing provisions to

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Paragraph 6, Landlord's consent shall not be required for (i) the movement, installation or modification of trade fixtures (including, without limitation, risers, utility feeds and related conduits and interior fresh air/exhaust louvers, but excluding any trade fixture to be installed on the outside of the Premises or the Building), furniture (including, without limitation, kitchen appliances, demountable partitions, computer racking and similar demountable fixtures) and trade equipment to be installed on the inside of the Premises or the Building; provided, however, that all of the foregoing items may be removed from the Premises without material injury thereto, or (ii) any alterations and improvements to the interior of the Building which do not affect the Building structure and which do not materially affect the Building's mechanical, electrical or plumbing systems.

C. Exterior Installations. Subject to Landlord's approval, not to be

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unreasonably withheld, Tenant shall have the right, at Tenant's sole cost and expense, to install (i) a load bank yard and related equipment, and (ii) additional transformers on the real



property described in Exhibit "A-1" as required by Tenant's permitted use of the Premises, all in locations approved by Landlord, which approval shall not be unreasonably withheld, provided that Tenant obtains all necessary approvals from the City of Austin and all other governmental authorities having jurisdiction over Tenant, the real property and the installations. Tenant shall remove the foregoing described installations and all associated equipment at the end of the Lease Term and shall repair all damage to the Project caused by such removal. Tenant shall at its expense, maintain the installations in good and operable condition and shall be responsible for the maintenance, repair, replacement and removal thereof, as necessary. Landlord agrees that the location set forth on Exhibit "A-7" is an approved location for the load bank yard.

7. SIGNS. Any exterior signage Tenant desires for the Premises shall be subject to Landlord's written approval, which approval shall not be unreasonably withheld or delayed. Subject to Landlord's approval of the design, location and method of installation, which approval will not be unreasonably withheld or delayed, Tenant shall be entitled to install, at Tenant's sole cost and expense, up to two (2) corporate identification signs on the exterior of the Building and one (1) monument along the entrance to Braker Lane, in a location to be mutually approved by Landlord and Tenant. Upon the expiration or earlier termination of this Lease, Tenant shall remove the two (2) corporate identification signs on the exterior of the Building. Tenant shall repair, paint and/or replace the Building fascia surface to which its signs are attached upon Tenant's vacating the Premises or the removal or alteration of its signage. Tenant shall not, without Landlord's prior written consent, (i) make any changes to the exterior of the Premises, such as painting; (ii) install any exterior lights, decorations, balloons, flags, pennants or banners; or (iii) except as otherwise provided herein, erect or install any signs, windows or door lettering, placards, decorations or advertising media of any type which can be viewed from the exterior of the Premises. All signs, decorations, advertising media, blinds, draperies and other window treatment or bars or other security installations visible from outside the Premises shall conform in all respects to the criteria established by Landlord and attached hereto as Exhibit "D". Landlord shall notify Tenant whether it consents to any exterior lighting or other change or alteration to the exterior of the Premises or the Building within ten (10) business days after Landlord has received plans and specifications therefor, which detail, without limitation, the method of attachment and location thereof. If Landlord fails to notify Tenant of its approval or disapproval of any requested exterior lighting, exterior cameras or other exterior installation within such ten (10) business day period, Landlord shall be deemed to have approved the installation of the same.

8. UTILITIES. Landlord agrees to provide normal water, electricity, sewer and gas service to the Premises. Tenant shall pay for all water, gas, heat, light, power, telephone, sewer, sprinkler charges and other utilities and services used on or at the Premises, together with any taxes, penalties, surcharges or the like pertaining to the Tenant's use of the Premises directly to the utility providing the same. All of said services except as provided below, shall be separately metered to Tenant, at Tenant's expense. Landlord shall not be liable for any interruption or failure of utility service on the Premises, and Tenant shall have no rights or claims as a result of any such failure. Notwithstanding the foregoing, in the event of a failure or interruption of electricity or water to the Premises which prohibits or unreasonably interferes with Tenant's ability to conduct business at the Premises and which (i) continues for forty-eight (48) consecutive hours, and (ii) is caused by Landlord or Landlord's agents, employees or contractors, Tenant shall be entitled to an abatement of rent payable hereunder after the expiration of such forty-eight (48) hour period until such electricity and/or is restored to the Premises to the extent necessary to permit Tenant to conduct business. In the event water is not separately metered to Tenant, Tenant agrees that it will not use water and sewer capacity for uses other than normal domestic restroom and kitchen usage without first obtaining Landlord's consent.

9. INSURANCE.

A. Landlord's Insurance. Landlord shall maintain during the Term of this

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Lease, insurance covering the Building in an amount equal to the full "replacement cost" thereof (exclusive of foundation and excavation costs), insuring against the perils of fire, lightning, extended coverage, vandalism and malicious mischief. Landlord shall also maintain during the Term of this Lease a policy or policies of commercial general liability insurance (including endorsement or separate policy for owned or non-owned automobile liability) covering the Project, with the premiums thereon fully paid on or before the due date, issued by and binding upon an insurance company or companies qualified to do business in the State of Texas. Such insurance shall afford minimum protection of not less than \$1,000,000.00 per occurrence per person coverage for bodily injury, property damage, personal injury, or combination thereof together with an umbrella or excess policy in an amount not less than \$5,000,000.00 over Landlord's base coverage amount. The term "personal injury" herein used means false arrest, detention or imprisonment, malicious prosecution, wrongful entry, libel and slander. If only a combined single limit coverage is available, it

shall be for at least \$3,000,000.00 per occurrence with an umbrella policy of at least \$5,000,000.00 combined single limit per occurrence.

B. Tenant's Insurance. Tenant, at its own expense, shall maintain

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during the Term of this Lease a policy or policies of workers' compensation insurance in compliance with the laws of the State of Texas and commercial general liability insurance, including personal injury and property damage, with contractual liability endorsement, in the amount of Five Hundred Thousand Dollars (\$500,000.00) for property damage and One Million Dollars (\$1,000,000.00) per occurrence and One Million Dollars (\$1,000,000.00) in the aggregate for personal injuries or deaths of persons occurring in or about the Premises. Tenant, at its own expense, shall also maintain during the term of this Lease fire and extended coverage insurance covering the replacement cost of all of Tenant's personal property contained within the Premises. The commercial general liability insurance policy shall (i) name the Landlord and the management company for the Project as additional insureds and any workers' compensation policy carried by Tenant, include a waiver of subrogation endorsement in favor of Landlord; (ii) be issued by an insurance company which is reasonably acceptable to Landlord; and (iii) provide that the issuer of such policy shall endeavor to notify Landlord thirty (30) days prior to any cancellation thereof. Certificates for such policies shall be delivered to Landlord by Tenant on or before the Commencement Date and upon each renewal of said insurance.

C. Prohibited Uses. Tenant will not permit the Premises to be used for

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any purpose or in any manner that would (i) void the insurance thereon, (ii) increase the insurance risk or cost thereof, or (iii) cause the disallowance of any sprinkler credits; including without limitation, use of the Premises for the receipt, storage or handling of any product, material or merchandise that is explosive or highly inflammable. Landlord represents that Tenant's intended use of the Premises shall not result in an increase in Landlord's insurance premiums. If any increase in the cost of any insurance on the Premises or the Building is caused by Tenant's use of the Premises or because Tenant vacates the Premises, then Tenant shall pay the amount of such increase to Landlord within thirty (30) days after receipt of an invoice therefor together with evidence substantiating that such increase was caused solely by Tenant.

10. FIRE AND CASUALTY DAMAGE.

A. Total or Substantial Damage and Destruction. If the Premises or the

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Building should be damaged or destroyed by fire or other peril, Tenant shall immediately give written notice to Landlord of such damage or destruction. If the Premises or the Building should be so damaged by fire or other casualty that, in Landlord's estimation, rebuilding or repairs cannot be completed within one hundred eighty (180) days after the date of such damage (or within ninety (90) days after the date of such damage, if the damage occurs during the last twelve (12) months of the Lease Term, unless Tenant exercises its renewal option, in which event the ninety (90) day period shall not apply), then either Landlord or Tenant shall have the right to terminate this Lease, and in the event of such termination, the rent shall be abated during the unexpired portion of this Lease, effective upon the date of the occurrence of such damage. Landlord shall notify Tenant within thirty (30) days after the date of the damage of Landlord's estimated repair period (the "Repair Estimate") and in the event the Repair Estimate reflects a repair period in excess of one hundred eighty (180) days (or ninety (90) days, if applicable), the Repair Estimate shall state whether Landlord elects to terminate this Lease. In the event the Repair Estimate reflects that the repair period is in excess of one hundred eighty (180) days (or ninety (90) days, if applicable) and Landlord does not elect to terminate this Lease, Tenant shall be entitled to terminate this Lease by delivering written notice of termination to Landlord within fifteen (15) business days after Tenant's receipt of the Repair Estimate. In the event neither Landlord nor Tenant terminate this Lease pursuant to this Paragraph 10A., Landlord, at its sole expense, shall perform Landlord's Restoration Work (hereinafter defined) with reasonable diligence and continuity. "Landlord's Restoration Work" shall mean all of the work necessary to repair and restore the Building (exclusive of Tenant's property) to substantially the same condition as that in which it was in immediately prior to the happening of the fire or other casualty.

B. Partial Damage or Destruction. If the Premises or the Building should

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be damaged by any peril covered by the insurance to be provided by Landlord under Paragraph 9A above and, the Repair Estimate reflects that rebuilding or repairs can be substantially completed within one hundred eighty (180) days (or ninety (90) days, if applicable) after the date of such damage, or in the event the damage cannot be repaired within one hundred eighty (180) days (or ninety (90) days, if applicable) but neither Landlord nor Tenant terminates this Lease under Paragraph 10A., then this Lease shall not terminate and Landlord shall promptly commence Landlord's Restoration Work.



C. Lienholders' Rights in Proceeds. Notwithstanding anything herein to

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the contrary, in the event the holder of any indebtedness secured by a mortgage or deed of trust covering the Premises requires that the insurance proceeds be applied to such indebtedness, then Landlord shall have the right to terminate this Lease by delivering written notice of termination to Tenant within fifteen (15) days after such requirement is made known to Landlord by any such holder, whereupon all rights and obligations hereunder shall cease and terminate.

D. Rent Abatement. If the Premises shall be rendered untenable or

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inaccessible as a result of a fire or other casualty, then all rent payable hereunder (including, without limitation the Tenant's Proportionate Share of Operating Expenses) shall be abated in proportion to the area of the Premises that has been rendered untenable, inaccessible or unfit for Tenant's use and occupancy for the period from the date of such damage or destruction until the earlier of the date on which Tenant reoccupies the Premises (or such portion thereof) for the normal conduct of its business.

E. Waiver of Subrogation. Notwithstanding anything to the contrary set

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forth herein, Tenant and Landlord each hereby waives on behalf of itself and their respective insurers (none of which shall ever be assigned any such claim or be entitled thereto due to subrogation or otherwise) any and all rights of recovery, claim, action, or cause of action, against the other of them or their respective agents, officers, and employees, for any loss or damage that may occur to the Premises, or any improvements thereto or the Building of which the Premises or the Project are a part, or any improvements thereto, or any personal property therein, by reason of fire, the elements, or any other cause(s) which are, or could be, insured against under the terms of a standard fire and extended coverage insurance policy issued in the state of Texas, regardless of whether such insurance is actually maintained and REGARDLESS OF THE CAUSE OR ORIGIN OF THE DAMAGE INVOLVED, INCLUDING THE SOLE JOINT OR CONCURRENT, NEGLIGENCE OF THE RELEASED PARTY OR ITS AGENTS, OFFICERS, EMPLOYEES OR BUILDING MANAGER.

F. Termination Right. In any case where the Repair Estimate does not

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give rise to Tenant's termination right as aforesaid (as well as any case where Tenant does not elect to exercise its termination right as aforesaid), Tenant shall have the right to terminate this Lease, if for any reason, Landlord's Restoration Work is not completed by the Outside Restoration Date (as defined below). Tenant may exercise the termination right described in the preceding sentence by delivering written notice thereof to Landlord at any time following the Outside Restoration Date and prior to the date Landlord completes Landlord's Restoration Work; provided however, Landlord may nullify such termination notice if Landlord completes Landlord's Restoration Work within thirty (30) days after its receipt of such notice, in which case this Lease shall continue in full force and effect. If Tenant terminates this Lease as provided in this Section 10.F, then such termination shall be effective on the date specified in Tenant's notice of termination but no later than one hundred eighty (180) days after the date of such notice as if said date were the date fixed for the expiration of the Term. Any rent paid by Tenant for a period beyond the date of termination of this Lease or for any period of abatement shall promptly be refunded by Landlord to Tenant. For purposes of this Lease, the term "Outside Restoration Date", with respect to any fire or other casualty, shall mean the date which is the day following the date of the casualty plus the repair period set forth in the Repair Estimate; provided, however, that the Outside Restoration Date shall be postponed by one day for each day that Landlord is actually delayed in completing such Landlord's Restoration Work as a result of one or more events of force majeure; provided, further, however, that (i) the Outside Restoration Date shall not be postponed by more than thirty (30) days in the aggregate as a result of events of force majeure, no matter how many days Landlord is actually delayed in completing Landlord's Restoration Work as a result of one or more events of force majeure, and (ii) Landlord shall not be deemed to have been actually delayed in completing the Landlord's Restoration Work by an event of force majeure unless, within five (5) days after such event of force majeure, Landlord shall have notified Tenant of such event of such event of force majeure and of the fact that the same is going to delay Landlord in completing the Landlord's Restoration Work.

The provisions of this Paragraph 10 shall be considered an express agreement governing any case of damage or destruction of the Building or the Premises by fire or other casualty and any law now or hereafter in force which is inconsistent with the provisions of this Paragraph 10 shall have no application.

11. LIABILITY AND INDEMNIFICATION. Except for any claims, rights of recovery and causes of action that Landlord has released, Tenant shall hold Landlord harmless from and defend Landlord against any and all claims or liability for any injury or damage (i) to any person or property whatsoever occurring in, on or about the Premises or any part thereof, the Building and/or other common

areas, the use of which Tenant may have in accordance with this Lease, if (and only if) and to the extent (and only to the extent) such injury or damage shall be caused in whole or in part by the act, neglect, fault or omission of any duty by Tenant, its agents, employees or contractors; and (ii) all costs, counsel fees, expenses and liabilities incurred in connection with any such claim or action or proceeding brought thereon. The provisions of this Paragraph 11 shall survive the expiration or termination of this Lease. Landlord shall not be liable in any event for personal injury or loss of Tenant's property caused by fire, flood, water leaks, rain, hail, ice, snow, smoke, lightning, wind, explosion, interruption of utilities or other occurrences. Landlord strongly recommends that Tenant secure Tenant's own insurance in excess of the amounts required elsewhere in this Lease to protect against the above occurrences if Tenant desires additional coverage for such risks. Tenant shall give prompt notice to Landlord of any significant accidents involving injury to persons or property. Furthermore, Landlord shall not be responsible for lost or stolen personal property, equipment, money or jewelry from the Premises or from the public areas of the Building or the Project, regardless of whether such loss occurs when the area is locked against entry. Landlord shall not be liable to Tenant or Tenant's employees, customers or invitees for any damages or losses to persons or property caused by any lessees in the Building or the Project, or for any damages or losses caused by theft or burglary. Landlord strongly recommends that Tenant provide its own security systems and services and secure Tenant's own insurance in excess of the amounts required elsewhere in this Lease to protect against the above occurrences if Tenant desires additional protection or coverage for such risks. Landlord may, but is not obligated to, enter into agreements with third parties for the provision, monitoring, maintenance and repair of any courtesy patrols or similar services or fire protective systems and equipment and, to the extent same is provided at Landlord's sole discretion, Landlord shall not be liable to Tenant for any damages, costs or expenses which occur for any reason in the event any such system or equipment is not properly installed, monitored or maintained or any such services are not properly provided. Landlord shall use reasonable diligence in the maintenance of existing lighting, if any, in the parking areas servicing the Premises, and Landlord shall not be responsible for additional lighting or any security measures in the Project, the Premises, or parking areas.

12. USE AND COMPLIANCE WITH LAWS.

A. Tenant's Use. The Premises shall be used only for the purpose of

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receiving, storing, shipping and selling (other than retail) products, materials and merchandise made and/or distributed by Tenant, for manufacturing (to the extent permitted by law) and assembly, and for such other lawful purposes as may be incidental thereto. Except as otherwise provided herein, outside storage, including without limitation storage of trucks and other vehicles, is prohibited without Landlord's prior written consent.

B. Tenant's Compliance Obligations. Subject to Paragraphs 4 and 12C

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hereof, Tenant shall comply with all governmental laws, ordinances and regulations applicable to Tenant's specific use of the Premises and shall promptly comply with all governmental orders and directives for the correction, prevention and abatement of nuisances in, upon or connected with the Premises, all at Tenant's sole expense. Tenant shall not permit any objectionable or unpleasant odors, smoke, dust, gas, noise or vibrations to emanate from the Premises, nor take any other action that would constitute a nuisance or would disturb, unreasonably interfere with or endanger Landlord or any other lessees of the Building or the Project.

C. Landlord's Compliance Obligations. Landlord shall be responsible at

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Landlord's expense for compliance with all federal, state and local laws, ordinances and regulations (including without limitation the ADA and the Texas Architectural Barriers Act) applicable to the Premises, the common areas of the Project and the exterior of the Building unless, such compliance is necessary solely as a result of Tenant's specific use of the Premises (and not as a result of Tenant's use of the Premises set forth in Paragraph 12 A above) and not merely due to the fact that Tenant is making alterations to the Premises.

13. HAZARDOUS WASTE. The term "Hazardous Substances," as used in this Lease, shall mean pollutants, contaminants, toxic or hazardous wastes, radioactive materials or any other substances, the use and/or the removal of which is required or the use of which is restricted, prohibited or penalized by any "Environmental Law," which term shall mean any federal, state or local statute, ordinance, regulation or other law of a governmental or quasi-governmental authority relating to pollution or protection of the environment or the regulation of the storage or handling of Hazardous Substances. Tenant hereby agrees that: (i) no activity will be conducted on the Premises that will produce any Hazardous Substances, except for such activities that are part of the ordinary course of Tenant's business activities (the "Permitted Activities"), provided said Permitted Activities are conducted in accordance with all Environmental Laws and have been approved in advance in writing by Landlord and, in connection therewith, Tenant shall be

responsible for obtaining any required permits or authorizations and paying any fees and providing any testing required by any governmental agency; (ii) the Premises will not be used in any manner for the storage of any Hazardous Substances, except for the temporary storage of such materials that are used in the ordinary course of Tenant's business (the "Permitted Materials"), provided such Permitted Materials are properly stored in a manner and location meeting all Environmental Laws and have been approved in advance in writing by Landlord, and, in connection therewith, Tenant shall be responsible for obtaining any required permits or authorizations and paying any fees and providing any testing required by any governmental agency; (iii) no portion of the Premises will be used as a landfill or a dump; (iv) Tenant will not install any underground tanks of any type; (v) Tenant will not cause any surface or subsurface conditions to come into existence that constitute, or with the passage of time may constitute, a public or private nuisance; and (vi) Tenant will not permit its agents or employees to bring any Hazardous Substances onto the Premises, except for the Permitted Materials, and if so brought thereon, the same shall be immediately removed, with proper disposal, and all required clean-up procedures shall be diligently undertaken by Tenant at its sole cost pursuant to all Environmental Laws. Landlord and Landlord's representatives shall have the right but not the obligation to enter the Premises upon reasonable prior notice for the purpose of inspecting the storage, use and disposal of any Permitted Materials to ensure compliance with all Environmental Laws; provided that Tenant's business operations are not unreasonably disturbed and Landlord repairs all damage resulting from such inspection. Should it be determined that any Permitted Materials are being improperly stored, used or disposed of, then Tenant shall immediately take such corrective action as is reasonable under the circumstances. If at any time during or after the term of this Lease, the Premises is found to be contaminated with Hazardous Substances which were brought onto the Premises by Tenant or Tenant's employees or agents, Tenant shall diligently institute proper and thorough clean-up procedures, at Tenant's sole cost. Tenant agrees to indemnify and hold Landlord harmless from all claims, demands, actions, liabilities, costs, expenses, damages, penalties and obligations of any nature arising from or as a result of any contamination of the Premises with Hazardous Substances brought onto the Premises by Tenant or Tenant's agents or employees. The foregoing indemnification and the responsibilities of Tenant shall survive the termination or expiration of this Lease.

Notwithstanding anything to the contrary contained in this Lease, Landlord (and not Tenant) shall be liable for, and Tenant shall not be deemed to have waived by taking possession of the Premises or otherwise, any violations of applicable laws (including applicable laws pertaining to health and the environment) or restrictive covenants or other encumbrances relating to the Project that: (i) occurred in whole or in part prior to the date hereof, including any violation continuing as of the date hereof; or (ii) result in whole or in part from the failure of the Project (as opposed any particular operation or conduct of Tenant in the Premises which may violate applicable laws or other provisions of this Lease) to comply with applicable laws or restrictive covenants or other encumbrances (excluding, however, any such failure that is caused by alterations to the Premises made by Tenant); or (iii) result in whole or in part from the presence, release or disposal of asbestos or other Hazardous Substances on or from the Project, excluding only Hazardous Substances placed on the Project by Tenant. In the event any asbestos or asbestos containing materials is found in the Premises and the same was not placed therein by Tenant or Tenant's agents or employees, Landlord shall, at Landlord's sole cost and expense, promptly cause the removal of all such asbestos and asbestos containing materials, whether or not such removal is required under applicable laws.

14. INSPECTION. Landlord's agents and representatives shall have the right to enter the Premises at any reasonable time during business hours (or at any time in case of emergency) upon reasonable prior notice (i) to inspect the Premises, (ii) to make such repairs as may be required or permitted pursuant to this Lease, and/or (iii) during the last six (6) months of the Lease Term, for the purpose of showing the Premises. In addition, during the last six (6) months of the Term Landlord shall have the right to erect a suitable sign on the Premises stating the Premises are available for lease.

#### 15. ASSIGNMENT AND SUBLETTING.

A. Tenant shall not assign, sublease, transfer or encumber this Lease or any interest therein without the prior written consent of Landlord, which consent shall not be unreasonably withheld. Any such attempted assignment in violation of the terms and covenants of this Paragraph shall, exercisable in Landlord's sole and absolute discretion, be voidable. If Tenant requests Landlord's consent to an assignment or sublease, Tenant shall submit to Landlord, in writing, the name of the proposed assignee or subtenant and the nature and character of the business of the proposed assignee or subtenant, the term, use, rental rate and all other material terms and conditions of the proposed assignment or sublease. Landlord shall within twenty (20) days after Landlord's receipt of such written request and information either consent to or refuse to consent to such assignment or sublease in writing (but no such consent to an assignment or sublease shall relieve Tenant of its obligations under this

Lease of any liability hereunder). If Landlord should fail to notify Tenant in writing of its decision within such twenty (20) day period, Landlord shall be deemed to have consented to such assignment or sublease.

B. In addition to the rent hereunder, Tenant hereby covenants and agrees to pay to Landlord fifty percent (50%) of any Net Profits (as hereinafter defined) which it receives which is in excess of the rent (including Base Rent, Operating Expenses and parking rent) payable hereunder within ten (10) days following receipt thereof by Tenant. The term "Net Profits" as used herein shall mean such portion of the rent payable by an assignee or subtenant under the applicable assignment or sublease in excess of the rent payable by Tenant under this Lease (or pro rata portion thereof in the event of a subletting) for the corresponding period, after deducting from such excess rent the following: (i) all of Tenant's reasonable costs associated with such assignment or subletting, including, without limitation, broker commissions, architectural fees, engineers' fees and attorney fees; (ii) any reasonable costs incurred by Tenant to prepare or alter the Premises, or portion thereof, for the assignee or sublessee; (iii) any design, construction or moving allowances, rental concessions or other out-of-pocket concession or costs incurred by Tenant. The provisions of this subparagraph B shall not apply to a Permitted Transfer, as hereinafter defined. Notwithstanding the foregoing, during the occurrence of an Event of Default under Paragraph 19A, Landlord shall be entitled to receive and Tenant shall pay to Landlord all rent payable by an assignee or subtenant, without deduction for any costs or expenses incurred by Tenant.

C. If at any time during the Lease Term the person or persons who own the voting shares of Tenant at the time of the execution of this Lease cease for any reason, including but not limited to merger, consolidation or other reorganization involving another corporation, to own a majority of such shares (except as the result of transfers by gift, bequest or inheritance to or for the benefit of members of the immediate family of such original shareholder(s)), such an event shall be deemed to be an assignment. The preceding sentence shall not apply whenever Tenant is a corporation, the outstanding stock of which is listed on a recognized security exchange, or if at least eighty percent (80%) of its voting stock is owned by another corporation, the voting stock of which is so listed.

D. Notwithstanding anything herein to the contrary, Tenant may assign its entire interest under this Lease or sublet the Premises to a wholly-owned corporate or controlled subsidiary or parent of Tenant or to any successor to Tenant by purchase, merger, consolidation or reorganization (hereinafter collectively referred to "Corporate Transfer") without the consent of Landlord provided: (i) Tenant is not in default under this Lease beyond any applicable cure period; (ii) if such proposed transferee is a successor to Tenant by purchase, said proposed transferee shall acquire all or substantially all of the stock or assets of Tenant's business or, if such proposed transferee shall acquire all or substantially all of the stock or assets of Tenant's business or, if such proposed transferee is a successor to Tenant by merger, consolidation or reorganization, the continuing or surviving corporation shall own all or substantially all of the assets of Tenant; (iii) in no event shall any transfer, release or relief of Tenant from any of its obligations under this Lease, unless Tenant ceases to exist as a result of the Corporate Transfer; and (iv) such transferee assumes in writing Tenant's obligations under this Lease or such transferee assumes Tenant's obligations under this Lease by operation of law. Tenant shall give Landlord written notice at least twenty (20) days prior to the effective date of such Corporate Transfer. As used herein, the terms "control" or "subsidiary" shall mean a corporate entity wholly-owned by Tenant or at least 51 percent of its voting stock is owned by Tenant. A transfer pursuant to the provisions of this Paragraph 15D shall sometimes be referred to herein as a "Permitted Transfer".

16. CONDEMNATION. If any portion of the Premises is taken for any public or quasi-public use under governmental law, ordinance or regulation, or by right of eminent domain or private purchase in lieu thereof, and the taking prevents or materially interferes with the use of the remainder of the Premises for the purpose for which they were leased to Tenant or, in Tenant's reasonable opinion, the remaining portion of the Premises is not suitable for Tenant's use, then Tenant shall have the right to terminate this Lease by delivering written notice of termination to Landlord within thirty (30) days of the taking, and the rent shall be abated during the unexpired portion of this Lease, effective on the date of such taking. In the event Tenant does not elect to terminate this Lease, the rent payable hereunder during the unexpired portion of this Lease shall be reduced to such extent as may be fair and reasonable under all of the circumstances. All compensation awarded in connection with or as a result of any of the foregoing proceedings shall be the property of Landlord, and Tenant hereby assigns any interest in any such award to Landlord; provided, however, Landlord shall have no interest in any award made to Tenant for loss of business or goodwill or for the taking of Tenant's trade fixtures and personal property, if a separate award for such items is made to Tenant.

17. HOLDING OVER. At the termination of this Lease by its expiration or otherwise, Tenant shall immediately deliver possession of the Premises to Landlord with all repairs and maintenance required herein to be performed by Tenant completed. If, for any reason, Tenant retains possession of the Premises after the expiration or termination of this Lease, unless the parties hereto otherwise agree in writing, such possession shall be deemed to be a tenancy at will only, and all of the other terms and provisions of this Lease shall be applicable during such period, except that Tenant shall pay Landlord from time to time, upon demand, as rental for the period of such possession, an amount equal to one and one-half (1 1/2) times the Base Rent in effect on the date of such termination of this Lease, computed on a daily basis for each day of such period. No holding over by Tenant, whether with or without consent of Landlord, shall operate to extend this Lease except as otherwise expressly provided. The preceding provisions of this Paragraph 17 shall not be construed as consent for Tenant to retain possession of the Premises in the absence of written consent thereto by Landlord.

18. QUIET ENJOYMENT. Landlord represents that it has the authority to enter into this Lease and that, so long as Tenant pays all amounts due hereunder and performs all other covenants and agreements herein set forth, Tenant shall peaceably and quietly have, hold and enjoy the Premises for the term hereof without hindrance or molestation from Landlord, subject to the terms and provisions of this Lease.

19. EVENTS OF DEFAULT. The following events (herein individually referred to as an "Event of Default") each shall be deemed to be a default in or breach of Tenant's obligations under this Lease:

A. Tenant shall fail to pay any installment of the rent herein reserved when due, or any other payment or reimbursement to Landlord required herein when due, and such failure shall continue for a period of five (5) days from the date Tenant receives written notice that such payment was not made when due; provided however, that Landlord shall not be required to provide such written notice to Tenant more than two (2) times in any calendar year.

B. Tenant shall fail to discharge any lien placed upon the Premises in violation of Paragraph 22 hereof within twenty (20) days after Tenant's receipt of notice of any such lien or encumbrance being filed against the Premises.

C. Tenant shall fail to comply with any term, provision or covenant of this Lease (other than those listed above in this paragraph) and shall not cure such failure within thirty (30) days after written notice thereof from Landlord, (except that if compliance cannot reasonably be achieved within the thirty (30) day period, there shall be no event of default so long as Tenant commences the cure within the thirty (30) day period and diligently and continuously pursues actions intended to bring about compliance and brings about such compliance within sixty (60) days after the expiration of the initial thirty (30) day period).

20. REMEDIES. Upon each occurrence of an Event of Default, Landlord shall have the option to pursue any one or more of the following remedies without any notice or demand:

(a) Terminate this Lease;

(b) Enter upon and take possession of the Premises without terminating this Lease;

(c) Make such payments and/or take such action and pay and/or perform whatever Tenant is obligated to pay or perform under the terms of this Lease; and/or

(d) Alter all locks and other security devices at the Premises, with or without terminating this Lease, and pursue, at Landlord's option, one or more remedies pursuant to this Lease, and Tenant hereby expressly agrees that Landlord shall not be required to provide to Tenant the new key to the Premises, regardless of hour, including Tenant's regular business hours;

and in any such event Tenant shall immediately vacate the Premises, and if Tenant fails to do so, Landlord, without waiving any other remedy it may have, may enter upon and take possession of the Premises and expel or remove Tenant and any other person who may be occupying such Premises or any part thereof, without being liable for prosecution or any claim of damages therefore. The provisions of this Lease are intended to supersede Section 93.002 of the Texas Property Code and Tenant hereby expressly waives any and all rights and remedies Tenant may have under Paragraph (g) of such Section 93.002. Notwithstanding anything to the contrary contained in this Lease, in no event shall Tenant be liable for special or consequential damages as a result of a breach of or default under this Lease.

A. Damages Upon Termination. If Landlord terminates this Lease at  
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Landlord's option, Tenant shall be liable for and shall pay to Landlord the sum of all rental and other payments owed to Landlord hereunder accrued to the date of such termination, plus, as liquidated damages, an amount equal to the positive difference, if any, of (i) the present value calculated at an interest rate of ten percent (10%) of the total rental and other payments owed hereunder for the remaining portion of the Lease term, calculated as if such term expired on the date set forth in Paragraph 1, less (ii) the present value calculated at an interest rate of ten percent (10%) of the then fair market rental for the Premises for such period.

B. Damages Upon Repossession. If Landlord repossesses the Premises

without terminating this Lease, Tenant, at Landlord's option, shall be liable for and shall pay Landlord on demand all rental and other payments owed to Landlord hereunder, accrued to the date of such repossession, plus all amounts required to be paid by Tenant to Landlord until the date of expiration of the term as stated in Paragraph 1, diminished by all amounts actually received by Landlord through reletting the Premises during such remaining term (but only to the extent of the rent herein reserved). Actions to collect amounts due by Tenant to Landlord under this paragraph may be brought from time to time, on one or more occasions, without the necessity of Landlord's waiting until expiration of the Lease term.

C. Costs of Reletting, Removing, Repairs and Enforcement. Upon an

Event of Default, in addition to any sum provided to be paid under this Paragraph 20, Tenant also shall be liable for and shall pay to Landlord (i) brokers' fees and all other costs and expenses incurred by Landlord in connection with reletting the whole or any part of the Premises to the extent the same are not reimbursed under a new lease covering the Premises; (ii) the costs of removing, storing or disposing of Tenant's or any other occupant's property; (iii) the costs of repairing, altering, remodeling or otherwise putting the Premises into condition acceptable to a new tenant or tenants to the extent the same are not reimbursed under a new lease covering the Premises; (iv) any and all costs and expenses incurred by Landlord in effecting compliance with Tenant's obligations under this Lease; and (v) all reasonable expenses incurred by Landlord in enforcing or defending Landlord's rights and/or remedies hereunder, including without limitation all reasonable attorneys' fees and all court costs incurred in connection with such enforcement or defense.

D. Late Charge. In the event Tenant fails to make any payment due

hereunder within five (5) days after such payment is due, including without limitation any rental or escrow payment, in order to help defray the additional cost to Landlord for processing such late payments and not as interest, Tenant shall pay to Landlord on demand a late charge in an amount equal to five percent (5%) of such payment. The provision for such late charge shall be in addition to all of Landlord's other rights and remedies hereunder or at law, and shall not be construed as liquidated damages or as limiting Landlord's remedies in any manner. Notwithstanding the foregoing, Tenant shall not be required to pay a late charge on the first two (2) late payments in any calendar year provided that such payments are made within ten (10) days after receipt of notice that the same were not paid when due.

E. Interest on Past Due Amounts. If Tenant fails to pay any sum which

at any time becomes due to Landlord under any provision of this Lease as and when the same becomes due hereunder, and such failure continues for thirty (30) days after the due date for such payment, then Tenant shall pay to Landlord interest on such overdue amounts from the date due until paid at an annual rate which equals the lesser of (i) eighteen percent (18%) or (ii) the highest rate then permitted by law.

F. No Implied Acceptances or Waivers. Exercise by Landlord of any one or

more remedies hereunder granted or otherwise available shall not be deemed to be an acceptance by Landlord of Tenant's surrender of the Premises, it being understood that such surrender can be effected only by the written agreement of Landlord. Tenant and Landlord further agree that forbearance by Landlord or Tenant to enforce any of its rights under this Lease or at law or in equity shall not be a waiver of such party's right to enforce any one or more of its rights, including any right previously forborne, in connection with any existing or subsequent default. No re-entry or taking possession of the Premises by Landlord shall be construed as an election on its part to terminate this Lease, unless a written notice of such intention is given to Tenant, and, notwithstanding any such reletting or re-entry or taking possession of the Premises, Landlord may at any time thereafter elect to terminate this Lease for a previous default. Pursuit of any remedies

hereunder shall not preclude the pursuit of any other remedy herein provided or any other remedies provided by law, nor shall pursuit of any remedy herein provided constitute a forfeiture or waiver of any rent due to Landlord hereunder or of any damages occurring to Landlord by reason of the violation of any of the terms, provisions and covenants contained in this Lease. Landlord's acceptance of any rent following an Event of Default hereunder shall not be construed as Landlord's waiver of such Event of Default and Tenant's payment of rent after a Landlord default shall not be construed as a waiver of such default. No waiver by Landlord or Tenant of any violation or breach of any of the terms, provisions and covenants of this Lease shall be deemed or construed to constitute a waiver of any other violation or default.

G. Reletting of Premises. In the event of any termination of this Lease

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and/or repossession of the Premises for an Event of Default, Landlord shall use reasonable efforts to relet the Premises and to collect rental after reletting, with no obligation to accept any lessee that Landlord deems undesirable or to expend any funds in connection with such reletting other than customary expenses incurred in connection with new leases or collection of rents therefrom. Tenant shall not be entitled to credit for or reimbursement of any proceeds of such reletting in excess of the rental owed hereunder for the period of such reletting. Landlord may relet the whole or any portion of the Premises, for any period, to any tenant and for any use or purpose.

H. Landlord's Default. If Landlord fails to perform any of its

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obligations hereunder within thirty (30) days after written notice from Tenant specifying such failure except as otherwise provided herein, Tenant's exclusive remedy shall be an action for damages. Unless and until Landlord fails to so cure any default after such notice, Tenant shall not have any remedy or cause of action by reason thereof. All obligations of Landlord hereunder will be construed as covenants, not conditions; and all such obligations will be binding upon Landlord only during the period of its ownership of the Premises and not thereafter; provided that the subsequent owner of the Premises assumes in writing Landlord's obligations accruing hereunder accruing after the date of such transfer. The term "Landlord" shall mean only the owner, for the time being, of the Premises and, in the event of the transfer by such owner of its interest in the Premises, such owner shall thereupon be released and discharged from all covenants and obligations of the Landlord thereafter accruing, provided that such covenants and obligations shall be binding during the Lease term upon each new owner for the duration of such owner's ownership. Notwithstanding any other provision of this Lease, Landlord shall not have any personal liability hereunder. In the event of any breach or default by Landlord in any term or provision of this Lease, Tenant agrees to look solely to the equity or interest then owned by Landlord in the Project; however, in no event shall any deficiency judgment or any money judgment of any kind be sought or obtained against any Landlord.

I. Tenant's Personal Property. If Landlord repossesses the Premises

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pursuant to the authority herein granted, or if Tenant vacates or abandons all or any part of the Premises, then, in addition to Landlord's rights under Paragraph 27 hereof, Landlord shall have the right to (i) keep in place and use, or (ii) remove and store, all of the furniture, fixtures and equipment at the Premises, including that which is owned by or leased to Tenant, at all times prior to any repossession thereof by any lessor thereof or third party having a lien thereon. In addition to the Landlord's other rights hereunder, Landlord may dispose of the stored property if Tenant does not claim the property within ten (10) days after the date the property is stored. Landlord shall give Tenant at least ten (10) days prior written notice of such intended disposition. Landlord shall also have the right to relinquish possession of all or any portion of such furniture, fixtures, equipment and other property to any person ("Claimant") who presents to Landlord a copy of any instrument represented by Claimant to have been executed by Tenant (or any predecessor of Tenant) granting Claimant the right under various circumstances to take possession of such furniture, fixtures, equipment or other property, without the necessity on the part of Landlord to inquire into the authenticity or legality of said instrument. The rights of Landlord herein stated shall be in addition to any and all other rights that Landlord has or may hereafter have at law or in equity, and Tenant stipulates and agrees that the rights granted Landlord under this paragraph are commercially reasonable.

J. Landlord's Termination Right. In the event Tenant vacates all or

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substantially all of the Premises for any period of one hundred twenty (120) or more consecutive days (other than a vacancy due to a casualty, condemnation, or a vacancy for which Tenant is expressly entitled to abatement of Rent under this Lease), Tenant shall not be in default hereunder; provided however, Landlord shall have the right, but not the obligation, to terminate this Lease by delivering written notice of termination to Tenant prior to the date that Tenant re-occupies all or substantially all of the Premises and upon such termination, Tenant shall have no further obligation hereunder (except for any obligation

that expressly survives termination of this Lease).

21. MORTGAGES. Tenant accepts this Lease subject and subordinate to any mortgages and/or deeds of trust now or at any time hereafter constituting a lien or charge upon the Premises or the improvements situated thereon or the Building, provided that the foregoing subordination in respect to any mortgage or deed of trust placed on the Project after the date hereof shall not become effective until and unless the holder of such mortgage or deed of trust delivers to Tenant a non-disturbance agreement permitting Tenant, if Tenant is not then in default under this Lease after the expiration of all applicable notice and cure periods, to remain in occupancy of the Premises in accordance with the terms of this Lease in the event of a foreclosure of any such mortgage or deed of trust; and further provided, however, that if the mortgagee, trustee or holder of any such mortgage or deed of trust elects to have Tenant's interest in this Lease superior to any such instrument, then by notice to Tenant from such mortgagee, trustee or holder, this Lease shall be deemed superior to such lien, whether this Lease was executed before or after said mortgage or deed of trust. Tenant, at any time hereafter within fifteen (15) days after receipt of a request therefor, shall execute a commercially reasonable instrument or other document that may be reasonably requested by any mortgagee, trustee or holder for the purpose of evidencing the foregoing subordination. Tenant shall not terminate this Lease or pursue any other remedy available to Tenant hereunder for any default on the part of Landlord without first giving written notice by certified or registered mail, return receipt requested, to any mortgagee, trustee or holder of any such mortgage or deed of trust, the name and post office address of which Tenant has received written notice, specifying the default in reasonable detail and affording such mortgagee, trustee or holder a reasonable opportunity (but in no event less than thirty (30) days) to make performance, at its election, for and on behalf of Landlord. Landlord represents that the current holder of a mortgage on the Building is Nationwide Life Insurance Company and Landlord shall deliver a subordination, non-disturbance and attornment agreement from the current mortgage holder in the form of Exhibit "B" attached hereto prior to the Commencement Date. In the event Landlord fails to deliver such subordination, non-disturbance and attornment agreement prior to the Commencement Date, Tenant shall be entitled to terminate this Lease by delivering written notice of such termination to Landlord prior to Landlord's delivery of the same to Tenant.

22. MECHANIC'S LIENS. Tenant has no authority, express or implied, to create or place any lien or encumbrance of any kind or nature whatsoever upon, or in any manner to bind, the interest of Landlord or Tenant in the Premises. Tenant will save and hold Landlord harmless from any and all loss, cost or expense, including without limitation attorneys' fees, based on or arising out of asserted claims or liens against the leasehold estate or against the right, title and interest of the Landlord in the Premises or under the terms of this Lease.

23. MISCELLANEOUS.

A. Interpretation. The captions inserted in this Lease are for  
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convenience only and in no way define, limit or otherwise describe the scope or intent of this Lease, or any provision hereof, or in any way affect the interpretation of this Lease. Any reference in this Lease to rentable area shall mean the gross rentable area as determined by the roofline of the building in question.

B. Binding Effect. Except as otherwise herein expressly provided, the  
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terms, provisions and covenants and conditions in this Lease shall apply to, inure to the benefit of and be binding upon the parties hereto and upon their respective heirs, executors, personal representatives, legal representatives, successors and assigns. Landlord shall have the right to transfer and assign, in whole or in part, its rights and obligations in the Premises and in the Building and other property that are the subject of this Lease.

C. Evidence of Authority. Tenant agrees to furnish to Landlord, promptly  
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upon demand, a corporate resolution, proof of due authorization by partners or other appropriate documentation evidencing the due authorization of such party to enter into this Lease.

D. Force Majeure. Neither Landlord nor Tenant shall be held responsible  
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for delays in the performance of its obligations hereunder (other than the payment of any sum due hereunder) when caused by material shortages, acts of God, labor disputes or other events beyond the control of such party.

E. Payments Constitute Rent. Notwithstanding anything in this Lease to  
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the contrary, all amounts payable by Tenant to or on behalf of Landlord under this Lease, whether or not expressly denominated as rent, shall constitute rent.

F. Estoppel Certificates. Tenant agrees, from time to time, within  
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fifteen (15) days after request of Landlord, to deliver to Landlord, or



Landlord's designee, an estoppel certificate stating that this Lease is in full force and effect, the date to which rent has been paid, the unexpired term of this Lease, any defaults existing under this Lease (or the absence thereof) and such other factual

matters pertaining to this Lease as may be reasonably requested by Landlord. It is understood and agreed that Tenant's obligation to furnish such estoppel certificates in a timely fashion is a material inducement for Landlord's execution of this Lease.

G. Entire Agreement. This Lease constitutes the entire understanding and

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agreement of Landlord and Tenant with respect to the subject matter of this Lease, and contains all of the covenants and agreements of Landlord and Tenant with respect thereto. Landlord and Tenant each acknowledge that no representations, inducements, promises or agreements, oral or written, have been made by Landlord or Tenant, or anyone acting on behalf of Landlord or Tenant, which are not contained herein, and any prior agreements, promises, negotiations or representations not expressly set forth in this Lease are of no force or effect. EXCEPT AS SPECIFICALLY PROVIDED IN THIS LEASE, TENANT HEREBY WAIVES THE BENEFIT OF ALL WARRANTIES, EXPRESS OR IMPLIED, WITH RESPECT TO THE PREMISES, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTY THAT THE PREMISES ARE SUITABLE FOR ANY PARTICULAR PURPOSE. Landlord's agents and employees do not and will not have authority to make exceptions, changes or amendments to this Lease, or factual representations not expressly contained in this Lease. Under no circumstances shall Landlord or Tenant be considered an agent of the other. This Lease may not be altered, changed or amended except by an instrument in writing signed by both parties hereto.

H. Survival of Obligations. All obligations of Landlord and Tenant

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hereunder not fully performed as of the expiration or earlier termination of the term of this Lease shall survive the expiration or earlier termination of the term hereof, including without limitation all payment obligations with respect to taxes and insurance and all obligations concerning the condition and repair of the Premises. Upon the expiration or earlier termination of the term hereof, and prior to Tenant vacating the Premises, Tenant shall pay to Landlord any amount reasonably agreed by Landlord and Tenant as necessary to put the Premises in good condition and repair, reasonable wear and tear excluded, including without limitation the cost of repairs to and replacements of all heating and air conditioning systems and equipment therein, if the same is required. Tenant shall also, prior to vacating the Premises, pay to Landlord the amount, as reasonably estimated by Landlord, of Tenant's obligations hereunder for real estate taxes and insurance premiums for the year in which the Lease expires or terminates. All such amounts shall be used and held by Landlord for payment of such obligations of Tenant hereunder, with tenant being liable for any additional costs therefore upon demand by Landlord, or with any excess to be returned to Tenant after all such obligations have been determined and satisfied, as the case may be. Any Security Deposit held by Landlord may, at Landlord's option, be credited against any amounts due from Tenant under this Paragraph 23.H.

I. Severability of Terms. If any clause or provision of this Lease is

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illegal, invalid or unenforceable under present or future laws effective during the term of this Lease, then, in such event, it is the intention of the parties hereto that the remainder of this Lease shall not be affected thereby, and it is also the intention of the parties to this Lease that in lieu of each clause or provision of this Lease that is illegal, invalid or unenforceable, there be added, as a part of this Lease, a clause or provision as similar in terms to such illegal, invalid or unenforceable clause or provision as may be possible and be legal, valid and enforceable.

J. Effective Date. All references in this Lease to "the date hereof" or

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similar references shall be deemed to refer to the last date, in point of time, on which all parties hereto have executed this Lease.

K. Brokers' Commission. Tenant represents and warrants that it has dealt

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with and will deal with no broker other than Hill Partners (represented by Chris Whitworth), agent or other person in connection with this transaction or future related transactions and that no other broker, agent or other person brought about this transaction, and Tenant agrees to indemnify and hold Landlord harmless from and against any claims by any other broker, agent or other person claiming a commission or other form of compensation by virtue of having dealt with Tenant with regard to this leasing transaction. Landlord agrees to pay the commissions of Hill Partners due in connection with this Lease pursuant to a separate written agreement with Hill Partners.

L. Ambiguity. Landlord and Tenant hereby agree and acknowledge that this

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Lease has been fully reviewed and negotiated by both Landlord and Tenant, and that Landlord and Tenant have each had the opportunity to have this Lease reviewed by their respective legal counsel, and, accordingly, in the event of any ambiguity herein, Tenant does hereby waive the rule of construction that

such ambiguity shall be resolved against the party who prepared this Lease.

M. Joint Several Liability. If there be more than one Tenant, the

obligations hereunder imposed upon Tenant shall be joint and several. If there be a guarantor of Tenant's obligations hereunder, the obligations hereunder imposed upon Tenant shall be joint and several obligations of Tenant and such guarantor, and Landlord need not first proceed against Tenant before proceeding against such guarantor, nor shall any such guarantor be released from its guaranty for any reason whatsoever, including, without limitation, in case of any amendments hereto, waivers hereof or failure to give such guarantor any notices hereunder.

N. Third Party Rights. Nothing herein expressed or implied is intended,

or shall be construed, to confer upon or give to any person or entity, other than the parties hereto, any right or remedy under or by reason of this Lease.

O. Exhibits and Attachments. All exhibits, attachments, riders and

addenda referred to in this Lease, and the exhibits listed herein below and attached hereto, are incorporated into this Lease and made a part hereof for all intents and purposes as if fully set out herein. All capitalized terms used in such documents shall, unless otherwise defined therein, have the same meanings as are set forth herein.

P. Applicable Law. This Lease has been executed in the State of Texas

and shall be governed in all respects by the laws of the State of Texas. It is the intent of Landlord and Tenant to conform strictly to all applicable state and federal usury laws. All agreements between Landlord and Tenant, whether now existing or hereafter arising and whether written or oral, are hereby expressly limited so that in no contingency or event whatsoever shall the amount contracted for, charged or received by Landlord for the use, forbearance or retention of money hereunder or otherwise exceed the maximum amount which Landlord is legally entitled to contract for, charge or collect under the applicable state or federal law. If, from any circumstance whatsoever, fulfillment of any provision hereof at the time performance of such provision shall be due shall involve transcending the limit of validity prescribed by law, then the obligation to be fulfilled shall be automatically reduced to the limit of such validity, and if from any such circumstance Landlord shall ever receive as interest or otherwise an amount in excess of the maximum that can be legally collected, then such amount which would be excessive interest shall be applied to the reduction of rent hereunder, and if such amount which would be excessive interest exceeds such rent, then such additional amount shall be refunded to Tenant.

24. NOTICES. Each provision of this instrument or of any applicable governmental laws, ordinances, regulations and other requirements with reference to the sending, mailing or delivering of notice or the making of any payment by Landlord to Tenant or with reference to the sending, mailing or delivering of any notice or the making of any payment by Tenant to Landlord shall be deemed to be complied with when and if the following steps are taken:

(i) All rent and other payments required to be made by Tenant to Landlord hereunder shall be payable to Landlord at the address for Landlord set forth below or at such other address as Landlord may specify from time to time by written notice delivered in accordance herewith.

(ii) All payments required to be made by Landlord to Tenant hereunder shall be payable to Tenant at the address set forth below, or at such other address within the continental United States as Tenant may specify from time to time by written notice delivered in accordance herewith.

(iii) Except as expressly provided herein, any written notice, document or payment required or permitted to be delivered hereunder shall be deemed to be delivered when received or, whether actually received or not, upon first attempted delivery on a business day, when sent by United States Mail, postage prepaid, Certified or Registered Mail, addressed to the parties hereto at the respective addresses set out below, or at such other address as they have theretofore specified by written notice delivered in accordance herewith.

25. ADDITIONAL PROVISIONS. See EXHIBIT "C" attached hereto and incorporated herein by reference.

27. LANDLORD'S LIEN. Landlord hereby waives all statutory and contractual liens to which it may be entitled on Tenant's property located in or about the Premises.

EXECUTED BY LANDLORD as of the 27/th/ day of September, 2000.

<TABLE>

BC12 99, Ltd. a Texas limited partnership

By: ORI, Inc., a Texas corporation, General Partner

Attest/Witness

By: \_\_\_\_\_

Title: \_\_\_\_\_

Title: \_\_\_\_\_

Address: c/o Trammell Crow Central Texas, Inc.

301 Congress Avenue, Suite 1300, Austin, TX 78701

</TABLE>

EXECUTED BY TENANT as of the 27/th/ day of September, 2000.

<TABLE>

Active Power, Inc., a Delaware corporation

Attest/Witness

By: Dave Gino

Title: Vice President/Chief Financial Officer

Title: \_\_\_\_\_

Address: 11525 Stonehollow Drive, Suite 135

Austin, Texas 78758

Phone: 512-491-3134

</TABLE>

EXHIBIT "A"	Description of Premises
EXHIBIT "A-1"	Legal Description
EXHIBIT "A-2"	Initial Premises
EXHIBIT "A-3"	First Additional Premises
EXHIBIT "A-4"	Second Additional Premises
EXHIBIT "A-5"	Site Plan of Project
EXHIBIT "A-6"	Adjacent Parking Facility
EXHIBIT "A-7"	Approved Location of Load Bank Yard
EXHIBIT "B"	Form Subordination, Non-Disturbance and Attornment Agreement
EXHIBIT "C"	Additional Provisions
EXHIBIT "D"	Sign Criteria

EXHIBIT "A"  
FLOOR PLAN OF THE PREMISES

EXHIBIT "A-1"

LEGAL DESCRIPTION

Lot 5, Block C, Kramer Lane 65, Section 2, a subdivision in Travis County, Texas, according to the map or plat thereof recorded in Volume 81, Page 323, 324 and 325 of Plat Records of Travis County, Texas.

EXHIBIT "A-2"

FLOOR PLAN FOR INITIAL PREMISES

2

EXHIBIT "A-3"

FLOOR PLAN FOR FIRST ADDITIONAL PREMISES

1



EXHIBIT "A-4"

FLOOR PLAN OF SECOND ADDITIONAL PREMISES

EXHIBIT "A-5"  
SITE PLAN OF PROJECT

EXHIBIT "A-6"  
ADJACENT PARKING FACILITY

EXHIBIT "A-7"

APPROVED LOCATION OF LOAD BANK YARD

1

EXHIBIT "B"

FORM OF SUBORDINATION, NON-DISTURBANCE  
AND ATTORNMEN AGREEMENT

NON-DISTURBANCE AND ATTORNMEN AGREEMENT  
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Premises: 126,750 square feet of space located at 2128 Braker Lane, Austin, Texas 78758

Lease Date: September 27, 2000, by and between BC12 99, Ltd., a Texas limited partnership ("Landlord") and Active Power, Inc., a Delaware corporation ("Tenant").

This Agreement is made by and between Tenant, Landlord and Nationwide Life Insurance Company, One Nationwide Plaza, Columbus, Ohio 43216, Attention: Real Estate Investments, 01-34-02, ("Lender"), the holder or proposed holder of a note or other obligation secured, or to be secured, by a mortgage/deed of trust ("Mortgage") upon the Premises and assignee, or proposed assignee of the Lease under an assignment of leases, rents and profits ("Lease Assignment").

1. Tenant hereby agrees as follows:

a. The Lease and the rights of Tenant thereunder are, and shall be, subject and subordinate to the lien of the Mortgage and to all of the terms, conditions and provisions thereof, to all advances made or to be made thereunder, to the full extent of the principal sum and interest thereon from time to time secured thereby, and to an renewal, substitution, extension, modification or replacement thereof, including any increase in the indebtedness secured thereby or any supplements thereto.

b. Tenant will not pay any rent under the Lease more than one (1) month in advance of its due date.

c. Tenant will not consent to the modification of any of the terms of the Lease, or to the termination thereof by Landlord, without written approval of Lender, which approval shall not be unreasonably withheld or delayed.

d. Tenant will not seek to terminate the Lease or to setoff or abate any rent under the Lease by reason of any act or omission of Landlord, until Tenant has given prompt written notice of such act or omission to Lender (at the last address furnished to Tenant) and until Lender has received such notice and has been given the opportunity, but without undertaking Landlord's obligations, to cure the default within a sixty (60) day time period. In the event Lender has begun action to cure the default, but has not completed the same during the sixty (60) day period, Tenant agrees that Lender shall have a reasonable period of time thereafter to so do. If the default is such that it cannot practically be cured by Lender without taking possession of the Premises, Tenant agrees that any right it may have to terminate the Lease or to setoff or abate any rent under the Lease shall be suspended for a reasonable period of time so long as Lender is diligently proceeding to acquire possession of the Premises, by foreclosure or otherwise in order to cure said default.

e. Tenant will attorn to and recognize Lender or any purchaser at a foreclosure sale under the Mortgage, any transferee who acquires the Premises by deed in lieu of foreclosure, and the successors and assigns of such purchaser(s) as its landlord for the unexpired balance (and any extensions, if exercised) of the term of the Lease upon the same terms and conditions set forth in the Lease. Tenant further agrees that Lender or such purchaser shall not be: (i) liable for any act or omission of any prior landlord (including Landlord); (ii) liable for the return of any security deposit not actually received by Lender or such purchaser; (iii) subject to any offsets or defenses which Tenant might have against any prior landlord (including Landlord); (iv) bound by an advance payment of rent or additional rent made by Tenant to Landlord, except for rent or additional rent applicable to the then current month, or (v) bound by any amendment or modification of the Lease made without the written consent of Lender, which consent shall not be unreasonably withheld or delayed.

f. Upon receipt of notice from Lender, Tenant shall pay all monies then due or becoming due from Tenant under the Lease, to or at the direction of Lender, notwithstanding any provision of the Lease to the contrary. Tenant agrees that neither Lender's demanding or receiving any such payments, nor Lender's exercising any other right, remedy, privilege, power or immunity granted by the Mortgage or the Lease Assignment, will operate to impose any liability upon Lender for performance of any obligation of Landlord under the Lease unless and until Lender elects otherwise in writing. Such payments shall continue until Lender directs Tenant otherwise in writing.

g. Tenant agrees that, notwithstanding any provision in the Lease to

the contrary, all insurance proceeds payable with respect to any casualty loss at the Premises or the real property of which the Premises are a part and any and all awards or other compensation that may be payable for the condemnation of all or any portion of the Premises or the real property of which the Premises are a part, may be applied by Lender, at its option and to the extent set forth in the Mortgage or the Lease Assignment, to the indebtedness secured by the Mortgage.

2. Lender agrees that, provided Tenant is not in default under the terms of the Lease beyond any applicable notice or grace periods, Tenant's right of possession to the Premises shall not be affected or disturbed by Lender in the exercise of any of its rights under the Mortgage or the note secured thereby, the leasehold estate granted by the Lease be not be affected in any manner and the rights of Tenant granted under the Lease shall not be affected in any manner.

3. The agreements herein contained shall be binding upon and shall inure to the benefit of the parties hereto, their respective participants, successors and permitted assigns.

4. If Lender shall (a) advise Tenant that Landlord is in default under the Mortgage, and (b) direct Tenant to pay directly to Lender all monies then due or becoming due from Tenant under the Lease, then the Landlord hereby authorizes Tenant to pay directly to Lender all monies then due and thereafter coming due under the Lease, without any further authorization by Landlord and notwithstanding any protest by Landlord; and Landlord hereby agrees that any sums paid by Tenant to Lender pursuant to the provisions of this Paragraph 4 shall be deemed to have been paid by Tenant to Landlord under the Lease, and Tenant shall have no liability to Landlord whatsoever for any sums so paid by Tenant directly to Lender, whether or not Landlord protests the same.



STATE OF TEXAS            )  
                                  )  
COUNTY OF TRAVIS        )

The foregoing instrument was acknowledged before me this \_\_\_\_\_ day of \_\_\_\_\_, 2000 by \_\_\_\_\_, the \_\_\_\_\_ of ORI, Inc., a Texas corporation, as general partner of BC 12 99, Ltd., a Texas limited partnership, on behalf of said limited partnership.

[NOTARIAL SEAL]

\_\_\_\_\_  
Notary Public

My commission expires:  
\_\_\_\_\_



EXHIBIT "C"

ADDITIONAL PROVISIONS

TENANT FINISH ALLOWANCE

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(a) Tenant, at its sole cost and expense (subject to payment with the Finish Allowance (hereinafter defined)), shall submit to Landlord (i) architectural and engineering drawings of the work to be performed by Tenant in the Premises (the "Tenant's Work") and specifications for Tenant's Work (such architectural and engineering drawings and specifications are herein collectively referred to as the "Tenant's Plans"). Within ten (10) days after receipt by Landlord of Tenant's Plans, Landlord (i) shall give its written approval thereto or (ii) if Landlord reasonably believes that the work reflected on the Tenant's Plans does not comply with the Approval Criteria (hereinafter defined), shall request revisions or modifications to the Tenant's Plans (but only to the extent the same fails to comply with the Approval Criteria). Tenant shall submit such revisions or modifications to Landlord. Within five (5) days following receipt by Landlord of such revisions or modifications, Landlord shall give its written approval thereto or shall request other revisions or modifications therein (but relating only to the extent Tenant has failed to comply with Landlord's earlier requests). The preceding two sentences shall be implemented repeatedly until Landlord gives its written approval to the Tenant's Plans. If Landlord shall fail to respond to Tenant's Plans with its approval or request for revision s/modification within the time period(s) provided above, such failure shall be deemed Landlord's approval of Tenant's Plans. The Tenant's Plans as approved (or deemed approved) by Landlord shall herein be referred to as the "Final Tenant's Plans". Notwithstanding anything to the contrary set forth herein or in the Lease, Tenant shall not be required to remove any portion of Tenant's Work contained in the existing office portion of the Premises (the location of which is shown on Exhibit A-1 attached hereto) at the end of the Lease Term

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unless Landlord shall notify Tenant of such requirement in writing (which shall specifically describe that portion of the Tenant's Work that must be removed) at the time Landlord approves the Tenant's Plans.

(b) Landlord shall be entitled to object to any proposed Tenant Work, which when completed, either (x) will adversely affect the structural integrity of the Building or (y) will adversely affect the functioning outside the Premises of any Building System (in either case, other than to a de minimus extent) (the criteria specified in clauses (x) and (y) are herein referred to as the "Approval Criteria").

(c) Except as otherwise set forth in the Lease, Tenant may perform the Tenant's Work with any general contractor(s), construction manager(s), subcontractors and trade contractors as Tenant elects. Tenant shall perform the Tenant's Work in accordance with (i) the Final Tenant's Plans (subject to part (d) below), (ii) good construction practices, and (iii) all applicable laws.

(d) At any time after the Final Tenant's Plans are approved (or deemed approved) by Landlord and thereafter throughout Tenant's prosecution of the Tenant's Work, Tenant shall be permitted to direct changes in the Tenant's Work (each a "Tenant Change Order") (it being agreed, however, that Tenant must obtain Landlord's consent before prosecuting any Tenant Change Order that constitutes a material alteration (each, a "Material Tenant Change Order")). Within seven (7) days after its receipt of any proposed Material Tenant Change Order, Landlord (i) shall give its written approval thereto or (ii) if Landlord reasonably believes that such Material Tenant Change Order does not comply with the Approval Criteria, shall request revisions or modifications to such Material Tenant Change Order (but only to the extent the same fails to comply with the Approval Criteria). Upon its receipt of any such request from Landlord, Tenant, if it wishes to pursue such Material Tenant Change Order, shall submit such revisions or modifications to Landlord. Within five (5) days following receipt by Landlord of such revisions or modifications, Landlord shall give its written approval thereto or shall request other revisions or modifications therein (but relating only to the extent Tenant has failed to comply with Landlord's earlier requests). The preceding two sentences shall be implemented repeatedly until Landlord gives its written approval to the Material Tenant Change Order in question. If Landlord fails to make a submission or furnish a response timely in accordance with the provisions of this paragraph (d), Landlord shall be deemed to have approved the Material Tenant Change Order in question. Once approved or deemed approved by Landlord, a Material Tenant Change Order shall become part of the Final Tenant's Plans and the work shown on such Material Tenant Change Order shall be part of the Tenant's Work

(e) Landlord, at Tenant's expense, shall reasonably cooperate with Tenant's efforts to obtain any permits, certificates or final approvals in connection with any portion of the Tenant's Work including, without limitation, executing and delivering any documents or instruments that Landlord is required to sign

and which are reasonably required by Tenant in connection therewith. If, as a result of any failure by any tenant of the Building to comply with the terms of such tenant's lease, Tenant cannot obtain any required permits, approvals or certificates in connection with any portion of the Tenant's Work, then Landlord shall use commercially reasonable efforts to cause such tenant to comply with the terms of such tenant's lease to the extent necessary to enable Tenant to obtain such permits, approvals or certificates. Landlord shall not be entitled to impose upon Tenant any charges or fees of any kind (including, without limitation, charges or fees for profit, overhead or supervision) in connection with any Tenant's Work.

(f) Landlord shall provide Tenant with a Tenant Finish Allowance (the "Finish Allowance") equal to One Hundred Thousand and no/100 Dollars (\$100,000.00) to be used by Tenant to pay the cost of the Tenant's Work, including without limitation, space planning costs, architectural and engineering fees, general contractor fees and other similar fees and expenses. Tenant shall bear the entire cost of any Tenant's Work in excess of the Finish Allowance and shall pay for such excess over the Finish Allowance directly to the contractors performing the Tenant's Work. Landlord shall pay the Finish Allowance to Tenant within thirty (30) days after substantial completion of the Tenant's Work and Tenant's delivery to Landlord of final lien waivers from all contractors performing the Tenant's Work.

#### RENEWAL OPTION

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Provided that there is no Event of Default existing at the time of Tenant's election renew or as of the commencement of any renewal term, Tenant shall have the right and option to renew this Lease for one (1) additional term of three (3) years (the "First Renewal Term") and one (1) additional term of two (2) years (the "Second Renewal Term") by delivering written notice of Tenant's exercise of such renewal option to Landlord at least One Hundred Eighty (180) days prior to the expiration date of the then current Lease term. Upon the delivery of said notice and subject to the conditions set forth in the preceding sentence, this Lease shall be extended upon the same terms, covenants and conditions as provided in this Lease, except that the Base Rent payable during First Renewal

Term and the Second Renewal Term, as applicable, shall be the greater of (i) the Base Rent for the last day of the initial Lease Term, or (ii) the Base Rent determined pursuant to the Consumer Price Index calculation below, and the rent payable for the parking spaces in the Adjacent Parking Facility shall be mutually determined by Landlord and Tenant.

$$\text{Renewal Base Rent} = \text{Base Rent}_n \times \frac{(\text{CPI of Dec, of year}_n)}{(\text{CPI of Dec, of year}_{n-1})}$$

//n// = last year of current term

The monthly Base Rent shall increase five percent (5%) halfway through the applicable renewal term.

PRIVATE DRIVE:  
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Tenant desires that the private drive providing access to the Building and the building known as Braker K currently known as Dell Drive be re-named to Active Power Drive. Tenant acknowledges that the private drive is not owned by the Landlord and therefore the Landlord does not have the authority to rename the drive Active Power Drive. Landlord agrees to cooperate with Tenant to facilitate the desired name changed.

EXHIBIT "D"  
SIGN CRITERIA



SIXTH AMENDMENT TO LEASE AGREEMENT BETWEEN  
METROPOLITAN LIFE INSURANCE COMPANY, AS LANDLORD  
AND  
ACTIVE POWER, INC., AS TENANT

To be attached to and form a part of Lease made the 12/th/ day of March 1996 (which together with any amendments, modifications and extensions thereof, is hereinafter called the Lease), between Landlord and Tenant.

THIS SIXTH AMENDMENT TO LEASE AGREEMENT (this "Sixth Amendment") made and entered into as of the \_\_\_\_\_ day of \_\_\_\_\_, 2000 by and between METROPOLITAN LIFE INSURANCE COMPANY ("Landlord") and ACTIVE POWER, INC., ("Tenant").

W I T N E S S E T H:

Landlord and Tenant entered into that certain Lease Agreement dated March 12, 1996 (the "Lease" for space in Stonehollow 1), amended by the First Amendment dated June 24, 1996 increasing the square footage to 8,100 square feet in Stonehollow 1, Suite 135, amended by the Second Amendment dated September 4, 1996 notifying Landlord of a name change from "Magnetic Bearing Technologies" to "Active Power, Inc." amended by the Third Amendment dated October 10, 1997 expanding into STONEHOLLOW 2 for approximately an additional 15,080 square feet of space located at 11525 Stonehollow Drive, Suite 255, Austin, Texas for a total of 23,180 square feet of space, amended by the Fourth Amendment dated August 20, 1999 extending the term in Stonehollow 2, Suite 255 for an additional twelve months, and amended by the Fifth Amendment dated February 9, 2000 extending the lease term for Suite 135 and Suite 255 to expire on March 31, 2003 and expansion into Suites 120, 110 and 130 to expire March 31, 2003.

Landlord and Tenant now desire to further amend the Lease Agreement and Amendments in certain respects as more fully hereinafter set forth. Landlord and Tenant agree as follows:

1. Landlord and Tenant agree that Tenant shall expand into an additional 4,050 square feet of space located at 11525 Stonehollow Drive (Stonehollow 1) Suite 155 as outlined on the attached Exhibit "A" as "expansion space".
2. Landlord grants Tenant a finishout allowance of \$8,100.00.
3. Commencement Date for the "expansion space" (Suite 155) is estimated to be December 15, 2000, however this date is contingent upon existing tenant vacating the premises.
4. The Monthly Base Rental Rate for the "expansion space" (Suite 155) shall be as follows:  
 Stonehollow 1 - "Expansion Space" (Suite 155) 4,050 square feet  
 Commencement - 03/31/03 = \$0.90/sf (\$3,645.00 per month)
5. Tenant agrees to pay to Landlord an Additional Security Deposit in the amount of \$4,100.00.
6. Except as specifically amended hereby, the Lease shall remain unaffected hereby and in full force and effect as originally written.

Signatures on next page

DATED AS OF THE \_\_\_\_\_ DAY OF \_\_\_\_\_, 2000.

WITNESS:

LANDLORD:

Metropolitan Life Insurance Company, a New York Corporation; on behalf of a commingled separate account

BY: SSR Realty Advisors, Inc., a Delaware corporation, as Investment Advisor to Metropolitan Life Insurance Company

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Address: \_\_\_\_\_

\_\_\_\_\_

Telephone: \_\_\_\_\_

Fax: \_\_\_\_\_

DATED AS OF THE \_\_\_\_\_ DAY OF \_\_\_\_\_, 2000.

WITNESS:

TENANT:

ACTIVE POWER, INC.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Address: \_\_\_\_\_

\_\_\_\_\_

Telephone: \_\_\_\_\_

Fax: \_\_\_\_\_

Exhibit "A"  
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Stonehollow 1  
=====

Address: 11525 Stonehollow Drive, Suite 155 (expansion space)  
Austin, Texas 78758

Legal Description: Lot 1-A, Block A, Stonehollow Section 4-A Resubdivision of  
Lots 2 and 3 Stonehollow Section Four, a subdivision in  
Travis County, Texas according to the map or plat of record  
in Volume 98, Pages 36-37 in the Plat Records of Travis





SEVENTH AMENDMENT TO LEASE AGREEMENT BETWEEN  
METROPOLITAN LIFE INSURANCE COMPANY, AS LANDLORD  
AND  
ACTIVE POWER, INC., AS TENANT

To be attached to and form a part of Lease made the 12/th/ day of  
March 1996 (which together with any amendments, modifications and  
extensions thereof, is hereinafter called the Lease), between Landlord  
and Tenant.

THIS SEVENTH AMENDMENT TO LEASE AGREEMENT (this "Seventh Amendment") made  
and entered into as of the \_\_\_\_\_ day of \_\_\_\_\_, 2000 by and between  
METROPOLITAN LIFE INSURANCE COMPANY ("Landlord") and ACTIVE POWER, INC.,  
("Tenant").

W I T N E S S E T H:

Landlord and Tenant entered into that certain Lease Agreement dated March  
12, 1996 (the "Lease" for space in Stonehollow 1), amended by the First  
Amendment dated June 24, 1996 increasing the square footage to 8,100 square feet  
in Stonehollow 1, Suite 135, amended by the Second Amendment dated September 4,  
1996 notifying Landlord of a name change from "Magnetic Bearing Technologies" to  
"Active Power, Inc." amended by the Third Amendment dated October 10, 1997  
expanding into STONEHOLLOW 2 for approximately an additional 15,080 square feet  
of space located at 11525 Stonehollow Drive, Suite 255, Austin, Texas for a  
total of 23,180 square feet of space, amended by the Fourth Amendment dated  
August 20, 1999 extending the term in Stonehollow 2, Suite 255 for an additional  
twelve months, amended by the Fifth Amendment dated February 9, 2000 extending  
the lease term for Suite 135 and Suite 255 to expire on March 31, 2003 and  
expansion into Suites 120, 110 and 130 to expire March 31, 2003, and amended by  
the Sixth Amendment where Tenant expanded into Suite 155 for an additional 4,050  
square feet.

Landlord and Tenant now desire to further amend the Lease Agreement and  
Amendments in certain respects as more fully hereinafter set forth. Landlord and  
Tenant agree as follows:

Commencement Date for the "expansion space" (Suite 155) is confirmed to be  
December 15, 2000.

Except as specifically amended hereby, the Lease shall remain unaffected hereby  
and in full force and effect as originally written.

DATED AS OF THE \_\_\_\_\_ DAY OF \_\_\_\_\_, 2001.

WITNESS:

\_\_\_\_\_

LANDLORD:  
Metropolitan Life Insurance Company, a New  
York Corporation; on behalf of a  
commingled separate account

BY: SSR Realty Advisors, Inc., a Delaware  
corporation, as Investment Advisor to  
Metropolitan Life Insurance Company

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_  
Address: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

DATED AS OF THE \_\_\_\_\_ DAY OF \_\_\_\_\_, 2001.

WITNESS:

\_\_\_\_\_

TENANT:  
ACTIVE POWER, INC.

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_  
Address: \_\_\_\_\_



CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in (i) the Registration Statement (Form S-8 No. 333-43248) and (ii) the Registration Statement (Form S-8 No. 333-56122) pertaining to the 2000 Stock Incentive Plan and 2000 Employee Stock Purchase Plan of Active Power, Inc. of our report dated January 18, 2001, with respect to the financial statements of Active Power, Inc. included in the Annual Report (Form 10-K) for the year ended December 31, 2000.

/s/ Ernst & Young LLP

Austin, TX