

# ACTIVE POWER INC (ACPW)

## 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-30939

**ACTIVE POWER, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or organization)

2128 W. Braker Lane, BK12, Austin, Texas  
(Address of principal executive offices)

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

78758  
(Zip Code)

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).  Yes  No

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

(Do not check if a smaller reporting company)

Smaller Reporting Company

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

The number of shares of common stock, par value of \$0.001 per share, outstanding at October 29, 2012 was 95,457,376.

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

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

	<b>September 30, 2012</b>	<b>December 31, 2011</b>
	<u>(unaudited)</u>	<u></u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 14,079	\$ 10,357
Restricted cash	386	389
Accounts receivable, net of allowance for doubtful accounts of \$662 and \$337 at September 30, 2012 and December 31, 2011, respectively	17,666	11,163
Inventories	9,362	9,439
Prepaid expenses and other	1,457	414
Total current assets	<u>42,950</u>	<u>31,762</u>
Property and equipment, net	2,896	2,861
Deposits and other	307	404
Total assets	<u>\$ 46,153</u>	<u>\$ 35,027</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 4,653	\$ 4,757
Accrued expenses	3,849	5,351
Deferred revenue	5,464	2,366
Revolving line of credit	5,535	5,535
Total current liabilities	<u>19,501</u>	<u>18,009</u>
Long-term liabilities	798	726
Stockholders' equity:		
Common stock	95	80
Treasury stock	(135)	(115)
Additional paid-in capital	288,193	277,023
Accumulated deficit	(262,399)	(260,895)
Other accumulated comprehensive income	100	199
Total stockholders' equity	<u>25,854</u>	<u>16,292</u>
Total liabilities and stockholders' equity	<u>\$ 46,153</u>	<u>\$ 35,027</u>

*See accompanying notes.*

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>Revenues:</b>				
Product revenue	\$ 16,647	\$ 16,996	\$ 50,534	\$ 47,890
Service and other revenue	2,964	3,612	10,534	9,262
<b>Total revenue</b>	<b>19,611</b>	<b>20,608</b>	<b>61,068</b>	<b>57,152</b>
<b>Cost of goods sold:</b>				
Cost of product revenue	12,254	13,112	35,608	35,625
Cost of service and other revenue	1,742	2,649	6,766	7,337
<b>Total cost of goods sold</b>	<b>13,996</b>	<b>15,761</b>	<b>42,374</b>	<b>42,962</b>
<b>Gross profit</b>	<b>5,615</b>	<b>4,847</b>	<b>18,694</b>	<b>14,190</b>
<b>Operating expenses:</b>				
Research and development	1,325	1,272	4,045	3,279
Selling and marketing	3,447	3,527	10,891	10,397
General and administrative	1,691	1,280	5,175	4,083
<b>Total operating expenses</b>	<b>6,463</b>	<b>6,079</b>	<b>20,111</b>	<b>17,759</b>
<b>Operating loss</b>	<b>(848)</b>	<b>(1,232)</b>	<b>(1,417)</b>	<b>(3,569)</b>
Interest expense, net	(80)	(68)	(246)	(149)
Other income (expense), net	81	8	159	(34)
<b>Net loss</b>	<b>\$ (847)</b>	<b>\$ (1,292)</b>	<b>\$ (1,504)</b>	<b>\$ (3,752)</b>
<b>Net loss per share, basic and diluted</b>	<b>\$ (0.01)</b>	<b>\$ (0.02)</b>	<b>\$ (0.02)</b>	<b>\$ (0.05)</b>
Shares used in computing net loss per share, basic and diluted	95,575	80,119	91,998	79,990
<b>Comprehensive loss:</b>				
Net loss	\$ (847)	\$ (1,292)	\$ (1,504)	\$ (3,752)
Translation gain (loss) on subsidiaries denominated in foreign currencies	211	(193)	(99)	416
<b>Comprehensive loss</b>	<b>\$ (636)</b>	<b>\$ (1,485)</b>	<b>\$ (1,603)</b>	<b>\$ (3,336)</b>

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

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>Operating activities</b>		
Net loss	\$ (1,504)	\$ (3,752)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation expense	955	1,093
Change to allowance for doubtful accounts	325	16
(Gain) Loss on disposal of fixed assets	31	130
Stock-based compensation	1,131	1,149
Changes in operating assets and liabilities:		
Restricted cash	3	(403)
Accounts receivable	(6,828)	(2,033)
Inventories	77	(4,301)
Prepaid expenses and other assets	(946)	(80)
Accounts payable	(104)	13
Accrued expenses	(1,502)	(1,689)
Deferred revenue	3,098	2,074
Long-term liabilities	72	232
Net cash used in operating activities	<u>(5,192)</u>	<u>(7,551)</u>
<b>Investing activities</b>		
Sales/maturities of marketable securities	—	134
Purchases of property and equipment	(1,021)	(2,225)
Net cash used in investing activities	<u>(1,021)</u>	<u>(2,091)</u>
<b>Financing activities</b>		
Proceeds from private placement of common stock	9,750	—
Issuance costs of private placement	(187)	—
Proceeds from draw on revolving line of credit	2,017	3,000
Payments on revolving line of credit	(2,017)	—
Proceeds from employee stock purchases	491	277
Purchases of treasury stock	(20)	(12)
Net cash provided by financing activities	<u>10,034</u>	<u>3,265</u>
Translation gain (loss) on subsidiaries in foreign currencies	(99)	416
Change in cash and cash equivalents	3,722	(5,961)
Cash and cash equivalents, beginning of period	10,357	15,416
Cash and cash equivalents, end of period	<u>\$ 14,079</u>	<u>\$ 9,455</u>

*See accompanying notes.*

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

**1. Significant Accounting Policies**

**Organization and Basis of presentation**

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

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

**2. Supplemental Balance Sheet Information**

**Restricted Cash**

Restricted cash balance of \$386,000 as of September 30, 2012 consists of secured performance and deposit guarantees given to customers. Upon satisfaction of these guarantees, the restriction on these funds will be released.

**Receivables**

Accounts receivable consist of the following (in thousands):

	<b>September 30, 2012</b>	<b>December 31, 2011</b>
Trade receivables	\$ 18,328	\$ 11,500
Allowance for doubtful accounts	(662)	(337)
	<u>\$ 17,666</u>	<u>\$ 11,163</u>

**Inventory**

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

	<b>September 30, 2012</b>	<b>December 31, 2011</b>
Raw materials	\$ 6,897	\$ 6,493
Work in process	2,769	3,085
Finished goods	942	1,680
Allowances for obsolescence	(1,246)	(1,819)
	<u>\$ 9,362</u>	<u>\$ 9,439</u>

**Property and Equipment**

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

	<b>September 30, 2012</b>	<b>December 31, 2011</b>
Equipment	\$ 10,060	\$ 9,980
Demonstration units	2,149	1,345
Computers and purchased software	4,177	4,029
Furniture and fixtures	375	369
Leasehold improvements	7,647	7,425
Construction in progress	653	1,107
	<u>25,061</u>	<u>24,255</u>
Accumulated depreciation	<u>(22,165)</u>	<u>(21,394)</u>
	<u>\$ 2,896</u>	<u>\$ 2,861</u>

**Accrued Expenses**

Accrued expenses consist of the following (in thousands):

	<b>September 30, 2012</b>	<b>December 31, 2011</b>
Compensation and benefits	\$ 1,844	\$ 3,037
Warranty liability	614	583
Property, income, state, sales and franchise tax	336	529
Professional fees	466	463
Other	589	739
	<u>\$ 3,849</u>	<u>\$ 5,351</u>

**Warranty Liability**

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



Changes in our warranty liability are presented in the following table (in thousands):

Balance at December 31, 2011	\$	613
Warranty expense		1,060
Warranty charges incurred		(1,009)
Balance at September 30, 2012	\$	664
Warranty liability included in accrued expenses	\$	614
Long-term warranty liability		50
Balance at September 30, 2012	\$	664

### Revenue Recognition

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

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

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

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

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

**3. Net Loss Per Share**

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Numerator:				
Net loss	\$ (847)	\$ (1,292)	\$ (1,504)	\$ (3,752)
Denominator:				
Weighted-average shares of common stock outstanding used in computing basic and diluted net loss per share	95,575	80,119	91,998	79,990
Basic and diluted net loss per share	\$ (0.01)	\$ (0.02)	\$ (0.02)	\$ (0.05)
Common stock equivalents that were not included in the calculation because the option or restricted stock unit price was greater than the average market price of the common shares or the net loss would cause the effect of the options to be anti-dilutive:				
Employee stock options	9,641	10,260	9,641	10,260
Performance-based options	-	1,440	-	1,440
Restricted stock units	997	-	997	-
	<u>10,638</u>	<u>11,700</u>	<u>10,638</u>	<u>11,700</u>

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

**4. Fair Value of Financial Instruments**

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

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

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

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

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

Level 3—uses one or more significant inputs that are unobservable and supported by little or no market activity, and that reflect the use of significant management judgment.

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

Our Level 1 assets and liabilities consist of cash equivalents and short-term investments, which are primarily invested in money-market funds. These assets are classified as Level 1 because they are valued using quoted prices in active markets and other relevant information generated by market transactions involving identical assets and liabilities.

The fair value of our cash equivalents, which are primarily invested in money-market funds, was determined using the following inputs as of September 30, 2012 and December 31, 2011 (in thousands):

<b>September 30, 2012</b>				
<b>Fair Value Measurements at Reporting Date Using</b>				
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money-market funds	\$ 3,092	\$ —	\$ —	\$ 3,092
Total	<u>\$ 3,092</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,092</u>
Amounts included in:				
Cash and cash equivalents	\$ 3,092	\$ —	\$ —	\$ 3,092
Short-term investments	—	—	—	—
Total	<u>\$ 3,092</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,092</u>
<b>December 31, 2011</b>				
<b>Fair Value Measurements at Reporting Date Using</b>				
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money-market funds	\$ 3,093	\$ —	\$ —	\$ 3,093
Total	<u>\$ 3,093</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,093</u>
Amounts included in:				
Cash and cash equivalents	\$ 3,093	\$ —	\$ —	\$ 3,093
Short-term investments	—	—	—	—
Total	<u>\$ 3,093</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,093</u>

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

**5. Guarantees**

In certain geographical regions, particularly Europe and Africa, we are sometimes required to issue performance guarantees to our customers as a condition of sale. These guarantees usually provide financial protection to our customers in the event that we fail to fulfill our delivery or product warranty obligations. We secure these guarantees with standby letters of credit through our bank. At September 30, 2012 and December 31, 2011, we had \$433,000 and \$446,000 respectively, of performance guarantees outstanding to customers that were secured with letters of credit.

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

*The following discussion should be read in conjunction with, and is qualified in its entirety by reference to, the financial statements and notes thereto included in Item 1 of this Form 10-Q and the financial statements and notes thereto and our Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2011 included in our 2011 Annual Report on Form 10-K. This report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, that involve risks and uncertainties. Our expectations with respect to future results of operations that may be embodied in oral and written forward-looking statements, including any forward-looking statements that may be included in this report, are subject to risks and uncertainties that must be considered when evaluating the likelihood of our realization of such expectations. Our actual results could differ materially. The words "believe," "expect," "intend," "plan," "project," "will" and similar phrases as they relate to us are intended to identify such forward-looking statements. In addition, please see the "Risk Factors" in Part I, Item 1A of our 2011 Annual Report on Form 10-K and in Part II, Item 1A of this Form 10-Q for a discussion of items that may affect our future results.*

### Overview

Active Power designs and manufactures continuous power and infrastructure solutions. These solutions ensure continuity for data centers and other mission critical operations in the event of power disturbances.

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

We have sold our patented flywheel-based uninterruptible power supply ("UPS") systems since 1999. As of September 30, 2012, we have shipped more than 3,500 flywheels in UPS system installations, delivering more than 875 megawatts of power to customers in 43 countries around the world with more than 131 million runtime hours of operation.

In addition to selling stand-alone UPS systems, we also manufacture and sell modular infrastructure solutions ("MIS") that provide critical power and infrastructure solutions in a pre-packaged format and that offer the same customer benefits with regard to operating efficiency, reliability and cost as our UPS systems. These MIS solutions may include our UPS systems as a component. For example we manufacture and sell continuous power systems ("CPS") that integrate our UPS products with other related equipment such as switchgear and backup diesel generators that are sold as a complete power solution for customers. We also manufacture and sell other containerized power and infrastructure solutions. These solutions serve as the infrastructure for modular data center products which are self-contained fully functioning data centers. We design and build enclosures that have a fully built out interior – including electrical, cooling, monitoring and other elements – ready for the customer to add its IT racks and servers. We also integrate and build modular power and infrastructure solutions to specification, based on our customers and other third party designs. Once the customer adds its IT equipment to our infrastructure solution, it has a functional modular data center. These industry emerging products can be deployed rapidly and at a lower cost than traditional brick-and-mortar solutions and are optimally suited for hyper-scale IT and cloud applications.

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

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

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

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

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

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

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

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

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

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

In line with our ongoing efforts to improve margins and operational efficiency and to achieve consistent and growing levels of profitability, we have been evaluating our fixed cost position. During the third quarter of 2012, we executed cost savings measures that we expect to yield annualized savings of about \$1.6 million, and recorded a one-time restructuring charge of approximately \$200,000. We believe these measures will help ensure we are making appropriate investments for the future while also aligning our overhead to support consistent and profitable growth.

**Results of Operations**

(\$ in thousands)	Three Months Ended September 30,				Variance 2012 vs. 2011	
	2012	% of total revenue	2011	% of total revenue	\$	%
	Product revenue	\$ 16,647	85%	\$ 16,996	82%	\$ (349)
Service and other revenue	2,964	15%	3,612	18%	(648)	(18)%
Total revenue	19,611	100%	20,608	100%	(997)	(5)%
Cost of product revenue	12,254	62%	13,112	64%	(858)	(7)%
Cost of service and other revenue	1,742	9%	2,649	13%	(907)	(34)%
Total cost of goods sold	13,996	71%	15,761	76%	(1,765)	(11)%
Gross profit	5,615	29%	4,847	24%	768	16%
Operating expenses:						
Research and development	1,325	7%	1,272	6%	53	4%
Selling and marketing	3,447	18%	3,527	17%	(80)	(2)%
General and administrative	1,691	9%	1,280	6%	411	32%
Total operating expenses	6,463	33%	6,079	29%	384	6%
Operating profit (loss)	(848)	(4)%	(1,232)	(6)%	384	(31)%
Interest expense, net	(80)	—	(68)	—	(12)	18%
Other income (expense), net	81	—	8	—	73	913%
Net income (loss)	\$ (847)	(4)%	\$ (1,292)	(6)%	\$ 445	(34)%

(\$ in thousands)	Nine Months Ended September 30,				Variance 2012 vs. 2011	
	2012	% of total revenue	2011	% of total revenue	\$	%
	Product revenue	\$ 50,534	83%	\$ 47,890	84%	\$ 2,644
Service and other revenue	10,534	17%	9,262	16%	1,272	14%
Total revenue	61,068	100%	57,152	100%	3,916	7%
Cost of product revenue	35,608	58%	35,625	62%	(17)	—
Cost of service and other revenue	6,766	11%	7,337	13%	(571)	(8)%
Total cost of revenue	42,374	69%	42,962	75%	(588)	(1)%
Gross profit	18,694	31%	14,190	25%	4,504	32%
Operating expenses:						
Research and development	4,045	7%	3,279	6%	766	23%
Selling and marketing	10,891	18%	10,397	18%	494	5%
General and administrative	5,175	8%	4,083	7%	1,092	27%
Total operating expenses	20,111	33%	17,759	31%	2,352	13%
Operating loss	(1,417)	(2)%	(3,569)	(6)%	2,152	(60)%
Interest expense, net	(246)	—	(149)	—	(97)	65%
Other income (expense), net	159	—	(34)	—	193	(568)%
Net loss	\$ (1,504)	(2)%	\$ (3,752)	(6)%	\$ 2,248	(60)%

**Product revenue.** Product revenue primarily consists of sales of our CleanSource power quality products and our MIS solutions. Our CleanSource power quality products are comprised of both UPS and DC product lines and our MIS solutions consist of our CPS solutions (which are comprised of our UPS systems and some combination of third party ancillary equipment, such as engine generators and switchgear) and our other infrastructure solutions that provide a combination of power distribution, cooling capabilities, security systems, fire suppression and monitoring capabilities for our business partners. Our product revenue was derived from the following sources:

(\$ in thousands)	Three Months Ended September 30,		Variance	
	2012	2011	\$	%
Product revenue:				
UPS systems	\$ 14,785	\$ 5,991	\$ 8,794	147%
MIS solutions	1,862	11,005	(9,143)	(83)%
<b>Total product revenue</b>	<b>\$ 16,647</b>	<b>\$ 16,996</b>	<b>\$ (349)</b>	<b>(2)%</b>

  

(\$ in thousands)	Nine Months Ended September 30,		Variance	
	2012	2011	\$	%
Product revenue:				
UPS systems	\$ 28,554	\$ 20,764	\$ 7,790	38%
MIS solutions	21,980	27,126	(5,146)	(19)%
<b>Total product revenue</b>	<b>\$ 50,534</b>	<b>\$ 47,890</b>	<b>\$ 2,644</b>	<b>6%</b>

Total product revenue for the three-month period ended September 30, 2012 did not vary significantly from the same period of 2011. Product mix did change significantly, however, we saw a 147% increase in sales of our UPS products and an 83% decrease in our MIS solutions revenue compared to the prior year. The increase in UPS product revenue was primarily due to large UPS installations in the third quarter of 2012 in Europe, the Middle East and Africa (“EMEA”) and Asia and a broader increase in the number of UPS customers as we re-focused our sales activities on growing UPS product sales. Included in UPS systems revenue this quarter was approximately \$5.6 million of ancillary equipment related to completion of a large integrated UPS system deployment in Europe. Excluding ancillary equipment, UPS system revenue was approximately flat with the previous quarter’s revenue levels and up by 51% compared to the third quarter of 2011. There was also a 114% increase in OEM sales of UPS products compared to the previous year. UPS product sales comprised 89% of our product revenue for the third quarter of 2012, as compared to 35% for the third quarter of 2011. The decrease in MIS solutions revenue reflects the small number of customers and large order values inherent in this business that can result in large short-term fluctuations in MIS solution revenues. Due to timing of customer projects, there was \$499,000 or 3% of product revenue in sales of CPS products in the third quarter of 2012, compared to CPS product sales of \$7.0 million, or 41% of our product revenue, in the third quarter of 2011. Sales of infrastructure solutions decreased by \$2.6 million, or 66%, compared to the third quarter of 2011 due to lower customer orders.

Total product revenue for the nine-month period ended September 30, 2012 increased by \$2.6 million, or 6%, compared to the same period in 2011. This increase was driven primarily by an increase of \$7.8 million, or 38%, in sales of UPS products compared to the prior year, reflecting the higher level of ancillary equipment sales and also improved UPS sales performance and strong growth internationally for our UPS solutions. In the aggregate, MIS revenues declined by \$5.1 million, or 19%, compared to the first three quarters of 2011. Sales of our CPS solutions declined by \$14.7 million, or 73%, compared to 2011 due to the absence of large customer projects in the U.S. market compared to 2011, and less complementary sales of CPS solutions with infrastructure products compared to 2011. Sales of our infrastructure solutions for the first three quarters of 2012 increased by \$9.5 million compared to 2011, which offset this decline in CPS product revenues.

Product revenue from Active Power branded products through our direct and manufacturer’s representative channels was \$10.2 million, or 61% of our product revenue, for the three-month period ended September 30, 2012, compared to \$5.1 million, or 30% of our product revenue, in the same period of 2011, and \$7.9 million, or 45% of our product revenue, for the second quarter of 2012. For the nine-month period ended September 30, 2012, product sales of Active Power branded products through our direct and manufacturer’s representative channels were \$24.5 million, or 48% of our product revenue, compared to \$22.4 million, or 47% of our product revenue, for the same period of 2011.

Product revenue from our OEM channels for the three-month period ended September 30, 2012 was \$5.0 million, an increase of approximately \$3.0 million, or 149%, compared to \$2.0 million for the third quarter of 2011. This reflected several large multi-megawatt UPS systems sales in Asia in the current quarter and increased OEM activity in the EMEA market. For the nine-month period ended September 30, 2012, product revenue from our OEM channel was \$7.8 million, a decrease of \$1.4 million, or 15%, compared to \$9.2 million for the same period in 2011, reflecting lower OEM activity in the US market compared to 2011. Product revenue from our OEM channels for the three-month period ended September 30, 2012 increased by \$3.4 million, or 205%, compared to \$1.7 million for the second quarter of 2012. The size and volume of orders from our OEM channels can fluctuate significantly on a quarterly basis and in 2012 we have seen fewer, but larger value transactions from our OEM channel. We have supported our OEM partners’ efforts to sell total solutions to their customers that include generators and switchgear that they manufacture along with our UPS systems as a total solution. Sales to Caterpillar, our primary OEM channel, represented \$5.0 million and \$7.8 million, or 30% and 15% of our product revenue, for the three-month and nine-month periods ended September 30, 2012, respectively, compared to \$2.0 million and \$9.1 million, or 12% and 19% of our product revenue, in the comparable periods of 2011. Caterpillar remains one of our largest UPS customers as well as our largest OEM customer.

Product revenue from our IT channel for the third quarter of 2012 was \$1.4 million, compared to \$9.9 million for the third quarter of 2011, which represents a \$8.5 million, or 86%, decrease. This decrease was primarily due to a decrease in demand for infrastructure solutions from HP, our largest IT channel partner. Historically, we have manufactured and sold infrastructure solutions to HP, for them to re-sell to end users in conjunction with sales of their IT and computing products. Thus, the level of orders will fluctuate dependent upon our partner's success and need for infrastructure solutions. We have historically experienced large quarterly fluctuations in the number and value of such orders. Sales to HP accounted for 8% of our product revenue for the third quarter of 2012 compared to 58% in the same period of 2011.

Our MIS solutions transactions tend to be larger in value and from a smaller number of customers compared to sales of our UPS products. This smaller number of customers with greater transaction value can contribute to large quarterly fluctuations in revenue from each product family, due to the timing of orders or shipments in any particular accounting period and as evidenced by low MIS sales in the third quarter of 2012. Generally, the size of these transactions has been increasing and individual CPS and infrastructure transactions have been as high as \$6 million in 2011. A small number of transactions can therefore lead to significant revenue, but cause greater volatility in our quarterly results and increase liquidity risk for us as these orders require much larger amounts of working capital to fulfill, which we attempt to manage through customer and vendor payment terms as part of our working capital management.

North America product revenue was \$5.9 million or 35% of our product revenue for the three-month period ended September 30, 2012, compared to \$14.5 million, or 85% of our product revenue, for the same period in 2011 and \$12.1 million, or 69% of product revenue, in the second quarter of 2012. This decrease reflects lower MIS revenues which historically have largely originated in the North American market. For the nine-month period ended September 30, 2012, our North America product revenue was \$28.6 million, or 57% of our total product revenue, compared to \$30.8 million, or 64%, for the same period in 2011. The decrease in North American sales has been driven by the decrease in sales of MIS solutions.

We also sell products directly to customers in Asia and Western Europe and we have a network of international distributors in other territories that sell products for us. In these markets, customers are more likely to purchase a total power solution from us rather than a stand-alone UPS system. This usually results in a longer selling cycle and makes quarterly results from these regions more volatile. Thus the amount of revenue from our international markets can fluctuate significantly on a quarterly basis. Product sales to customers in Asia were \$2.0 million, or 12% of our total product revenue, in the three-month period ended September 30, 2012, compared to \$842,000, or 5%, for the same period in 2011 and \$1.0 million, or 6%, for the second quarter of 2012. Product revenue in EMEA was \$8.8 million, or 53% of product revenue, in the three-month period ended September 30, 2012, compared to \$1.6 million, or 10%, for the same period of 2011 and \$4.4 million, or 25%, for the second quarter of 2012. These fluctuations are primarily attributable to variations in sales of our MIS products in each region in the relevant periods and illustrate the impact of larger orders from fewer customers on quarterly revenue for each of these regions.

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

Service and other revenue decreased by approximately \$648,000, or 18%, for the three-month period ended September 30, 2012, compared to the same period of 2011. This decrease reflects lower professional fees associated with decreased MIS sales in the quarter compared to the prior period. For the nine-month period ended September 30, 2012, service and other revenue increased by approximately \$1.3 million, or 14%, compared to the same period in 2011. The increase for the nine-month period reflects higher levels of service and contract work from direct product sales and from higher professional fees associated with increased infrastructure sales. For our MIS customers, we provide a full power solution, including design services, site preparation, installation of an entire power solution and provision of all products required to provide a turnkey product to the end user, often including maintenance services. We had increased service revenues from maintenance contracts and repair-related activities as our increasing installed base of UPS customers provides greater opportunities to generate such revenues. Where we make sales through our OEM channel, it is typical for the OEM to provide these types of services to their end-user customers, so these revenue opportunities do not typically exist for us on our OEM sales. We anticipate that service and other revenue will continue to grow with product revenue, particularly as our PowerHouse system revenue grows and as our installed base of UPS product expands, because as more units are sold to customers, more installation, startup and maintenance services will be required.



**Cost of product revenue.** Cost of product revenue includes the cost of component parts of our products, ancillary equipment that is sourced from external suppliers, personnel, equipment and other costs associated with our assembly and test operations, depreciation of our manufacturing property and equipment, shipping costs, warranty costs, and the costs of manufacturing support functions such as logistics and quality assurance. The cost of product revenue as a percentage of total product revenue was 74% for the three-month period ended September 30, 2012, compared to 77% for the same period in 2011, and was 70% in the nine-month period ended September 30, 2012 compared to 74% in the same period of 2011. These decreases in costs as a percentage of revenue reflect more favorable UPS pricing compared to 2011 and higher levels of absorbed overhead costs attributable to a higher level of UPS system production. We continue to operate a manufacturing facility that has a manufacturing and testing capacity significantly greater than our current product revenue levels. A large portion of the costs involved in operating this manufacturing facility are fixed in nature and we have incurred unabsorbed overhead each quarter depending on the level of UPS system production. We continue to work on reducing our product costs through design enhancements and modifications, vendor management programs and increasing our sales volume to absorb these expenses. We have also improved our capabilities and efficiency in manufacturing and managing our infrastructure solutions which have reduced our total cost of production for these products and further contributed to the decrease in cost of product revenue as a percentage of revenue.

**Cost of service and other revenue.** Cost of service and other revenue includes the cost of component parts that we use in service or sell as spare parts, as well as labor and overhead costs of our service organization, including travel and related costs incurred in fulfilling our service obligations to our customers. Costs paid to third parties in fulfillment of service and design or installation services are also included in costs of service and other revenue. The cost of service and other revenue decreased to 59% of service and other revenue in the three-month period ended September 30, 2012, compared to 73% for the same period of 2011, and decreased to 64% in the nine-month period ended September 30, 2012 compared to 79% in the same period of 2011. These percentage decreases reflect higher utilization of our service personnel and improved revenues on the professional service work we perform for MIS systems installation. We have had higher costs relative to the increase in service and other revenues as we have continued to expand our service team and broaden the geographic regions where we have service capability as our total business grows. The utilization of our service personnel will also be affected by the number of MIS solution products implemented in a particular period, and in periods where we have a low number of installation projects we would expect our costs as a percentage of revenue to increase due to lower employee utilization. A large portion of the costs involved in operating our service organization are fixed in nature and depending upon the revenues for the quarter, we may incur unabsorbed overhead each quarter. We continue to work on reducing our service overhead through better utilization of our service employees and cost control measures. This infrastructure also means that we can leverage this investment and grow our service capabilities substantially by adding direct technical labor only as required.

**Gross profit.** For the three-month period ended September 30, 2012, our gross profit was 29% of revenue, compared to a 24% gross profit margin for the third quarter of 2011 and a 36% gross profit margin for the second quarter of 2012. The improvement from the third quarter of 2011 reflects improved margins on our UPS business as a result of more favorable pricing and from higher manufacturing efficiency. The decrease in the margin from the second quarter of 2012 reflects the change in product mix from the prior quarter in which we had a significant increase of \$5.3 million in revenue from third party ancillary equipment revenue in the third quarter. We experience lower margins from the sale of third-party equipment compared to the margins on our manufactured UPS and MIS products. Historically, MIS sales of our CPS and infrastructure products have generated lower margins for us than sales of our UPS products because they include a higher proportion of third party ancillary equipment. Our ability to improve our gross profit from these product lines has come from our ability to continue to reduce material costs and our efforts to improve our service margins through pricing and operational efficiency. Our ability to further improve gross margins will depend, in part, on our ability to further improve our sales channel mix, increase sales of higher margin products such as our UPS products, increase product prices, improve our professional service margins through further pricing and operating efficiency, and increase our total revenues to a level that will allow us to improve the utilization of our manufacturing and service operations.

**Research and development.** Research and development expense primarily consists of compensation and related costs for employees engaged in research, development and engineering activities, third party consulting and product development activities, as well as an allocated portion of our occupancy costs. Overall, our research and development expenses were approximately \$53,000, or 4%, higher in the third quarter of 2012 compared to the third quarter of 2011 and were \$107,000, or 7%, lower than the second quarter of 2012. We are currently developing a new generation of UPS product that we believe will offer greater power modularity and space efficiencies especially as we target the larger power market segments, which we expect to introduce later this year. We have increased headcount and prototyping expenses to support this new product development and meet our delivery deadline and to support new infrastructure and UPS products that we believe will contribute to future revenue growth.

**Selling and marketing.** Selling and marketing expense primarily consists of compensation, including variable sales compensation, and related costs for sales and marketing personnel, and related travel, selling and marketing expenses, as well as an allocated portion of our occupancy costs and the cost of our foreign sales operations. Selling and marketing costs were approximately \$80,000, or 2%, lower in the third quarter of 2012 compared to the third quarter of 2011 and decreased approximately \$450,000, or 12%, from the second quarter of 2012 primarily from lower headcount and lower commissions for third party manufacturers' representatives as well as lower employee sales compensation.

**General and administrative.** General and administrative expense is primarily comprised of compensation and related costs for executive and administrative personnel, professional fees, and taxes, including sales, property and franchise taxes. General and administrative expenses for the third quarter of 2012 increased approximately \$411,000, or 32%, compared to the same period in 2011 due to higher recruiting and other professional services fees, as well as an increase in our provision for doubtful accounts, and decreased by approximately \$249,000, or 13%, compared to the second quarter of 2012 due to lower compensation costs and professional fees.

**Interest expense, net.** Net interest expense for the third quarter of 2012 increased by approximately \$12,000, or 18%, compared to the third quarter of 2011. We incurred higher interest expense in 2012 as we had a larger average outstanding balance on our revolving credit facility. Our average cash and investments balance over the three-month period ending September 30, 2012 increased by \$4.8 million, or 45%, compared to the average balance over the same period ending September 30, 2011. This higher average cash balance resulted in higher interest income, which offset a portion of the higher interest expense.

**Other income (expense), net.** Other income (expense) in the third quarter of 2012 and 2011 primarily reflects foreign exchange gains (losses) on a bank account and sales contracts held in foreign currencies.

### **Liquidity and Capital Resources**

Our primary sources of liquidity at September 30, 2012 are our cash and investments on hand, our bank credit facilities and projected cash flows from operating activities. If we meet our cash flow projections in our current business plan, we expect that we will have adequate capital resources in order to continue operating our business for at least the next 12 months. Our business plan and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, there are potential risks, including that our revenues may not meet our projections, our costs may exceed our estimates or our working capital needs may be greater than anticipated. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in the remainder of 2012 and beyond or significantly affect our level of liquidity, which may limit our opportunity to pursue certain opportunities to grow our business.

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

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

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

(\$ in thousands)	Nine Months Ended September 30,		Variance 2012 vs. 2011	
	2012	2011	\$	%
	Cash used in operating activities	\$ (5,192)	\$ (7,551)	\$ 2,359

Cash used in operating activities decreased by \$2.4 million in the nine-month period ended September 30, 2012 compared to the same period of 2011. This was primarily due to a \$2.2 million decrease in our level of operating losses and from changes in our working capital requirements caused by the timing of product shipments to our customers. This timing of large orders can cause large fluctuations in the amount of cash required for operations on a quarterly basis.

The fluctuations in working capital are impacted by the timing of product orders and shipments. In the nine-month period ended September 30, 2012, we saw a decrease of approximately \$77,000 in inventory as inventory levels declined primarily due to timing of product delivery on MIS projects. Our receivables increased by \$6.5 million since December 31, 2011, reflecting the higher revenue levels and a higher proportion of revenues that were recognized toward the end of the reporting period. Our prepaid expenses and other assets increased by \$1.0 million since December 31, 2011, due to prepayments required on supplier purchase orders for inventory required to fulfill infrastructure solutions sales orders. These uses of funds were offset by an increase in deferred revenue of \$3.1 million since December 31, 2011. These increases reflect timing of customer deposits and advance payments related to the timing of our large CPS and infrastructure projects. We anticipate that cash provided by (used in) operations will fluctuate significantly based upon the volume and size of our CPS and infrastructure solutions sold and by the timing of product delivery relative to our reporting periods, and that such volatility in sources and uses of funds will continue based upon growth of our CPS and infrastructure solutions businesses.

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

(\$ in thousands)	Nine Months Ended September 30,		Variance 2012 vs. 2011	
	2012	2011	\$	%
	Cash used in investing activities	\$ (1,021)	\$ (2,091)	\$ 1,070

Investing activities primarily consist of purchases of property and equipment. Capital expenditures were \$1.2 million, or 54% lower in the nine-month period ending September 30, 2012, compared to the same period of 2011, which is attributable to the fact that in the 2011 period that we invested in multiple demonstration CPS systems in Asia and Europe. This year's expenditure is related to the commencement tooling for our next generation UPS product.

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

(\$ in thousands)	Nine Months Ended September 30,		Variance 2012 vs. 2011	
	2012	2011	\$	%
	Cash provided by financing activities	\$ 10,034	\$ 3,265	\$ 6,769

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

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

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

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

We renegotiated the term of our \$12.5 million revolving line of credit facility with Silicon Valley Bank during the third quarter of 2012. The new facility is on substantially the same terms and conditions as our previous facility and extends the expiration date of this facility until August 2014. We believe the renegotiated credit facility will enable us to extend and better utilize this credit facility and provide us greater flexibility in our working capital management.

We believe that our cash and investments and our sources of available liquidity, including our bank credit facility, will be sufficient to fund our operations for at least the next 12 months. However, a sudden change in business volume or product mix, positive or negative, from any of our business or channel partners or in our direct business could significantly impact our expected revenues. The global economic downturn has reduced our confidence at predicting future revenues, and even with improving economic conditions, there is still uncertainty and risk in our forecasting. However, we feel we have sufficient demand visibility to provide us with some opportunity to adjust expenditures or take other measures to reduce our cash consumption if we can see and anticipate a shortfall in revenue or give us time to identify additional sources of funding if we anticipate an increase in our working capital requirements due to increased revenues or changes in our revenue mix. A significant increase in sales, especially in our PowerHouse or our infrastructure solutions business, would likely increase our working capital requirements, due to the longer production time and cash cycle of sales of these products.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

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

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

Our international sales were historically made in U.S. dollars. As we have increased sales in foreign markets and opened operations in multiple foreign countries, we have executed more transactions that are denominated in other currencies, primarily Euro, British pounds and Chinese Renminbi. Those sales and expenses in currencies other than U.S. dollars can result in translation gains and losses which have not been significant to date. Currently, we do not engage in hedging activities for our international operations other than increasing the amount of sales and support expenses being incurred in foreign currencies as a natural hedge. However, recent volatility in currencies, particularly with the pound and Euro, is increasing the amount of potential translation gains and losses and we may engage in hedging activities in the future to mitigate the risks caused by such currency volatility.

**Item 4. Controls and Procedures.**

**Evaluation of disclosure controls and procedures.**

Our Chief Executive Officer and our Chief Financial Officer, based on the evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, have concluded that, as of September 30, 2012, our disclosure controls and procedures were effective to ensure that the information we are required to disclose in reports that we file or submit under the Exchange Act, (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in internal control over financial reporting.**

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

**PART II – OTHER INFORMATION**

**Item 1. Legal Proceedings.**

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

**Item 1A. Risk Factors.**

*You should carefully consider the risks described below and in Item 1A of our 2011 Annual Report on Form 10-K before making a decision to invest in our common stock or in evaluating Active Power and our business. The risks and uncertainties described below and in our 2011 Annual Report on Form 10-K are not the only ones we face. Additional risks and uncertainties that we do not presently know, or that we currently view as immaterial, may also impair our business operations. This report is qualified in its entirety by these risk factors.*

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

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

Our increased emphasis on larger and more complex system solutions has increased the effort and time required by us to complete sales to customers. Further, a larger portion of our quarterly revenue is derived from relatively few large transactions with relatively few customers. For example, during the three months ended September 30, 2012, our three largest customers contributed an aggregate of 65% of our revenue. Any delay in completing these large sales transactions or reduction in business volume from these large customers, may result in significant fluctuations in our quarterly revenue. In addition, we use anticipated revenues to establish our operating budgets and a large portion of our expenses, particularly rent and salaries are fixed in the short term. As a result, any shortfall or delay in revenue could result in increased losses and would likely cause our operating results to be below public expectations. Further, we may purchase inventory and enter into commitments with our suppliers based on purchase orders we receive from our customers, which orders subsequently may be cancelled or deferred. While our customers are typically legally obligated to take delivery against a purchase order, any such cancellation or deferral may extend the amount of time between our expenditures for inventory and supplier commitments and our receipt of payment from our customers. The occurrence of any of these events would likely materially adversely affect our results of operations, and could adversely impact our liquidity, which would likely cause the market price of our common stock to decline.

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

Caterpillar (including its dealer network) is our primary OEM customer and our largest single customer for our UPS products. Caterpillar and its dealer network accounted for 19%, 16%, and 15% of our revenue in 2010, 2011 and the nine months ended September 30, 2012, respectively. HP is our largest IT channel partner and accounted for 25%, 36%, and 36% of our revenue in 2010, 2011 and the nine months ended September 30, 2012, respectively. A number of factors could cause these customers to cancel or defer orders, including interruptions to their operations due to a downturn in their industries, delays or changes in their product offerings or securing other sources for the products that we manufacture, cancellations or deferrals by their customers, or developing such products internally. If our relationships with HP or with Caterpillar are not successful or suffer a material adverse change, such as a material reduction in the level of orders or their failure to timely pay us, our business and operating results would likely suffer.

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

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

In addition, on June 13, 2012, John Penver delivered his resignation as our Vice President of Finance, Chief Financial Officer and Secretary, to be effective as of October 31, 2012. We have hired a new Chief Financial Officer, Steven Fife, who will assume responsibility on November 1, 2012. The transition to a new Chief Financial Officer will require time and expense, may cause disruptions in our finance and accounting function and may limit the ability of our management team to effectively execute on our business plan. If we are unable to manage this transition efficiently and effectively, our business and operating results may be adversely affected.

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

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

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

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

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

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

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

The following documents are filed as exhibits to this report:

- 3.1\* Restated Certificate of Incorporation, dated June 7, 2006 (filed as Exhibit 3.1 to Active Power's Quarterly Report on Form 10-Q filed on April 30, 2012)
- 3.2\* Second Amended and Restated Bylaws as adopted February 1, 2007 (filed as Exhibit 3.2 to Active Power's Quarterly Report on Form 10-Q filed on April 30, 2012)
- 3.3\* Amendment to Second Amended and Restated Bylaws as adopted December 6, 2007 (filed as Exhibit 3.3 to Active Power's Quarterly Report on Form 10-Q filed on April 30, 2012)
- 4.1\* Specimen certificate for shares of Common Stock (filed as Exhibit 4.1 to Active Power's IPO Registration Statement on Form S-1 (SEC File No. 333-36946))
- 4.2\* See Exhibits 3.1, 3.2 and 3.3 for provisions of the Certificate of Incorporation and Bylaws of the registrant defining the rights of holders of common stock
- 10.1\* Second Amendment to Second Amended and Restated Loan and Security Agreement with Silicon Valley Bank, dated August 15, 2012 (filed as Exhibit 10.1 to Active Power's Current Report on Form 8-K filed on August 20, 2012)
- [10.2](#) Offer Letter, dated October 1, 2012, between Active Power, Inc. and Steven R. Fife
- [10.3](#) Severance Benefits Agreement, dated October 8, 2012, between Active Power, Inc. and Steven R. Fife
- [31.1](#) Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
- [31.2](#) Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
- [32.1](#) Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003
- [32.2](#) Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003
- 101 The following financial statements from the Active Power's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL: (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations and Comprehensive Loss, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) Notes to Condensed Consolidated Financial Statements.

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\* Incorporated by reference to the indicated filing.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**ACTIVE POWER, INC.**  
(Registrant)

October 31, 2012  
(Date)

/s/ J. Douglas Milner

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

October 31, 2012  
(Date)

/s/ John K. Penver

**John K. Penver**  
**Chief Financial Officer and Secretary**  
**(Principal Financial and Accounting Officer)**



October 1, 2012

Steven R. Fife  
4209 Brindisi Place  
Pleasanton, CA 94566

**Re: Offer of Employment with Active Power, Inc.**

Dear Steven:

On behalf of Active Power, Inc. (the "Company"), I am pleased to invite you to join the Company as its Chief Financial Officer ("CFO"), reporting to the Chief Executive Officer of the Company. In this position, you will be expected to devote your full business time, attention, and energies to the performance of your duties with the Company at its location in Austin, Texas, or while traveling on Company business. The effective date of your employment will be October 8, 2012 or such other date as you and the Company mutually agree in writing. Notwithstanding the foregoing, your title shall initially be Vice President of Finance, and you shall assume the role of CFO on the later of (i) October 31, 2012, or (ii) the date of the termination of John Penver as Chief Financial Officer. Such initial period shall be referred to herein as the "Transition Period."

The terms of this offer of employment are as follows:

1. At-Will Employment. You understand and acknowledge that your employment with the Company is for an unspecified duration and constitutes "at-will" employment. You also understand that any representation to the contrary is unauthorized and not valid unless obtained in writing and signed by the Company's Chief Executive Officer or President. You acknowledge that this employment relationship may be terminated at any time, with or without good cause or for any or no cause, at the option either of the Company or you. You further acknowledge that the Company may modify job titles, salaries and benefits from time to time as it deems necessary, and that any such change shall not alter the at-will nature of your employment with the Company. We request that you give the Company at least two weeks' notice in the event of a resignation. Notwithstanding the foregoing, you may be eligible for certain severance payments upon any such termination of your employment pursuant to the terms and conditions of the Company's Severance Benefits Agreement, a copy of which is attached hereto as Exhibit B (the "Severance Benefits Agreement").

2. Position and Duties. You will serve in a full-time capacity as CFO of the Company following the Transition Period. You will render such business and professional services consistent with your executive position, as shall reasonably be assigned to you by the Company.

3. Compensation. The Company will pay you a salary at the rate of \$280,000 per year (the "Base Salary"), payable in accordance with the Company's standard payroll policies, including compliance with applicable withholding. Any increase or decrease in Base Salary (together with the then existing Base Salary) shall serve as the "Base Salary" for future employment under this offer letter. The first and last payment by the Company to you will be adjusted, if necessary, to reflect a commencement or termination date other than the first or last working day of a pay period.

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4. Equity Grants. Subject to approval by the Board, you will be granted the following: (a) an option to purchase 300,000 shares of the Company's Common Stock (the "Option Shares") at an exercise price equal to the fair market value per share of the Common Stock on the date the Board approves the option grant; and (b) 100,000 restricted stock units ("RSU's"). The Option Shares and RSU's shall vest as follows: 25% of the Option Shares and RSU's shall vest upon completion of one year of service measured from your vesting commencement date, and the balance of the Option Shares and RSU's shall vest quarterly in a series of 12 successive equal installments upon your completion of each additional quarter of service measured from the one-year anniversary of your vesting commencement date. This option grant and the RSU grant shall both be subject to the terms and conditions of the Company's 2010 Equity Incentive Plan and Stock Option Agreement, including vesting requirements (the "Stock Agreements"). Subject to the Company's insider trading policy, and subject to applicable securities laws, Employee may establish a 10b5-1 trading plan that provides for the sale of RSU's to satisfy any taxes payable as a result of the vesting of the RSU's.

5. Bonus Program. You will be eligible to earn a bonus of up to 60% of your Base Salary based on the achievement of corporate objectives at target and MBO's, subject to the terms and conditions of the Company's Executive Bonus Program as approved from time to time by the Board of Directors (the "Bonus Program"). The bonus is determined and paid at the time and manner set forth under the Bonus Program by the Board of Directors, and the amount of bonus payable maybe subject to thresholds and accelerators. Subject to the Severance Benefits Agreement, receipt of any bonus is contingent upon your continued employment with the Company through the date the bonus is paid. Any bonus payment for 2012 will be pro-rated for the remainder of the year, provided that it has been earned under the Bonus Program. Except with respect to 2012, and subject to the Severance Benefits Agreement, no "prorated" or partial bonus will be provided unless approved by the Board in its sole discretion.

6. Benefits. During the term of your employment, you will be entitled annually to 22 days of paid time off ("PTO") subject to the Company's PTO policy. You will also be eligible for benefits covering employees at your level, as such may be in effect from time to time.

7. Temporary Living Expenses; Relocation Assistance. The Company is also offering you reimbursement for the following relocation expenses for your move from Pleasanton, California to Austin, Texas: (a) the reasonable costs of moving your and your family's household goods to Austin, not to exceed \$25,000; (b) closing costs on the purchase of a home in Austin, presuming a 0 point mortgage, and (c) reimbursement for realtor commissions incurred directly by you on the sale of your home in Pleasanton, California, not to exceed \$60,000 (collectively, the "Relocation Expenses"). The Company will reimburse you for the following temporary living expenses, not to exceed \$36,000 (the "Temporary Living Expenses"): (a) temporary corporate housing for the period beginning with your date of hire and continuing until you complete your relocation process, up to a maximum of six (6) months from your date of hire (the "Temporary Housing Period"), (b) coach airfare for you between Austin and San Francisco, California for you to visit family on weekends during the Temporary Housing Period; and (c) up to two (2) house-hunting trips for you and your spouse during the Temporary Housing Period. We will only reimburse you for these expenditures once you submit valid receipts to the Company and they are approved by the Chief Executive Officer. If any Relocation Expenses or Temporary Living Expenses are deemed taxable income to you, the Company will tax equalize these items (the "Gross-Up") no later than the end of the calendar year following the calendar year in which you remit the tax on the payment for which the Company is providing the Gross-Up to fully offset your taxes attributable to relocation expenses. In addition to the reimbursement for Relocation Expenses and the Temporary Living Expenses, the Company will provide to you a car for your use in Austin during the Temporary Housing Period only. The Company expects that during the Temporary Housing Period you will devote the same amount of time in the performance of your duties and responsibilities as Chief Financial Officer as would be expected of a person in the same position whose principal residence is located in Austin, Texas. Notwithstanding the foregoing, (i) if, on or before the date that is six (6) months following your date of hire, you resign your employment with the Company for any reason other than Good Reason (as defined in the Severance Benefits Agreement) or are terminated for Cause (as defined in the Severance Benefits Agreement), you will repay the entire amount of reimbursements provided to you by the Company for Relocation Expenses and Temporary Living Expenses, as well as all costs and expenses of the Company to lease a car to be provided to you during the Temporary Housing Period and any Gross-Up paid to you by the Company (collectively, the "Paid Reimbursements") or (ii) if, after the date that is six (6) months following your date of hire and on or before the one (1) year anniversary of your date of hire, you resign your employment with the Company for any reason other than Good Reason (as defined in the Severance Benefits Agreement) or are terminated for Cause (as defined in the Severance Benefits Agreement), you will repay a decreasing prorated portion of the aggregate amount of the Paid Reimbursements based on your percentage completion of your second six months of service with the Company (such that, for illustration purposes only, if such termination date occurred on the date that is eight (8) months following your date of hire, you would be required to repay an amount equal totwo-thirds of the aggregate amount of the Paid Reimbursements), in each case, within thirty (30) days of such termination date.

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8. Immigration Laws. For purposes of federal immigration laws, you will be required to provide to the Company documentary evidence of your identity and eligibility for employment in the United States. Such documentation must be provided within 3 business days of the effective date of your employment, or your employment relationship with the Company may be terminated.

9. Employee Proprietary Information Agreement. As a condition of this offer of employment, you will be required to complete, sign, and return the Company's standard form of employee proprietary information agreement (the "EPIA"), a copy of which is attached hereto as Exhibit A.

10. Severance Benefits. Should you accept the position offered by the Company, you will be eligible for severance benefits subject to the terms and conditions, including any conditions precedent, of the Severance Benefits Agreement.

11. Resignation on Termination. By signing below, you understand and agree that, upon the termination of your employment, regardless of the reason for such termination, you shall immediately (and with contemporaneous effect) resign any directorships, offices or other positions that you may hold in the Company or any affiliate, unless otherwise agreed in writing by you and the Company.

12. Background Check. You also understand that this offer of employment is contingent upon the successful completion of a background check, and you consent to such background check, and agree to timely complete the Company's standard forms required for such check upon request by the Company.

13. Indemnification. The Company will extend to you the coverage under its directors' and officers' insurance policy currently in effect. The Company will also enter into its standard form of Indemnification Agreement with you, providing for, among other things, indemnification in connection your discharging your fiduciary duties to the Company.

14. General. This offer letter, the EPIA, the Severance Benefits Agreement, and the Stock Agreements (if an option and/or restricted stock unit grant is approved by the Board) covering the grant described in paragraph 4, when signed by you, set forth the terms of your employment with the Company and supersede any and all prior representations and agreements, whether written or oral. In the event of a conflict between the terms and provisions of this offer letter and the EPIA, the Severance Benefits Agreement, and the Stock Agreements, the terms and provisions of the EPIA, the Severance Benefits Agreement, and the Stock Agreements will control. Any amendment of this offer letter or any waiver of a right under this offer letter must be in a writing signed by you and an officer of the Company. **Texas law will govern this offer letter.**

We look forward to you joining the Company. If the foregoing terms are agreeable, please indicate your acceptance by signing this offer letter in the space provided below and returning it to me, along with your completed and signed EPIA and Severance Benefits Agreement.

Sincerely,

**ACTIVE POWER, INC.**

By: /s/ Doug Milner  
Doug Milner, Chief Executive Officer

**AGREED TO AND ACCEPTED:**

**"Employee"**

/s/ Steven R. Fife  
Steven R. Fife

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## SEVERANCE BENEFITS AGREEMENT

THIS SEVERANCE BENEFITS AGREEMENT (the "Agreement") is made as of the 8th day of October, 2012 between Active Power, Inc., (the "Company"), and Steven R. Fife, an individual resident of California ("Employee"). Employee and the Company are collectively referred to herein as the "Parties."

1. At-Will Employment Status. Employee has accepted employment with the Company on an "at will" basis, which means that either the Company or Employee may terminate Employee's employment with the Company at any time and for any or no reason.

2. Severance Benefits upon Involuntary Termination Without Cause or Resignation for Good Reason. Although Employee's employment is at-will, if Employee is terminated by the Company without Cause (as defined below) or resigns with Good Reason (as defined below), then Employee shall be entitled to receive:

(a) continuing severance pay at a rate equal to 100% of Employee's base salary, as in effect (i) immediately prior to the consummation of the Change of Control (as defined below), if such termination occurs within twelve (12) months after such Change of Control (as defined below), or (ii) otherwise, immediately prior to the time of such termination (in each case, less applicable withholding taxes), in each case for a period of twelve (12) months from the date of such termination, to be paid periodically in accordance with the Company's normal payroll practices; and

(b) all stock options and restricted stock units held by Employee in which Employee would have vested if Employee had remained employed with the Company for a period of twelve (12) months following the date of termination shall immediately vest and, if applicable, become exercisable as of the date of termination; and

(c) if Employee elects continuation coverage pursuant to the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended ("COBRA") for Employee, within the time period prescribed pursuant to COBRA, the Company will reimburse Employee for the COBRA premiums for such coverage (at the coverage levels in effect immediately prior to Employee's termination) until the earlier of (i) a period of twelve (12) months from the last date of employment of the Employee with the Company, (ii) until Employee has secured other employment, or (iii) the date Employee is no longer eligible to receive continuation coverage pursuant to COBRA. COBRA reimbursements shall be made by the Company to Employee consistent with the Company's normal expense reimbursement policy, provided that Employee submits documentation to the Company substantiating Employee's payments for such COBRA coverage; and

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(d) all or a portion of Employee's bonus under the Company's Executive Bonus Program, as may be in effect, for the year in which Employee's termination without Cause or resignation for Good Reason occurs, determined as follows: (i) with respect to corporate or individual objectives that are measured over a period of time (such as revenue for a fiscal year), the amount of such bonus with respect to such objective shall be determined based on a comparison of the amount of such objective actually achieved through the date of such termination against a pro rated portion (based on a number of days, weeks or months, as applicable, during the applicable measurement period for which Employee remained a service provider of the Company) of the target objective, and shall be payable on a pro rata basis (based on the number of days during the applicable measurement period for which Employee remained a service provider of the Company), and (ii) with respect to corporate or individual objectives that are measured based on the occurrence of a specific event at a point in time, the full amount of such bonus with respect to such objective shall be payable if such objective is achieved prior to the date of such termination. All determinations of the amount of the achievement of such objectives and the amounts of such bonuses shall be made by the Board of Directors of the Company (the "Board"), in its sole discretion.

3. Acceleration Upon Termination After a Change in Control. Although Employee's employment is at-will, in the event that Employee is terminated by the Company without Cause or resigns with Good Reason within twelve (12) months after a Change in Control (as defined below), in addition to the benefits set forth in Sections 2(a), 2(c) and 2(d), but in lieu of the benefits set forth in Section 2(b) above, one hundred percent (100%) of the stock options and restricted stock units held by Employee prior to the date of the Change of Control shall immediately vest and, if applicable, become exercisable as of the date of termination.

4. Conditions Precedent. Any severance payments and/or benefits contemplated by Sections 2 and 3 above are conditional on Employee:

(a) continuing to comply with the terms of this Agreement and the Employee Proprietary Information Agreement between Employee and the Company (the "EPIA");

(b) signing and not revoking a separation agreement and release of claims in the form attached hereto as Exhibit A (the "Release") which becomes effective and irrevocable no later than sixty (60) days following the termination date (such deadline, the "Release Deadline"). If the Release does not become effective and irrevocable by the Release Deadline, Employee will forfeit any rights to severance payments and benefits under this Agreement. In no event will severance payments or benefits be paid or provided until the Release becomes effective and irrevocable.

(i) In the event the termination occurs at a time during the calendar year where the Release could become effective in the calendar year following the calendar year in which Employee's termination occurs (whether or not it actually becomes effective in the following year), then any severance payments and benefits under this Agreement that would be considered Deferred Payments (as defined in below) will be paid on the first payroll date to occur during the calendar year following the calendar year in which such termination occurs, or, if later, (A) the date the Release actually becomes effective, (B) such time as required by the payment schedule applicable to each payment or benefit as set forth in Section 2 above or (C) such time as required by Section 7 below.

(ii) No severance payments and benefits under this Agreement will be paid or provided until the Release becomes effective and irrevocable, and any such severance payments and benefits otherwise payable between Employee's termination date and the date the Release becomes effective and irrevocable will be paid on the date the Release becomes effective and irrevocable. In the event of Employee's death before all of the severance payments and benefits under this Agreement have been paid, such unpaid amounts will be paid in a lump sum payment promptly following such event to Employee's designated beneficiary, if living, or otherwise to the personal representative of Employee's estate; and

(c) in the event of a resignation for Good Reason, providing the Company with written notice of the acts or omissions constituting the grounds for Good Reason within ninety (90) days of the initial existence of the grounds for Good Reason and a reasonable opportunity for the Company to cure the conditions giving rise to such Good Reason, which shall not be less than thirty (30) days following the date of notice from Employee. If the Company cures the conditions giving rise to such Good Reason within thirty (30) days of the date of such notice, Employee will not be entitled to severance payments and/or benefits contemplated by Section 2 or 3 above if Employee thereafter resigns from the Company based on such grounds. Unless otherwise required by law, no severance payments and/or benefits under Sections 2 or 3 will be paid and/or provided until after the expiration of any relevant revocation period.

5. Definitions. For purposes of this Agreement,

(a) *Cause.* For purposes of this Agreement, "Cause" shall mean (i) Employee's continued failure to substantially perform the duties and obligations of Employee's position (for reasons other than death or Disability (as defined below)), which failure, if curable within the discretion of the Company, is not cured to the reasonable satisfaction of the Company within thirty (30) days after receipt of written notice from the Company of such failure; (ii) Employee's failure to devote the same amount of time in the performance of his duties and responsibilities as Chief Financial Officer as would be expected of a person in the same position whose principal residence is located in Austin, Texas, which failure, if curable within the discretion of the Company, is not cured to the reasonable satisfaction of the Company within thirty (30) days after receipt of written notice from the Company of such failure; (iii) Employee's failure or refusal to comply with reasonable written policies, standards and regulations established by the Company from time to time which failure, if curable in the discretion of the Company, is not cured to the reasonable satisfaction of the Company within thirty (30) days after receipt of written notice of such failure from the Company; (iv) any act of personal dishonesty, fraud, embezzlement, misrepresentation, or other unlawful act committed by Employee that results in a substantial gain or personal enrichment of Employee at the expense of the Company; (v) Employee's conviction of a violation of a federal or state law or regulation applicable to the Company's business, which violation was or is reasonably likely to be materially injurious to the Company; (vi) Employee's conviction of a violation of, or a plea of nolo contendere or guilty to, a felony under the laws of the United States or any state; (vii) the Employee's material breach of the terms of the EPIA; or (viii) failing to consent to or to satisfactorily complete the Company's background check following his acceptance of employment with the Company or failing to satisfy the federal immigration requirements set forth under paragraph 8 of his offer letter.

(b) *Change in Control.* For purposes of this Agreement, "Change in Control" shall mean the occurrence of any of the following events:

(i) Change in Ownership of the Company. A change in the ownership of the Company which occurs on the date that any one person, or more than one person acting as a group ("Person"), acquires ownership of the stock of the Company that, together with the stock held by such Person, constitutes more than 50% of the total voting power of the stock of the Company, except that any change in the ownership of the stock of the Company as a result of a private financing of the Company that is approved by the Board will not be considered a Change in Control; or

(ii) Change in Effective Control of the Company. If the Company has a class of securities registered pursuant to Section 12 of the Exchange Act, a change in the effective control of the Company which occurs on the date that a majority of members of the Board is replaced during any twelve (12) month period by directors whose appointment or election is not endorsed by a majority of the members of the Board prior to the date of the appointment or election. For purposes of this clause (ii), if any Person is considered to be in effective control of the Company, the acquisition of additional control of the Company by the same Person will not be considered a Change in Control; or

(iii) Change in Ownership of a Substantial Portion of the Company's Assets. A change in the ownership of a substantial portion of the Company's assets which occurs on the date that any Person acquires (or has acquired during the twelve (12) month period ending on the date of the most recent acquisition by such person or persons) assets from the Company that have a total gross fair market value equal to or more than 50% of the total gross fair market value of all of the assets of the Company immediately prior to such acquisition or acquisitions. For purposes of this subsection (iii), gross fair market value means the value of the assets of the Company, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

For these purposes, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the Company.

Notwithstanding the foregoing provisions of this definition, a transaction will not be deemed a Change in Control unless the transaction qualifies as a change in control event within the meaning of Section 409A.

Further and for the avoidance of doubt, a transaction will not constitute a Change in Control if: (i) its sole purpose is to change the state of the Company's incorporation, or (ii) its sole purpose is to create a holding company that will be owned in substantially the same proportions by the persons who held the Company's securities immediately before such transaction.



(c) *Disability*. For purposes of this Agreement, “Disability” shall mean Employee's inability to perform the essential functions of Employee's duties herein with or without a reasonable accommodation by reason of illness or physical or mental incapacity as certified by a medical doctor, which inability has continued for a period aggregating 180 days, whether or not continuous, in any continuous period of 365 days.

(d) *Good Reason*. For purposes of this Agreement, “Good Reason” shall mean, without Employee’s written consent: (i) there is a material reduction in Employee’s role, responsibilities and authority, except to the extent that (x) his authority is reduced solely as a result of a merger into a larger entity such that he remains the CFO for a stand-alone entity, and (y) Employee continues to report to the CEO of the surviving entity; (ii) a material change in the geographic location at which Employee must perform his services; provided, that in no instance will the relocation of Employee to a facility or a location of fifty (50) miles or less from Employee’s then current office location be deemed material for purposes of this Agreement; (iii) there is a material reduction in Employee’s level of base compensation (except where there is a general reduction of compensation applicable to the management team generally); or (iv) there is a material breach of this Agreement by the Company which is not cured, in the discretion of the Board to the reasonable satisfaction of Employee, within thirty (30) days following written notice provided to the Company by Employee. In no instance will a resignation by Employee be deemed to be for Good Reason if it is made more than twenty four (24) months following the initial occurrence of any of the events that otherwise would constitute Good Reason hereunder. Notwithstanding any other provision of this Agreement, if there is a material reduction in Employee’s role, responsibilities and authority as a result of a merger into a larger entity that would allow Employee to otherwise resign for Good Reason under (i) above, Employee may not resign for Good Reason until the earlier of six months after the closing date of such merger, or the date set forth in a written notice from the Company or the successor in interest of the Company as the earliest date Employee may so resign.

(e) The Board shall make all determinations relating to termination, including without limitation any determination regarding Cause.

6. Tax Treatment. The Company makes no representations or warranties with respect to the tax consequences of the payment of any sums to Employee under the terms of this Agreement. Employee agrees and understands that, with the exception of the withholdings from the severance payments, Employee is responsible for payment of any local, state and/or federal taxes on the sums paid hereunder by the Company and any penalties or assessments thereon. Employee further agrees to indemnify and hold the Company harmless from any claims, demands, deficiencies, penalties, assessments, executions, judgments, or recoveries by any government agency against the Company for any amounts claimed due on account of Employee’s failure to pay federal or state taxes or damages sustained by the Company by reason of any such claims, including reasonable attorney fees.

7. Section 409A.

(a) Notwithstanding anything to the contrary in this Agreement, no severance payments or benefits payable to Employee, if any, pursuant to this Agreement that, when considered together with any other severance payments or separation benefits, is considered deferred compensation under Internal Revenue Code Section 409A (together, the “Deferred Payments”) will be payable until Employee has a “separation from service” within the meaning of Section 409A (“Section 409A”) of the Internal Revenue Code of 1986, as amended (the “Code”). Similarly, no severance payable to Employee, if any, pursuant to this Agreement that otherwise would be exempt from Section 409A pursuant to Treasury Regulation Section 1.409A-1(b)(9) will be payable until Employee has a “separation from service” within the meaning of Section 409A.

(b) Further, if Employee is a “specified employee” within the meaning of Section 409A at the time of Employee’s separation from service (other than due to death), any Deferred Payments that otherwise are payable within the first six (6) months following Employee’s separation from service will become payable on the first payroll date that occurs on or after the date six (6) months and one (1) day following the date of Employee’s separation from service. All subsequent Deferred Payments, if any, will be payable in accordance with the payment schedule applicable to each payment or benefit. Notwithstanding anything herein to the contrary, in the event of Employee’s death following Employee’s separation from service but prior to the six (6) month anniversary of Employee’s separation from service (or any later delay date), then any payments delayed in accordance with this paragraph will be payable in a lump sum as soon as administratively practicable after the date of Employee’s death and all other Deferred Payments will be payable in accordance with the payment schedule applicable to each payment or benefit. Each payment and benefit payable under the Agreement is intended to constitute a separate payment for purposes of Section 1.409A-2(b)(2) of the Treasury Regulations.

(c) Any severance payment that satisfies the requirements of the “short-term deferral” rule set forth in Section 1.409A-1(b)(4) of the Treasury Regulations shall not constitute Deferred Payments for purposes of the Agreement. Any severance payment that qualifies as a payment made as a result of an involuntary separation from service pursuant to Section 1.409A-1(b)(9)(iii) of the Treasury Regulations that does not exceed the Section 409A Limit shall not constitute Deferred Payments for purposes of the Agreement. For purposes of this subsection (c), “Section 409A Limit” will mean the lesser of two (2) times: (i) Employee’s annualized compensation based upon the annual rate of pay paid to Employee during Employee’s taxable year preceding Employee’s taxable year of Employee’s separation from service as determined under Treasury Regulation Section 1.409A-1(b)(9)(iii)(A)(1) and any Internal Revenue Service guidance issued with respect thereto; or (ii) the maximum amount that may be taken into account under a qualified plan pursuant to Section 401(a)(17) of the Code for the year in which Employee’s employment is terminated.

(d) The foregoing provisions are intended to comply with the requirements of Section 409A so that none of the severance payments and benefits to be provided under the Agreement will be subject to the additional tax imposed under Section 409A, and any ambiguities herein will be interpreted to so comply. Employee and the Company agree to work together in good faith to consider amendments to the Agreement and to take such reasonable actions which are necessary, appropriate or desirable to avoid imposition of any additional tax or income recognition prior to actual payment to Employee under Section 409A.

8. Limitation on Payments. In the event that the severance and other benefits provided for in this Agreement or otherwise payable to Employee (i) constitute "parachute payments" within the meaning of Section 280G of the Code, and (ii) would be subject to the excise tax imposed by Section 4999 of the Code (the "Excise Tax"), then Employee's benefits under this Agreement shall be either

(a) delivered in full, or

(b) delivered as to such lesser extent which would result in no portion of such benefits being subject to the Excise Tax, whichever of the foregoing amounts, taking into account the applicable federal, state and local income taxes and the Excise Tax, results in the receipt by Employee on an after-tax basis, of the greatest amount of benefits, notwithstanding that all or some portion of such benefits may be taxable under Section 4999 of the Code. If a reduction in severance and other benefits constituting "parachute payments" is necessary so that benefits are delivered to a lesser extent, reduction will occur in the following order: reduction of cash payments, cancellation of equity awards granted within the twelve (12) month period prior to a "change in control" (as determined under Code Section 280G) that are deemed to have been granted contingent upon the change in control (as determined under Code Section 280G), cancellation of accelerated vesting of equity awards, reduction of employee benefits.

Unless the Company and Employee otherwise agree in writing, any determination required under this Section shall be made in writing by the Company's independent public accountants (the "Accountants"), whose determination shall be conclusive and binding upon Employee and the Company for all purposes. For purposes of making the calculations required by this Section, the Accountants may make reasonable assumptions and approximations concerning applicable taxes and may rely on reasonable, good faith interpretations concerning the application of Section 280G and 4999 of the Code. The Company and Employee shall furnish to the Accountants such information and documents as the Accountants may reasonably request in order to make a determination under this Section. The Company shall bear all costs the Accountants may reasonably incur in connection with any calculations contemplated by this Section.

9. Confidential Information. Employee shall continue to comply with the terms and conditions of the EPIA, and maintain the confidentiality of all of the Company's confidential and proprietary information. Such information includes, but is not limited to, all customer lists, equipment, records, data, notes, reports, proposals, correspondence, specifications, drawings, blueprints, sketches, materials, or other documents or property belonging to the Company.

10. Miscellaneous.

(a) Withholding Taxes. The Company may withhold from all benefits payable under this Agreement all federal, state, city or other taxes as shall be required pursuant to any law or governmental regulation or ruling.

(b) Entire Agreement; Binding Effect. This Agreement and the EPIA set forth the entire understanding between the Parties as to the subject matter of this Agreement and supersede all prior agreements, commitments, representations, writings and discussions between them; and neither of the Parties shall be bound by any obligations, conditions, warranties or representations with respect to the subject matter of this Agreement, except as expressly provided herein or therein or as duly set forth on or subsequent to the date hereof in a written instrument signed by the proper and fully authorized representative of the party to be bound hereby. This Agreement is binding on Employee and on the Company and his/her and its successors and assigns (whether by assignment, by operation of law or otherwise).

(c) Arbitration. The Parties agree that any and all disputes arising out of, or relating to, the terms of this Agreement, their interpretation, and any of the matters herein released, shall be subject to binding arbitration as set forth under Section 13 of the EPIA.

(d) Governing Law; Jurisdiction. This Agreement shall be governed by, and construed and enforced in accordance with, the employment laws of Texas and the other laws of the State of Texas as they apply to contracts entered into and wholly to be performed therein by residents thereof. In addition, each party hereto irrevocably and unconditionally agrees that, subject to Section 10(c) above, any suit, action or other legal proceeding arising out of this Agreement may be brought only in a state or federal court within Texas.

(e) Severability. In the event that any provision hereof becomes or is declared by a court of competent jurisdiction to be illegal, unenforceable or void, this Agreement shall continue in full force and effect without said provision.

(f) Effect of Headings. The Section and subsection headings contained herein are for convenience only and shall not affect the construction hereof.

(g) Counterparts. This Agreement may be executed in multiple counterparts, each of which shall be deemed to be an original, and all such counterparts shall constitute but one instrument.

*[Remainder of page intentionally left blank. Signature page follows.]*

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

**Employee**

**Active Power, Inc.**

/s/ Steven R. Fife

/s/ J. Douglas Milner

Steven R. Fife

Name: J. Douglas Milner  
Title: Chief Executive Officer

Dated: October 8, 2012

Dated: October 8, 2012

SIGNATURE PAGE TO SEVERANCE BENEFITS AGREEMENT  
ACTIVE POWER, INC.

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**EXHIBIT A**  
**ACTIVE POWER, INC.**  
**RELEASE OF CLAIMS**

This Release of Claims ("Agreement") is made by and between Active Power, Inc. (the "Company"), and Steven R. Fife ("Employee").

WHEREAS, Employee has agreed to enter into a release of claims in favor of the Company upon certain events specified in the Severance Benefits Agreement by and between Company and Employee (the "Severance Benefits Agreement").

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

1. Termination. Employee's employment from the Company terminated on \_\_\_\_\_.
  2. Confidential Information. Employee shall continue to maintain the confidentiality of all confidential and proprietary information of the Company and shall continue to comply with the terms and conditions of the Proprietary Information and Nondisclosure Agreement between Employee and the Company (the "EPIA"). Employee shall return all the Company property and confidential and proprietary information in his possession to the Company on the Effective Date of this Agreement.
  3. Payment of Salary. Employee acknowledges and represents that the Company has paid all salary, wages, bonuses, accrued vacation, commissions and any and all other benefits due to Employee.
  4. Release of Claims. Except as set forth in the last paragraph of this Section 4, Employee agrees that the foregoing consideration as specified in the Severance Benefits Agreement represents settlement in full of all outstanding obligations owed to Employee by the Company. Employee, on behalf of himself, and his respective heirs, family members, executors and assigns, hereby fully and forever releases the Company and its past, present and future officers, agents, directors, employees, investors, shareholders, administrators, affiliates, divisions, subsidiaries, parents, predecessor and successor corporations, and assigns, from, and agrees not to sue or otherwise institute or cause to be instituted any legal or administrative proceedings concerning any claim, duty, obligation or cause of action relating to any matters of any kind, whether presently known or unknown, suspected or unsuspected, that he may possess arising from any omissions, acts or facts that have occurred up until and including the Effective Date of this Agreement including, without limitation,
    - (a) any and all claims relating to or arising from Employee's employment relationship with the Company and the termination of that relationship;
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(b) any and all claims relating to, or arising from, Employee's right to purchase, or actual purchase of shares of stock of the Company, including, without limitation, any claims for fraud, misrepresentation, breach of fiduciary duty, breach of duty under applicable state corporate law, and securities fraud under any state or federal law;

(c) any and all claims for wrongful discharge of employment; termination in violation of public policy; discrimination; breach of contract, both express and implied; breach of a covenant of good faith and fair dealing, both express and implied; promissory estoppel; negligent or intentional infliction of emotional distress; negligent or intentional misrepresentation; negligent or intentional interference with contract or prospective economic advantage; unfair business practices; defamation; libel; slander; negligence; personal injury; assault; battery; invasion of privacy; false imprisonment; and conversion;

(d) any and all claims for violation of any federal, state or municipal statute, including, but not limited to, Title VII of the Civil Rights Act of 1964, the Civil Rights Act of 1991, the Age Discrimination in Employment Act of 1967, the Americans with Disabilities Act of 1990, the Fair Labor Standards Act, the Employee Retirement Income Security Act of 1974, The Worker Adjustment and Retraining Notification Act, any provisions of the Texas Labor Code, and any other law of the State of Texas;

(e) any and all claims for violation of the federal, or any state, constitution;

(f) any and all claims arising out of any other laws and regulations relating to employment or employment discrimination; and

(g) any and all claims for attorneys' fees and costs.

Employee agrees that the release set forth in this section shall be and remain in effect in all respects as a complete general release as to the matters released. Nothing in this Agreement waives Employee's rights to indemnification or any payments under any fiduciary insurance policy, if any, provided by any act or agreement of the Company, state or federal law or policy of insurance.

5. Acknowledgment of Waiver of Claims under ADEA. Employee acknowledges that he is waiving and releasing any rights he may have under the Age Discrimination in Employment Act of 1967 ("ADEA") and that this waiver and release is knowing and voluntary. Employee and the Company agree that this waiver and release does not apply to any rights or claims that may arise under the ADEA after the Effective Date of this Agreement. Employee acknowledges that the consideration given for this waiver and release Agreement is in addition to anything of value to which Employee was already entitled. Employee further acknowledges that he has been advised by this writing that (a) he should consult with an attorney prior to executing this Agreement; (b) he has at least twenty-one (21) days within which to consider this Agreement; (c) he has seven (7) days following the execution of this Agreement by the parties to revoke the Agreement; (d) this Agreement shall not be effective until the revocation period has expired; and (e) nothing in this Agreement prevents or precludes Employee from challenging or seeking a determination in good faith of the validity of this waiver under the ADEA, nor does it impose any condition precedent, penalties or costs for doing so, unless specifically authorized by federal law. Any revocation should be in writing and delivered to [\_\_\_\_\_] at the Company by close of business on the seventh day from the date that Employee signs this Agreement.

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

7. Application for Employment. Employee understands and agrees that, as a condition of this Agreement, he shall not be entitled to any employment with the Company, its subsidiaries, or any successor, and he hereby waives any right, or alleged right, of employment or re-employment with the Company.

8. No Cooperation. Employee agrees that he will not counsel or assist any attorneys or their clients in the presentation or prosecution of any disputes, differences, grievances, claims, charges, or complaints by any third party against the Company and/or any officer, director, employee, agent, representative, shareholder or attorney of the Company, unless under a subpoena or other court order to do so.

9. Cooperation with Company. Employee agrees to cooperate, at the request of the Company, in the defense and/or prosecution of any charges, claims, investigations (internal or external), administrative proceedings and/or lawsuits relating to matters occurring during or relating to Employee's period of employment about which Employee may have relevant information. Employee shall further reasonably cooperate with regard to the transition of Employee's job duties and business relationships. Employee agrees to respond to reasonable requests for information from the Company in a timely manner. The Company agrees to pay Employee for his time in so cooperating at his then applicable consulting rate of pay, not to exceed \$300 per hour, and to reimburse Employee for any and all reasonable expenses, including travel.

10. No Admission of Liability. No action taken by the Company, either previously or in connection with this Agreement shall be deemed or construed to be (a) an admission of the truth or falsity of any claims heretofore made or (b) an acknowledgment or admission by the Company of any fault or liability whatsoever to the Employee or to any third party.

11. Costs. The Parties shall each bear their own costs, expert fees, attorneys' fees and other fees incurred in connection with this Agreement.

12. Authority. Employee represents and warrants that he has the capacity to act on his own behalf and on behalf of all who might claim through him to bind them to the terms and conditions of this Agreement.

13. No Representations. Employee represents that he has had the opportunity to consult with an attorney, and has carefully read and understands the scope and effect of the provisions of this Agreement. Neither party has relied upon any representations or statements made by the other party hereto which are not specifically set forth in this Agreement.



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

15. Entire Agreement. This Agreement, along with the Severance Benefits Agreement, the EPIA, and Employee's written equity compensation agreements with the Company, represents the entire agreement and understanding between the Company and Employee concerning Employee's separation from the Company.

16. No Oral Modification. This Agreement may only be amended in writing signed by Employee and a duly authorized officer of the Company (other than Employee).

17. Governing Law. This Agreement shall be governed by the internal substantive laws, but not the choice of law rules, of the State of Texas.

18. Effective Date. Each Party has seven (7) days after that Party signs this Agreement to revoke it. This Agreement will become effective on the eighth (8th) day after Employee signed this Agreement, so long as it has been signed by both Parties (the "Effective Date").

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

20. Voluntary Execution of Agreement. This Agreement is executed voluntarily and without any duress or undue influence on the part or behalf of the Parties hereto, with the full intent of releasing all claims. The Parties acknowledge that:

(a) They have read this Agreement;

(b) They have had the opportunity of being represented in the preparation, negotiation, and execution of this Agreement by legal counsel of their own choice or that they have voluntarily declined to seek such counsel;

(c) They understand the terms and consequences of this Agreement and of the releases it contains;

(d) They are fully aware of the legal and binding effect of this Agreement.

*[Remainder of page intentionally left blank. Signature page follows.]*

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

Dated: \_\_\_\_\_, 20\_\_

Active Power, Inc.

By \_\_\_\_\_

Steven R. Fife, an individual

Dated: \_\_\_\_\_, 20\_\_

\_\_\_\_\_

## CERTIFICATIONS

I, J. Douglas Milner, certify that:

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

Date: October 31, 2012

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

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## CERTIFICATIONS

I, John K. Penver, certify that:

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

Date: October 31, 2012

/s/ John K. Penver  
John K. Penver  
Chief Financial  
Officer and Secretary  
(Principal Financial and Accounting Officer)

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

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

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

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

/s/ J. Douglas Milner  
\_\_\_\_\_  
J. Douglas Milner  
President and Chief Executive Officer  
October 31, 2012

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

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

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

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

/s/ John K. Penver  
\_\_\_\_\_  
John K. Penver  
Chief Financial Officer and Secretary  
October 31, 2012

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