
**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, 2015

or

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

Commission file number: 000-30939

ACTIVE POWER, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

74-2961657

(I.R.S. Employer Identification No.)

2128 W. Braker Lane, BK 12, Austin, Texas

(Address of principal executive offices)

78758

(Zip Code)

(512) 836-6464

(Registrant's telephone number, including area code)

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 the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (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

The number of shares of common stock, par value of \$0.001 per share, outstanding at October 23, 2015 was 23,108,209.

ACTIVE POWER, INC.
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PART I – FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

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

	September 30, 2015	December 31, 2014
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 10,615	\$ 14,824
Restricted cash	37	40
Accounts receivable, net of allowance for doubtful accounts of \$109 and \$212 at September 30, 2015 and December 31, 2014, respectively	14,063	11,222
Inventories, net	7,938	6,845
Prepaid expenses and other	438	800
Total current assets	33,091	33,731
Property and equipment, net	2,064	2,076
Deposits and other	280	291
Total assets	\$ 35,435	\$ 36,098
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 5,119	\$ 4,044
Accrued expenses	4,330	4,134
Deferred revenue	3,678	2,771
Revolving line of credit	5,535	5,535
Total current liabilities	18,662	16,484
Long-term liabilities	630	821
Commitments and contingencies		
Stockholders' equity:		
Preferred stock - \$0.001 par value; 2,000 shares authorized	—	—
Common stock - \$0.001 par value; 40,000 shares authorized; 23,169 and 23,162 shares issued and 23,108 and 23,094 shares outstanding at September 30, 2015 and December 31, 2014, respectively	23	23
Treasury stock	(239)	(231)
Additional paid-in capital	303,710	302,667
Accumulated deficit	(287,548)	(283,995)
Other accumulated comprehensive income	197	329
Total stockholders' equity	16,143	18,793
Total liabilities and stockholders' equity	\$ 35,435	\$ 36,098

See accompanying notes.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Product revenue	\$ 11,168	\$ 9,729	\$ 33,621	\$ 24,670
Service and other revenue	3,744	2,963	11,275	9,114
Total revenue	14,912	12,692	44,896	33,784
Cost of goods sold:				
Cost of product revenue	8,496	7,490	24,556	19,747
Cost of service and other revenue	2,492	1,442	6,611	5,434
Total cost of goods sold	10,988	8,932	31,167	25,181
Gross profit	3,924	3,760	13,729	8,603
Operating expenses:				
Research and development	1,448	1,516	4,394	5,196
Selling and marketing	2,636	2,891	8,057	8,931
General and administrative	1,468	1,455	4,550	4,530
Total operating expenses	5,552	5,862	17,001	18,657
Loss from operations	(1,628)	(2,102)	(3,272)	(10,054)
Interest expense, net	(95)	(94)	(252)	(301)
Other expense, net	(13)	(42)	(29)	(170)
Loss before income taxes	(1,736)	(2,238)	(3,553)	(10,525)
Income tax expense	—	(258)	—	(258)
Net loss	\$ (1,736)	\$ (2,496)	\$ (3,553)	\$ (10,783)
Net loss per share, basic and diluted	\$ (0.08)	\$ (0.11)	\$ (0.15)	\$ (0.48)
Shares used in computing net loss per share, basic and diluted	23,135	23,124	23,132	22,271
Comprehensive loss:				
Net loss	\$ (1,736)	\$ (2,496)	\$ (3,553)	\$ (10,783)
Translation loss on subsidiaries denominated in foreign currencies	(65)	(95)	(132)	(75)
Comprehensive loss	\$ (1,801)	\$ (2,591)	\$ (3,685)	\$ (10,858)

See accompanying notes.

Active Power, Inc.
Condensed Consolidated Statement of Stockholders' Equity
(in thousands; unaudited)

	<u>Common Stock</u>		<u>Treasury Stock</u>		<u>Additional Paid-In Capital</u>	<u>Accumulated Deficit</u>	<u>Other Accumulated Comprehensive Income (Loss)</u>	<u>Total Stockholders' Equity</u>
	<u>Number of Shares</u>	<u>Par Value</u>	<u>Number of Shares</u>	<u>At Cost</u>				
Balance at December 31, 2014	23,162	\$ 23	56	\$ (231)	\$ 302,667	\$ (283,995)	\$ 329	\$ 18,793
Release of Restricted Stock	7	—	—	—	—	—	—	—
Shares held in treasury	—	—	5	(8)	—	—	—	(8)
Net translation loss on foreign subsidiaries	—	—	—	—	—	—	(132)	(132)
Stock-based compensation	—	—	—	—	1,043	—	—	1,043
Net loss	—	—	—	—	—	(3,553)	—	(3,553)
Balance at September 30, 2015	<u>23,169</u>	<u>\$ 23</u>	<u>61</u>	<u>\$ (239)</u>	<u>\$ 303,710</u>	<u>\$ (287,548)</u>	<u>\$ 197</u>	<u>\$ 16,143</u>

See accompanying notes.

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

	Nine Months Ended September 30,	
	2015	2014
Operating activities		
Net loss	\$ (3,553)	\$ (10,783)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation expense	763	922
Net change to allowance for doubtful accounts	(103)	(96)
Loss (gain) on disposal of fixed assets	—	(15)
Impairment on fixed assets	—	57
Stock-based compensation	1,043	798
Changes in operating assets and liabilities:		
Restricted cash	3	478
Accounts receivable	(2,738)	(2,014)
Inventories	(1,193)	3,056
Prepaid expenses and other assets	373	(37)
Accounts payable	1,075	(517)
Accrued expenses	196	(1,464)
Deferred revenue	907	841
Long term liabilities	(191)	111
Net cash used in operating activities	(3,418)	(8,663)
Investing activities		
Purchases of property and equipment	(679)	(291)
Proceeds from sale of fixed assets	—	19
Net cash used in investing activities	(679)	(272)
Financing activities		
Proceeds from public offering of common stock, net of issuance costs	—	10,438
Proceeds from employee stock option exercises	—	129
Taxes paid related to net share settlement of equity awards	(8)	(14)
Net cash (used in) provided by financing activities	(8)	10,553
Effects of exchange rates on cash	(104)	(75)
Change in cash and cash equivalents	(4,209)	1,543
Cash and cash equivalents, beginning of period	14,824	12,261
Cash and cash equivalents, end of period	<u>\$ 10,615</u>	<u>\$ 13,804</u>

See accompanying notes.

Active Power, Inc.
Notes to Condensed Consolidated Financial Statements
September 30, 2015
(unaudited)

1. Basis of Presentation

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

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

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

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

The accompanying condensed consolidated balance sheet as of December 31, 2014, which has been derived from our audited financial statements, and the unaudited condensed consolidated financial statements as of September 30, 2015, have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim reporting, and include the accounts of the Company and its consolidated subsidiaries. All intercompany transactions and balances have been eliminated upon consolidation. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although we believe the disclosures made are adequate to make the information not misleading. 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 our Annual Report on Form 10-K for the year ended December 31, 2014.

2. Significant Accounting Policies and Supplemental Balance Sheet Information

For a complete description of our principal accounting policies see Note 1. “Summary of Significant Accounting Policies,” to our Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014. Shown below are certain of our principal accounting policies.

Restricted Cash

Our restricted cash balance of \$37,000 as of September 30, 2015, consists of a \$6,000 deposit guarantee for our building lease in Germany, which renews every six months through the term of the lease agreement and a \$31,000 performance guarantee to a customer that was secured with a letter of credit, which expires in June 2017. Our \$0.5 million performance guarantee to a customer that was secured with a letter of credit as of June 30, 2015 expired in July 2015. As of December 31, 2014, our restricted cash balance was \$40,000, which consisted primarily of secured performance and deposit guarantees.

Receivables

Accounts receivable consist of the following (in thousands):

	September 30, 2015	December 31, 2014
Trade receivables	\$ 14,172	\$ 11,434
Less: Allowance for doubtful accounts	(109)	(212)
	<u>\$ 14,063</u>	<u>\$ 11,222</u>

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

Inventories, net

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

	September 30, 2015	December 31, 2014
Raw materials	\$ 5,248	\$ 5,440
Work in process	2,334	473
Finished goods	356	932
	<u>\$ 7,938</u>	<u>\$ 6,845</u>

Accrued Expenses

Accrued expenses consist of the following (in thousands):

	September 30, 2015	December 31, 2014
Compensation, severance and benefits	\$ 2,102	\$ 1,296
Warranty liability	535	475
Taxes, other than income	702	1,080
Professional fees	355	463
Other	636	820
	<u>\$ 4,330</u>	<u>\$ 4,134</u>

Warranty Liability

Generally, the warranty period for our 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 provide longer warranty periods to certain customers. The warranty period for products sold to our primary OEM customer, Caterpillar, is 12 months from the date of shipment to the end-user, or up to 36 months from shipment from Active Power, whichever period is shorter. 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 as follows (in thousands):

Balance at December 31, 2014	\$	527
Warranty expense		506
Payments		(446)
Balance at September 30, 2015	\$	587
Warranty liability included in Accrued expenses	\$	535
Warranty liability included in Long-term liabilities		52
Balance at September 30, 2015	\$	587

Revenue Recognition

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

- We recognize product revenue at the time of shipment for a significant portion of all products sold directly to customers and through distributors because title and risk of loss typically pass on delivery to the common carrier. Our customers and distributors do not have the right to return products. We may enter into bill-and-hold arrangements and when this occurs delivery may not be present, but other criteria are reviewed to determine proper timing of revenue recognition.
- Unless performed under a maintenance contract, we recognize installation, service and maintenance revenue at the time the service is performed.
- We recognize revenue associated with maintenance agreements over the life of the contracts using the straight-line method, which approximates the expected timing in which applicable services are performed. Amounts collected in advance of revenue recognition are recorded as a current liability in the deferred revenue line of the consolidated balance sheet or as a 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 agreements using the straight-line method. Amounts collected in advance of revenue recognition are recorded as a current or long-term liability based on the time from the balance sheet date to the future date of revenue recognition.

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

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

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

Recently issued accounting pronouncements not yet adopted

In July 2015, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) No. 2015-11, (“ASU 2015-11”), *“Inventory (Topic 330): Simplifying the Measurement of Inventory”*. ASU 2015-11 requires an entity to measure in scope inventory at the lower of cost and net realizable value. The amendment does not apply to inventory that is measured using the last-in, first-out or the retail inventory method. For public entities, ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, and is to be applied prospectively. We do not expect the adoption of this standard will have a material effect on our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, (“ASU 2015-03”), *“Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs”*. ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. For public entities, ASU 2015-03 is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. ASU 2015-03 is to be applied on a retrospective basis and represents a change in accounting principle. We do not expect the adoption of this standard will have a material effect on our consolidated financial statements.

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

In May 2014, the FASB issued ASU 2014-09, *“Revenue from Contracts with Customers”, “Topic 606”*. This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance, and creates a Topic 606 Revenue from Contracts with Customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which defers the effective date of its new revenue recognition standard by one year. We will adopt this guidance January 1, 2018. We are evaluating the new guidelines to see if they will have a significant impact on our consolidated results of operation, financial condition or cash flows.

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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net loss	\$ (1,736)	\$ (2,496)	\$ (3,553)	\$ (10,783)
Basic and dilutive:				
Weighted-average shares of common stock outstanding used in computing basic and diluted net loss per share	23,135	23,124	23,132	22,271
Basic and diluted net loss per share	\$ (0.08)	\$ (0.11)	\$ (0.15)	\$ (0.48)

The calculation of diluted loss per share excludes 3,296,829 and 2,361,866 shares of common stock issuable upon exercise of employee stock options for the nine months ended September 30, 2015 and 2014, respectively, and non-vested shares of restricted stock units issuable upon vesting of 10,413 and 25,943 for the nine months ended September 30, 2015 and 2014, respectively, because their inclusion would be anti-dilutive.

4. Fair Value of Financial Instruments

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

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

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

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

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

Our Level 1 assets consist of cash equivalents, which are primarily invested in money-market funds. These assets are classified as Level 1 because they are valued using quoted prices in active markets and other relevant information generated by market transactions involving identical assets and liabilities. The fair value was \$3.1 million as of September 30, 2015 and December 31, 2014.

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

5. Guarantees

In certain geographical regions, particularly Europe, we are sometimes required to issue performance guarantees to our customers as a condition of sale. These guarantees usually provide financial protection to our customers in the event that we fail to fulfill our delivery or warranty obligations. We secure these guarantees with standby letters of credit through our bank. At September 30, 2015, we had a \$6,000 deposit guarantee outstanding for our building lease in Germany which renews every six months through the term of the lease agreement and a \$31,000 performance guarantee to a customer that was secured with a letter of credit, which expires in June 2017. Our \$0.5 million performance guarantee to a customer that was secured with a letter of credit as of June 30, 2015 expired in July 2015. As of December 31, 2014, our restricted cash balance was \$40,000, which consisted

primarily of secured performance and deposit guarantees. Our restricted cash, as shown on the balance sheet, is related to these guarantees.

6. Revolving Line of Credit

On July 28, 2014, we entered into a Third Amended and Restated Loan and Security Agreement (“Loan Agreement”) with Silicon Valley Bank (“SVB”). This amended three-year loan facility provides for a secured revolving line of credit in an aggregate amount of up to eighty percent (80%) of the facility amount of \$18.8 million, or \$15.0 million, and increased our inventory and purchase order availability from \$3.5 million to \$7.0 million, subject to certain borrowing bases. Purchase orders and eligible inventory are subject to a sublimit of \$4.0 million, and accounts receivable in the UK and Germany have a \$5.0 million sublimit. If we maintain our Liquidity Ratio of 2.50:1.00 for the immediately preceding Reconciliation Period, the sublimit will be uncapped. Further, the Third Amendment extended the maturity date to August 5, 2017 and reduces the finance charge to a per annum rate equal to SVB’s prime rate, subject to a minimum prime rate of 4.00%, plus (a) 0.50% for eligible accounts, inventory and purchase orders when we are Borrowing Base Eligible (as defined in the Loan Agreement), or (b) 1.20% for eligible accounts when we are not Borrowing Base Eligible. On September 30, 2015 the prime rate was 3.25%.

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

The other key terms of the Loan Agreement remain unchanged, including customary affirmative covenants, a minimum liquidity ratio, the borrowing base eligibility (formerly called the “streamline ratio”), reporting requirements, and other terms and conditions. We are currently in compliance with all loan covenants under the loan facility. As of September 30, 2015, we had outstanding borrowings of \$5.5 million under this loan facility and, based on the borrowing base formula, the additional amount available to us was \$9.4 million at September 30, 2015. As of December 31, 2014, our additional amount available to us was \$4.6 million. For further information regarding this loan facility, refer to our Annual Report on Form 10-K for the year ended December 31, 2014, and to our Current Report on Form 8-K filed on July 29, 2014.

7. Commitments and Contingencies

We may be involved, either as plaintiff or defendant, in a variety of ongoing claims, demands, suits, investigations, tax matters and proceedings that arise from time to time in the ordinary course of its business. We evaluated all potentially significant litigation, government investigations, claims or assessments in which we are involved and determined there were no contingent losses, either accrued or reasonably possible of loss that could materially affect its results of operations, financial condition, or cash flows.

We record an accrual with respect to a claim, suit, investigation or proceeding when it is reasonably probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Any recorded liabilities, including any changes to such liabilities for the quarter ended September 30, 2015, were not material to the Consolidated Financial Statements.

The following is a summary of our more significant legal matters.

SEC Inquiry

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

Settled Stockholder Litigation

Class action complaint

On September 10, 2013, a purported class action complaint was filed in the United States District Court for the Western District of Texas against us and certain of our former executives. The case was captioned *Don Lee v. Active Power, Inc., et. al.*

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

On September 23, 2014, we reached an agreement in principle and entered into a memorandum of understanding to settle the class action complaint. The parties to the class action signed a definitive settlement agreement on December 2, 2014, which was granted final approval by the Court on May 15, 2015. The settlement resolved for all defendants all of the issues that were pending in the class action complaint. The class action settlement resulted in a payment of \$1.5 million to the settlement class, inclusive of fees and expenses. This settlement amount was paid from insurance proceeds.

Derivative actions

On September 13, 2013 and October 14, 2013, two separate stockholders filed complaints in the District Court of Travis County, Texas, purporting to bring derivative actions on behalf of us against certain current and former officers and directors of the Company. The first derivative action was captioned *Okumura v. Almgren, et. al.* (Cause No. D-1-GN-13-003230), and the second derivative action was captioned *Shaev v. Milner, et. al.* (Cause No. D-1-GN-13-003557). The allegations of each derivative complaint mirrored those of the class action complaint, and they asserted claims for breach of fiduciary duty, unjust enrichment, and/or abuse of control and sought damages on our behalf. These derivative actions were stayed by agreement pending resolution of the motion to dismiss the securities class action. The stay was lifted and on August 4, 2014, the parties filed a joint motion to consolidate the two derivative cases. On September 18, 2014, the District Court appointed lead counsel in the consolidated derivative action.

On September 23, 2014, we reached an agreement in principle and entered into a memorandum of understanding to settle the consolidated derivative actions. The parties to the consolidated derivative actions signed a definitive settlement agreement on January 30, 2015, which was granted final approval by the Court on May 12, 2015. The settlement resolved for all defendants all of the issues that were pending in the consolidated derivative actions. The settlement fees and expenses were paid from insurance proceeds.

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, 2014, included in our 2014 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. For further discussion regarding forward-looking statements, please see “Cautionary Statement Regarding Forward-Looking Statements.” In addition, please see the “Risk Factors” in Part I, Item 1A, of our 2014 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, manufactures, sells, and services flywheel-based UPS products that use kinetic energy to provide short-term power as a cleaner alternative to conventional electro-chemical battery-based energy storage. We also design, manufacture, sell, and service MIS that integrate critical power components into a pre-packaged, purpose-built enclosure that may include our UPS products as a component. Our products and solutions are based on our patented flywheel and power electronics technology and are designed to ensure continuity for data centers and other mission critical operations in the event of power disturbances.

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

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

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

Results of Operations

Below are our revenues and costs and expenses for the three-month and nine-month periods ended September 30, 2015 and 2014. This information should be read in conjunction with our Consolidated Financial Statements and notes thereto contained in Item 1 of this Form 10-Q.

(\$ in thousands)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2015	2014	\$ change	% change	2015	2014	\$ change	% change
Product revenue	\$ 11,168	\$ 9,729	\$ 1,439	15 %	\$ 33,621	\$ 24,670	8,951	36 %
Service and other revenue	3,744	2,963	781	26 %	11,275	9,114	2,161	24 %
Total revenue	14,912	12,692	2,220	17 %	44,896	33,784	11,112	33 %
Cost of product revenue	8,496	7,490	1,006	13 %	24,556	19,747	4,809	24 %
Cost of service and other revenue	2,492	1,442	1,050	73 %	6,611	5,434	1,177	22 %
Total cost of goods sold	10,988	8,932	2,056	23 %	31,167	25,181	5,986	24 %
Gross profit	3,924	3,760	164	4 %	13,729	8,603	5,126	60 %
Operating expenses:								
Research and development	1,448	1,516	(68)	(4)%	4,394	5,196	(802)	(15)%
Selling and marketing	2,636	2,891	(255)	(9)%	8,057	8,931	(874)	(10)%
General and administrative	1,468	1,455	13	1 %	4,550	4,530	20	— %
Total operating expenses	5,552	5,862	(310)	(5)%	17,001	18,657	(1,656)	(9)%
Loss from Operations	(1,628)	(2,102)	474	23 %	(3,272)	(10,054)	6,782	67 %
Interest expense, net	(95)	(94)	(1)	(1)%	(252)	(301)	49	16 %
Other income (expense), net	(13)	(42)	29	69 %	(29)	(170)	141	83 %
Loss before income taxes	(1,736)	(2,238)	502	22 %	(3,553)	(10,525)	6,972	66 %
Income tax expense	—	(258)	258	100 %	—	(258)	258	100 %
Net loss	\$ (1,736)	\$ (2,496)	\$ 760	30 %	\$ (3,553)	\$ (10,783)	\$ 7,230	67 %

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

(\$ in thousands)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2015	2014	Variance		2015	2014	Variance	
			\$ change	% change			\$ change	% change
Product revenue:								
UPS product revenue	\$ 5,528	\$ 8,383	\$ (2,855)	(34)%	\$ 21,543	\$ 21,178	\$ 365	2%
Modular Infrastructure Solutions	5,640	1,346	4,294	319 %	12,078	3,492	8,586	246%
Total product revenue	\$ 11,168	\$ 9,729	\$ 1,439	15 %	\$ 33,621	\$ 24,670	\$ 8,951	36%

Total product revenue for the three-month period ended September 30, 2015 increased by \$1.4 million, or 15%, to \$11.2 million compared to \$9.7 million in the same period in 2014. The increase was driven primarily by an increase in MIS sales of \$4.3 million and offset by a decrease in UPS sales of \$2.9 million. The increase is due to a large order from our IT channel partner this quarter. Inherent variability in demand for our products contributes to quarterly fluctuations in mix as orders can range from multi-million dollar MIS or UPS shipments to a single module UPS shipment for less than \$100,000. One large MIS order in a quarter, for example, can have a significant impact on the business in any particular period.

Product revenue for the nine-month period ended September 30, 2015 increased by \$9.0 million, or 36%, to \$33.6 million compared to \$24.7 million in the same period in 2014. The increase was driven primarily by the increase in MIS business that was driven by a large order from our IT channel partner. The level of future orders will continue to fluctuate depending on our partner's success and need for infrastructure solutions.

Product revenue from our OEM channel for the three-month period ended September 30, 2015 was \$0.6 million, a decrease of approximately \$2.3 million, compared to revenue of \$2.9 million for the third quarter of 2014. For the nine-month period ended September 30, 2015, product revenue from our OEM channel was \$9.3 million, an increase of \$3.3 million, compared to \$6.0 million for the same period in 2014. The size and volume of orders from our OEM channel can fluctuate significantly on a quarterly basis, and we continue to see a small number of large transactions from our OEM channel. Total sales inclusive of service and spare parts to Caterpillar, our primary OEM channel, represented \$1.7 million and \$12.0 million, or 11% and 27% of our total revenue for the three-month and nine-month periods ended September 30, 2015, respectively, compared to \$3.0 million and \$6.7 million, or 24% and 20% of our total revenue, in the comparable periods of 2014.

Product revenue from our IT channel for the third quarter of 2015 was \$5.6 million, compared to \$1.3 million for the third quarter of 2014. For the nine-month period ended September 30, 2015, product revenue from our IT channel was \$10.1 million, an increase of \$8.0 million, compared to \$2.1 million for the same period of 2014. This increase in both periods was driven primarily by large orders that were partially shipped in the second quarter of 2015 and completed in the third quarter of 2015. Total sales to HPE, our primary IT channel partner, represented 38% and 23% of our total revenue for the three-month and nine-month periods ended September 30, 2015, compared to 0% and 2% of our total revenue, in the comparable periods of 2014.

Product revenue in the Americas was \$8.9 million, or 80% of our product revenue, for the three-month period ended September 30, 2015, compared to \$6.8 million, or 70% of our product revenue, for the same period in 2014. For the nine-month period ended September 30, 2015, our sales in the Americas were \$24.8 million, or 74% of our total product revenue, compared to \$15.9 million, or 65% for the same period in 2014. The increase reflects higher MIS revenues of \$4.3 million for the three-month period ended September 30, 2015 and \$8.4 million for the nine-month period ended September 30, 2015 due to large orders that were completed during the second and third quarters of 2015. We sell products directly to customers in APAC and EMEA and also through a network of international distributors. Product sales to customers in APAC were \$1.0 million, or 9% of our total product revenue, in the three-month period ended September 30, 2015, compared to \$0.6 million, or 6% for the same period in 2014. Our sales in APAC were \$1.3 million, or 4% of our total product revenue, in the nine-month period ended September 30, 2015, compared to \$1.8 million, or 7% for the same period in 2014. The decrease was driven by lower UPS sales.

Product revenue in EMEA was \$1.3 million, or 11% of product revenue, in the three-month period ended September 30, 2015, compared to \$2.3 million, or 24%, for the same period of 2014. Our sales in EMEA were \$7.6 million, or 22% of product revenue, in the nine-month period ended September 30, 2015, compared to \$6.9 million, or 28% for the same period in 2014. The

decrease in product revenue in EMEA for the three-month period ended September 30, 2015 was primarily attributable to lower OEM channel partner sales during the quarter. The increase in product revenue in EMEA for the nine-month period ended September 30, 2015 was primarily related to higher OEM channel partner sales for the year.

Service and other revenue. Service and other revenue increased by approximately \$0.8 million, or 26%, to \$3.7 million for the three-month period ended September 30, 2015, compared to \$3.0 million in the same period of 2014. For the nine-month period ended September 30, 2015, our service and other revenue increased by approximately \$2.2 million, or 24%, to \$11.3 million compared to \$9.1 million in the same period of 2014. These increases primarily reflects higher sales of spare parts and service revenue.

Cost of product revenue. Cost of product revenue as a percentage of total product revenue was 76% and 73% for the three-month and nine-month periods ended September 30, 2015, compared to 77% and 80% for the same periods in 2014. The decrease in costs as a percentage of revenue for the three-month and nine-month periods ended September 30, 2015 reflects a favorable mix with higher margin UPS and MIS sales along with continued improvements in manufacturing absorption associated with increased production from the prior year.

Cost of service and other revenue. Cost of service and other revenue as a percentage of total service and other revenue was 67% and 59% for the three-month and nine-month periods ended September 30, 2015, compared to 49% and 60% for the same periods of 2014. The increase in cost as a percentage of service revenue for the three-month period ended September 30, 2015 reflects higher unabsorbed costs and training costs for new employees. The decrease in cost as a percentage of service revenue for the nine-month period ended September 30, 2015 reflects a favorable mix of higher service contracts, an increase of higher margin spare parts and lower unabsorbed costs.

Gross profit. For the three-month periods ended September 30, 2015 and 2014, our gross profit was 26% and 30% of revenue, respectively. For the nine-month period ended September 30, 2015, our gross profit was 31% of revenue, compared to 25% for the same period of 2014. The margin decrease for the three-month period ended September 30, 2015 was related to an unfavorable mix of lower margin UPS sales, MIS mix containing a high proportion of third party content at lower margins and lower absorption. The lower margin UPS sales are a function of supply chain commitments we made more than two years ago to support our CleanSource HP UPS product at prices higher than we expect in the future. We expect to fully absorb these costs in the first half of 2016 resulting in improved margins. The margin increase for the nine-month period ended September 30, 2015 was related to a favorable mix of higher margin UPS sales along with higher MIS margins as we continue to improve manufacturing absorption from the previous year.

Research and development. Research and development expenses were \$1.4 million, \$0.1 million, or 4%, lower in the third quarter of 2015 compared to \$1.5 million in the third quarter of 2014. The decrease was primarily due to lower payroll expense of \$0.1 million and reduced fees from external parties of \$0.1 million related to prototype and testing expenses which were incurred in fiscal 2014.

For the nine-month period ended September 30, 2015, our research and development expense was \$4.4 million, compared to \$5.2 million or 15% lower for the same period of 2014. The decrease was primarily due to lower payroll expense and employee benefits of \$0.5 million and reduced fees from external parties of \$0.4 million related to prototype and testing expenses which were incurred in fiscal 2014.

Selling and marketing. Selling and marketing costs were approximately \$2.6 million in the third quarter of 2015, compared to \$2.9 million for the same period of 2014. The decrease was primarily due to lower payroll expense and sales commissions of \$0.3 million in 2015 compared to 2014.

Selling and marketing expenses were approximately \$8.1 million for the nine-month period ended September 30, 2015, compared to \$8.9 million for the same period of 2014. The decrease was primarily due to lower payroll expense and sales commissions of \$0.7 million and \$0.1 million in professional fees in 2015 compared to 2014.

General and administrative. General and administrative expenses for the three-month periods ended September 30, 2015 and 2014, were both approximately \$1.5 million. The decrease of bad debt expense of \$0.2 million was offset by an increase in salaries and employee benefits of \$0.2 million. General and administrative expenses for the nine-month period ending September 30, 2015 and 2014 was approximately \$4.6 million and \$4.5 million, respectively. The decrease of legal expenses of \$0.2 million were offset by the increase in stock compensation expense of \$0.3 million.

Interest expense, net. Net interest expense for the three months ended September 30, 2015 remained flat at \$0.1 million compared to the same period in 2014. Net interest expense decreased approximately \$49,000 for the nine months ended

September 30, 2015, compared to the same period in 2014. The decrease is related to the lower interest rate related to our amended Loan Agreement (defined herein) in fiscal 2014 from the outstanding balance on our revolving credit facility.

Other income (expense), net. Other income (expense), net for the three months ended September 30, 2015 decreased approximately \$29,000 compared to the same period of 2014, which primarily reflects foreign exchange losses or gains on settlement of intercompany balances and sales contracts held in foreign currencies.

Other income (expense), net for the nine month period ended September 30, 2015 decreased approximately \$0.1 million, or 83%, compared to the same period of 2014, and primarily reflects foreign exchanges losses or gains on settlement of intercompany balances and sales contracts held in foreign currencies.

Liquidity and Capital Resources

Our primary sources of liquidity at September 30, 2015 are our cash and cash equivalents, our bank credit facilities, and projected cash flows from operating activities. If we meet our cash flow projections, we expect we will have adequate capital resources to continue operating our business for at least the next twelve months. Our projections and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, there are scenarios in which our revenues may not meet our projections, our costs may exceed our estimates, or our working capital needs may be greater than anticipated. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in the remainder of 2015 and beyond or significantly affect our level of liquidity.

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

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

The other key terms of the Loan Agreement remain unchanged, including customary affirmative covenants, a minimum liquidity ratio, the borrowing base eligibility (formerly called the “streamline ratio”), reporting requirements, and other terms and conditions. We are currently in compliance with all loan covenants under the loan facility. As of September 30, 2015, we had outstanding borrowings of \$5.5 million under this loan facility and, based on the borrowing base formula, the additional amount available to us for use ranged between \$9.2 million and \$9.5 million during the quarter. For further information regarding this loan facility, refer to our Annual Report on Form 10-K for the year ended December 31, 2014, and to our Current Report on Form 8-K filed on July 29, 2014.

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

Should additional funding be required or desirable, we would expect to raise the required funds through borrowings or public or private sales of debt or equity securities. If we raise additional funds through the issuance of convertible debt or equity securities, the ownership of our existing stockholders could be significantly diluted. If we obtain additional debt financing, a substantial portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, and the terms of the debt securities issued could impose significant restrictions on our operations. We do not know whether we

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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.

Operating Activities

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

(\$ in thousands)	Nine Months Ended September 30,		Variance	
	2015	2014	\$	%
Cash used in operating activities	\$ (3,418)	\$ (8,663)	\$ 5,245	61%

Cash used in operating activities was \$3.4 million in the nine-month period ended September 30, 2015 compared to \$8.7 million for the same period of 2014. Cash used in operating activities in 2015 was primarily derived from our net loss of \$3.6 million along with our \$2.7 million increase in accounts receivables and our \$1.2 million increase in inventory offset by a \$1.3 million increase in accounts payables and accrued expenses. These changes reflect the frequent changes in our working capital, which can be impacted by the timing of product orders and shipments and can result in very large fluctuations in inventory, payables and receivables based on the large size of some of our orders.

Cash used in operating activities in 2014 was primarily due to higher net losses combined with a reduction in accrued expenses.

Investing Activities

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

(\$ in thousands)	Nine Months Ended September 30,		Variance	
	2015	2014	\$	%
Cash used in investing activities	\$ (679)	\$ (272)	\$ (407)	(150)%

Investing activities consist of purchases of property and equipment. Capital expenditures were \$0.4 million higher in the nine-month period ending September 30, 2015, compared to the same period of 2014, as we invested more in capital improvements during 2015.

Financing Activities

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

(\$ in thousands)	Nine Months Ended September 30,		Variance	
	2015	2014	\$	%
Cash (used in) provided by financing activities	\$ (8)	\$ 10,553	\$ (10,561)	(100)%

Funds used in financing activities in the nine-month ended September 30, 2015 primarily includes net share settlement of equity awards.

Funds provided by financing activities in the nine-month period ended September 30, 2014 primarily includes the sale of common stock at a purchase price of \$3.15 per share, for proceeds, net of fees and expenses, of approximately \$10.4 million, in a public underwritten offering, and also reflects the proceeds from the exercise of employee stock options.

We believe that our cash and cash equivalents, projected cash flows from operations and sources of available liquidity will be sufficient to fund our operations for the next 12 months. However, a sudden change in business volume, positive or negative, from any of our business or channel partners, or in our direct business, or any customer-driven events such as order or delivery deferral, could significantly impact our revenues and cash needs. We do have some opportunity to adjust expenditures or take

other measures to reduce our cash consumption or to identify additional sources of funding if we anticipate an increase in our working capital requirements due to increased revenues or changes in our revenue mix. A significant increase in sales, especially in our MIS business, would likely increase our working capital requirements, due to the longer production time and cash cycle of sales of these products.

Off-Balance Sheet Arrangements, Guarantees and Other Contingent Obligations

There have been no significant changes to our off-balance sheet arrangements or contractual commitments from those disclosed in our 2014 Annual Report on Form 10-K.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

For a description of our market risks, see Part I, Item 7A in our 2014 Annual Report on Form 10-K. There have been no material changes in our exposures to market risk since December 31, 2014.

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, 2015, our disclosure controls and procedures were effective at a reasonable assurance level 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, 2015, 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.

Refer to note 7, "Commitments and Contingencies," on pages 12 to 13 of this Form 10-Q.

Item 1A. Risk Factors.

There have been no material changes from the risk factors described in our 2014 Annual Report on Form 10-K. You should carefully consider the risks described in Item 1A of our 2014 Annual Report on Form 10-K before making a decision to invest in our common stock or evaluating Active Power and our business. The risks and uncertainties described in our 2014 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.

Item 6. Exhibits.

See the Exhibit Index beginning on page 22 of this Form 10-Q.

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INDEX TO EXHIBITS

Exhibit No.	Description of Exhibit
3.1*	Restated Certificate of Incorporation of Active Power, Inc., as amended (filed as Exhibit 3.1 to Active Power Inc.'s Quarterly Report on Form 10-Q filed on August 1, 2014)
3.2*	Second Amended and Restated Bylaws of Active Power, Inc., as amended (filed as Exhibit 3.2 to Active Power Inc.'s Quarterly Report on Form 10-Q filed on May 1, 2014)
4.1*	Specimen certificate for shares of Common Stock (filed as Exhibit 4.1 to Active Power's IPO Registration Statement on Form S-1 (SEC File No. 333-36946))
4.2*	See Exhibits 3.1 and 3.2 for provisions of the Certificate of Incorporation and Bylaws of the registrant defining the rights of holders of common stock
10.1†	Seventeenth Amendment to Lease between TR Stonehollow Corp. (successor-in-interest to Stonehollow Industrial Investors, LLC) and Active Power, Inc.
10.2†	Fifth Amendment to Lease Agreement between Levy Braker 12 Associates, LLC and Active Power, Inc.
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 2002
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 2002
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 2002
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 2002
101†	The following financial statements from the Active Power's Quarterly Report on Form 10-Q for the quarter ended September 30, 2015, formatted in XBRL: (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations and Comprehensive Loss, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) Notes to Condensed Consolidated Financial Statements.

* Incorporated by reference to the indicated filing.

† Filed with this report.

†† Furnished with this report.

SEVENTEENTH AMENDMENT TO LEASE

This **SEVENTEENTH AMENDMENT TO LEASE** (this "Seventeenth Amendment") is made this 27th day of July, 2015 ("Execution Date"), by and between **TR STONEHOLLOW CORP.**, a Delaware corporation ("Landlord"), and **ACTIVE POWER, INC.**, a Delaware corporation ("Tenant").

WHEREAS, Braker Phase III, Ltd. (the "Prior Landlord"), a predecessor-in-interest to Landlord, and Magnetic Bearing Technologies, Inc. ("MBT"), now known as Tenant as a result of a name change, entered into that certain Lease Agreement dated March 12, 1996 (the "Original Lease"), as amended by that certain First Amendment to Lease Agreement dated as of June 24, 1996 between Prior Landlord, and MBT (the "First Amendment"), as further amended by that certain Second Amendment to Lease Agreement dated as of September 4, 1996 between Prior Landlord and Tenant (the "Second Amendment"), as amended by that certain Third Amendment to Lease Agreement dated as of October 10, 1997 between Prior Landlord and Tenant (the "Third Amendment"), as amended by that certain Fourth Amendment to Lease Agreement dated as of August 20, 1999 between Metropolitan Life Insurance Company, a predecessor-in-interest to Landlord ("Met Life") and Tenant (the "Fourth Amendment"), as amended by that certain Fifth Amendment to Lease Agreement dated as of February 9, 2000 between Met Life and Tenant (the "Fifth Amendment"), as amended by that certain Sixth Amendment to Lease Agreement dated as of September 22, 2000 between Met Life and Tenant (the "Sixth Amendment"), as amended by that certain Seventh Amendment to Lease Agreement dated as of April 10, 2001 between Met Life and Tenant (the "Seventh Amendment"), as amended by that certain Eighth Amendment to Lease Agreement dated as of May 7, 2001 between Met Life and Tenant (the "Eighth Amendment"), as amended by that certain Ninth Lease Amendment to Lease Agreement dated as of June 27, 2002 between Met Life and Tenant (the "Ninth Amendment"), as amended by that certain Tenth Amendment to Lease Agreement dated as of January 31, 2003 between Met Life and Tenant (the "Tenth Amendment"), as amended by that certain Eleventh Amendment to Lease Agreement dated as of July 31, 2003 between Met Life and Tenant (the "Eleventh Amendment"), as amended by that certain Twelfth Amendment to Lease Agreement dated as of February 8, 2005 between Met Life and Tenant (the "Twelfth Amendment"), as amended by that certain Thirteenth Amendment to Lease Agreement dated as of December 7, 2005 between Braker-Stonehollow, Ltd., a predecessor-to-Landlord, and Tenant (the "Thirteenth Amendment"), as amended by that certain Fourteenth Amendment to Lease Agreement dated as of March 6, 2007 between Windsor at Stonehollow, LP, a predecessor-to-Landlord ("Windsor") and Tenant (the "Fourteenth Amendment"), as amended by that certain Fifteenth Amendment to Lease Agreement dated as of January 19, 2010 between Windsor and Tenant (the "Fifteenth Amendment"), and as further amended by that certain Sixteenth Amendment to Lease Agreement dated April 12, 2012 between Stonehollow Industrial Investors, LLC, a predecessor-in-interest to Landlord, and Tenant (the "Sixteenth Amendment", and collectively with the Original Lease, First Amendment, Second Amendment, Third Amendment, Fourth Amendment, Fifth Amendment, Sixth Amendment, Seventh Amendment, Eighth Amendment, Ninth Amendment, Tenth Amendment, Eleventh Amendment, Twelfth Amendment, Thirteenth Amendment, Fourteenth Amendment and Fifteenth Amendment, the "Lease"), under which Landlord demised to Tenant the premises comprising approximately 12,150 rentable square

feet on the first (1st) floor of the building, known as Suites 130 and 135 (together, the "Premises") of the building known as Stonehollow 1 located at 11525 Stonehollow Drive, Austin, Texas (the "Building"), all as more particularly set forth in the Lease.

WHEREAS, Landlord and Tenant desire to extend the Term, modify the rent due under the Lease and amend certain other provisions of the Lease, as more particularly set forth in this Seventeenth Amendment.

NOW, THEREFORE, in consideration of the mutual agreements herein set forth, the mutual agreements set forth in the Lease, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant have agreed, and hereby agree that the Lease is amended as follows:

1. **Recitals Incorporated.** The Recitals set forth above are hereby incorporated by this reference and shall be deemed terms and provisions hereof with the same force and effect as if fully set forth in this Section 1.

2. **Defined Terms.** Capitalized terms which are not otherwise defined herein shall be deemed to have the same meanings herein as are ascribed to such terms in the Lease. All references herein to "Lease" shall be deemed to be references to the Lease, as amended hereby.

3. **Term.** The term currently expires on March 31, 2016. The term is hereby extended for a period of sixty nine (69) months commencing on April 1, 2016 (the "Extension Term Commencement Date") and terminating on December 31, 2021 (the foregoing period being referred to as the "Extension Term"), unless earlier terminated or extended as provided in the Lease.

4. **Base Rent and Additional Rent.** Commencing on April 1, 2016 and continuing through the expiration of the Extension Term, Tenant shall pay the following amounts as Base Rent for the Premises which shall be payable in accordance with the provisions of the Lease:

<u>Period</u>	<u>Annual Base Rent</u>	<u>Monthly Base Rent</u>	<u>Annual Rate Per Rentable Square Foot</u>
04/01/16 – 03/31/17	\$164,025.00	\$13,668.75	\$13.50
04/01/17 – 03/31/18	\$166,941.00	\$13,911.75	\$13.74
04/01/18 – 03/31/19	\$169,857.00	\$14,154.75	\$13.98
04/01/19 – 03/31/20	\$172,773.00	\$14,397.75	\$14.22
04/01/20 – 03/31/21	\$175,689.00	\$14,640.75	\$14.46
04/01/21 – 12/31/21	\$178,605.00	\$14,883.75	\$14.70

All other terms of the Lease regarding the payment of Base Rent remain unchanged. Tenant shall continue to pay all other amounts payable under the Lease.

5. **Condition of Premises.** Tenant is in possession of the Premises and accepts the same “as is” without any representations or warranties of any kind except those provided in the Lease, if any. No agreement of Landlord to alter, remodel, decorate, repair or improve the Premises, or the Building (except to provide Tenant with the credit or allowance for the same as described in Section 6 of this Seventeenth Amendment), and no representation regarding the condition of the Premises, or the Building, have been made by or on behalf of Landlord or relied upon by Tenant.

6. **Tenant Improvements; Allowance.**

(a) **Tenant Improvements.** Landlord agrees that Tenant may complete, at Tenant's sole cost and expense, subject to the application of the Improvement Allowance (defined in Section 6(b) below), certain improvements in the Premises which include, but are not limited to: new paint, new carpet and break room upgrades (collectively, the “Interior Improvements”); and mechanical expenses solely related to HVAC unit repair and replacement expenses (the “Mechanical Expenses”, and together with the Interior Improvements, the "Tenant Improvements") in accordance with the plans (the "Plans") and the terms and conditions set forth in this Section 6. The Tenant Improvements shall be completed (i) in a good and workmanlike manner, (ii) in accordance with the Plans and any revisions to the Plans submitted by Tenant and approved by Landlord in writing, (iii) subject to all terms and conditions of the Lease, including, but not limited to, Article 6 of the Original Lease governing alterations and additions in the Premises by Tenant, (iv) by contractors and subcontractors selected by Tenant, which contractors and subcontractors shall be subject to the prior approval of Landlord, and (v) in compliance with all applicable building codes, laws and regulations (including, without limitation, the Americans with Disabilities Act).

(b) **Improvement Allowance.** Provided that Tenant is not then in default under the Lease beyond the expiration of any applicable notice and grace periods, Landlord shall provide Tenant with an improvement allowance of Sixty Five Thousand and 00/100 Dollars (\$65,000.00) (the "Improvement Allowance"), for actual, verifiable, out-of-pocket Construction Costs (as hereinafter defined) incurred by Tenant for the Tenant Improvements. At least Thirty Thousand and 00/100 Dollars (\$30,000.00) of the Improvement Allowance must be used for the Mechanical Expenses (the “HVAC Portion of the Allowance”). The "Construction Costs" shall be deemed to mean and include only the following costs incurred by Tenant in completion of the Tenant Improvements: (1) all hard costs and expenses pertaining to the completion of the Tenant Improvements, including, but not limited to, parts and supplies, mechanical units, and costs charged by suppliers, contractors, subcontractors and other parties for materials and labor, (2) architectural and engineering fees, and (3) costs of permits, licenses and other governmental approvals required for the performance of the Tenant Improvements. The HVAC Portion of the Allowance shall be paid by Landlord to Tenant within fourteen (14) days after Landlord's receipt and approval of applicable purchase orders for the Mechanical Expenses. The balance of the Improvement Allowance shall be paid by Landlord to Tenant within fourteen (14) days after Landlord's receipt and approval of the applicable purchase orders therefor. Tenant shall be solely and exclusively responsible for all Construction Costs which exceed the amount of the Improvement Allowance and any costs of completing the Tenant Improvements that do not qualify as Construction Costs.

(c) Procedure. Intentionally Omitted.

(d) Completion of Tenant Improvements. Upon completion of the Tenant Improvements, Tenant shall furnish Landlord with: (i) a written certification signed by Tenant stating the work performed and/or materials provided with respect to the Tenant Improvements; (ii) a written detailed list of the amounts theretofore paid thereon (with receipted invoices or other evidence supporting the payment of such amounts); and (iii) final unconditional waivers of liens and contractors' affidavits, in such form as is required to release any such lien rights, from all parties performing labor or supplying materials or services in connection with the Tenant Improvements showing that all of said parties have been compensated in full and waiving all liens in connection with the Premises and the Building. If, at the expiration of the Extension Term, as extended, if applicable, or the earlier termination of the Lease, any portion of the Improvement Allowance remains unapplied, such portion shall be deemed forfeited by Tenant and shall remain with Landlord.

7. Option to Extend.

(a) Provided that an Event of Default has not occurred and is continuing under the Lease, and provided further that the Lease shall not have theretofore been assigned, nor all or more than 50% of the Premises sublet, Tenant shall have the right, at Tenant's option, to extend the term of the Lease for one (1) additional period of five (5) years (the "Renewal Term"). Such option to extend (the "Option to Extend") shall be exercised by Tenant giving written notice of the exercise thereof to Landlord not less than six (6) months before the expiration date of the Extension Term. The Renewal Term shall be upon the same terms, covenants, and conditions as set forth in the Lease with respect to the term, except that (a) unless otherwise agreed to by Landlord and Tenant, Landlord shall have no obligation whatsoever to alter, improve or remodel the Premises and (b) the Annual Base Rent and additional rent, including Tenant's Proportionate Share of Tenant Costs, payable during the Renewal Term, if exercised, shall equal then-prevailing Fair Market Rental Rate for the Premises, as defined below. At any time within eight (8) months prior to the expiration date of the Extension Term, Tenant may request in writing that Landlord provide Tenant with its determination of the Fair Market Rental Rate for the Premises which shall apply during the Renewal Term and Landlord shall furnish same in writing to Tenant within thirty (30) days after such request.

(b) For purposes of this Section, the term "Fair Market Rental Rate" shall mean the fair rental, as of the date for which such Fair Market Rental Rate is being calculated, per annum per rentable square foot for comparable space for a comparable term, by reference to comparable space with a comparable use in the Building, and in other buildings comparable to the Building in quality and location in the Austin, Texas industrial market (the "Pertinent Market") (but excluding those leases where the tenant has an equity interest in the property), where the landlord has had a reasonable time to locate a tenant who rents with the knowledge of the uses to which the Premises can be adapted, and neither landlord nor the prospective tenant is under any compulsion to rent. The Fair Market Rental Rate shall take into account and reflect the rental rates for new tenancies of similar quality properties and size.

(c) Tenant shall have fifteen (15) days ("Tenant's Review Period") after receipt of Landlord's notice of the Fair Market Rental Rate within which to accept such rental or to object

thereto in writing. In the event Tenant fails to accept or reject Landlord's determination of the Fair Market Rental Rate in writing prior to the expiration of Tenant's Review Period, Tenant shall be deemed to have accepted Landlord's determination and it shall be binding on Tenant. In the event that Tenant objects to Landlord's determination of the Fair Market Rental Rate in writing during Tenant's Review Period, Landlord and Tenant shall attempt to agree upon such Fair Market Rental Rate using their good faith efforts. If Landlord and Tenant fail to reach agreement within fifteen (15) days following the expiration of Tenant's Review Period (the "Outside Agreement Date"), then each party shall place in a separate sealed envelope their final proposal as to Fair Market Rental Rate and such determination shall be submitted to arbitration in accordance with subsections (d) and (e) below.

(d) Landlord and Tenant shall meet with each other within five (5) business days of the Outside Agreement Date and exchange their respective determinations of the Fair Market Rental Rate in sealed envelopes and then open such envelopes in each other's presence (each determination respectively, "Landlord's Determination" and "Tenant's Determination", and together, the "Determinations"). If Landlord and Tenant do not mutually agree upon the Fair Market Rental Rate within one (1) business day of the exchange and opening of envelopes, then, the Fair Market Rental Rate shall be determined as follows, each party being bound by its determination and Landlord's Determination and Tenant's Determination establishing the only two choices available to the Appraisal Panel (as hereinafter defined).

(e) Within ten (10) days after the parties exchange the Determinations, the parties shall each appoint an arbitrator who shall be (A) a licensed Texas real estate broker with at least ten (10) years' experience in leasing industrial space in buildings similar to the Building in the Pertinent Market immediately prior to his or her appointment and (B) familiar with the rentals then being charged in the Building and in the comparable buildings. Landlord and Tenant may each appoint the real estate brokers who assisted in shaping Landlord's Determination and Tenant's Determination, respectively, as their respective arbitrators. If either Landlord or Tenant fails to appoint an arbitrator within the ten (10) day period, the Fair Market Rental Rate for the Extension Term shall be deemed to be the Determination of the party who properly selected an arbitrator. Within ten (10) days following their appointment, the two arbitrators so selected shall appoint a third, similarly qualified, independent arbitrator who has not had any prior business relationship with either party (the "Independent Arbitrator"). If an Independent Arbitrator has not been so selected by the end of such ten (10) day period, then either party, on behalf of both, may request such appointment by the local office of the Texas Association of Realtors or the American Arbitration Association (or any successor thereto). Within five (5) days after the appointment of the Independent Arbitrator, Landlord and Tenant shall submit copies of Landlord's Determination and Tenant's Determination to the three arbitrators (the "Appraisal Panel"). The Appraisal Panel shall conduct a hearing, at which Landlord and Tenant may each make supplemental oral and/or written presentation, with an opportunity for rebuttal by the other party and for questioning by the members of the Appraisal Panel, if they so wish. Within ten (10) days following the hearing, the Appraisal Panel, by majority vote, shall select either Landlord's Determination or Tenant's Determination of Fair Market Rental Rate for the Renewal Term, shall have no right to propose a middle ground or to modify either of the two proposals or the provisions of the Lease, and the Appraisal Panel shall render such decision to Landlord and Tenant within such ten (10) day period. The decision of the

Appraisal Panel shall be final and binding upon the parties, and may be enforced in accordance with the provisions of the law of the State of Texas. In the event of the failure, refusal or inability of any member of the Appraisal Panel to act, a successor shall be appointed in the manner that applied to the selection of the member being replaced. The party whose determination was not selected by the Appraisal Panel shall pay all of the fees and expenses of the arbitrators designated by each party, the fees and expenses of the Independent Arbitrator, and the costs and expenses incident to the proceedings (excluding attorneys' fees and similar expenses of the parties which shall be borne separately by each of the parties).

(f) Should the term of the Lease be extended hereunder, Tenant shall, if required by Landlord, execute an amendment modifying the Lease within ten (10) business days after Landlord presents same to Tenant, which agreement shall set forth the Annual Base Rent for the Renewal Term and the other economic terms and provisions in effect during the Renewal Term. Should Tenant fail to execute the amendment (which amendment accurately sets forth the economic terms and provisions in effect during the Renewal Term) within ten (10) business days after presentation of same by Landlord, time being of the essence, Tenant's right to extend the term of the Lease shall, at Landlord's sole option, terminate, and Landlord shall be permitted to lease such space to any other person or entity upon whatever terms and conditions are acceptable to Landlord in its sole discretion.

8. **Notices.** The address of Landlord for notices under the Lease is hereby amended to substitute the following addresses:

c/o Cornerstone Real Estate Advisers LLC
150 South Wacker Drive, Suite 350
Chicago, Illinois 60606
Attention: Asset Manager, Stonehollow

With a copy to:

Holland & Knight LLP
131 S. Dearborn Street, 30th Floor
Chicago, Illinois 60603
Attention: James T. Mayer, Esq.

9. **Broker.** Landlord and Tenant represent and warrant to each other that they have had no dealings with any real estate broker, finder or other person entitled to compensation for services rendered in connection with the negotiation or execution of this Seventeenth Amendment other than HPI Corporate Services, LLC, representing Tenant (the "Broker"), and Landlord and Tenant each agree to defend, indemnify and hold harmless the other from and against any claim for broker's or finder's fees or commissions made by any entity, other than the Broker, asserting such claim by, through or under it. Landlord shall be responsible to pay a commission to the Broker pursuant to a separate agreement.

10. **Counterparts.** This Seventeenth Amendment may be executed in counterparts, each of which shall constitute an original, and all of which, when taken together, shall constitute one and the same instrument.

11. **Time is of the Essence.** Time is of the essence of this Seventeenth Amendment and the Lease and each provision hereof and thereof.

12. **Submission of Seventeenth Amendment.** Submission of this instrument for examination shall not bind Landlord and no duty or obligation on Landlord shall arise under this instrument until this instrument is signed and delivered by Landlord and Tenant.

13. **Entire Agreement.** This Seventeenth Amendment and the Lease contain the entire agreement between Landlord and Tenant with respect to Tenant's leasing of the Premises. Except for the Lease and this Seventeenth Amendment, no prior agreements or understandings with respect to the Premises shall be valid or of any force or effect.

14. **Severability.** If any provision of this Seventeenth Amendment or the application thereof to any person or circumstance is or shall be deemed illegal, invalid or unenforceable, the remaining provisions hereof shall remain in full force and effect and this Seventeenth Amendment shall be interpreted as if such illegal, invalid or unenforceable provision did not exist herein.

15. **Lease In Full Force and Effect.** Except as modified by this Seventeenth Amendment, all of the terms, conditions, agreements, covenants, representations, warranties and indemnities contained in the Lease remain in full force and effect. In the event of any conflict between the terms and conditions of this Seventeenth Amendment and the terms and conditions of the Lease, the terms and conditions of this Seventeenth Amendment shall prevail.

16. **Successors and Assigns.** This Seventeenth Amendment is binding upon and shall inure to the benefit of the parties hereto and their respective heirs, legal representatives, successors and assigns.

17. **U.S. Regulations - Patriot Act.** Tenant represents and warrants to, and covenants with, Landlord that neither Tenant nor any of its respective constituent owners or affiliates currently are, or shall be at any time during the term, in violation of any laws relating to terrorism or money laundering (collectively, the "Anti-Terrorism Laws"), including without limitation Executive Order No. 13224 on Terrorist Financing, effective September 24, 2001 and relating to Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten to Commit, or Support Terrorism (the "Executive Order") and/or the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (Public Law 107-56) (the "USA Patriot Act"). Tenant covenants with Landlord that neither Tenant nor any of its respective constituent owners or affiliates are or shall be during the term a "Prohibited Person," which is defined as follows: (i) a person or entity that is listed in the Annex to, or is otherwise subject to, the provisions of the Executive Order; (ii) a person or entity owned or controlled by, or acting for or on behalf of, any person or entity that is listed in the Annex to, or is otherwise subject to the provisions of, the Executive Order; (iii) a person or entity with whom Landlord is prohibited from dealing with or otherwise engaging in any transaction by any Anti-Terrorism Law, including without limitation the

Executive Order and the USA Patriot Act; (iv) a person or entity who commits, threatens or conspires to commit or support "terrorism" as defined in Section 3(d) of the Executive Order; (v) a person or entity that is named as a "specially designated national and blocked person" on the then-most current list published by the

U.S. Treasury Department Office of Foreign Assets Control at its official website, <http://www.treas.gov/offices/eotffc/ofac/sdn/t11sdn.pdf>, or at any replacement website or other replacement official publication of such list; and (vi) a person or entity who is affiliated with a person or entity listed in items (i) through (v), above.

18. **Confidentiality.** It is agreed and understood that Tenant has publicly filed the Lease with the United States Securities and Exchange Commission ("SEC"), and that Tenant will similarly publicly file this Seventeenth Amendment with the SEC.

19. **Exculpation.** It is understood and agreed expressly by and between the parties hereto, anything herein to the contrary notwithstanding, that each and all of the representations, warranties, covenants, undertakings and agreements made herein or in the Lease on the part of Landlord, while in form purporting to be the representations, warranties, covenants, undertakings and agreements of Landlord, are nevertheless each and every one of them made and intended, not as personal representations, warranties, covenants, undertakings and agreements by Landlord or for the purpose or with the intention of binding Landlord personally, but are made and intended for the purpose only of subjecting Landlord's interest in the Building and the Land to the terms of this Seventeenth Amendment and the Lease and for no other purpose whatsoever, and in case of default hereunder by Landlord, Tenant shall look solely to the interests of Landlord in the Building and the Land; that Landlord shall have no personal liability whatsoever to pay any indebtedness accruing hereunder or to perform any covenant, either express or implied, contained herein; and that no personal liability or personal responsibility of any sort is assumed by, nor shall at any time be asserted or enforceable against, said Landlord, individually or personally, on account of any representation, warranty, covenant, undertaking or agreement of Landlord in this Seventeenth Amendment or the Lease contained, either express or implied, all such personal liability, if any, being expressly waived and released by Tenant and by all persons claiming by, through or under Tenant.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, Landlord and Tenant have executed this Seventeenth Amendment as of the day and year first above written.

LANDLORD:

TR STONEHOLLOW CORP.,
a Delaware corporation

By: /s/ T. Fleming
Name: T. Fleming
Its: Vice President

TENANT:

ACTIVE POWER, INC., a Delaware corporation

By: /s/ James A. Powers
Name: James A. Powers
Its: Chief Financial Officer and Vice President of Finance

FIFTH AMENDMENT TO LEASE AGREEMENT

THIS FIFTH AMENDMENT TO LEASE AGREEMENT (this "Fifth Amendment") is entered into as of the 30th day of September 2015, by and between Levy Braker 12 Associates, LLC, successor in interest BC 12 99, LTD ., a Texas Limited Partnership (the "Landlord"), and Active Power, Inc. (the "Tenant").

WITNESSETH

WHEREAS, Landlord and Tenant previously entered into a Lease, dated the 27th day of September, 2000 (which together with any amendments, modifications and extensions thereof, is hereinafter referred to as the "Lease") pursuant to which Landlord leased to Tenant certain premises located at 2128 Braker Lane, Austin, Texas 78758 known as Braker 12, containing approximately 126, 750 square feet of space ("Existing Premises").

WHEREAS, Landlord and Tenant desire to extend the terms of the Lease for the Premises on the terms and conditions set forth below:

NOW THEREFORE, in consideration of Ten Dollars (\$10.00) and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Landlord and Tenant agree as follows:

1. The Term of the Lease is hereby extended for five (5) years, commencing on January 1, 2017 ("Commencement Date of Extension Term") and continuing through and including December 31, 2021 (the "Extension Term").
2. The Monthly Base Rent for the Existing Premises during the Extension Term, due and payable in accordance with the Lease, shall be as follows:

January 1, 2017 through December 31, 2017: \$0.5767 per square foot/month
January 1, 2018 through December 31, 2018: \$0.5908 per square foot/month
January 1, 2019 through December 31, 2019: \$0.6058 per square foot/month
January 1, 2020 through December 31, 2020: \$0.6208 per square foot/month
January 1, 2021 through December 31, 2021: \$0.6367 per square foot/month

3. Landlord grants Tenant two (2) options to renew of five (5) years each under terms and conditions as outlined in Exhibit A to this Fifth Amendment to Tenant's lease.
4. Improvement Allowance: Landlord grants Tenant an Improvement Allowance with the terms and guidelines as stipulated in Allowance (A) and Allowance (B) below:

Allowance (A): Immediately upon execution of this Fifth Amendment, Landlord will provide Tenant an Allowance for Improvements to the Demised Premises and/or building, which must first be approved by the Landlord, not to unreasonably withheld. To qualify for

reimbursement from the Landlord, the Improvements (herein after referred to as the "Qualified Improvements") must enhance and/or add value to the Building and/or the Property and will be retained as the property of the Landlord once the Tenant vacates the Premises, and Landlord has the right to approve the proposed improvements, not to be unreasonably withheld.

Landlord will bear the financial responsibility for \$0.667 out of each \$1.00 expended on all Qualified Improvements, with a cap on the Landlord's expenditures of \$321,429. Tenant will bear the financial responsibility for \$0.333 out of each \$1.00 of each Qualified Improvements and for any other expenditures that are not deemed to be Qualified Improvements or exceed the Landlord's cap. To qualify for reimbursement from the Landlord, all such expenditures must be made between the time this Fifth Amendment is executed and the end of the amended term which expires on 12/31/2021. Landlord will reimburse Tenant within 30 days after Tenant submits copies of paid invoices showing the work to be completed and, if applicable, the associated release of liens from the contractor.

Allowance (B): Upon the execution of this Fifth Amendment, all previous financial commitments for HVAC Replacement costs will be considered null and void and the following language will apply instead. Landlord will bear the financial responsibility for \$0.667 out of each \$1.00 expended on the replacement of HVAC units, with a cap on the Landlord's expenditures of \$107,143. For clarification, the Improvement Allowance (A) above may also be used by Tenant towards HVAC Replacement costs. Tenant will bear the financial responsibility for \$0.333 out of each \$1.00 expended on the cost of each HVAC replacement and for any other such expenditures that exceed the Landlord's cap. Landlord will reimburse Tenant within 30 days after Tenant submits copies of paid invoices showing the work to be completed and the associated release of lien from the contractor.

5. During the Original Lease negotiations, Active Power requested the exclusive use of additional parking spaces not owned by the Landlord, but adjacent to the Property. To accommodate the request, a Parking Easement Agreement was created with the neighboring land owner, whereby as described in Section 5 B of the Original Lease, the Landlord is obligated to pay the owner of the additional parking spaces and the Tenant reimburses the Landlord for the associated costs. At Active Power's request, Landlord will use its commercially reasonable efforts to terminate the Parking Easement Agreement. Once terminated, both the Landlord and the Tenant will be relieved of the associated financial obligation. Tenant will be obligated to reimburse Landlord for any reasonable costs (legal, lender, etc.) associated with terminating the Parking Easement Agreement.
 6. Insofar as the specific terms and provisions of this Fifth Amendment purport to amend or modify or are in conflict with the specific terms, provisions and exhibits of the Lease, the terms and provisions of this Fifth Amendment shall govern and control; in all other respects, the terms, provisions and exhibits of the Lease shall remain unmodified and in full force and effect.
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7. Tenant and Landlord warrant to each other that they have had no dealings with any real estate broker or agent in connection with the negotiation or execution of this Amendment other than Blake Patterson and HPI Corporate Services, LLC, as Broker for the Tenant (the "Broker"), and that they know of no other real estate brokers or agents who are or might be entitled to a commission in connection with this Amendment. Tenant will indemnify, defend and hold harmless Landlord from and against any liability or claim arising in respect to any brokers or agents claiming a commission in connection with this Amendment by, through or under Tenant, other than the Broker. Landlord will pay Broker a commission equal to two percent (2%) of the aggregate Base Rental payable to Landlord less the aggregate of the Improvement Allowance dollars (\$428,572) defined in "4" above for the Premises over the Extension Term. Commission will be paid 50% upon full execution of the Amendment document and 50% within 30 days after the start of the renewal period and receipt of an invoice from the broker.

All other terms and conditions of the lease, except as expressly amended and modified hereby, shall remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have signed this Fifth Amendment to Lease Agreement as of the day and year first above written.

TENANT: LANDLORD:
Active Power, Inc. **Levy Braker 12 Associates, LLC**

By: /s/ James A. Powers By: Glen Una Management Company
Title: James A. Powers, CFO and VP of Finance Title: Its General Partner

By: /s/ Shuan Brannon
Shaun Brannon, Authorized Signer

Date: 9/24/15 Date: 9-28-15

Exhibit A
To Fifth Amendment
Tenant: Active Power, Inc.

Terms and Conditions for Tenant's Renewal Options:

(a) Provided that an Event of Default has not occurred and is continuing under the Lease, and provided further that the Lease shall not have theretofore been assigned, nor all or more than 50% of the Premises sublet, Tenant shall have the right, at Tenant's option, to extend the term of the Lease for two (2) additional periods of five (5) years (the "Renewal Term"). Such option to extend (the "Option to Extend") shall be exercised by Tenant giving written notice of the exercise thereof to Landlord not less than six (6) months before the expiration date of the Extension Term. The Renewal Term shall be upon the same terms, covenants, and conditions as set forth in the Lease with respect to the term, except that (a) unless otherwise agreed to by Landlord and Tenant, Landlord shall have no obligation whatsoever to alter, improve or remodel the Premises and (b) the Annual Base Rent and additional rent, including Tenant's Proportionate Share of Tenant Costs, payable during the Renewal Term, if exercised, shall equal then-prevailing Fair Market Rental Rate for the Premises, as defined below, however, notwithstanding the forgoing, in no case will the Annual Base Rent for the first year of the Renewal Term be less than the then current Base Rent which Base Rent will then escalate annually at a rate that is reasonable and comparable to a market escalation rate. At any time within eight (8) months prior to the expiration date of the Extension Term, Tenant may request in writing that Landlord provide Tenant with its determination of the Fair Market Rental Rate for the Premises which shall apply during the Renewal Term and Landlord shall furnish same in writing to Tenant within thirty (30) days after such request.

(b) For purposes of this Section, the term "Fair Market Rental Rate" shall mean the fair rental, as of the date for which such Fair Market Rental Rate is being calculated, per annum per rentable square foot for comparable space for a comparable term, by reference to comparable space with a comparable use in the Building, and in other buildings comparable to the Building in quality and location in the Austin, Texas industrial market (the "Pertinent Market") (but excluding those leases where the tenant has an equity interest in the property), where the landlord has had a reasonable time to locate a tenant who rents with the knowledge of the uses to which the Premises can be adapted, and neither landlord nor the prospective tenant is under any compulsion to rent. The Fair Market Rental Rate shall take into account and reflect the rental rates for new tenancies of similar quality properties and size.

(c) Tenant shall have fifteen (15) days ("Tenant's Review Period") after receipt of Landlord's notice of the Fair Market Rental Rate within which to accept such rental or to object thereto in writing. In the event Tenant fails to accept or reject Landlord's determination of the Fair Market Rental Rate in writing prior to the expiration of Tenant's Review Period, Tenant shall be deemed to have accepted Landlord's determination and it shall be binding on Tenant. In the event that Tenant objects to Landlord's determination of the Fair Market Rental Rate in writing during Tenant's Review Period, Landlord and Tenant shall attempt to agree upon such Fair Market Rental Rate using their good faith efforts. If Landlord and Tenant fail to reach agreement within fifteen (15) days following the expiration of Tenant's Review Period (the "Outside Agreement Date"), then each party shall place in a separate sealed envelope their final proposal as to Fair Market Rental Rate and such determination shall be submitted to arbitration in accordance with subsections (d) and (e) below.

(d) Landlord and Tenant shall meet with each other within fifteen (15) business days of the Outside Agreement Date and exchange their respective determinations of the Fair Market Rental Rate in sealed envelopes and then open such envelopes in each other's presence (each determination respectively, "Landlord's Determination" and "Tenant's Determination", and together, the "Determinations"). If Landlord and Tenant do not mutually agree upon the Fair Market Rental Rate within five (5) business day of the exchange and opening of envelopes, then, the Fair Market Rental Rate shall be determined as follows, each party being bound by its determination and Landlord's Determination and Tenant's Determination establishing the only two choices available to the Appraisal Panel (as hereinafter defined).

(e) Within ten (10) days after the parties exchange the Determinations, the parties shall each appoint an arbitrator who shall be (A) a licensed Texas real estate broker with at least ten (10) years' experience in leasing industrial space in buildings similar to the Building in the Pertinent Market immediately prior to his or her appointment and (B) familiar with the rentals then being charged in the Building and in the comparable buildings. Landlord and Tenant may each appoint the real estate brokers who assisted in shaping Landlord's Determination and Tenant's Determination, respectively, as their respective arbitrators. If either Landlord or Tenant fails to appoint an arbitrator within the ten (10) day period, the Fair Market Rental Rate for the Extension Term shall be deemed to be the Determination of the party who properly selected an arbitrator. Within ten (10) days following their appointment, the two arbitrators so selected shall appoint a third, similarly qualified, independent arbitrator who has not had any prior business relationship with either party (the "Independent Arbitrator"). If an Independent Arbitrator has not been so selected by the end of such ten (10) day period, then either party, on behalf of both, may request such appointment by the local office of the Texas Association of Realtors or the American Arbitration Association (or any successor thereto). Within five (5) days after the appointment of the Independent Arbitrator, Landlord and Tenant shall submit copies of Landlord's Determination and Tenant's Determination to the three arbitrators (the "Appraisal Panel"). The Appraisal Panel shall conduct a hearing, at which Landlord and Tenant may each make supplemental oral and/or written presentation, with an opportunity for rebuttal by the other party and for questioning by the members of the Appraisal Panel, if they so wish. Within ten (10) days following the hearing, the Appraisal Panel, by majority vote, shall select either Landlord's Determination or Tenant's Determination of Fair Market Rental Rate for the Renewal Term, shall have no right to propose a middle ground or to modify either of the two proposals or the provisions of the Lease, and the Appraisal Panel shall render such decision to Landlord and Tenant within such ten (10) day period. The decision of the Appraisal Panel shall be final and

binding upon the parties, and may be enforced in accordance with the provisions of the law of the State of Texas. However, to stipulate what has already been stated in "(a)", notwithstanding the forgoing, in no case will the Annual Base Rent for the first year of the Renewal Term be less than the then current Base Rent which Base Rent will then escalate annually at a rate that is reasonable and comparable to a market escalation rate. In the event of the failure, refusal or inability of any member of the Appraisal Panel to act, a successor shall be appointed in the manner that applied to the selection of the member being replaced. The party whose determination was not selected by the Appraisal Panel shall pay all of the fees and expenses of the arbitrators designated by each party, the fees and expenses of the Independent Arbitrator, and the costs and expenses incident to the proceedings (excluding attorneys' fees and similar expenses of the parties which shall be borne separately by each of the parties). However, if Landlord's Determination is indeed the then current Base Rent with the market annual escalation rate, and Tenant still chooses to go to Arbitration, the Tenant will be responsible for all associated costs. Should the term of the Lease be extended hereunder, Tenant shall, if required by Landlord, execute an amendment modifying the Lease within ten (10) business days after Landlord presents same to Tenant, which agreement shall set forth the Annual Base Rent for the Renewal Term and the other economic terms and provisions in effect during the Renewal Term. Should Tenant fail to execute the amendment (which amendment accurately sets forth the economic terms and provisions in effect during the Renewal Term) within ten (10) business days after presentation of same by Landlord, time being of the essence, Tenant's right to extend the term of the Lease shall, at Landlord's sole option, terminate, and Landlord shall be permitted to lease such space to any other person or entity upon whatever terms and conditions are acceptable to Landlord in its sole discretion.

CERTIFICATIONS

I, Mark A. Ascolese, 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 27, 2015

/s/ Mark A. Ascolese

Mark A. Ascolese
President and Chief Executive Officer
(Principal Executive Officer)

CERTIFICATIONS

I, James A. Powers, 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 27, 2015

/s/ James A. Powers

James A. Powers

Chief Financial

Officer and Vice President Finance

(Principal Financial and Accounting Officer)

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

In connection with the Quarterly Report on Form 10-Q of Active Power, Inc. (the "Company") for the period ending September 30, 2015, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark A. Ascolese, 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/ Mark A. Ascolese

Mark A. Ascolese

President and Chief Executive Officer

October 27, 2015

**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, 2015 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James A. Powers, Chief Financial Officer and Vice President of Finance 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/ James A. Powers

James A. Powers

Chief Financial Officer and Vice President of
Finance

October 27, 2015
