

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

**SCHEDULE TO  
TENDER OFFER STATEMENT UNDER SECTION 14(d)(1) OR 13(e)(1) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

**Active Power, Inc.**

(Name of Subject Company (Issuer) and Name of Filing Person (Offeror))

**Options to Purchase Common Stock, Par Value \$0.001 Per Share**

(Title of Class of Securities)

**00504W100**

(CUSIP Number of Class of Securities)  
(Underlying Ordinary Shares)

**John K. Penver  
Chief Financial Officer  
2128 W. Braker Lane, BK12  
Austin, Texas 78758  
(512) 836-6464**

(Name, address, and telephone numbers of person authorized to receive notices and communications on behalf of filing persons)

*Copies to:*

**Derek L. Willis, Esq.  
Wilson Sonsini Goodrich & Rosati  
Professional Corporation  
8911 Capital of Texas Highway  
Westech 360, Suite 3350  
Austin, Texas 78759  
Tel: (512) 338-5400**

**CALCULATION OF FILING FEE**

Transaction Valuation*	Amount of Filing Fee**
\$ 1,896,928	\$ 58.24

\* Estimated solely for the purposes of calculating the Amount of Filing Fee. The calculation of the Transaction Valuation assumes that all options to purchase the Issuer's common stock that are eligible for the offer will be repriced pursuant to this offer. These options have an aggregate value of \$1,896,928 as of November 9, 2007, calculated based on a modified Black-Scholes option pricing model.

\*\* The Amount of Filing Fee calculated in accordance with Rule 0-11(b) of the Securities Exchange Act of 1934, as amended, equals \$30.70 for each \$1,000,000 of the value of the transaction.

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

Amount Previously Paid:  
Form or Registration No.:

Filing Party:  
Date Filed:

Check the box if the filing relates solely to preliminary communications made before the commencement of a tender offer.

Check the appropriate boxes below to designate any transactions to which the statement relates:

- third-party tender offer subject to Rule 14d-1.  
 issuer tender offer subject to Rule 13e-4.  
 going-private transaction subject to Rule 13e-3.  
 amendment to Schedule 13D under Rule 13d-2.

Check the following box if the filing fee is a final amendment reporting the results of the tender offer:

## SCHEDULE TO

This Tender Offer Statement on Schedule TO relates to an offer (the "Offer") by Active Power, Inc., a Delaware corporation ("Active Power" or the "Company"), to amend certain outstanding options and receive a cash payment as set forth under the Offer to Amend the Exercise Price of Certain Options dated November 9, 2007 (the "Offer to Amend"), which is filed as Exhibit (a)(1)(A) hereto and incorporated herein by reference.

This Offer is being made upon the terms and subject to the conditions set forth in the Offer to Amend, which, as may be amended or supplemented from time to time, constitutes the Offer, and which is filed as Exhibit (a)(1)(A) hereto. This Tender Offer Statement on Schedule TO is intended to satisfy the reporting requirements of Section 13(e) of the Securities Exchange Act of 1934, as amended.

### **Item 1. Summary Term Sheet.**

The information set forth under "Summary Term Sheet and Questions and Answers" in the Offer to Amend is incorporated herein by reference.

### **Item 2. Subject Company Information.**

#### **(a) Name and address.**

The name of the issuer is Active Power, Inc., a company organized under the laws the State of Delaware, and the address of its principal executive office is 2128 W. Braker Lane, BK12, Austin, Texas 78758. Active Power's telephone number is (512) 836-6464. The information set forth in the Offer to Amend under Section 10, "Information concerning the Company," is incorporated herein by reference.

#### **(b) Securities.**

This Tender Offer Statement on Schedule TO relates to an offer by Active Power to holders of certain outstanding options to purchase its common stock granted under the Company's 2000 Stock Incentive Plan (the "2000 Stock Plan"), to amend certain of their outstanding options to purchase Active Power common stock and receive a cash payment as set forth in the Offer to Amend and upon the terms and subject to the conditions described in (i) the Offer to Amend attached hereto as Exhibit (a)(1)(A), (ii) the letter to all eligible employees from James Clissem, dated November 9, 2007, attached hereto as Exhibit (a)(1)(B), and (iii) the Election Form attached hereto as Exhibit (a)(1)(C).

As of November 2, 2007, there were options to purchase 825,785 shares of Active Power common stock outstanding and eligible to participate in this Offer.

#### **(c) Trading market and price.**

There is no established trading market for options to purchase the Company's common stock.

The information with respect to the Company's common stock set forth in the Offer to Amend under Section 8, "Price range of shares underlying the options," is incorporated herein by reference.

**Item 3. Identity and Background of Filing Person.**

**(a) Name and address.**

The filing person is the issuer. The information set forth under Item 2(a) above is incorporated herein by reference.

Pursuant to General Instruction C to Schedule TO, the information set forth on Schedule A to the Offer to Amend is incorporated herein by reference.

**Item 4. Terms of the Transaction.**

**(a) Material terms.**

The information set forth in the Offer to Amend under “Summary Term Sheet and Questions and Answers,” “Eligibility” (Section 1), “Number of options and amount of consideration; expiration date” (Section 2), “Procedures for electing to participate in this offer” (Section 4), “Withdrawal rights and change of election” (Section 5), “Acceptance of options for amendment, issuance of cash payments, and amended options” (Section 6), “Conditions of the offer” (Section 7), “Source and amount of consideration; terms of amended options” (Section 9), “Status of options amended by us in the offer; accounting consequences of the offer” (Section 12), “Legal matters; regulatory approvals” (Section 13), “Material United States income tax consequences” (Section 14), and “Extension of offer; termination; amendment” (Section 15), is incorporated herein by reference.

**(b) Purchases.**

None of the members of Active Power’s Board of Directors or Active Power’s executive officers may participate in the offer. The information set forth in the Offer to Amend under Section 11, “Interests of directors and executive officers; transactions and arrangements concerning the options,” is incorporated herein by reference.

**Item 5. Past Contracts, Transactions, Negotiations and Arrangements.**

**(a) Agreements involving the subject company’s securities.**

The information set forth in the Offer to Amend under Section 9, “Source and amount of consideration; terms of amended options,” and Section 11, “Interests of directors and executive officers; transactions and arrangements concerning the options,” is incorporated herein by reference. See also (i) the amended form of stock option agreement under the 2000 Stock Plan attached hereto as Exhibit (a)(1)(H), and (ii) the Active Power, Inc. 2000 Stock Incentive Plan (incorporated by reference to Exhibit 10.2 to Active Power’s Registration Statement on Form S-1 (SEC File No. 333-36946)).

**Item 6. Purposes of the Transaction and Plans or Proposals.**

**(a) Purposes.**

The information set forth in the Offer to Amend under Section 3, “Purposes of the offer” is incorporated herein by reference.

**(b) Uses of securities acquired.**

The information set forth in the Offer to Amend under Section 6, "Acceptance of options for amendment, issuance of cash payments, and amended options," and Section 12, "Status of options amended by us in the offer; accounting consequences of the offer," is incorporated herein by reference.

**(c) Plans.**

The information set forth in the Offer to Amend under Section 3, "Purpose of the offer," is incorporated herein by reference.

**Item 7. Source and Amount of Funds or Other Consideration.**

**(a) Sources of funds.**

The information set forth in the Offer to Amend under Section 9, "Source and amount of consideration; terms of amended options," and Section 16, "Fees and expenses," is incorporated herein by reference.

**(b) Conditions.**

The information set forth in the Offer to Amend under Section 7, "Conditions of the offer," is incorporated herein by reference.

**(c) Borrowed funds.**

Not applicable.

**Item 8. Interest in Securities of the Subject Company.**

**(a) Securities ownership.**

The information set forth in the Offer to Amend under Section 11, "Interests of directors and executive officers; transactions and arrangements concerning the options," is incorporated herein by reference.

**(b) Securities transactions.**

The information set forth in the Offer to Amend under Section 11, "Interests of directors and executive officers; transactions and arrangements concerning the options," is incorporated herein by reference.

**Item 9. Person/Assets, Retained, Employed, Compensated or Used.**

**(a) Solicitations or Recommendations.**

Not applicable.

**Item 10. Financial Statements.**

**(a) Financial information.**

The information set forth in the Offer to Amend under Section 18, "Financial statements," is incorporated herein by reference.

**(b) Pro forma information.**

Not applicable.

**Item 11. Additional Information.**

**(a) Agreements, regulatory requirements and legal proceedings.**

The information set forth in the Offer to Amend under Section 11, "Interests of directors and executive officers; transactions and arrangements concerning the options," and Section 13, "Legal matters; regulatory approvals," is incorporated herein by reference.

**(b) Other material information.**

Not applicable.

**Item 12. Exhibits.**

<b>Exhibit Number</b>	<b>Description</b>
(a)(1)(A)	Offer to Amend the Exercise Price of Certain Options, dated November 9, 2007
(a)(1)(B)	Email to all eligible employees from James Clishem, dated November 9, 2007
(a)(1)(C)	Election form
(a)(1)(D)	Email relating to addendum and form of addendum
(a)(1)(E)	Form of acknowledgment of receipt of documents relating to the offer
(a)(1)(F)	Form of reminder emails
(a)(1)(G)	Form amendment(s) to stock option agreements and promise to make cash payment under the 2000 Stock Incentive Plan, as amended and restated
(a)(1)(H)(i)	Form stock option agreement under Active Power, Inc. 2000 Stock Incentive Plan
(a)(1)(H)(ii)	Active Power, Inc. 2000 Stock Incentive Plan, incorporated by reference to Exhibit 10.2 to Active Power's Registration Statement on Form S-1 (SEC File No. 333-36946)
(b)	Not applicable
(d)	Not applicable
(g)	Not applicable
(h)	Not applicable

**Item 13. Information Required by Schedule 13e-3.**

Not applicable.

**SIGNATURE**

After due inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

ACTIVE POWER, INC.

/s/ JOHN K. PENVER

John K. Penver  
Chief Financial Officer

Date: November 9, 2007

## INDEX TO EXHIBITS

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(a)(1)(H)(ii)	Active Power, Inc. 2000 Stock Incentive Plan, incorporated by reference to Exhibit 10.2 to Active Power's Registration Statement on Form S-1 (SEC File No. 333-36946)
(b)	Not applicable
(d)	Not applicable
(g)	Not applicable
(h)	Not applicable

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ACTIVE POWER, INC.

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**OFFER TO AMEND THE EXERCISE PRICE OF CERTAIN OPTIONS**

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*This document constitutes part of a prospectus covering securities  
that have been registered under the Securities Act of 1933, as amended.*

**NOVEMBER 9, 2007**

ACTIVE POWER, INC.

Offer to Amend the Exercise Price of Certain Options

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**This offer and withdrawal rights will expire at  
5:00 p.m., Central Time, on December 11, 2007 unless we extend them.**

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By this Offer to Amend the Exercise Price of Certain Options (the “Offer to Amend”), we are giving all eligible employees holding eligible options to purchase shares of our common stock the right to amend certain outstanding options and, only if they hold certain outstanding options with an original exercise price per share less than \$2.50, to receive cash payments (we refer to this as the “offer”). Each eligible employee holding eligible options will be provided with an addendum (referred to as the “Addendum”) setting forth his or her eligible options, the new exercise price that would apply to each eligible option, if amended, a description of any potential cash payments and other details relating to your eligible options.

Active Power, Inc. has determined that certain of your stock options may have been granted at a discount from fair market value and therefore may be subject to adverse tax consequences under Section 409A of the United States Internal Revenue Code of 1986, as amended (the “Code”). These consequences include income inclusion at vesting, an additional 20% penalty tax and interest charges plus continued taxation, penalty taxes and interest charges in subsequent years (until the eligible option is exercised or expires) on any increase in the value of the underlying stock. **If you elect to participate in this offer, your eligible options no longer will be subject to such adverse tax consequences.**

You are an “eligible employee” only if:

- you are an employee of Active Power, Inc. or our subsidiaries (collectively referred to as “Active Power,” the “Company,” “we,” “our,” or “us”) as of the last date on which this offer remains open for acceptance;
- you are subject to taxation in the United States;
- you hold otherwise eligible options; and
- as of the last date on which this offer remains open for acceptance, you are not and have never been an officer or director of the Company for purposes of Section 16 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

An option to purchase common stock is eligible for this offer (“eligible option”) only to the extent that each of the following conditions is met:

- the option was granted under the Active Power, Inc. 2000 Stock Incentive Plan (the “Active Power Stock Plan”);
- it has been determined that the option may have an original exercise price per share that was less than the fair market value per share of the common stock underlying the option on the option’s measurement date (that is, it was granted at a “discount” to the then-current fair market value of the underlying stock);

- the option was unvested as of December 31, 2004 (if only a portion of an option grant was unvested as of December 31, 2004, the unvested portion of the grant may be an “eligible option”); and
- the option is outstanding as of the last date on which this offer remains open for acceptance.

If you participate in this offer, any eligible option with respect to which you accept this offer will be replaced with the following consideration:

1. Your eligible option will be amended to increase the exercise price per share to the fair market value of a share of the common stock of Active Power on the option’s measurement date for financial reporting purposes. If only a portion of your option grant vested or is scheduled to vest after December 31, 2004, then only that portion of the option grant is an eligible option and will be amended to increase the exercise price. Your Addendum will list the original exercise price of your eligible options, as well as the new exercise price of such options, should you accept this offer with respect to those options; and

2. In addition, if your eligible option had an original exercise price less than \$2.50 per share (“eligible cash payment option”), for each such eligible cash payment option amended in this offer, you will receive a cash payment, less applicable tax withholding, on the Company’s first payroll date in 2008 equal to the difference between the new exercise price per share of the amended option, and the original exercise price per share, multiplied by the number of unexercised shares of Active Power common stock subject to the amended option in the manner described below. Your Addendum will list the number of unexercised shares subject to your option, and, to the extent applicable, the cash payment you will be entitled to receive for each eligible cash payment option you elect to have amended.

#### Amended Options and Cash Payments

If you elect to participate in this offer, the eligible option will be amended on the date that this offer expires (currently expected to be December 11, 2007) and you will receive a promise to make payments promptly after the expiration of the offer. Each amended option will be subject to option agreements between you and the Company, as amended by this offer. Any amended option you receive will continue to be subject to the same vesting schedule.

Promptly following the expiration of the offer, we will send you an “Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment” evidencing the amendment of the options you elected to amend. In addition, the “Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment” will evidence your right to receive a cash payment for the eligible cash payment options you elected to have amended pursuant to this offer. Cash payments will be paid on the Company’s first payroll date in 2008 and all such payments will be subject to applicable tax withholding. Cash payments will not be subject to any vesting conditions, so you will receive any cash payments to which you are entitled on the Company’s first payroll date in 2008, regardless of whether the eligible cash payment option is vested and regardless of whether or not you are providing services to us then.

#### Other Matters

The offer is not conditioned upon this offer being accepted with respect to a minimum number of the outstanding eligible options, but the offer is subject to customary conditions, which we describe in Section 7 of this Offer to Amend. You are not required to accept this offer.

Our common stock is traded on The Nasdaq Global Market under the symbol “ACPW.” On November 8, 2007 the closing price of our common stock was \$2.01 per share. Before deciding to participate in this offer, you should evaluate current market quotes for our common stock, among other risks of participating in this offer.

See "Risks of Participating in the Offer" beginning on page 15 for a discussion of risks that you should consider before participating in this offer.

### IMPORTANT – ACTION ITEMS TO PARTICIPATE

If you participate in this offer, you must complete and sign the attached election form, and return it before 5:00 p.m., Central Time, on December 11, 2007, via fax or email to:

Jennifer Crow  
Finance Manager  
Active Power, Inc.  
Fax: (512) 836-4511  
Email: jennifercrow@activepower.com

Election forms submitted via email must contain your properly completed and signed election form as an attachment to your email. Only responses that are complete, signed, and actually received by the Company by the deadline will be accepted. Responses that are received after the deadline will not be accepted. The delivery of election forms is at your risk. Active Power intends to confirm the receipt of your election form by email within two U.S. business days. If you have not received an email confirmation that Active Power has received your response, you must confirm that we have received your election form. If you need to confirm receipt after two U.S. business days have elapsed, you may email Jennifer Crow at jennifercrow@activepower.com. Responses may be submitted only via fax or email. Responses submitted by any other means, including hand delivery, United States mail and Federal Express (or similar delivery service) are not permitted.

Neither the Securities and Exchange Commission (the "SEC") nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this offer. Any representation to the contrary is a criminal offense.

Active Power will not provide tax advice specific to an individual's circumstances. We recommend that you discuss the personal tax consequences of this offer with your financial, legal and/or tax advisors. You should direct general questions about the terms of this offer to:

John K. Penver  
Chief Financial Officer  
Active Power, Inc.  
Tel: (512) 744-9234  
Fax: (512) 836-4511  
Email: johnpenver@activepower.com

### Offer to Amend the Exercise Price of Certain Options, dated November 9, 2007.

**You should rely only on the information contained in this Offer to Amend or documents to which we have referred you. We have not authorized anyone to provide you with different information. Some state jurisdictions may also impose additional taxes with respect to your eligible options. We recommend that you consult with your financial, legal and/or tax advisors regarding any state tax consequences. We are not making an offer of the cash consideration or amended options in any jurisdiction in which the offer is not permitted. We are not aware of any jurisdiction where the making of the offer is not in compliance with applicable law. If we become aware of any jurisdiction where the making of the offer is not in compliance with any valid applicable law, we will make a good faith effort to comply with such law. If, after such good faith effort, we cannot comply with such law, the offer will not be made to, nor will options be accepted from, the option holders residing in such jurisdiction. You should not assume that the information provided in this Offer to Amend is accurate as of any date other than the date as of which is shown, or if no date is otherwise indicated, the date of this offer.**

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## SUMMARY TERM SHEET AND QUESTIONS AND ANSWERS

The following are answers to some of the questions that you may have about this offer. You should read carefully this entire offer, the accompanying email from James Clissem dated November 9, 2007, and the election form together with its associated instructions. This offer is made subject to the terms and conditions of these documents as they may be amended. The information in this summary is not complete. Additional important information is contained in the remainder of this Offer to Amend and the other offer documents. We have included in this summary references to other sections in this Offer to Amend to help you find a more complete description of these topics.

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**Q1. What is the offer?**

A1. This offer is a voluntary opportunity for eligible employees to elect to have certain outstanding options amended and, with respect to eligible options with an original exercise price per share less than \$2.50, to receive a cash payment. This opportunity is described in the following questions and answers and in the remainder of this Offer to Amend.

**Terms Used in the Offer**

The following are some terms that are frequently used in this Offer to Amend.

- “Active Power Stock Plan” refers to the Active Power, Inc. 2000 Stock Incentive Plan.
- “amended options” refers to eligible options that are amended pursuant to this offer.
- “amendment date” refers to the date when the eligible options with respect to which you accept this offer will be amended to reflect the new exercise price. We expect that the amendment date will be December 11, 2007, which is the same date as the expiration date of the offer. If the expiration date is extended, then the amendment date will be extended similarly.
- “Addendum” refers to the document that will be provided to each eligible employee. The Addendum will list eligible options and, for each eligible option, will list the original exercise price, the number of unexercised shares subject to the option, the new exercise price if the option is amended and, to the extent applicable, the cash payment related to an eligible cash payment option, if amended.
- “eligible employee” refers to each individual who is an employee of Active Power, Inc. or its subsidiaries as of the last date on which this offer remains open for acceptance; is subject to taxation in the United States; holds otherwise eligible options; and as of the last date on which this offer remains open for acceptance, is not and has never been an officer or director of the Company for purposes of Section 16 of the Exchange Act.
- “eligible cash payment options” refers to all eligible options that had an original exercise price per share less than \$2.50, with respect to which you may accept this offer in exchange for amended options and cash payments, as described in Question and Answer 4 and Section 1 of the Offer to Amend.
- “eligible options” refers to all options with respect to which you may accept this offer in exchange for amended options and, to the extent applicable, cash payments, as described in Question and Answer 4 and Section 1 of the Offer to Amend.
- “Exchange Act” refers to the Securities Exchange Act of 1934, as amended.
- “executive officers” refers to those officers of Active Power listed on Schedule A, including those who are officers for purposes of Section 16 of the Exchange Act.
- “expiration date” refers to the date that this offer expires. The expiration date will be December 11, 2007 at 5:00 p.m., Central Time, unless the offer is extended. We may extend the expiration date at our discretion. If we extend the offer, the term “expiration date” will refer to the time and date at which the extended offer expires.
- “new exercise price” refers to the exercise price per share at which amended options may be exercised to purchase Active Power common stock. An amended option’s new exercise price will be equal to the fair market value of a share of Active Power common stock on the applicable eligible option’s measurement date for financial reporting purposes. Your Addendum will list this new exercise price for each of your eligible options should you accept this offer with respect to such options.

- “offer period” or “offering period” refers to the period from the commencement of this offer to the expiration date. This period will commence on November 9, 2007, and end at 5:00 p.m., Central Time, on December 11, 2007, unless the offer is extended.
- “option” refers to an option to purchase one or more shares of our common stock.
- “original exercise price” refers to the original exercise price of an eligible option, as described in Question and Answer 7. Your Addendum will list the original exercise price of each of your eligible options.
- “Section 409A” refers to Section 409A of the United States Internal Revenue Code of 1986, as amended, and the final and proposed tax regulations thereunder, issued pursuant to the American Jobs Creation Act of 2004.

**Q2. Why is Active Power making this offer?**

A2. It has been determined that certain options granted under the Active Power Stock Plan were issued with an exercise price less than the fair market value of the underlying Active Power common stock on the date of grant. Unfortunately, Section 409A provides that the portion of options that were granted at a discount and vest after December 31, 2004 likely will subject the eligible employees to unfavorable tax consequences. If the eligible options are amended, the unfavorable tax consequences, as described in Section 14 of this Offer to Amend, will be eliminated. (See Section 3)

We believe that this offer will foster retention of our valuable employees and better align the interests of our employees and stockholders to maximize stockholder value. The currently outstanding options were issued to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to individuals who perform services for Active Power and to promote the success of our business.

**Q3. Who is eligible to participate in this offer?**

A3. You may participate in this offer if:

- you are an employee of Active Power as of the last date on which this offer remains open for acceptance;
- you are subject to taxation in the United States;
- you hold otherwise eligible options; and
- as of the last date on which this offer remains open for acceptance, you are not and have never been an officer or director of the Company for purposes of Section 16 of the Exchange Act. (See Section 1)

None of our executive officers or directors are eligible to participate in this offer.

**Q4. Which options are eligible for amendment in this offer?**

A4. An option to purchase the Company’s common stock is an eligible option under this offer only if each of the following conditions is met:

- the option was granted under the Active Power Stock Plan;

- the option had an original exercise price per share that was less than the fair market value per share of the common stock underlying the option on the option's measurement date (that is, it was granted at a "discount" to the then-current fair market value of the underlying stock);
- the option was unvested as of December 31, 2004 (if only a portion of an option grant was unvested as of December 31, 2004, the unvested portion of the grant may be an "eligible option"); and
- the option is outstanding as of the last date on which this offer remains open for acceptance.

**Q5. How do I participate in this offer?**

A5. If you choose to participate in this offer, you must do the following before 5:00 p.m., Central Time, on December 11, 2007 (the "expiration date"):

1. Properly complete the attached election form by selecting the "Accept Offer" box and signing and dating the form.
2. Fax the completed and signed election form to Jennifer Crow at the fax number (512) 836-4511. Alternatively, you may send an email to Jennifer Crow at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com) with the completed and signed election form attached to your email.

If you participate in this offer, you will be required to accept the offer with respect to the entire eligible portion of all of your eligible options listed on your Addendum, including any options which are legally, but not beneficially, owned by you. You will not be permitted to participate in the offer if you hold more than one eligible option and wish to accept the offer only with respect to some, but not all, of your eligible options. To help you determine your outstanding eligible options and to give you the tools to make an informed decision, we will provide you with an Addendum listing your eligible option grants, the new exercise price that will apply if the eligible options are amended and, to the extent applicable, the cash payment you will receive for the eligible cash payment options, if amended. If you hold an option that is not listed on the Addendum, the option is not an eligible option.

This is a one time offer, and we will strictly enforce the election period. We reserve the right to reject any election to accept this offer that we determine is not in good order or that we determine is unlawful to accept. Subject to the terms and conditions of this offer, promptly after the expiration of this offer we will accept all eligible options with respect to which a proper election has been made. (See Section 4)

Your election to participate becomes irrevocable at 5:00 p.m., Central Time, on December 11, 2007, unless the offer is extended past that time, in which case your election will become irrevocable upon the new expiration date. The only exception is that if we have not accepted your options by 5:00 p.m., Central Time, on January 10, 2008, you may withdraw your election at any time thereafter.

We may extend this offer. If we extend this offer, we will issue a press release, email or other communication disclosing the extension no later than 8:00 a.m., Central Time, on the U.S. business day following the previously scheduled expiration date.

**If you participate in this offer, you must complete and sign the attached election form, and return it before 5:00 p.m., Central Time, on December 11, 2007, via fax or email to:**

Jennifer Crow  
Finance Manager  
Active Power, Inc.  
Fax: (512) 836-4511  
Email: [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com)

Election forms submitted via email must contain your properly completed and signed election form as an attachment to your email.

**Only responses that are complete, signed, and actually received by the Company before the deadline will be accepted. The delivery of election forms is at your risk. Active Power intends to confirm the receipt of your election form by email within two U.S. business days. If you have not received an email confirmation that Active Power has received your response, we recommend that you confirm that we have received your election form. If you need to confirm receipt after two U.S. business days have elapsed, you may email Jennifer Crow at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com). Responses may be submitted only via fax or email. Responses submitted by any other means, including hand delivery, United States mail and Federal Express (or similar delivery service) are not permitted.**

**Q6. If I decide to participate in the offer, what will happen to my current eligible options?**

A6. If you elect to participate in the offer, your eligible options will be amended on the same day as the expiration date (but following the expiration of the offer). The expiration date will be December 11, 2007, unless the offer period is extended. In addition, with respect to any eligible cash payment options amended pursuant to this offer, you will become entitled to receive the cash payment described below, less applicable tax withholding.

The amended option will continue to be subject to the terms and conditions of the Active Power Stock Plan under which the original option was granted, and to an amended option agreement between you and the Company. (See Section 6)

**Q7. What will I receive in return for my options?**

A7. If you participate in this offer, any eligible option with respect to which you accept this offer will be replaced with the following consideration:

1. Your eligible option will be amended to increase the original exercise price per share to the new exercise price. The new exercise price will be the fair market value of a share of Active Power common stock on the option's measurement date for financial reporting purposes.

If only a portion of your option grant vested or is scheduled to vest after December 31, 2004, then only that portion of the option grant is an eligible option and will be amended to increase the exercise price. The portion that vested on or before December 31, 2004 is not subject to the adverse tax consequences that this offer is designed to allow you to avoid and so that portion of the option grant will not be eligible for inclusion in the offer. Instead, the portion of any option grant that vested on or before December 31, 2004 will remain outstanding in accordance with its original terms, including its original exercise price.

Your Addendum will list the original exercise price of your eligible options, as well as the new exercise price of such options, should you accept this offer with respect to those options.

2. In addition, for each eligible option with an original exercise price per share less than \$2.50 (we refer to such eligible option as an "eligible cash payment option") amended in this offer, you will receive a cash payment, less applicable tax withholding, equal to the difference between the new exercise price per share of the amended option and the original exercise price per share multiplied by the number of unexercised shares subject to the amended option in the manner described below.

Your Addendum will list the number of unexercised shares subject to your eligible option and, to the extent applicable, the cash payment you will be entitled to receive for each eligible cash payment option you elect to have amended.

For purposes of this offer, the term “option” generally refers to an option to purchase one or more shares of our common stock.

***Eligible Option Example 1***

You were granted an option on December 8, 2004 to purchase 1,000 shares of Active Power common stock with an exercise price per share equal to \$1.50 per share, with a 4 year vesting schedule. Of the number of shares subject to your option, no shares vested on or before December 31, 2004. On the option’s original measurement date, the fair market value of Active Power common stock was \$2.50 per share. As of the offer expiration date, you had not exercised any portion of the option.

1. The option to purchase 1,000 shares will be amended to increase the exercise price to \$2.50 per share.
2. A cash payment of \$1,000 (\$2.50 minus \$1.50 multiplied by 1,000) (the portion of the option eligible as of the expiration date of the offer), less applicable tax withholding, payable on the Company’s first payroll date in 2008.

***Eligible Option Example 2***

You were granted an option on December 8, 2004 to purchase 1,000 shares of Active Power common stock with an exercise price per share equal to \$3.50 per share, with a 4 year vesting schedule. Of the number of shares subject to your option, no shares vested on or before December 31, 2004. On the option’s original measurement date, the fair market value of Active Power common stock was \$4.50 per share. As of the offer expiration date, you had not exercised any portion of the option.

1. The option to purchase 1,000 shares will be amended to increase the exercise price to \$4.50 per share.
2. Since the original exercise price of the option of \$3.50 is greater than \$2.50, the option is not an eligible cash payment option and consequently, no cash payment will be made with respect to this option.

**Q8. When will I receive my amended options and, if applicable, cash payments?**

A8. Any eligible options with respect to which you have elected to accept this offer will be amended on the amendment date (following the expiration of the offer). The amendment date will be the same date on which this offer expires. We expect the amendment date will be December 11, 2007. If the expiration date of the offer is delayed, the amendment date similarly will be delayed. Promptly after the expiration of the offer, you will receive an “Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment” evidencing the amendment of the options you elected to amend. (See Section 6)

In addition, the “Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment” will evidence your right to receive a cash payment for the eligible cash payment options (if any) you elected to have amended pursuant to the offer. The cash payment owed to you (if any) will be paid to you, less any applicable tax withholding, on the Company’s first payroll date in 2008. This payment will not be subject to any vesting conditions or otherwise be subject to forfeiture. (See Section 6)

If you do not receive the Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment within seven U.S. business days after the expiration date, please email Jennifer Crow at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com).

**Q9. Why won't I receive my cash payment immediately following the expiration of the offer?**

A9. The tax regulations under Section 409A that allow us to offer you the opportunity to avoid unfavorable tax consequences by amending your eligible cash payment options also impose certain requirements regarding the timing of the cash payments. These regulations do not allow us to make the cash payments in the same calendar year in which the eligible cash payment options are amended. Therefore, the earliest we can make these cash payments to eligible employees who participate in the offer is in 2008.

**Q10. Am I required to participate in this offer?**

A10. No. Participation in this offer is completely voluntary.

If you do not participate in this offer, you may be subject to certain adverse tax consequences. Please also see Question and Answers 15 and 16 for a description of the potential consequences to you if you decide not to participate in the offer and instead keep your current options.

If you do participate in this offer, with respect to each eligible option grant that you elect to have amended in this offer, you must accept this offer with respect to the entire eligible portion of all of your eligible options listed on your Addendum. (See Section 2)

**Q11. Once my eligible options are accepted for amendment, is there anything I must do to receive the amended options or, if applicable, cash payments?**

A11. No. Once the offer has expired and your election with respect to eligible options has been accepted, your eligible options will be amended. There is nothing that you must do to receive your amended options. Your amended options will be amended on the same day that the offer expires (but following the expiration of the offer. (See Section 2)

You also do not need to do anything in order to receive your cash payments for your eligible cash payment options. Note that you will receive a cash payment only with respect to your eligible cash payment options that are amended in this offer. The cash payment for these options will be made on the Company's first payroll date in 2008. Promptly following the expiration of the offer, we will send you an "Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment" evidencing your right to receive a cash payment for these options. This payment will not be subject to any vesting conditions or otherwise be subject to forfeiture.

**Q12. When will my amended options vest?**

A12. If your eligible options are amended, they will continue to vest according to the vesting schedule of your original options. Future vesting is subject to your continued service to us through each relevant vesting date. (See Section 9)

**Q13. Will the terms and conditions of my amended options be the same as my original options?**

A13. Yes. Except for the new exercise price of your amended options, the terms and conditions of your amended options will remain the same as the terms and conditions of your original eligible options. (See Sections 2, 9 and 14)

**Q14. What happens to my options if I elect to participate in the offer with respect to eligible options but then exercise those options before expiration of the offer?**

A14. If you elect to participate in the offer but exercise your eligible options prior to expiration of the offer, those options which you exercise no longer will be eligible to be amended in this offer and, if those options which you exercise are eligible cash payment options, you will not receive a cash payment with

respect to such options. Your options instead will terminate upon exercise in accordance with their terms and you will be subject to adverse tax consequences as described in Question and Answer 16. (See Question and Answer 15)

**Q15. What happens to my eligible options if I do not turn in my election form by the deadline, choose not to participate or my eligible options are not accepted?**

A15. If we do not receive your election form by the deadline, you choose not to participate, or your eligible options are not accepted by us under this offer, your existing eligible options will (1) remain outstanding until they expire by their terms, including but not limited to expiration in connection with your termination of employment or other service, (2) retain their original exercise price, (3) retain their share amount available for purchase, (4) retain their current terms for exercise, and (5) retain their current vesting schedule. As described in Question and Answer 2, you may be required to recognize ordinary income before the options are exercised and may also be subject to an additional 20% tax and interest penalty plus continued taxation, penalty taxes and interest charges in subsequent years (until the eligible option is exercised or expires) on any increase in the value of the underlying stock. Certain states, including California, have adopted provisions similar to Section 409A under state tax law, and for optionees subject to income taxation in such states, the total penalty tax could be higher than 20% (that is, a 20% federal penalty tax and potentially a state penalty tax). We recommend that you consult with your financial, legal and/or tax advisors regarding any state tax consequences. (See Section 14)

**Q16. Are there any positive or negative tax consequences to my participation in the offer?**

A16. Yes. As a result of participation in this offer, you may avoid potentially adverse tax consequences associated with your eligible options pursuant to Section 409A.

The tax regulations issued by the Treasury Department and the Internal Revenue Service (“IRS”) do not provide final guidance with respect to the tax consequences associated with such options. However, based on previously issued guidance, we believe that, in the tax year in which a discount option vests, eligible employees will have income recognition equal to the difference between the fair market value of the shares and the exercise price (the “spread”) and will be subject to the 20% penalty tax on the spread, plus interest charges. In addition, we believe that during each subsequent tax year (until such option is exercised or expires), eligible employees will be subject to additional annual income and penalty taxes, plus interest charges, on any increase in value of the underlying stock. Finally, certain states have also adopted laws similar to Section 409A. Consequently, eligible employees may also incur additional taxes and penalties under state law provisions. For example, California has adopted a provision similar to Section 409A and thereby imposes a 20% penalty tax with regard to discounted stock options (in addition to the federal 20% penalty tax, interest charges and any federal and state income taxes).

Active Power cannot guarantee any particular tax results related to your eligible options; furthermore, there is uncertainty because the tax regulations may change. However, Active Power will withhold taxes and report income amounts to the IRS and other taxing authorities as required by applicable laws. Because this offer involves complex tax considerations, we urge you to consult a financial, legal and/or tax advisor before you make any decisions about participating in this offer.

**Example:** You hold options to purchase 4,000 shares of Active Power common stock with an original exercise price per share of \$1.00 which was granted at a time when the fair market value of a share of Active Power common stock on the option’s measurement date for financial reporting purposes was \$1.50. On February 14, 2008 a total of 250 of the shares subject to the option vest and on such date the per share fair market value of the Active Power’s common stock is \$2.00. Upon the vesting date, you may have taxable income equal to \$250 (the difference between \$2.00 fair market value and \$1.00 exercise price multiplied by the 250 shares that vest) and owe an additional \$50 due to the 20% tax (20%

of \$250). Additionally, you may owe an interest penalty with the calculation of such penalty dating back to the original date of grant and you may owe additional taxes in subsequent years, based on an increase in value of the underlying stock.

Please also see Question and Answer 15 for a description of the potential consequences to you if you decide not to participate in the offer and instead keep your current options.

If you participate in the offer, you should not be required under current United States law to recognize income for United States federal income tax purposes on the option at the time you choose to accept the offer. On the amendment date, you should not be required under current law to recognize income for United States federal income tax purposes with respect to any amended options. However, you will have taxable income to the extent you receive any cash payments with respect to eligible cash payment options. In addition, you may have taxable income when you exercise your amended options or when you sell your shares acquired pursuant to such options. (See Section 14)

#### ***Uncertainty***

Unfortunately, the guidance issued by the Treasury Department and the IRS has not provided final guidance with respect to the tax consequences of discount options. There is a chance that future guidance issued may provide some relief with respect to certain eligible options and a tax advisor may advocate a position under the current statute and available guidance that your eligible options are exempt from Section 409A. We cannot guarantee the effect of any future Section 409A guidance, but Active Power will work as quickly as administratively feasible if future Section 409A guidance is issued to analyze it and provide information to our eligible employees regarding such guidance.

In addition, if you are subject to taxation in the United States, and also are subject to taxation in another country, there may be additional tax consequences relating to your participation in this offer. Further, some states, including California, may impose additional penalty taxes. We recommend that you consult with a financial, legal and/or tax advisor regarding any tax consequences, including any state tax consequences.

**Q17. If I choose to participate in this offer, are there circumstances under which my eligible options would be amended but I would not receive a cash payment for them?**

A17. Yes, if you choose to accept this offer with respect to an option that is an eligible option but not an eligible cash payment option, you will receive an amended option but you will not receive a cash payment. You will receive an amended option and cash payment in accordance with Sections 2 and 6 of this offer only with respect to your eligible cash payment options that are amended in this offer.

However, your option will not be amended and cash payment will not be made if we are prohibited from doing so by applicable laws. For example, we could become prohibited from amending eligible options as a result of changes in SEC or Nasdaq Global Market rules. We do not anticipate any such prohibitions at this time. (See Section 13)

**Q18. How will Active Power confirm to me that my election form has been received?**

A18. Active Power intends to confirm the receipt of your election form by email within two U.S. business days. If you have not received an email confirmation within two U.S. business days, we recommend that you confirm that we have received your election form by emailing Jennifer Crow at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com).

**Q19. Can I accept this offer with respect to shares of Active Power common stock that I previously acquired upon exercise of options?**

A19. No. This offer relates only to eligible options. You may not accept this offer with respect to any other shares of Active Power common stock or other options to purchase Active Power common stock. (See Section 2)

**Q20. Will my decision to participate in the offer have an impact on my ability to receive options in the future?**

A20. No. Your election to participate or not to participate in the offer will not have any effect on our making future grants of options to purchase common stock, or any other rights to you or anyone else. (See Section 7)

**Q21. What are the accounting consequences of the offer?**

A21. The offer with respect to all eligible options is considered a modification of those options for financial reporting purposes. As a result, the Company will record any incremental compensation expense calculated as any increase in the fair value of the modified options compared to the fair value of the original option as of the end of the offer period recognized over the remaining requisite service period. We will also recognize compensation expense for financial reporting purposes in the aggregate amount of cash payments that become payable pursuant to the terms of the offer. (See Section 12)

**Q22. How does Active Power determine whether I properly have accepted this offer?**

A22. We will determine, at our discretion, all questions about the validity, form, eligibility (including time of receipt) and acceptance of any options. Our determination of these matters will be final and binding on all parties. We reserve the right to reject any election form or any eligible options under this offer that we determine are not in good order or that we determine are unlawful to accept. We will accept for amendment all eligible options for which a proper election has been made and that are not validly withdrawn by you, subject to the terms of this offer. No election with respect to eligible options will be deemed to have been made properly until all defects or irregularities have been cured by you or waived by us. We have no obligation to give notice of any defects or irregularities in any election form, and we will not incur any liability for failure to give any notice. (See Section 4)

**Q23. When will my amended options expire?**

A23. Your amended options, if any, will expire on the same date as the scheduled expiration of your original eligible options or earlier upon your termination of employment or other service with the Company or as required by the Active Power Stock Plan. (See Section 9)

**Q24. Will I receive any paperwork indicating my options have been amended?**

A24. Yes. Promptly after the expiration of the offer, the Company will send you an Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment regarding your amended options. (See Section 9)

**Q25. Are there any conditions to this offer?**

A25. Yes. The completion of this offer is subject to a number of customary conditions that are described in Section 7 of this Offer to Amend. However, the implementation of this offer is not conditioned upon it being accepted with respect to a minimum number of eligible options. (See Section 7)

**Q26. If you extend the offer, how will you notify me?**

A26. If we extend this offer, we will issue a press release, email, or other form of communication disclosing the extension no later than 8:00 a.m., Central Time, on the next U.S. business day following the previously scheduled expiration date. (See Sections 2 and 15)

**Q27. How will you notify me if the offer is changed?**

A27. If we change the offer, we will issue a press release, email, or other form of communication disclosing the change no later than 8:00 a.m., Central Time, on the next U.S. business day following the day we change the offer. (See Section 15)

**Q28. Can I change my mind and withdraw from this offer?**

A28. Yes. You may change your mind after you have submitted an election form and withdraw from the offer at any time before the expiration date. If we extend the expiration date, you may withdraw your election with respect to all of your eligible options at any time until the extended offer expires. You may change your mind as many times as you wish, but you will be bound by the last properly submitted election form we receive before the expiration date. However, if we have not accepted your election by 5:00 p.m., Central Time, on January 10, 2008, you may withdraw your tendered options at any time thereafter. (See Section 5)

**Q29. How do I withdraw my election?**

A29. To withdraw your election with respect to all of your eligible options, you must do the following before the expiration date:

1. Properly complete the attached election form by selecting the "Reject Offer" box and signing and dating the form.
2. Fax the completed and signed election form to Jennifer Crow at the fax number (512) 836-4511. Alternatively, you may send an email to Jennifer Crow at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com) with the completed and signed election form attached to your email.

If you withdraw from participation in this offer, you must withdraw with respect to all of your eligible options. Any acceptance or rejection of the offer you make will remain in effect under this offer pursuant to the last properly submitted election form. (See Section 5)

**Q30. What if I withdraw my election and then decide again that I want to participate in this offer?**

A30. If you have withdrawn your election to participate and then decide again that you would like to participate in this offer, you may re-elect to participate by submitting a new properly completed election form before the expiration date. You may elect to accept this offer with respect to all of your eligible options. The new election form must be signed and dated after the date of your last-submitted form. (See Section 5)

**Q31. Can I change my mind about which eligible options I want to accept with respect to this offer?**

A31. No. If you wish to participate in the offer, you are required to accept this offer with respect to all of your eligible options. Any attempt to accept this offer with respect to only a portion of your eligible options will be null and void. However, if you have accepted this offer with respect to all of your eligible options, you may change your mind and withdraw your election as described in Question and Answer 29.

If we extend the expiration date, you may change your election at any time until the extended offer expires. You may change your mind as many times as you wish, but you will be bound by the last properly submitted election form we receive before the expiration date. Please be sure that any new election form you submit is clearly dated after your last-submitted form.

**Q32. How should I decide whether or not to accept this offer with respect to my eligible options?**

A32. We understand that the decision whether or not to accept this offer with respect to your eligible options will be a challenging one for many eligible employees. The program does carry risk (see “Risks of Participating in the Offer” on page 15 for information regarding some of these risks), and there are no guarantees that you would not ultimately receive greater value from your eligible options, even considering the potential tax consequences of keeping them (as described in Section 14), than what we are offering as consideration in the offer. For example, it is possible that the Section 409A rules could be changed in a manner more favorable to you. The decision to participate in the offer must be your own. We recommend that you consult with your financial, legal and/or tax advisors to determine if participation in this offer is right for you. You may also contact John K. Penver, Chief Financial Officer at Active Power with any general questions regarding the terms of this offer. (See Section 3)

**Q33. What happens if I have an eligible option that is subject to a domestic relations order or comparable legal document as the result of the end of a marriage?**

A33. If you have an eligible option that is subject to a domestic relations order (or comparable legal document as the result of the end of a marriage) and a person who is not an eligible employee beneficially owns a portion of that eligible option, you may accept this offer with respect to the entire remaining outstanding portion of the eligible option if so directed by the beneficial owner as to his or her portion in accordance with the domestic relations order or comparable legal documents. As noted above, this is an all or nothing offer, so your participation must be with respect to all or none of the eligible options legally owned by you. As you are the legal owner of the eligible option, the Company will respect an election properly made by you and accepted by the Company and will not be responsible to you or the beneficial owner of the eligible option for any errors made by you with respect to such an election.

**Q34. Will my amended options remain nonstatutory stock options for United States tax purposes?**

A34. Your amended options will remain nonstatutory stock options for purposes of United States tax law.

For more detailed information, please read the rest of the Offer to Amend, and see the tax disclosure set forth under the section entitled “Material United States federal income tax consequences.” (Section 14)

We recommend that you read the tax discussion in this Offer to Amend and discuss the personal tax consequences of nonstatutory stock options with your financial, legal and/or tax advisors. (See Sections 9 and 14)

**Q35. Does Section 409A impact the Employee Stock Purchase Plan (ESPP) shares?**

A35. No, ESPP shares are not impacted by Section 409A or this offer.

**Q36. Whom can I contact if I need to confirm Active Power’s receipt of my election form, I have questions about the offer or if I need additional copies of the offer documents?**

A36. Active Power intends to confirm the receipt of your election form by email within two U.S. business days. If you have not received an email confirmation that Active Power has received your election form, we recommend that you confirm that we have received your election form. If you need to confirm receipt after two U.S. business days have elapsed, you may email Jennifer Crow at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com). If you need additional copies of the offer documents or the election form, you should contact:

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Jennifer Crow  
Finance Manager  
Active Power, Inc.  
Phone: (512) 744-9254  
Fax: (512) 836-4511  
Email: jennifercrow@activepower.com

For general questions concerning this offer, please contact:

John K. Penver  
Chief Financial Officer  
Active Power, Inc.  
Tel: (512) 744-9234  
Fax: (512) 836-4511  
Email: johnpenver@activepower.com

## RISKS OF PARTICIPATING IN THE OFFER

Participating in the offer involves a number of risks, including those described below. This list and the risk factors set forth in Item 1A, "Risk Factors," in our annual report on Form 10-K for the fiscal year ended December 31, 2006, filed with the SEC on May 5, 2007, highlight the material risks of participating in this offer. You should carefully consider these risks and you are encouraged to speak with a financial, legal and/or tax advisor as necessary before deciding to participate in the offer. In addition, we strongly urge you to read the sections in this Offer to Amend discussing the tax consequences in the United States, as well as the rest of this Offer to Amend for a more in depth discussion of the risks that may apply to you before deciding to participate in the offer.

All statements in this Offer to Amend, other than statements of historical fact, are forward looking statements that are subject to risks and uncertainties that could cause such statements to differ materially from actual future events or results. Such forward looking statements are generally, but not necessarily, accompanied by words such as "plan," "if," "estimate," "expect," "believe," "could," "would," "anticipate," "may," or other words that convey uncertainty of future events or outcomes. These forward looking statements and other statements made elsewhere in this Offer to Amend are made in reliance, in part, on the Private Securities Litigation Reform Act of 1995. These forward looking statements are based on current information and expectations, and involve a number of risks and uncertainties. Actual results may differ materially from those projected in such forward looking statements due to various factors, including but not limited to, inability to accurately predict revenue and budget for expenses for future periods; fluctuations in revenue and operating results; overall market performance; potential for significant losses to continue decreases and/or delays in capital spending; limited product offerings; inability to expand and integrate new distribution channels; inability to manage new and existing product distribution relationships; dependence on the Company's relationship with Caterpillar®; competition; delays in research and development; dependence on sole or limited source suppliers; inability to increase product sales; inventory risks; dependence upon key personnel; inability to protect the Company's intellectual property rights; potential future acquisitions; volatility of the Company's stock price regardless of the Company's actual financial performance; ability to successfully prosecute and defend any future litigation; additional issues identified by the Company arising out of or related to the Special Committee's investigation into the Company's historical stock option grants and related procedures and accounting; impact of additional tax liabilities that have not yet been estimated; future rule-making, pronouncements or guidance by the SEC, PCAOB, NASDAQ or other regulatory agencies; and other factors detailed in the Company's filings with the Securities and Exchange Commission. Any one of these factors may cause the Company's actual financial results to differ materially from its projected results. The forward looking statements in this Offer to Amend speak only as of the date they are made. The Company undertakes no obligation to revise or update publicly any forward looking statement for any reason, including forward looking statements made herein.

The following discussion should be read in conjunction with the financial statements and notes to the financial statements attached as Schedule B of this Offer to Amend, as well as our most recent Forms 10-K, 10-Q and 8-K's. We caution you not to place undue reliance on forward-looking statements contained in this Offer to Amend, which speak only as of the date hereof.

### **Economic Risks**

***If your eligible options are amended, there is no guarantee that in the future you will be in a better economic position than you would be if your eligible options were not amended.***

This offer was designed in a way that preserves as best as practicable the economic characteristics originally contemplated when the options were granted. However, certain future events such as a change in our

stock price may result in a lower value realized in the future than you might have realized had you not agreed to the amendment which increased the exercise price of your eligible options (even after taking the adverse tax consequence into account). Please consult your own individual tax and/or financial advisor for assistance on how this may affect your individual situation.

#### **U.S. Federal Tax Related Risks**

##### ***The federal tax authorities could change Section 409A tax consequences.***

The Treasury Department and the IRS have issued final regulations with respect to Section 409A, but these regulations do not provide final guidance with respect to the tax consequences of discount options. It is possible that the Treasury Department and the IRS could issue further guidance, and such guidance could be significantly different from the current guidance. Changes to the regulations could impose less onerous tax consequences on discount options and, as a result, it may have been more beneficial to you not to participate in the offer and to have retained your eligible options.

Although we have designed this offer in a way that is specifically contemplated by the Treasury Department and the IRS to avoid adverse tax treatment under Section 409A, there can be no guarantee of any specific tax treatment with respect to this offer or in the future should the tax laws change again in a manner that would adversely affect your amended options. In that event, Active Power cannot provide any assurance that an offer similar to this one will be made.

##### ***Taxable events even if amended options are not exercised.***

Any cash payments received for eligible cash payment options will be subject to regular income and employment tax withholding at the time of receipt. Your resulting tax liability when you file your income tax return could differ from the amount of taxes we are required to withhold and, as a result, it is possible that additional taxes may be due for the year you receive the cash payment.

##### ***U.S. State tax-related risks.***

If you are subject to tax in the U.S., you should be aware that certain states have laws similar to Section 409A. Consequently you may incur additional taxes and penalties under state law provisions. For example, California has a provision similar to Section 409A and imposes a 20% tax plus interest charges with regard to discount stock options (in addition to the federal 20% tax and any federal and state income taxes). You should be certain to consult a tax advisor to discuss these consequences.

##### ***Tax-related risks for tax residents of multiple or other countries.***

If you are subject to the tax laws in more than one jurisdiction, you should be aware that there may be tax and social insurance consequences of more than one country that may apply to you. You should also be certain to consult a tax advisor to discuss these consequences.

#### **General Risks Regarding Active Power**

***The matters relating to the investigation by the Special Committee of our Board of Directors into our stock option granting practices and the restatement of our consolidated financial statements may result in future litigation or regulatory inquiries which could harm our financial condition and results of operations.***

The matters relating to the investigation by the Special Committee of our Board of Directors into our stock option granting practices and the restatement of our consolidated financial statements may result in future litigation or regulatory inquiries which could harm our financial condition and results of operations.

On January 9, 2007, we announced that the Board of Directors had appointed a Special Committee and that this committee, with the assistance of the Company's outside legal advisers, as well as accounting and tax experts, was conducting a review of our stock option granting practices from the time of our Initial Public Offering in August 2000 through December 2006.

On February 2, 2007 the Company announced that the Special Committee had reached certain preliminary conclusions in the investigation. Specifically, the Special Committee had come to the conclusion that the actual measurement date for certain past stock option grants differed from the stated grant date for such awards, which would result in additional charges to the Company for stock-based compensation expenses. At the time of that disclosure, the amount of such additional charges was unknown. On March 12, 2007 the Company announced that the Company, the Audit Committee and the Board of Directors had determined, based on information provided by the Special Committee and its advisors, that the amount of additional stock-based compensation expense to be recognized would be material. Therefore, we concluded that our previously filed unaudited interim and audited annual consolidated financial statements for the years ended December 31, 2005, 2004, 2003, 2002 and 2001 (including associated interim periods), as well as the unaudited interim financial statements for the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006 should no longer be relied upon because these financial statements contained amounts that would need to be restated. We disclosed this conclusion in our Current Report on Form 8-K, filed with the SEC on March 12, 2007. Various representatives of the Company, including members of the Audit Committee, the Board of Directors, the Special Committee and authorized officers, discussed those matters with the Company's independent auditors, Ernst & Young LLP, prior to filing that Current Report on Form 8-K.

This review of our historical stock option granting practices has required us to incur substantial expenses for legal, accounting, tax and other professional services, and has diverted our management's attention from our business, and could in the future adversely affect our business, financial condition, results of operations and cash flows.

Our historical stock option granting practices and the restatement of our prior financial statements have exposed us to greater risks associated with litigation and regulatory proceedings. There can be no guarantee that any such litigation or regulatory reviews will reach the same conclusions as that of the Special Committee. The conduct and resolution of these matters could be time consuming, expensive and distracting from the conduct of our business.

We voluntarily contacted the United States Securities and Exchange Commission (SEC) regarding the Special Committee's investigation into our stock option granting practices and have agreed to share the results of the Special Committee with the SEC. We have received requests for voluntary production of documents from the SEC and we are fully cooperating with the SEC.

While we believe that we have made appropriate judgments in concluding the correct measurement dates for stock option grants and option modifications, the SEC may disagree with the manner in which we have accounted for and reported, or not reported, the financial impact of past stock option errors, and there is a risk that any SEC inquiry could lead to circumstances in which we may have to further restate our prior financial statements, or otherwise take actions not currently contemplated. Any such circumstances could also lead to future delays in filing our subsequent SEC reports and possible delisting of our stock from the Nasdaq Global Market. Furthermore, if we are subject to adverse findings in any of these other matters, we could be required to

pay damages or penalties or have other remedies imposed upon us which could harm our business, financial condition, results of operations and cash flows. Please see Note 2, "Restatement of Consolidated Financial Statements" of the Notes to Consolidated Financial Statements included in our Form 10-K for the fiscal year ended December 31, 2006, filed with the SEC on May 14, 2007.

***We have incurred significant losses and anticipate losses for at least the next several quarters.***

We have incurred operating losses since our inception and expect to continue to incur losses for at least the next several quarters. As of September 30, 2007 and December 31, 2006, we had an accumulated deficit of \$219.3 and \$204.8 million, respectively. To date, we have funded our operations principally through the public and private sale of our stock, product revenue and \$10.0 million in development funding from Caterpillar. We will need to generate significant additional revenue in order to achieve profitability, and we cannot assure you that we will ever realize such revenue levels. We also expect to incur product development, sales and marketing and administrative expenses significantly in excess of our product revenue after costs, and, as a result, we expect to continue to incur losses for the next several quarters.

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

As of September 30, 2007, we have generated a total of \$128.8 million in product revenue since January 1, 1998, with \$23.4 million generated in the nine months ended September 30, 2007. We are uncertain whether our products will achieve market acceptance such that our revenue will increase or whether we will be able to achieve significant revenue. Therefore, we have a very limited ability to predict future revenue. Our limited operating experience, the uncertain market acceptance for our products, and other factors that are beyond our control make it difficult for us to accurately forecast our quarterly and annual revenue. However, we use our forecasted revenue to establish our expense budget. Most of our expenses, particularly rent and salaries, are fixed in the short term or incurred in advance of anticipated revenue. As a result, we may not be able to decrease our expenses, if desired, in a timely manner to offset any revenue shortfall. If our revenue does not increase as anticipated, we will continue to incur significant losses. As a result of the foregoing, we cannot assure you that our revenues will grow or remain stable in future periods or that we will become profitable. In addition, in some future quarters, our financial results may be below the expectations of public market analysts or investors. In such event, the market price of our common stock would likely fall.

***If we do not achieve significant sales of our CoolAir products, we may be forced to take an impairment charge for inventory we keep relating to that product line.***

At September 30, 2007 and December 31, 2006, we had approximately \$4.2 million and \$4.5 million, respectively, in inventory relating exclusively to our CoolAir family of products. During 2006 our sales of CoolAir products did not meet our initial expectations. If we are unable to sell sufficient quantities of our finished CoolAir products, we may not be able to make use of this inventory and we may therefore determine that those assets are impaired. If we find that our inventory assets relating to the CoolAir products are significantly impaired, we will be required to record a charge for some or all of the value of that inventory, which would have the effect of reducing our net income in the period when the impairment determination is made.

***Our financial results may vary significantly from quarter to quarter.***

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

- timing of orders from our customers and the possibility that customers may change their order requirements with little or no notice to us;

- rate of adoption of our flywheel-based energy storage system or our thermal and compressed air system as alternatives to lead-acid batteries;
- ongoing need for short-term power outage protection in traditional UPS systems;
- deferral of customer orders in anticipation of new products from us or other providers of power quality systems;
- timing of deferred revenue components associated with large orders;
- new product releases, licensing or pricing decisions by our competitors;
- commodity and raw material component prices;
- lack of order backlog;
- loss of a significant customer or distributor;
- impact of changes to our product distribution strategy and pricing policies;
- changes in the mix of domestic and international sales;
- rate of growth of the markets for our products; and
- other risks described below.

We derive a significant portion of our revenue from relatively few large transactions. The sales cycle for these large transactions tend to be longer than the sales cycle on smaller orders. The longer sales cycle for large transactions makes it difficult to predict the quarter in which these sales will occur. Accordingly, our operating results may fluctuate from quarter to quarter based on the existence and timing of larger transactions. A reduction in the number of large transactions, or a delay in closing of such a sales transaction could materially impact our revenue in a particular period.

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

Significant portions of our expenses are not variable in the short term and cannot be quickly reduced to respond to decreases in revenue. Therefore, if our revenue is below our expectations, our operating results are likely to be adversely and disproportionately affected. In addition, we may change our prices, modify our distribution strategy and policies, accelerate our investment in research and development, sales or marketing

efforts in response to competitive pressures or to pursue new market opportunities. Any one of these activities may further limit our ability to adjust spending in response to revenue fluctuations. We use forecasted revenue to establish our expense budget. Because most of our expenses are fixed in the short term or incurred in advance of anticipated revenue, any shortfall in revenue may result in significant losses.

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

The percentage of our product revenue derived from customers located outside of the United States was 42%, 45% and 50% in 2006, 2005 and 2004, respectively, and 43% for the nine months ended September 30, 2007. Our international operations are subject to a number of risks, including:

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

To date, the majority of our sales to international customers and purchases of components from international suppliers have been denominated in U.S. dollars. As a result, an increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive for our international customers to purchase, thus rendering our products less competitive. As we increase direct sales in foreign markets, we are making more sales that are denominated in other currencies, primarily euro. Those sales in currencies other than U.S. dollars can result in translation gains and losses. Currently, we do not engage in hedging activities for our international operations. However, we may engage in hedging activities in the future.

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

We derive a substantial portion of our revenue from a limited number of products, and we expect these products to continue to account for a large percentage of our revenues in the near term. Continued market acceptance of these products is therefore critical to our future success. Our future success will also depend on our ability to reduce our dependence on these few products by developing and introducing to the market new products and product enhancements in a timely manner. Specifically, our ability to capture significant market share

depends on our ability to develop and market extensions to our existing UPS product line at higher and lower power range offerings, and on our ability to develop and market our extended runtime products, such as the CoolAir DC. Even if we are able to develop and commercially introduce new products and enhancements, they may not achieve market acceptance, which would substantially impair our revenue, profitability and overall financial prospects. Successful product development and market acceptance of our existing and future products depend on a number of factors including:

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

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

The future growth of our business will depend in part on our ability to expand our existing relationships with distributors, to identify and develop additional channels for the distribution and sale of our products and to manage these relationships. As part of our growth strategy, we may expand our relationships with distributors and develop relationships with new distributors, such as we did in the fourth quarter of 2006 with four new distributor agreements for the Asian market, predominantly in Korea, and India. We will also look to identify and develop new relationships with additional parties that could serve as an outlet for our products, including CoolAir DC. We also entered into a long-term supply agreement with GE Zenith Controls in 2005 to source UPS systems from them that we intend to sell along side our CoolAir DC product. Our inability to successfully execute this strategy, and to integrate and manage our existing OEM channel partners, Caterpillar and Eaton Electric, and our new manufacturer's representatives could impede our future growth.

***We must continue to hire and retain skilled personnel.***

We believe our future success will depend in large part upon our ability to attract, motivate and retain highly skilled managerial, engineering and sales and marketing personnel. There is a limited supply of skilled employees in the power quality marketplace. A decline in our stock price can result in a substantial number of "underwater" stock options, whereby the exercise price of the option is greater than the current market value of our common stock. As a result, the financial attractiveness of the stock options is substantially diminished, which may cause certain of our employees to seek employment elsewhere as a result of this decreased financial incentive, or impair our ability to recruit new employees. Our efforts to attract and retain highly skilled employees could be harmed by our past or any future workforce reductions. Our failure to attract and retain the highly trained technical personnel who are essential to our product development, marketing, sales, service and support teams may limit the rate at which we can develop new products or generate revenue. If we are unable to retain the personnel we currently employ, or if we are unable to quickly replace departing employees, our operations and new product development may suffer.

***We are significantly dependent on our relationship with Caterpillar, our primary OEM customer. If this relationship is unsuccessful, for whatever reason, our business and financial prospects would likely suffer.***

Caterpillar and its dealer network are our primary OEM customer for our flywheel based products. Caterpillar and its dealer network accounted for 35%, 42% and 54% of our revenue, during 2006, 2005 and 2004, respectively, and 27% for the nine months ended September 30, 2007. If our relationship with Caterpillar is not successful, or if Caterpillar's distribution of the Cat UPS product is not successful or suffers a material change, our business and financial prospects would likely suffer. Pursuant to our distribution agreement with Caterpillar, they are the exclusive OEM distributor, subject to limited exceptions, of our CleanSource UPS product. Caterpillar is not obligated to purchase any CleanSource UPS units. Pursuant to our development agreements Caterpillar has provided us with \$10.0 million in funding to support the development of the Cat UPS product line and other development efforts. In exchange for these payments, Caterpillar received co-ownership of the proprietary rights in this product. Either Caterpillar or Active Power may license to others the intellectual property that we jointly own without seeking the consent of the other, and the licensing party will solely retain all licensing revenue generated by licensing this intellectual property. We are currently in the process of renegotiating a new multi-year extension of our OEM distributor agreement with Caterpillar on substantially the same terms as the existing agreement. If we are unable to successfully renegotiate this agreement, our business and financial prospects would suffer materially.

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

In 2001, we completed and equipped a 127,000 square foot facility used for manufacturing and testing of our three-phase product line, including our DC and UPS products. To be financially successful, and to fully utilize the capacity of this facility and allocate its associated overhead, we must achieve significantly higher sales volumes. We must accomplish this while also preserving the quality levels we achieved when manufacturing these products in more limited quantities. To date, we have not been successful at increasing our sales volume to a level that fully utilizes the capacity of the facility and we may never increase our sales volume to necessary levels. We also manufacture and test our CoolAir DC product in this facility, which will help increase the utilization of our facility. Further, in 2007, we subleased approximately 49,000 square feet of this facility to help reduce our facility expenses. If we do not reach these necessary sales volume levels, or if we cannot sell our products at our suggested prices, our ability to reach profitability will be materially limited.

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

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

The market perception of our products and related acceptance of the products is highly dependent upon the quality and reliability of the products that we build. Any quality problems attributable to the CleanSource DC, CleanSource UPS or CoolAir DC product lines may substantially impair our revenue prospects. Moreover, quality problems for our product lines could cause us to delay or cease shipments of products or have to recall or

field upgrade products, thus adversely affecting our ability to meet revenue or cost targets. In addition, while we seek to limit our liability as a result of product failure or defects through warranty and other limitations, if one of our products fails, a customer could suffer a significant loss and seek to hold us responsible for that loss.

***We currently operate without a significant backlog.***

We generally operate our business without any significant backlog of orders from customers. Normally our products are shipped and revenue is recognized shortly after the order is received. This lack of backlog makes revenue in any quarter substantially dependent on orders booked and shipped throughout that quarter.

***Seasonality may contribute to fluctuations in our quarterly operating results.***

Our business has, on occasion, experienced seasonal customer buying patterns. In recent years, we have generally experienced relatively weaker demand in the first calendar quarter of the year. We believe that this pattern will continue. In addition, we anticipate that demand for our products in Europe and Africa may decline in the summer months, as compared to other regions, because of reduced corporate buying patterns during the vacation season.

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

We purchase several component parts from sole source and limited source suppliers. As a result of our current volumes, we lack significant leverage with these suppliers. If our suppliers receive excess demand for their products, we may receive a low priority for order fulfillment as large volume customers will receive priority that may result in delays in our acquiring components. If we are delayed in acquiring components for our products, the manufacture and shipment of our products also will be delayed. We are, however, continuing to enter into long-term agreements with our sole suppliers and other key suppliers, when available, using a rolling sales volume forecast to stabilize component availability. Lead times for ordering materials and components vary significantly and depend on factors such as specific supplier requirements, contract terms, the extensive production time required and current market demand for such components. Some of these delays may be substantial. As a result, we purchase several components in large quantities to protect our ability to deliver finished products. If we overestimate our component requirements, we may have excess inventory, which will increase our costs. If we underestimate our component requirements, we will have inadequate inventory, which will delay our manufacturing and render us unable to deliver products to customers on scheduled delivery dates. If we are unable to obtain a component from a supplier or if the price of a component has increased substantially, we may be required to manufacture the component internally, which will also result in delays or be required to absorb price increases. Manufacturing delays could negatively impact our ability to sell our products and could damage our customer relationships.

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

***We face significant competition from other companies.***

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

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

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

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

In recent years, there has been significant litigation in the United States involving patents, trademarks and other intellectual property rights. We may become involved in litigation in the future to protect our intellectual property or defend allegations of infringement asserted by others. Legal proceedings could subject us to significant liability for damages or invalidate our intellectual property rights. Any litigation, regardless of its merits or its outcome, would likely be time consuming and expensive to resolve and would divert management's time and attention. Any potential intellectual property litigation also could force us to take specific actions, including:

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

- redesign those products that use infringing intellectual property or cease to use an infringing trademark; or
- cease to use an infringing trademark.

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

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

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

Provisions of our certificate of incorporation and bylaws could have the effect of discouraging, delaying or preventing a merger or acquisition that a stockholder may consider favorable. Additionally, in December 2001 our board of directors approved a stockholder rights plan, which would require a potential acquiror to negotiate directly with our board of directors regarding any planned acquisition. We also are subject to the anti-takeover laws of the State of Delaware, which may further discourage, delay or prevent someone from acquiring or merging with us. In addition, our agreement with Caterpillar for the distribution of CleanSource UPS provides that Caterpillar may terminate the agreement in the event we are acquired or undergo a change in control. The possible loss of our most significant customer could be a significant deterrent to possible acquirers and may substantially limit the number of possible acquirers. All of these factors may decrease the likelihood that we would be acquired, which may depress the market price of our common stock.

***Volatility in our stock price could result in claims against us.***

Historically the market price of our common stock has fluctuated significantly. In 2006 the sales price of our common stock ranged from \$1.76 to \$5.91. During the nine months ended September 30, 2007, the sales price of our common stock ranged from \$1.28 to \$2.81. In addition to those risks described earlier in this section, the market price of our common stock can be expected to fluctuate significantly in response to numerous other factors, many of which are beyond our control, including the following:

- actual or anticipated fluctuations in our operating results;
- changes in financial estimates by securities analysts or our failure to perform in line with such estimates;
- changes in market valuations of other technology companies, particularly those that sell products used in power quality systems;
- announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;

- 
- introduction of technologies or product enhancements that reduce the need for flywheel energy storage systems;
  - the loss of one or more key OEM customers;
  - inability to successfully expand our distribution channels;
  - departures of key personnel; and
  - changing external capital market conditions.

## THE OFFER

### 1. Eligibility.

You are an “eligible employee” only if you are an employee of Active Power as of the last date on which this offer remains open for acceptance, you hold eligible options as described in Section 2 below, you are subject to United States taxation and as of the last date on which this offer remains open for acceptance, you are not and have never been an officer or director of the Company for purposes of Section 16 of the Exchange Act.

Unless expressly provided by an agreement between you and Active Power or by the requirements of applicable law, your employment or other service with Active Power will remain “at will” and can be terminated by you or us at any time, with or without cause or notice.

None of our executive officers or directors are eligible to participate in this offer.

### 2. Number of options and amount of consideration; expiration date.

Subject to the terms and conditions of this offer, we will accept for amendment eligible options that are held by eligible employees and with respect to which proper elections are made, and are not validly withdrawn by you, before the expiration date.

An option to purchase common stock is eligible for this offer only if each of the following conditions is met:

- the option was granted under the Active Power, Inc. 2000 Stock Incentive Plan;
- it has been determined that the option may have an original exercise price per share that was less than the fair market value per share of the common stock underlying the option on the option’s measurement date (that is, it was granted at a “discount” to the then-current fair market value of the underlying stock);
- the option was unvested as of December 31, 2004 (if only a portion of an option grant was unvested as of December 31, 2004, the unvested portion of the grant may be an “eligible option”); and
- the option is outstanding as of the last date on which this offer remains open for acceptance.

As noted above, in order to be eligible, options must be outstanding as of the expiration date of the offer (regardless of whether or not we extend the expiration date). For example, if a particular option grant expires after commencement, but before the expiration date, that particular option grant is not eligible for this offer.

If you choose to participate in this offer, you will be required to accept the offer with respect to the entire eligible portion of all of your eligible options listed on your Addendum, including any options which are legally, but not beneficially, owned by you. In other words, you must accept the offer with respect to all the shares subject to each particular eligible option. You will not be permitted to participate in the offer if you hold more than one eligible option and wish to accept the offer only with respect to some, but not all, of your eligible options. If you have exercised a portion of an eligible option grant, your election will apply to the portion that remains outstanding and unexercised.

**Employee Election Example:**

If you hold: (1) an eligible option to purchase 1,000 shares of Active Power common stock, which you have exercised with respect to 700 shares and (2) an eligible option to purchase 500 shares, of which 100 shares were vested as of December 31, 2004, you have the following alternatives with respect to this offer:

- Accept the offer with respect to: (1) all 300 shares of your first option and (2) the 400 shares of your second option that vested after December 31, 2004; or
- Do not accept the offer with respect to any of your eligible options.

These are your only choices in this example.

If you have an eligible option that is subject to a domestic relations order (or comparable legal document as the result of the end of a marriage) and a person who is not an eligible employee beneficially owns a portion of that eligible option, you may accept this offer with respect to the entire remaining outstanding portion of the eligible option if so directed by the beneficial owner as to his or her portion in accordance with the applicable domestic relations order or comparable legal documents. This is an all or nothing offer, so your participation must be with respect to all or none of the eligible options legally owned by you. Since you are the legal owner of the eligible option, Active Power will respect an election properly made by you and accepted by the Company and will not be responsible to you or the beneficial owner of the eligible option for any errors made by you with respect to such an election.

Subject to the terms of this offer and upon our acceptance of your election to participate in the offer with respect to all of your eligible options, if you accept this offer:

1. Your eligible option will be amended to increase the exercise price per share to the fair market value of a share of the common stock of Active Power on the option's measurement date for financial reporting purposes. If only a portion of your option grant vested or is scheduled to vest after December 31, 2004, then only that portion of the option grant is an eligible option and will be amended to increase the exercise price. The portion that vested on or before December 31, 2004 is not subject to the adverse tax consequences that this offer is designed to allow you to avoid and so that portion of the option grant will not be eligible for inclusion in the offer. Instead, the portion of any option grant that vested on or before December 31, 2004 will remain outstanding in accordance with its original terms, including its original exercise price.

You will be provided with an Addendum which will list the eligible options and, for each eligible option, the original exercise price of your eligible options and the new exercise price of the eligible options, should you accept this offer with respect to those options.

2. In addition, if your eligible option had an original exercise price per share less than \$2.50 (we refer to such eligible option as an "eligible cash payment option"), for each eligible cash payment option amended in this offer, you will receive a cash payment, less applicable tax withholding, equal to the difference between the new exercise price per share of the amended option and the original exercise price per share multiplied by the number of unexercised shares subject to the amended option in the manner described below.

Your Addendum will list the number of unexercised shares subject to your eligible option and, to the extent applicable, the cash payment you will be entitled to receive for each eligible cash payment option you elect to have amended.

For purposes of this offer, the term “option” generally refers to an option to purchase one or more shares of our common stock.

#### ***Eligible Option Example 1***

You were granted an option on December 8, 2004 to purchase 1,000 shares of Active Power common stock with an exercise price per share equal to \$1.50 per share, with a 4 year vesting schedule. Of the number of shares subject to your option, no shares vested on or before December 31, 2004. On the option’s original measurement date, the fair market value of Active Power common stock was \$2.50 per share. As of the offer expiration date, you had not exercised any portion of the option.

1. The option to purchase 1,000 shares will be amended to increase the exercise price to \$4.50 per share.

2. A cash payment of \$1,000 (\$2.50 minus \$1.50 multiplied by 1,000) (the portion of the option eligible as of the expiration date of the offer), less applicable tax withholding, payable on the Company’s first payroll date in 2008.

#### ***Eligible Option Example 2***

You were granted an option on December 8, 2004 to purchase 1,000 shares of Active Power common stock with an exercise price per share equal to \$3.50 per share, with a 4 year vesting schedule. Of the number of shares subject to your option, no shares vested on or before December 31, 2004. On the option’s original measurement date, the fair market value of Active Power common stock was \$4.50 per share. As of the offer expiration date, you had not exercised any portion of the option.

1. The option to purchase 1,000 shares will be amended to increase the exercise price to \$4.50 per share.

2. Since the original exercise price of the option of \$3.50 is greater than \$2.50, the option is not an eligible cash payment option and consequently, no cash payment will be made with respect to this option.

The vesting schedule of your amended options will not change. As a result, once you cease to be an employee or other service provider of Active Power, there will be no further vesting of your amended option.

All amended options will be subject to the terms of the Active Power Stock Plan and to option agreements between you and the Company as amended by this offer. The current form of option agreements under the Active Power Stock Plan is attached as an exhibit to the Schedule TO with which this offer has been filed. See Section 9 of this Offer to Amend for a description of the Active Power Stock Plan.

The expiration date for this offer will be 5:00 p.m., Central Time, on December 11, 2007, unless we extend the offer. We may, in our discretion, extend the offer, in which event the expiration date shall refer to the latest time and date at which the extended offer expires. See Section 15 of this Offer to Amend for a description of our rights to extend, terminate and amend the offer.

### **3. Purpose of the offer.**

Active Power has determined that certain options granted under the Active Power, Inc. 2000 Stock Incentive Plan were issued with an exercise price less than the fair market value of the underlying Active Power common stock on the date of grant. Section 409A provides that the portion of options that were granted at a

discount and vest after December 31, 2004 likely will subject option holders to unfavorable tax consequences. If the eligible options are amended, the unfavorable tax consequences, as described in Section 14 of this Offer to Amend, will be eliminated. We believe that this offer will foster retention of our valuable employees and better align the interests of our employees and stockholders to maximize stockholder value. The currently outstanding options were issued to motivate Active Power employees to perform at high levels and to provide an effective means of recognizing employee contributions to the success of its business.

Except as otherwise disclosed in this offer or in our SEC filings, we presently have no plans or proposals that relate to or would result in:

- any extraordinary transaction, such as a merger, reorganization or liquidation involving the Company;
- any purchase, sale or transfer of a material amount of our assets;
- any material change in our present dividend rate or policy, or our indebtedness or capitalization;
- any change in our present board of directors or management, including a change in the number or term of directors or to fill any existing board of director vacancies or to change any executive officer's material terms of employment;
- any other material change in our corporate structure or business;
- our common stock being delisted from The Nasdaq Global Market or not being authorized for quotation in an automated quotation system operated by a national securities association;
- our common stock becoming eligible for termination of registration pursuant to Section 12(g)(4) of the Exchange Act;
- the suspension of our obligation to file reports pursuant to Section 15(d) of the Exchange Act;
- the acquisition by any person of an amount of our securities or the disposition of an amount of any of our securities; or
- any change in our certificate of incorporation or bylaws, or any actions that may impede the acquisition of control of us by any person.

In the ordinary course of business, from time to time, the Company evaluates acquisition opportunities. At the present time, we are reviewing a number of opportunities. These transactions may be announced or completed in the ordinary course of business consistent with past practice during the pendency of this offer, but there can be no assurance that an opportunity will be available to us or that we will choose to take advantage of an opportunity.

In the ordinary course of business, the Company makes changes in the composition and structure of its board of directors and/or management. The Company expects that it will continue to make changes in this regard.

Neither we nor our board of directors makes any recommendation as to whether you should accept this offer, nor have we authorized any person to make any such recommendation. Active Power has prepared communications regarding this offer and will provide general tax information to eligible employees with respect to this offer. Active Power will not provide tax advice specific to an individual's circumstances. You must make your own decision about whether to participate in this offer. We recommend that you discuss the personal tax consequences of this offer with your financial, legal and/or tax advisors.

#### **4. Procedures for electing to participate in this offer.**

##### ***Proper election to elect to participate in this offer.***

Participation in this offer is voluntary. To participate in this offer, you must do the following before 5:00 p.m., Central Time, on December 11, 2007 (the expiration date):

1. Properly complete the attached election form by selecting the "Accept Offer" box and signing and dating the form.

2. Fax the completed and signed election form to Jennifer Crow at the fax number (512) 836-4511. Alternatively, you may send an email to Jennifer Crow at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com) with the completed and signed election form attached to your email.

If you participate in this offer, you must accept this offer with respect to all of the shares subject to the outstanding portion of that option grant except as detailed in Section 2 of this Offer to Amend. To help you recall your outstanding eligible option grants and give you the tools to make an informed decision, we will provide you with an Addendum listing your eligible options (including the numbers of shares subject to the eligible option and its original exercise price), the new exercise price that will apply if the eligible options are amended and, to the extent applicable, the cash payments you will receive for the eligible cash payment options, if amended. If you hold an option that is not listed on the Addendum, the option is not an eligible option.

Your election to participate becomes irrevocable at 5:00 p.m., Central Time, on December 11, 2007, unless the offer is extended past that time, in which case your election will become irrevocable at the new expiration date, except as provided in Section 5 of this Offer to Amend. You may change your mind after you have submitted an election form and withdraw from the offer at any time before the expiration date, as described in Section 5 of this Offer to Amend. You may change your mind as many times as you wish, but you will be bound by the last properly submitted election form we receive before the expiration date.

**The delivery of all documents, including election forms, is at your risk. Active Power intends to confirm the receipt of your election form by email within two U.S. business days. If you have not received an email confirmation, you must confirm that we have received your election form. Only responses that are complete, signed, and actually received by the Company by the deadline will be accepted. Responses may only be submitted via fax or email. Responses submitted by any other means, including hand delivery, are not permitted.**

This is a one time offer, and we will strictly enforce the election period. We reserve the right to reject any election that we determine is not in good order or that we determine is unlawful to accept. Subject to the terms and conditions of this offer, promptly after the expiration of this offer we will accept all options with respect to which proper elections are made.

Our receipt of your election form is not by itself an acceptance of your options. For purposes of this offer, we will be deemed to have accepted options with respect to which proper elections have been made and are not properly withdrawn by you as of the time when we give oral or written notice to the option holders generally of our acceptance of eligible options. We may issue this notice of acceptance by press release, email, or other methods of communication. Eligible options accepted will be amended on the expiration date, which we presently expect will be December 11, 2007.

***Determination of validity; rejection of options; waiver of defects; no obligation to give notice of defects.***

We will determine, at our discretion, all questions as to the validity, form, eligibility (including time of receipt), and acceptance of any options. Our determination of these matters will be final and binding on all parties. We reserve the right to reject any election form or any eligible options with respect to which elections have been made that we determine are not in good order or that we determine are unlawful to accept. We will accept all eligible options with respect to which proper elections are made that are not validly withdrawn by you. We also reserve the right to waive any of the conditions of the offer or any defect or irregularity in any election of any particular eligible options or for any particular option holder, provided that if we grant any such waiver, it will be granted with respect to all option holders and eligible options with respect to which elections have been made. No elections will be deemed to have been properly made until all defects or irregularities have been cured by the option holder or waived by us. Neither we nor any other person is obligated to give notice of any defects or irregularities in elections, nor will anyone incur any liability for failure to give any notice. This is a one time offer. We will strictly enforce the election period, subject only to an extension that we may grant in our discretion.

***Our acceptance constitutes an agreement.***

Your election through the procedures described above constitutes your acceptance of the terms and conditions of this offer. Our acceptance of your eligible options for amendment will constitute a binding agreement between Active Power and you upon the terms and subject to the conditions of this offer.

**5. *Withdrawal rights and change of election.***

You may withdraw all your options from participation in this offer and any such withdrawal must be in accordance with the provisions of this section.

If you have previously elected to accept this offer with respect to all of your eligible options, you may withdraw that election with respect to all of these eligible options at any time before the expiration date, which is expected to be 5:00 p.m., Central Time, on December 11, 2007. If we extend the offer, you may withdraw your election at any time until the extended expiration date.

In addition, although we intend to accept all eligible options with respect to which valid elections have been made promptly after the expiration of this offer, if we have not accepted your eligible options by 5:00 p.m., Central Time, on January 10, 2008, you may withdraw your eligible options at any time thereafter.

To withdraw your election with respect to all of your eligible options, you must do the following before the expiration date:

1. Properly complete the attached election form by selecting the "Reject Offer" box and signing and dating the form.

2. Fax the completed and signed election form to Jennifer Crow at the fax number (512) 836-4511. Alternatively, you may send an email to Jennifer Crow at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com) with the completed and signed election form attached to your email.

You may change your mind as many times as you wish, but you will be bound by the last properly submitted election form we receive before the expiration date. The Company must receive the properly completed and signed election form before the expiration date. The expiration date will be 5:00 p.m., Central Time, on December 11, 2007, unless we extend the offer.

You may not rescind any withdrawal. If you change your mind after you have submitted a withdrawal and wish to participate in the offer, you must submit a new election form. If you do not withdraw your eligible options, they will remain bound pursuant to your prior election form. To re-elect to accept this offer with respect to the withdrawn eligible options, you must complete and submit a new election form before the expiration date by following the procedures described in Section 4 of this Offer to Amend. This new election form must be completed properly and submitted after your prior election form rejecting the offer.

Neither we nor any other person is obligated to give you notice of any defects or irregularities in any election form, nor will anyone incur any liability for failure to give any notice. We will determine, in our discretion, all questions as to the form and validity, including time of receipt, of election forms. Our determination of these matters will be final and binding.

**The delivery of all documents, including election forms, is at your risk. Active Power intends to confirm the receipt of your election form by email within two U.S. business days. If you have not received an email confirmation, you must confirm that we have received your election form. Only responses that are complete, signed and actually received via fax or email by Active Power by the deadline will be accepted. Responses may be submitted only by fax or email. Responses submitted by any other means, including hand delivery, United States mail (or other post) and Federal Express (or similar delivery service) are not permitted.**

#### **6. Acceptance of options for amendment, issuance of cash payments and amended options.**

Upon the terms and conditions of this offer and promptly following the expiration date, we will accept for amendment all eligible options with respect to which proper elections have been made that have not been validly withdrawn by you before the expiration date.

Subject to the terms and conditions of this offer, if elections with respect to your eligible options are made properly and accepted by us, these eligible options will be amended as of the amendment date (but following the expiration of the offer), which is on the same date as the expiration date. We expect that the expiration date will be December 11, 2007, unless the offer period is extended. We expect that the amendment date will be December 11, 2007 (but following the expiration of the offer), unless the offer period is extended. If the expiration date is delayed, the amendment date similarly will be delayed. Once eligible options with respect to which you elect to accept this offer are amended, those options will be replaced in full by the amended options.

For purposes of the offer, we will be deemed to have accepted eligible options for you with respect to which valid elections have been made and are not properly withdrawn by you as of the time when we give oral or written notice to the option holders generally of our acceptance for amendment of the eligible options. This notice may be made by press release, email, or other method of communication. Subject to our rights to terminate the offer, discussed in Section 15 of this Offer to Amend, we currently expect that we will accept promptly after the expiration date all options with respect to which proper elections have been made that are not validly withdrawn by you.

In lieu of the eligible options with respect to which you choose to accept this offer, you will be entitled to receive amended options and, to the extent applicable, cash payments, as described in Section 2 of this Offer to Amend, subject to any applicable vesting conditions. Eligible options with respect to which you choose to accept this offer will be amended on the amendment date, which is the same date as the expiration date. The amendment date will be December 11, 2007, unless the offer period is extended. Promptly after the expiration of the offer, you will receive an "Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment" evidencing the amendment of the eligible options you elected to amend.

In addition, if you elected to amend any eligible cash payment option, the “Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment” will evidence your right to receive the cash payment. Any cash payment owed to you for an eligible cash payment option with respect to which you have chosen to accept this offer will be paid to you, less any applicable tax withholding, on the Company’s first payroll date in 2008. This payment will not be subject to any vesting conditions or otherwise be subject to forfeiture. Promptly following the expiration of the offer we will send you an “Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment” evidencing your right to receive the cash payment, if any. If you do not receive an Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment within seven U.S. business days after the expiration date, please contact Jennifer Crow by email at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com).

The proposed regulations under Section 409A that allow us to offer you the opportunity to avoid unfavorable tax consequences by amending your eligible cash payment options also impose certain requirements regarding the timing of the cash payments. These regulations do not allow us to make the cash payments in the same calendar year in which the eligible cash payment options are amended. Therefore, the earliest we can make these cash payments to eligible employees who participate in the offer is in 2008.

Options that we do not accept for amendment will remain outstanding until they expire by their terms and will retain their current exercise terms and current vesting schedule. If you elect to participate in the offer but exercise your eligible options prior to expiration of the offer, those eligible options which you exercise will no longer be eligible to be amended in this offer and you will not receive a cash payment, to the extent you exercise options that are eligible cash payment options. Your options instead will terminate upon exercise in accordance with their terms. Please see Section 14 of this Offer to Amend for a description of the tax consequences to you of accepting and not participating in this offer.

## **7. Conditions of the offer.**

If Active Power is acquired prior to the expiration of the offer, we reserve the right to withdraw the offer, in which case your eligible options and your rights under them will remain intact and exercisable for the time period set forth in your option agreement and you will receive no amended options. Notwithstanding any other provision of this offer, we will not be required to accept any eligible options for amendment, and we may terminate the offer, or postpone our acceptance and amendment of any eligible options for which elections to amend have been made, in each case, subject to Rule 13e-4(f)(5) under the Exchange Act, if at any time on or after the date this offer begins, and before the expiration date, any of the following events has occurred, or has been determined by us to have occurred:

- there shall have been threatened or instituted or be pending any action, proceeding or litigation seeking to enjoin, make illegal or delay completion of the offer or otherwise relating in any manner, to the offer;
- any order, stay, judgment or decree is issued by any court, government, governmental authority or other regulatory or administrative authority and is in effect, or any statute, rule, regulation, governmental order or injunction shall have been proposed, enacted, enforced or deemed applicable to the offer, any of which might restrain, prohibit or delay completion of the offer or impair the contemplated benefits of the offer to us (see Section 3 of this Offer to Amend for a description of the contemplated benefits of the offer to us);
- there shall have occurred:
  - any general suspension of trading in, or limitation on prices for, our securities on any national securities exchange or in an over-the-counter market in the United States,

- the declaration of a banking moratorium or any suspension of payments in respect of banks in the United States,
- any limitation, whether or not mandatory, by any governmental, regulatory or administrative agency or authority on, or any event that, in our reasonable judgment, might affect the extension of credit to us by banks or other lending institutions in the United States,
- in our reasonable judgment, any extraordinary or material adverse change in United States financial markets generally, including, a decline of at least 10% in either the Dow Jones Industrial Average, the NYSE Index, the Nasdaq Composite Index or the Standard & Poor's 500 Index from the date of the commencement of the offer,
- the commencement or continuation of a war or other national or international calamity directly or indirectly involving the United States, which could reasonably be expected to affect materially or adversely, or to delay materially, the completion of the offer, or
- if any of the situations described above existed at the time of commencement of the offer and that situation, in our reasonable judgment, deteriorates materially after commencement of the offer;
- a tender or offer, other than this offer by us, for some or all of our shares of outstanding common stock, or a merger, acquisition or other business combination proposal involving us, shall have been proposed, announced or made by another person or entity or shall have been publicly disclosed or we shall have learned that:
  - any person, entity or group has purchased all or substantially all of our assets,
  - any person, entity or "group" within the meaning of Section 13(d)(3) of the Exchange Act acquires more than 5% of our outstanding shares of common stock, other than a person, entity or group that had publicly disclosed such ownership with the SEC prior to the date of commencement of the offer,
  - any such person, entity or group that had publicly disclosed such ownership prior to such date shall acquire additional common stock constituting more than 1% of our outstanding shares,
  - any new group shall have been formed that beneficially owns more than 5% of our outstanding shares of common stock that in our judgment in any such case, and regardless of the circumstances, makes it inadvisable to proceed with the offer or with such acceptance for amendment of eligible options, or
  - any person, entity or group shall have filed a Notification and Report Form under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, or made a public announcement reflecting an intent to acquire us or any of our subsidiaries or any of the assets or securities of us or any of our subsidiaries;
- there shall have occurred any change, development, clarification or position taken in generally accepted accounting principles that could or would require us to record for financial reporting purposes compensation expense against our earnings in connection with the offer other than as contemplated as of the commencement date of this offer (as described in Section 12);

- any change or changes shall have occurred in the business, condition (financial or other), assets, income, operations or stock ownership of Active Power that have resulted or may result, in our reasonable judgment, in a material impairment of the contemplated benefits of the offer to us (see Section 3 of this Offer to Amend for a description of the contemplated benefits of the offer to us); or
- any rules or regulations by any governmental authority, the National Association of Securities Dealers, the Nasdaq Global Market, or other regulatory or administrative authority or any national securities exchange have been enacted, enforced, or deemed applicable to the Company, which might restrain, prohibit, or delay completion of the offer or impair the contemplated benefits of the offer to us (see Section 3 of this Offer to Amend for a description of the contemplated benefits to us).

If any of the above events occur, we may:

- terminate the offer and promptly return all eligible options with respect to which elections have been made to the eligible employees;
- complete and/or extend the offer and, subject to your withdrawal rights, retain all options with respect to which elections have been made until the extended offer expires;
- amend the terms of the offer; or
- waive any unsatisfied condition and, subject to any requirement to extend the period of time during which the offer is open, complete the offer.

The conditions to this offer are for our benefit. We may assert them in our discretion regardless of the circumstances giving rise to them before the expiration date. We may waive any condition, in whole or in part, at any time and from time to time before the expiration date, in our discretion, whether or not we waive any other condition to the offer. Our failure at any time to exercise any of these rights will not be deemed a waiver of such rights, but will be deemed a waiver of our ability to assert the condition that was triggered with respect to the particular circumstances under which we failed to exercise our rights. Any determination we make concerning the events described in this Section 7 will be final and binding upon all persons.

#### 8. Price range of shares underlying the options.

The Active Power common stock that underlies your eligible options is traded on The Nasdaq Global Market under the symbol “ACPW.” The following table shows, for the periods indicated, the high and low intraday sales price per share of our common stock as reported by the Nasdaq Global Market.

	<u>High</u>	<u>Low</u>
<b>2007</b>		
Third Quarter	\$2.30	\$1.28
Second Quarter	2.00	1.46
First Quarter	2.81	1.80
<b>2006</b>		
Fourth Quarter	\$2.94	\$2.01
Third Quarter	3.85	1.76
Second Quarter	5.91	2.65
First Quarter	5.01	3.83

	<u>High</u>	<u>Low</u>
<b>2005</b>		
Fourth Quarter	\$4.66	\$3.10
Third Quarter	4.39	3.01
Second Quarter	3.59	2.39
First Quarter	4.61	3.01

On November 8, 2007, the closing sale price of our common stock, as reported by The Nasdaq Global Market was \$2.01 per share.

**You should evaluate current market quotes for our common stock, among other factors, before deciding whether or not to accept this offer.**

## **9. Source and amount of consideration; terms of amended options.**

### ***Consideration.***

We will issue cash payments in addition to amended options with respect to eligible cash payment options for which proper elections have been made and accepted. Cash payments will be made from Active Power's general corporate assets, and you will be a general creditor of Active Power with respect to the cash payments until they are received.

If we receive and accept elections from eligible employees of all options eligible for this offer, subject to the terms and conditions of this offer, we will amend options to purchase a total of approximately 825,785 shares of our common stock, or approximately 1% of the total shares of our common stock outstanding as of November 8, 2007, and the maximum aggregate cash payments payable pursuant to the offer will be approximately \$30,000.

### ***General terms of amended options.***

If we have accepted your election to amend your eligible options, you will receive the consideration described in Section 2 of this Offer to Amend. Each amended option will be amended on the amendment date (expected to be December 11, 2007). All amended options will be evidenced by a letter or other paperwork, which will be sent to you promptly after the expiration of the offer.

Except for the new exercise price of your amended options, the terms and conditions of your amended options will remain the same as the terms and conditions of your eligible options.

The following description summarizes the material terms of the Active Power, Inc. 2000 Stock Incentive Plan. Our statements in this Offer to Amend concerning the Active Power, Inc. 2000 Stock Incentive Plan and the amended options are merely summaries and do not purport to be complete. The statements are subject to, and are qualified in their entirety by reference to, the Active Power, Inc. 2000 Stock Incentive Plan, and the forms of option agreement under the Active Power, Inc. 2000 Stock Incentive Plan, which have been filed as exhibits to the Schedule TO of which this offer is a part. Please contact Jennifer Crow at phone number (512) 744-9254, or by email at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com), to receive a copy of the Active Power, Inc. 2000 Stock Incentive Plan, and the forms of option agreement thereunder. We will promptly furnish you copies of these documents upon request at our expense.

### **Summary of the Active Power, Inc. 2000 Stock Incentive Plan.**

We have currently reserved 13,568,969 shares of our common stock for issuance under the Active Power, Inc. 2000 Stock Incentive Plan (the "Active Power Stock Plan"). The share reserve under the Active Power Stock Plan automatically increases on the first trading day in January of each calendar year by an amount equal to two percent (2%) of the total number of shares of our common stock outstanding on the last trading day of December in the prior calendar year, but in no event will this annual increase exceed 1,080,000 shares. In addition, no participant in the Active Power Stock Plan may be granted stock options, separately exercisable stock appreciation rights or direct stock issuances for more than 1,080,000 shares of common stock in total in any calendar year. The Active Power Stock Plan has three separate programs:

- the discretionary option grant program, under which eligible individuals may be granted options to purchase shares of our common stock at an exercise price less than, equal to or greater than the fair market value of those shares on the grant date;
- the stock issuance program, under which eligible individuals may be issued shares of common stock directly, upon the attainment of performance milestones, the completion of a specified period of service or as a bonus for past services; and
- the automatic option grant program, under which option grants will be made automatically at periodic intervals to eligible non-employee board members to purchase shares of common stock at an exercise price equal to the fair market value of those shares on the grant date.

#### *Eligibility.*

The individuals eligible to participate in the Active Power Stock Plan include our officers and other employees, our non-employee board members and any consultants or other independent advisors we hire.

#### *Administration.*

The Company's Board of Directors has authority to administer the discretionary option grant and stock issuance program but has the authority to delegate administration (other than with respect to Section 16 officers for purposes of the Exchange Act) to a committee of the Board of Directors. Subject to the terms of the Active Power Stock Plan, the Administrator determines which eligible individuals are to receive option grants or stock issuances under those programs, the terms and conditions of such options and stock, and to construe and interpret the terms of the Active Power Stock Plan and awards granted thereunder.

#### *Exercise price.*

The Administrator generally determines the exercise price at the time the option is granted. The exercise price of the amended options will have an exercise price per share equal to the fair market value of the underlying stock on the measurement date of such option for financial reporting purposes.

#### *Vesting and exercise.*

The Administrator generally determines the terms of vesting. Any amended option you receive will be subject to the same vesting schedule as the eligible option it amends, and you will receive vesting credit for any vesting credit that accrued under the original eligible option. That means that upon the amendment date, your amended options will be vested to the same extent and will continue to vest at the same rate as the eligible options they replace. Continued vesting is subject to your continued service to us through each relevant vesting date.

*Term of options.*

The term of options granted under the Active Power Stock Plan is as stated in the option agreements. All amended options granted pursuant to this offer will expire on the same date as the scheduled expiration of the eligible options they amend. Amended options will expire earlier upon your termination of employment or other service with Active Power.

*Additional plan features.*

The Active Power Stock Plan includes the following features:

- The exercise price for any options granted under the Active Power Stock Plan may be paid in cash, check or in shares of our common stock valued at the fair market value on the exercise date. The option may also be exercised through a same-day sale program through an independent brokerage firm without any cash outlay by the optionee.
- Stock appreciation rights may be issued to selected optionees under the discretionary option grant program. These rights will provide the holders with the election to surrender their outstanding options for a payment from us equal to the fair market value of the shares subject to the surrendered options less the exercise price payable for these shares. We may make the payments in cash or in shares of our common stock.

*Termination of employment.*

If you are currently an employee or other service provider of Active Power, your employment or other service will remain “at-will” regardless of your participation in the offer and can be terminated by you or us at any time, with or without cause or notice. If your employment or other service terminates before the expiration date, your options will have ceased to vest in accordance with their terms and you will be eligible to participate in this offer only to the extent that you hold options which have vested and remain outstanding as of the last date on which this offer remains open for acceptance. Any options with respect to which you have accepted this offer that are not eligible for amendment will be returned to you and will terminate in accordance with their terms.

Options granted under the Active Power Stock Plan generally are exercisable, to the extent vested, within the period of time specified in the optionee’s option agreement. If the optionee is terminated for Misconduct or should the optionee engage in Misconduct while his or her options are outstanding, then all such option shall terminate immediately. For these purposes, Misconduct is defined as the commission of any act of fraud, embezzlement or dishonesty, any unauthorized use or disclosure of confidential information or trade secrets, or any intentional wrongdoing which materially adversely affects the business or affairs of Active Power.

If you participate in this offer, any amended options will continue to be subject to the same vesting schedule in place under the terms of your eligible option immediately prior to such amendment. In addition, with respect to any eligible cash payment options that you elect to amend pursuant to this offer, you will be entitled to receive cash payments. Such cash payments will be made regardless of whether you remain employed with or otherwise in service to the Company on the actual cash payment date, which will be on Active Power’s first payroll date in 2008.

*Automatic option grant program.*

Each individual who first becomes a non-employee board member receives an option grant to purchase 25,000 shares of common stock on the date such individual initially is elected or appointed to the board. In

addition, on the date of each annual stockholders meeting beginning with the 2001 Annual Stockholder Meeting, each non-employee board member who is to continue to serve as a non-employee board member, including each of our current non-employee board members, will automatically be granted an option to purchase 7,500 shares of common stock, provided such individual has served on the board for at least six months.

Each automatic grant will have an exercise price per share equal to the fair market value per share of our common stock on the grant date and will have a term of 10 years, subject to earlier termination following the optionee's cessation of board service. The option will be immediately exercisable for all of the option shares; however, we may repurchase, at the exercise price paid per share, any shares purchased under the option which are not vested at the time of the optionee's cessation of board service. The shares subject to each initial 25,000-share automatic option grant will vest in a series of three successive annual installments upon the optionee's completion of each year of board service over the three-year period measured from the grant date. The shares subject to each annual 7,500 share automatic grant will vest upon the optionee's completion of one year of service measured from the grant date. However, the shares will vest immediately in full upon the optionee's death or disability while then serving as a board member. In the event of certain changes in control while the optionee is serving as a board member, the shares will vest immediately in full prior to the effective date of such transaction.

*Adjustments upon certain events.*

Although we do not currently anticipate any such merger or acquisition, if we merge or consolidate with or are acquired by another entity, prior to the expiration of the offer, you may choose to withdraw any eligible options with respect to which you elected to accept this offer and your eligible options will be treated in accordance with the option plan under which they were granted and with your option agreement. Further, if Active Power is acquired prior to the expiration of the offer, we reserve the right to withdraw the offer, in which case your eligible options and your rights under them will remain intact and remain exercisable for the time period set forth in your option agreement and you will receive no amended options, cash payments or other consideration for the eligible options. If Active Power is acquired prior to the expiration of the offer but does not withdraw the offer, we (or the successor entity) will notify you of any material changes to the terms of the offer or amended options, including any adjustments to the exercise price or number of shares that will be subject to the amended options. Under such circumstances, we expect that the type of security and the number of shares covered by each amended option would be adjusted based on the consideration per share given to holders of options to acquire our common stock that are outstanding at the time of the acquisition. Such amended options will generally have an exercise price equal to the closing price of the acquirer's stock on the expiration date. As a result of this adjustment, you may receive eligible options for more or fewer shares of the acquirer's common stock than the number of shares subject to the eligible options with respect to which you accept this offer or than the number you would have received pursuant to an amended option if no acquisition had occurred.

You should be aware that these types of transactions could affect our stock price significantly, including potentially substantially increasing the price of our shares. Your amended options may be exercisable for stock of the acquirer, not Active Power common stock, while option holders who decide not to participate in this offer might be able to exercise their options before the effective date of the merger or acquisition and sell their Active Power common stock before the effective date.

If we are acquired, it is possible that an acquirer could terminate your employment or other service and therefore, to the extent that you have any amended options subject to vesting, such options will cease to vest and will terminate in accordance with their terms. Regardless of whether you remain an employee or other service provider on the scheduled payment date, you still will receive any payments to which you are entitled as a result of your participation in this offer.

Finally, if we are acquired after the eligible options with respect to which you have chosen to accept this offer have been accepted for amended options, the treatment of your amended options in such a transaction will be governed by the terms of the transaction agreement or the terms of the Active Power Stock Plan under which they were granted and your amended option agreements.

*Change in control.*

The Active Power Stock Plan includes the following change in control provisions which may result in the accelerated vesting of outstanding option grants and stock issuances:

- In the event that we are acquired by merger or asset sale or board-approved sale by the stockholders of more than 50% of our outstanding voting stock, each outstanding option under the discretionary option grant program which is not to be assumed by the successor corporation or otherwise continued in effect will become exercisable for all the option shares immediately prior to the effective date of the change in control, and all outstanding unvested shares will vest immediately prior to the effective date of the change in control, except to the extent our repurchase rights with respect to those shares are to be assigned to the successor corporation or otherwise continued in effect.
- The Administrator has complete discretion to grant one or more options which will become exercisable for all the option shares in the event those options are assumed in the acquisition but the optionee's service with us or the acquiring entity is subsequently involuntarily terminated. The vesting of any outstanding shares under the Active Power Stock Plan may be accelerated upon similar terms and conditions.
- The Administrator may grant options and structure repurchase rights so that the shares subject to those options or repurchase rights will vest automatically in connection with a hostile takeover effected through a successful tender offer for more than 50% of our outstanding voting stock or a change in the majority of our board through one or more contested elections. Such accelerated vesting may occur either at the time of such transaction or upon the subsequent termination of the optionee's services.

*Amendment and termination.*

The board of directors may amend or modify the Active Power Stock Plan at any time, subject to any required stockholder approval. The Active Power Stock Plan will terminate no later than July 12, 2010.

*Registration of shares underlying the options.*

All of the shares of Active Power common stock issuable upon exercise of amended options have been registered under the United States Securities Act of 1933, as amended (the "Securities Act"), on registration statements on Form S-8 filed with the SEC. Unless you are an employee who is considered an affiliate of Active Power for purposes of the Securities Act, you will be able to sell the shares issuable upon exercise of your amended options free of any transfer restrictions under applicable United States securities laws.

*United States federal income tax consequences.*

You should refer to Section 14 of this Offer to Amend for a discussion of the United States federal income tax consequences of the amended options and the eligible options with respect to which you choose to accept this offer, as well as the consequences of accepting or rejecting this offer. We strongly recommend that you consult with your own advisors to discuss the consequences to you of participating or not participating in this offer.

Certain states, including California, have adopted provisions similar to Section 409A under state tax law, and for optionees subject to income taxation in such states the total penalty tax could be higher than 20% (a 20% federal penalty tax and potentially a state penalty tax). We recommend that you consult with your financial, legal and/or tax advisors regarding any state tax consequences.

*Federal income tax consequences in multiple jurisdictions.*

If you are a citizen or resident of the United States, and also are subject to the tax laws of another non-United States jurisdiction, you should be aware that there might be other tax and social insurance consequences that may apply to you. We strongly recommend that you consult with your own advisors to discuss the consequences to you of participating or not participating in this offer.

**10. Information concerning the Company.**

Active Power designs, manufactures and markets power quality products that provide consistent, reliable and cost-effective ride through, or temporary, power for the majority of power disturbances, such as voltage sags and surges, and bridge the gap between a power outage and restoration of power or the time required to switch to generator power. Our products are designed to be environmentally friendly compared to existing solutions without compromising functionality, efficiency or cost. We have shipped over 1,700 flywheels, or more than 425 megawatts of our products to business locations in over 35 countries around the world since our founding in 1992. We are headquartered in Austin, Texas.

Our patented flywheel energy storage systems store kinetic energy by constantly spinning a compact steel wheel (“flywheel”) driven from utility power in a low-friction environment. When the utility power used to spin the flywheel fluctuates or is interrupted, the flywheel’s inertia causes it to continue spinning. The resulting kinetic energy of the spinning flywheel generates electricity known as “bridging power” for short periods until utility power is fully restored or a backup electric generator starts and takes over generating longer-term backup power in the case of an extended electrical outage. We believe that our flywheel products provide many competitive advantages over traditional battery-based systems, including substantial space savings, high power densities, “green” energy storage and power efficiencies as high as 98% that reduce total operational energy costs. We offer our flywheel products with load capabilities from 65 kVA to 3600 kVA, while typically targeting higher power density applications above 200 kVA since the majority of these customers already have back-up generators. We market our flywheel products under the brand name CleanSource®. CleanSource DC is a non-chemical replacement for lead-acid batteries used for bridging power. Utilizing our flywheel energy storage technology, the CleanSource DC is a stand-alone direct current (DC) product that is compatible with all major brands of uninterruptible power supplies (UPS). We built on the technological success of CleanSource DC by creating a battery-free UPS, CleanSource UPS, which integrates the UPS electronics and our flywheel energy storage system into one compact cabinet. CleanSource UPS represents the majority of our current revenues. Combining our CleanSource UPS with a generator provides customers with complete short and long-term protection in the event of a power disturbance. We sell our CleanSource flywheel products to commercial and industrial customers across a variety of vertical markets including manufacturing, technology, communications, utilities, healthcare, banking and military and in all major geographic regions of the world, but particularly in North America and Europe.

To address the longer runtime requirements of customers without backup generators that still need protection from utility disturbances, we also have developed a patented extended runtime product that we call CoolAir™ DC. We initially have targeted CoolAir DC at lower power levels than our flywheel products, and it is sold as a minute-for-minute replacement for lead-acid batteries. CoolAir DC can provide backup power for

several minutes to hours depending on the customer application. CoolAir DC utilizes mature thermal and compressed air storage (TACAS) technologies combined in a proprietary manner to produce backup power during an electrical disturbance. This product discharges cool air as a by-product of its operation that also can be used by customers during an electrical disturbance as a source of backup cooling. In addition to offering a DC-only solution, when customers desire a complete backup solution with an extended runtime, we have introduced the CoolAir UPS that couples our CoolAir DC product with a third party double-conversion UPS. CoolAir initially is being targeted at small to medium-size data center customers in North America following its commercial introduction in the US in the second quarter of 2006 and the international version in the fourth quarter of 2006.

Our principal executive office is located at 2138 W. Braker Lane, BK12, Austin, Texas 78758, and our telephone number is (512) 836-6464. Our website address is [www.activepower.com](http://www.activepower.com). Questions regarding how to participate in this offer should be directed to Jennifer Crow at Active Power at:

Jennifer Crow  
 Finance Manager  
 Active Power, Inc.  
 Phone: (512) 744-9254  
 Fax: (512) 836-4511

A summary of the financial information included in our annual report on Form 10-K for the fiscal year ended December 31, 2006 and our quarterly report on Form 10-Q for the fiscal quarter ended September 30, 2007, which is incorporated herein by reference, is attached hereto as Schedule B to this Offer to Amend. Please see Section 18 of this Offer to Amend entitled, "Additional Information," for instructions on how you can obtain copies of our SEC filings, including filings that contain our financial statements.

We had a book value per share of \$0.65 at September 30, 2007.

The following table sets forth our ratio of earnings to fixed charges for the periods specified:

	Year Ended		Nine Months Ended
	December 31, 2006	December 31, 2005	September 30, 2007
Ratio of earnings to fixed charges [1]			

[1] Our earnings were insufficient to cover fixed charges and preferred stock dividends in all of the periods presented. Because of the deficiency, the ratio information is not applicable. Earnings were inadequate to cover fixed charges by \$22.9 million, \$21.1 million and \$14.6 million for the years ended December 31, 2005 and 2006 and the nine months ended September 30, 2007, respectively. We did not have any preferred stock outstanding and we did not pay or accrue any preferred stock dividends during the periods presented above. As a result, the ratio of earnings to combined fixed charges and preferred stock dividends is the same as the ratio of earnings to fixed charges.

For purposes of computing the deficiency of earnings available to cover fixed charges, fixed charges represent interest. Deficiency of earnings consists of loss before income taxes plus fixed charges. We had no fixed charges or income tax expenses in all of the periods presented above.

**11. Interests of directors and executive officers; transactions and arrangements concerning the options.**

A list of our directors and named executive officers is attached to this Offer to Amend as Schedule A. None of our executive officers or directors are eligible to participate in this offer.

As of November 2, 2007, our executive officers and directors as a group held options unexercised and outstanding under the Active Power Stock Plan to purchase a total of 2,335,123 of our shares, which represented approximately 45.28% of the shares subject to all options outstanding under our Active Power Stock Plan as of that date.

The following table below sets forth the beneficial ownership of each of our executive officers and directors of options under the Active Power Stock Plan outstanding as of November 2, 2007. The percentages in the table below are based on the total number of outstanding options (i.e., whether or not eligible for amendment) to purchase shares of our common stock under the Active Power Stock Plan which was 5,157,025 as of November 2, 2007. The executive officers and directors listed below are not eligible to participate in the offer.

<u>Name</u>	<u>Number of Options Outstanding Under the Active Power Stock Plan as of November 2, 2007</u>	<u>Percentage of Total Outstanding Options Under the Active Power Stock Plan</u>
James A. Clishem President, Chief Executive Officer & Director	700,000	13.57%
John K. Penver Vice President of Finance, Chief Financial Officer and Secretary	245,000	4.75%
James M. Murphy Vice President Sales—EMA	58,000	1.12%
Gary P. Rackow Vice President Sales—America	50,000	*
Lisa M. Brown Vice President –Marketing & Sales Operations	105,000	2.04%
Karl Scheutze Vice President—Engineering	125,260	2.43%
David Perkins Chief Technology Officer	406,301	7.88%
Jason P. Rubin Vice President—Manufacturing	128,562	2.49%
Ake Almgren Director	75,000	1.45%
Richard E. Anderson Director	90,000	1.75%
Rodney S. Bond Director	117,000	2.27%
Brad Boston Director	60,000	1.16%
Jan H. Lindelow Director	90,000	1.75%
Benjamin L. Scott Director	85,000	1.65%
Total – all officers and directors	2,335,123	45.28%

\* Less than 1%.

None of our directors or executive officers, nor any affiliates of ours, nor the executive officers and directors of Active Power were engaged in transactions involving our common stock during the 60 days before and including the commencement of this offer.

**12. Status of options amended by us in the offer; accounting consequences of the offer.**

Eligible options that we acquire through the acceptance of elections under this offer will be amended under the Active Power Stock Plan.

The offer with respect to all eligible options is considered a modification of those options for financial reporting purposes. As a result, the Company will record any incremental compensation expense calculated as any increase in the fair value of the modified options compared to the fair value of the original option as of the end of the offer period recognized over the remaining requisite service period. We will also recognize compensation expense for financial reporting purposes in the aggregate amount of cash payments that become payable pursuant to the terms of the offer.

**13. Legal matters; regulatory approvals.**

We are not aware of any license or regulatory permit that appears to be material to our business that might be affected adversely by our acceptance of options for amendment and issuance of amended options as contemplated by the offer, or of any approval or other action by any government or governmental, administrative or regulatory authority or agency or any Nasdaq Global Market listing requirements that would be required for the acquisition or ownership of our options as contemplated herein. Should any additional approval or other action be required, we presently contemplate that we will seek such approval or take such other action. We cannot assure you that any such approval or other action, if needed, could be obtained or what the conditions imposed in connection with such approvals would entail or whether the failure to obtain any such approval or other action would result in adverse consequences to our business. Our obligation under the offer to accept elections with respect to eligible options and to issue amended options is subject to the conditions described in Section 7 of this Offer to Amend.

If we are prohibited by applicable laws or regulations from granting amended options on the amendment date, we will not grant any amended options. We are unaware of any such prohibition at this time, and we will use reasonable efforts to affect the grant, but if the grant is prohibited on the amendment date we will not grant any amended options.

**14. Material United States federal income tax consequences.**

If You Participate in this Offer.

As a result of participation in this offer, you may avoid potentially adverse tax consequences associated with your eligible options. Please read this section carefully, as well as the following section summarizing the potential tax consequences to you if you decide to keep your current options.

The following is a summary of the material United States federal income tax consequences of participating in the offer for those eligible employees subject to United States federal income tax. This discussion is based on the Internal Revenue Code of 1986, as amended, its legislative history, treasury regulations thereunder and administrative and judicial interpretations (the "Code" or "Internal Revenue Code") as of the date of this Offer to Amend, all of which are subject to change, possibly on a retroactive basis. The federal tax laws may change and the federal, state and local tax consequences for each eligible employee will depend upon that eligible employee's individual circumstances. This summary does not discuss all of the tax consequences that may be relevant to you in light of your particular circumstances, nor is it intended to be applicable in all respects to all categories of option holders. We strongly recommend that you consult with your financial, legal and/or tax advisors to discuss the consequences to you of this transaction.

If you are subject to taxation in the United States, and are also subject to the tax laws of another country, you should be aware that there might be other tax and social insurance consequences that may apply to you.

Further, certain states, including California, have adopted provisions similar to Section 409A under state tax law, and for option holders subject to income taxation in such states, the total penalty tax could be higher than 20% (a 20% federal penalty tax and potentially a state penalty tax). We strongly recommend that you consult with your financial, legal and/or tax advisors to discuss the consequences to you of this transaction.

***We recommend that you consult your financial, legal and/or tax advisors with respect to the federal, state and local tax consequences of participating in the offer, as the related tax consequences to you are dependent on your individual tax situation. You may also contact John K. Penver, Chief Financial Officer for Active Power with any general questions regarding the terms of this offer.***

#### ***Cash payments.***

The cash payments you will receive as part of consideration for your eligible cash payment options, if any, under this offer will be taxable to you as compensation income. We generally will be entitled to a deduction equal to the amount of compensation income taxable to you if we comply with eligible reporting requirements. If you were an employee of Active Power at the time the eligible options with respect to which you accepted this offer were granted, any income recognized upon your receipt of a cash payment will constitute wages for which withholding will be required.

#### ***Amended options.***

If you are an eligible employee who chooses to accept this offer with respect to your eligible options, you should not be required to recognize income for United States federal income tax purposes at the time of the acceptance and amendment of such options. We believe that the acceptance and amendment of eligible options will be treated as a non-taxable exchange.

All eligible options are nonstatutory stock options for purposes of United States tax law. Your amended options will continue to be nonstatutory stock options for purposes of United States tax law. Under current law, an option holder generally will not realize taxable income upon the grant of a nonstatutory stock option. However, when an option holder exercises the option, the difference between the exercise price of the option and the fair market value of the shares subject to the option on the date of exercise will be compensation income taxable to the option holder. As a result of Section 409A of the Internal Revenue Code, however, nonstatutory stock options granted with an exercise price below the fair market value of the underlying stock may be taxable to a participant before he or she exercises an award. If you elect to participate in this offer, your eligible options that are amended will be no longer subject to the adverse tax consequences under Section 409A that this offer was designed to allow you to avoid.

We generally will be entitled to a deduction equal to the amount of compensation income taxable to the option holder if we comply with eligible reporting requirements.

Upon disposition of the shares, any gain or loss is treated as capital gain or loss. If you were an employee of Active Power at the time of the grant of the eligible option, any income recognized upon exercise of a nonstatutory stock option generally will constitute wages for which withholding will be required.

***In addition, if you are a resident of more than one country, you should be aware that there might be tax and social insurance consequences for more than one country that may apply to you. We strongly recommend that you consult with your financial, legal and/or tax advisors to discuss the consequences to you of this transaction. We strongly recommend that you consult with your financial, legal and/or tax advisors with respect to the federal, state and local tax consequences of participating in the offer. You may also contact John K. Penver, Chief Financial Officer for Active Power with any general questions regarding the terms of this offer.***

If You Do Not Participate in this Offer.

The following is a summary of the material United States federal income tax consequences of declining to participate in the offer for those eligible employees subject to United States federal income tax. This discussion is based on the Internal Revenue Code, its legislative history, treasury regulations thereunder and administrative and judicial interpretations as of the date of this Offer to Amend, all of which are subject to change, possibly on a retroactive basis. The federal tax laws may change and the federal, state and local tax consequences for each eligible employee will depend upon that eligible employee's individual circumstances. This summary does not discuss all of the tax consequences that may be relevant to you in light of your particular circumstances, nor is it intended to be applicable in all respects to all categories of option holders. If you are subject to taxation in the United States, and are also subject to the tax laws of another country, you should be aware that there might be other tax and social security consequences that may apply to you. Further, certain states, including California, have adopted provisions similar to Section 409A under state tax law, and for optionees subject to income taxation in such states, the total penalty tax could be higher than 20% (a 20% federal penalty tax and potentially a state penalty tax). We strongly recommend that you consult with your own advisors to discuss the consequences to you of this transaction.

***We recommend that you consult your financial, legal and/or tax advisors with respect to the federal, state and local tax consequences of participating in the offer, as the tax consequences to you are dependent on your individual tax situation. You may also contact John K. Penver, Chief Financial Officer for Active Power with any general questions regarding the terms of this offer.***

Your decision not to accept this offer with respect to your eligible options could result in potentially adverse tax consequences to you. Please read this section carefully and talk to your tax advisors about your decision regarding participation in this offer.

As a result of participation in this offer, you may avoid potentially adverse tax consequences associated with your eligible options. Pursuant to Section 409A, holders of eligible options may have income recognition and owe an additional 20% penalty tax as well as be liable for certain interest penalties.

The Treasury Department and the IRS have issued final regulations with respect to Section 409A, but the regulations do not provide final guidance with respect to the tax consequences of discount options. Based on currently available guidance, we believe that, in the tax year in which an option vests, eligible employees will have income recognition equal to the difference between the fair market value of the shares and the exercise price (the "spread") and will be subject to the 20% penalty tax on the spread, plus interest charges. In addition, we

believe that during each subsequent tax year (until the option is exercised or expires), eligible employees will be subject to additional annual income, penalty taxes, plus interest charges on any increase in value of the underlying stock. Finally, certain states have also adopted laws similar to Section 409A. Consequently, eligible employees also may incur additional taxes and penalties under state law provisions.

**Example:** You hold options to purchase 4,000 shares of Active Power common stock with an original exercise price per share of \$1.00 which was granted at a time when the fair market value of a share of Active Power common stock on the option's measurement date for financial reporting purposes was \$1.50. On February 14, 2008 a total of 250 of the shares subject to the option vest and on such date the per share fair market value of the Active Power's common stock is \$2.00. Under the tax regulations and other published guidance, upon the vesting date, you may have taxable income equal to \$250 (the difference between the \$2.00 fair market value and the \$1.00 exercise price multiplied by 250 shares that vest) and owe an additional \$50 due to the 20% tax (20% of \$250). Additionally, you may owe an interest penalty with the calculation of such penalty dating back to the original date of grant and you may owe additional taxes in subsequent years, based on an increase in value of the underlying stock.

### **Uncertainty**

Unfortunately, the guidance issued by the Treasury Department and the IRS has not provided final guidance with respect to the tax consequences of discount options. There is a chance that future guidance issued may provide some relief with respect to certain eligible options and a tax advisor may advocate a position under the current statute and available guidance that your eligible options are exempt from Section 409A. We cannot guarantee the effect of any future Section 409A guidance, but Active Power will work as quickly as administratively feasible if future guidance is issued to analyze it and provide information to our eligible employees regarding such guidance.

Active Power cannot guarantee any particular tax results related to your eligible options; furthermore, there is uncertainty because the final tax regulations do not provide final guidance with respect to the tax consequences of discount options. Since this offer involves complex tax considerations, we urge you to consult a financial, legal and/or tax advisor before you make any decisions about participating in this offer.

In addition, if you are subject to taxation in the United States, and also are subject to taxation in another country, there may be additional tax consequences relating to your participation in this offer. **Further, some states, including California, may impose additional penalty taxes. We recommend that you consult with a financial, legal and/or tax advisor regarding any tax consequences, including any state tax consequences.**

### **15. Extension of offer; termination; amendment.**

We reserve the right, at our discretion, at any time and regardless of whether or not any event listed in Section 7 of this Offer to Amend has occurred or is deemed by us to have occurred, to extend the period of time during which the offer is open and delay the acceptance for amendment of any options. If we elect to extend the period of time during which this offer is open, we will give you written notice of the extension and delay, as described below. If we extend the expiration date, we will also extend your right to withdraw elections with respect to eligible options until such extended expiration date. In the case of an extension, we will issue a press release, email or other form of communication no later than 8:00 a.m., Central Time, on the next U.S. business day after the previously scheduled expiration date.

We also reserve the right, in our reasonable judgment, before the expiration date to terminate or amend the offer and to postpone the expiration of the offer (resulting in a delay of our acceptance and amendment of any options with respect to which elections have been made) if any of the events listed in Section 7 of this Offer to

Amend occurs, by giving written notice of the termination or postponement to you or by making a public announcement of the termination. Our reservation of the right to delay our acceptance and amendment of options with respect to which elections have been made is limited by Rule 13e-4(f)(5) under the Exchange Act, which requires that we must pay the consideration offered or return the options promptly after termination or withdrawal of an offer like this.

Subject to compliance with applicable law, we further reserve the right, before the expiration date, in our discretion, and regardless of whether any event listed in Section 7 of this Offer to Amend has occurred or is deemed by us to have occurred, to amend the offer in any respect, including by decreasing or increasing the consideration offered in this offer to option holders or by decreasing or increasing the number of options being sought in this offer. As a reminder, if a particular option expires after commencement, but before amendment under the offer, that particular option is not eligible for amendment. Therefore, if we extend the offer for any reason and if a particular option with respect to which an election to accept the offer was made before the originally scheduled expiration of the offer expires after such originally scheduled expiration date but before the actual amendment date under the extended offer, that option would not be eligible for amendment.

The minimum period during which the offer will remain open following material changes in the terms of the offer or in the information concerning the offer, other than a change in the consideration being offered by us or a change in amount of existing options sought, will depend on the facts and circumstances of such change, including the relative materiality of the terms or information changes. If we modify the number of eligible options being sought in this offer or the consideration being offered by us for the eligible options in this offer, the offer will remain open for at least ten U.S. business days from the date of notice of such modification. If any term of the offer is amended in a manner that we determine constitutes a material change adversely affecting any holder of eligible options, we will promptly disclose the amendments in a manner reasonably calculated to inform holders of eligible options of such amendment, and we will extend the offer's period so that at least five U.S. business days, or such longer period as may be required by the tender offer rules, remain after such change.

For purposes of the offer, a "business day" means any day other than a Saturday, Sunday or a United States federal holiday and consists of the time period from 12:01 a.m. through 12:00 midnight, U.S. Eastern Time.

#### **16. Fees and expenses.**

Active Power has prepared communications regarding this offer and will provide general tax information to eligible employees with respect to this offer. Active Power will not provide tax advice specific to an individual's circumstances. We will not pay any fees or commissions to any broker, dealer or other person for soliciting elections with respect to this offer.

#### **17. Additional information.**

This Offer to Amend is part of a Tender Offer Statement on Schedule TO that we have filed with the SEC. This Offer to Amend does not contain all of the information contained in the Schedule TO and the exhibits to the Schedule TO. We recommend that you review the Schedule TO, including its exhibits, and the following materials that we have filed with the SEC before making a decision on whether to elect to accept this offer with respect to your eligible options:

1. Description of our common stock contained in our registration statement on Form S-1 (File No. 333-36946), filed with the SEC on May 12, 2000, including any amendment or report filed for the purpose of updating such description;

2. Our annual report on Form 10-K for our fiscal year ended December 31, 2006, filed with the SEC on May 14, 2007;
3. Our quarterly reports on Form 10-Q for the quarter ended March 30, 2007, June 30, 2007 and September 30, 2007, filed with the SEC on May 15, 2007, July 27, 2007 and October 29, 2007, respectively;
4. Our definitive proxy statement for our 2007 annual meeting of stockholders, filed with the SEC on June 1, 2007; and
5. Our current reports on Form 8-K filed with the SEC on January 9, 2007, February 2, 2007, February 13, 2007, March 1, 2007, March 12, 2007, March 19, 2007, March 26, 2007, May 15, 2007, May 24, 2007, August 14, 2007 and October 10, 2007 (other than the portions of those documents deemed to have been furnished and not to have been filed).

The SEC file number for these filings is 000-30939. These filings, our other annual, quarterly and current reports, our proxy statements and our other SEC filings may be examined, and copies may be obtained, at the SEC's public reference room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330. Our SEC filings are also available to the public on the SEC's Internet site at [www.sec.gov](http://www.sec.gov).

Each person to whom a copy of this Offer to Amend is delivered may obtain a copy of any or all of the documents to which we have referred you, other than exhibits to such documents, unless such exhibits are specifically incorporated by reference into such documents, at no cost, by writing to us at Active Power, Inc., 2128 W. Braker Lane, BK12, Austin, Texas 78758, Attention: Jennifer Crow, or telephoning Jennifer Crow at (512) 744-9254.

As you read the documents listed above, you may find some inconsistencies in information from one document to another. If you find inconsistencies between the documents, or between a document and this Offer to Amend, you should rely on the statements made in the most recent document.

The information contained in this Offer to Amend about us should be read together with the information contained in the documents to which we have referred you, in making your decision as to whether or not to participate in this offer.

#### **18. Financial statements.**

Attached as Schedule B to this Offer to Amend are our summary financial statements for our fiscal quarter ended September 30, 2007 and for our fiscal year ended December 31, 2006. Our full financial statements included in our Quarterly Report on Form 10-Q for our fiscal quarter ended September 30, 2007, filed with the SEC on October 29, 2007, and our Annual Report on Form 10-K for our fiscal year ended December 31, 2006, filed with the SEC on May 14, 2007, are incorporated by reference herein. More complete financial information may be obtained by accessing our public filings with the SEC's website at [www.sec.gov](http://www.sec.gov).

#### **19. Miscellaneous.**

We are not aware of any jurisdiction where the making of the offer is not in compliance with applicable law. If we become aware of any jurisdiction where the making of the offer is not in compliance with any valid applicable law, we will make a good faith effort to comply with such law. If, after such good faith effort, we cannot comply with such law, the offer will not be made to, nor will options be accepted from the option holders residing in such jurisdiction.

We have not authorized any person to make any recommendation on our behalf as to whether you should elect to accept this offer with respect to your eligible options. Active Power has prepared communications regarding this offer and will provide general tax information to eligible employees with respect to this offer. Active Power will not provide tax advice specific to an individual's circumstances. You should rely only on the information in this document or documents to which we have referred you. Except to the extent abovementioned, we have not authorized anyone to give you any information or to make any representations in connection with the offer other than the information and representations contained in this Offer to Amend the Exercise Price of Certain Options and in the related offer documents. If anyone makes any recommendation or representation to you or gives you any information, you must not rely upon that recommendation, representation or information as having been authorized by us.

Active Power, Inc.  
November 9, 2007

**SCHEDULE A**

**INFORMATION CONCERNING THE EXECUTIVE OFFICERS  
AND DIRECTORS OF ACTIVE POWER, INC.**

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The directors and executive officers of Active Power are set forth in the following table:

<u>Name</u>	<u>Position and Offices Held</u>
James Clishem	President, Chief Executive Officer and Director
John K. Penver	Vice President of Finance, Chief Financial Officer and Secretary
James M. Murphy	Vice President Sale – EMEA
Gary P. Rackow	Vice President Sales – Americas
Lisa M. Brown	Vice President – Marketing & Sales Operations
Karl Scheutze	Vice President – Engineering
David Perkins	Chief Technology Officer
Jason P. Rubin	Vice President – Manufacturing
Ake Almgren	Director
Richard E. Anderson	Director
Rodney S. Bond	Director
Brad Boston	Director
Jan H. Lindelow	Director
Benjamin L. Scott	Director

The address of each executive officer and director is: c/o Active Power, Inc., 2128 W. Braker Lane, BK12, Austin, Texas 78758.

SCHEDULE B

SUMMARY FINANCIAL INFORMATION  
OF ACTIVE POWER, INC.

(in thousands, except per share data)

	Year Ended		Nine Months Ended	
	December 31, 2006	December 31, 2005	September 30, 2007	September 30, 2006
<b>Summary of consolidated statements of operations:</b>				
Net sales	\$ 25,029	\$ 17,788	\$ 23,389	\$ 16,763
Gross profit	686	(298)	3,469	638
Net income (loss)	(21,149)	(22,906)	(14,582)	(17,309)
Net Income (loss) per common share-basic	\$ (0.43)	\$ (0.48)	\$ (0.28)	\$ (0.35)
Net Income (loss) per common share-diluted	\$ (0.43)	\$ (0.48)	\$ (0.28)	\$ (0.35)
<b>Summary of consolidated balance sheets:</b>				
Total current assets		\$ 39,153	\$ 49,677	\$ 40,977
Total non-current assets		7,573	10,688	6,647
Total current liabilities		7,948	6,492	8,655
Total non-current liabilities		—	—	—
Total stockholders' equity		38,778	53,873	38,944
Stockholders' equity (book value)—per share		\$ 0.78	\$ 1.10	\$ 0.65

	Year Ended		Nine Months Ended
	December 31, 2006	December 31, 2005	September 30, 2007
Ratio of earnings to fixed charges [1]			

[1] Our earnings were insufficient to cover fixed charges and preferred stock dividends in all of the periods presented. Because of the deficiency, the ratio information is not applicable. Earnings were inadequate to cover fixed charges by \$22.9 million, \$21.1 million and \$14.6 million for the years ended December 31, 2005 and 2006 and the nine months ended September 30, 2007, respectively. We did not have any preferred stock outstanding and we did not pay or accrue any preferred stock dividends during the periods presented above. As a result, the ratio of earnings to combined fixed charges and preferred stock dividends is the same as the ratio of earnings to fixed charges.

For purposes of computing the deficiency of earnings available to cover fixed charges, fixed charges represent interest. Deficiency of earnings consists of loss before income taxes plus fixed charges. We had no fixed charges or income tax expenses in all of the periods presented above.

## EMAIL TO ALL ELIGIBLE EMPLOYEES

To: [EMAIL ADDRESS]  
From: [EMAIL ADDRESS] on behalf of James Clishem  
Date: November 9, 2007  
Subject: Action Required: Urgent Information Regarding Your Stock Options

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Recently enacted Internal Revenue Code Section 409A ("Section 409A") imposes certain adverse tax consequences (including income tax at vesting, an additional 20% penalty tax and interest charges) on stock options that were granted at a discount from fair market value ("discount options") and which vest after December 31, 2004.

You are receiving this email because it has been determined that certain of your stock options may be affected by Section 409A because they were discount options. Active Power, Inc. is offering you the opportunity to avoid the Section 409A impact by amending certain of these stock options and receive cash payments for those eligible stock options to the extent the options' exercise price per share was less than \$2.50.

**INFORMATIONAL MEETINGS**

To help (i) explain the potential adverse tax impact of Section 409A, (ii) explain how Active Power, Inc. has addressed the situation and the choices you have, and (iii) answer any other questions you may have, an informational meeting will be held on:

Monday, November 12, 2007 at 1:00 p.m. CST at the Company's headquarters located at 2128 Braker Lane, BK12, Austin, Texas 78758.

If you cannot attend this meeting, you may call in using the number listed below. This audio cast will not be recorded. The live audio cast will be held on:

Monday, November 12, 2007 at 1:00 p.m. CST.

Dial-in Number: 1-866-836-3116 or (203) 210-2502 (Passcode: 586814)

**KEY DOCUMENTS AND MATERIALS**

(1) Tender Offer Document (this is a very large file):

[TENDER OFFER ATTACHED OR LINK]

(2) Election Form:

[ELECTION FORM ATTACHED]

Shortly after receiving this email, you will receive a separate email from Active Power, Inc. which will provide a personal addendum to the Tender Offer with a list of your “eligible” option grants. Your addendum will also include a description of any potential cash payments (if any) if you choose to participate in the Tender Offer and the amended option exercise price.

#### **ACTION ITEMS**

After reviewing the above materials, if you wish to participate in the Tender Offer, you will need to fill out, sign, and date the Election Form (see the attached document). The Election Form must be received by the Company via fax or email **no later than 5:00 p.m., Central Time, on December 11, 2007.**

#### **QUESTIONS**

Active Power, Inc. has prepared communications regarding this offer and provided general tax information regarding this offer. Active Power, Inc. will not provide tax advice specific to an individual’s circumstances or make any recommendation. You should direct general questions about the terms of this offer or requests for general tax information about this offer to John K. Penver, Chief Financial Officer, at [johnpenver@activepower.com](mailto:johnpenver@activepower.com). **We strongly recommend that you discuss the personal tax consequences of this offer with your financial, legal and/or tax advisors.**

## ACTIVE POWER, INC.

**ELECTION FORM FOR  
OFFER TO AMEND THE EXERCISE PRICE OF CERTAIN OPTIONS**

Before completing this election form, please make sure you have received, read and understand the documents that make up this offer, including:

- (1) the Offer to Amend the Exercise Price of Certain Options (the "Offer to Amend");
- (2) the email from James Clishem, dated November 9, 2007;
- (3) this election form; and
- (4) your personalized addendum containing information regarding your eligible option(s).

The offer is subject to the terms of these documents as they may be amended. In addition, these documents collectively will be referred to herein as the "Offer Documents." All of these documents are available on Active Power's intranet at [http://intranet/base/hr/hr\\_documents/Tender%20Offer.doc](http://intranet/base/hr/hr_documents/Tender%20Offer.doc).

**Delivery of Election Form**

In order to participate in the offer, a properly completed and submitted Election Form must be received by Active Power before 5:00 p.m., Central Time, on December 11, 2007 (the "expiration date"). If the offer is otherwise extended, the expiration date also will be extended.

You must complete your Election Form by selecting the "ACCEPT OFFER" box on the Election Form and signing, dating and emailing or faxing the Election Form to Active Power before the expiration date. You may submit your properly completed Election Form to Jennifer Crow via email at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com) or by fax at (512) 836-4511. Election forms submitted via email must contain your properly completed and signed election form as an attachment to your email. Only responses that are complete, signed, dated and actually received by Active Power before the deadline will be accepted. Responses may be submitted only via email or fax. Responses submitted by any other means, including hand delivery, United States mail (or other post) and Federal Express (or similar delivery service) are not permitted.

Active Power's receipt of your Election Form is not by itself an acceptance of your eligible options for amendment. For purposes of the offer, we will be deemed to have accepted valid elections with respect to eligible options that have not been withdrawn properly as of the date we give notice to the eligible employees generally of our acceptance of elections. This notice may be made by press release, email or other method of communication.

Active Power will not accept any alternative, conditional or contingent elections. Although it is the Company's intent to send you an email confirmation of receipt of this Election Form, by signing and submitting this Election Form, you waive any right to receive any notice of the receipt of the election with respect to your options, except as provided for in the Offer to Amend. Any confirmation of receipt sent to you will be merely a notification that Active Power has received your Election Form and does not mean that your options have been amended. Your options that are accepted will be amended on the same day as the expiration of the offer, which is scheduled to be December 11, 2007.

If you participate in this offer, you must accept the offer with respect to all of the shares subject to an outstanding eligible option granted to you under the Active Power, Inc. 2000 Stock Incentive Plan. Vesting of any amended options on any date is subject to your continued employment or service with Active Power through each relevant vesting date.

### **Withdrawal of Participation**

To withdraw validly from participation in this offer, you must submit your withdrawal before the expiration date by completing a new Election Form, selecting the "REJECT OFFER" box on the Election Form and signing, dating and emailing or faxing the Election Form to Active Power before the expiration date. You may submit your properly completed Election Form to Jennifer Crow via email at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com) or by fax at (512) 836-4511. Election forms submitted via email must contain your properly completed and signed election form as an attachment to your email.

You may change your mind as many times as you wish, but you will be bound by the last properly submitted Election Form we receive before the expiration date. Active Power must receive the properly completed and submitted Election Form via email or fax before the expiration date. The expiration date will be 5:00 p.m., Central Time, on December 11, 2007, unless we extend the offer. If we extend the offer, you may withdraw your eligible options at any time until the extended expiration date. In addition, although we intend to accept all eligible options with respect to which valid elections have been made promptly after the expiration of this offer, if we have not accepted your options by 5:00 p.m., Central Time, on January 10, 2008, you may withdraw your eligible options at any time thereafter.

### **Assistance**

If you have general questions concerning the offer or general questions about the tax consequences of the offer, you may contact John K. Penver via email at [johnpenver@activepower.com](mailto:johnpenver@activepower.com). If you have questions concerning the submission of your Election Form or you need additional copies of the Offer Documents, you may contact Jennifer Crow at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com). Copies of the Offer Documents will be furnished promptly at Active Power's expense. You can also view and print the Offer Documents on Active Power's intranet at [http://intranet/base/hr/hr\\_documents/Tender%20Offer.doc](http://intranet/base/hr/hr_documents/Tender%20Offer.doc).

### **Questions of Validity**

We will determine, in our discretion, all questions as to the validity, form, eligibility (including time of receipt) and acceptance of any eligible options. Our determination of these matters will be final and binding on all parties. We reserve the right to reject any Election Form or any options with respect to which elections have been made that we determine are not proper or that we determine are unlawful to accept. We will accept all elections with respect to eligible options that are timely and properly made and that are not validly withdrawn. No elections will be deemed to have been properly made until all defects or irregularities have been cured by the eligible employee or waived by us. Neither we nor any other person is obligated to give notice of any defects or irregularities in elections, nor will anyone incur any liability for failure to give any notice. This is a one-time offer. We will strictly enforce the offer period, subject only to an extension that we may grant in our discretion.

**Important: The properly completed Election Form must be received by Active Power via email or fax before 5:00 p.m., Central Time, on December 11, 2007.**

### **Important Tax Information**

You should refer to Section 14 of the Offer to Amend which contains important U.S. federal tax information. We also recommend that you consult with a financial, legal and/or tax planner regarding the personal tax consequences of this offer to you before deciding whether or not to participate in this offer.

### **Persons Submitting the Election Form**

If you are submitting this Election Form by fax, and your Election Form is signed by a trustee, executor, administrator, guardian, attorney-in-fact, officer of a corporation or other person acting in a fiduciary or representative capacity, that person should so indicate when submitting the Election Form and proper evidence satisfactory to Active Power of the authority of that person to act in that capacity must be submitted to us no later than the expiration date, which is expected to be 5:00 p.m., Central Time, on December 11, 2007.

### **Agreements and Acknowledgments**

1. I agree that my decision to accept or reject the Offer to Amend with respect to all of my eligible options is entirely voluntary and is subject to the terms and conditions of the Offer Documents.

2. I agree and acknowledge that, if I submit an Election Form in which I have selected "REJECT OFFER," I have rejected the offer with respect to all of my eligible options and my eligible options may be subject to the adverse personal tax consequences described in the Offer to Amend.

3. I agree that, if prior to the expiration of the offer, I exercise my eligible options (or a portion thereof) with respect to which I have accepted the offer, such option(s) will be no longer eligible for amendment pursuant to the terms of the offer and I will not receive a cash payment with respect to such option(s).

4. I understand that I may change my election at any time by completing and submitting an Election Form before 5:00 p.m., Central Time, on December 11, 2007 (unless the offer is otherwise extended) and that any Election Form submitted and/or received after such time will be void and of no further force and effect.

5. If my service with Active Power terminates prior to the expiration of the offer, I understand that I will cease to be an eligible employee under the terms of the Offer to Amend and any election that I have made prior to the termination of my employment to amend my eligible options will be ineffective. As a result, my eligible options will not be amended under the Offer to Amend and I will not receive a cash payment.

6. I acknowledge and agree that none of Active Power or any of their respective employees or agents, has made any recommendation to me as to whether or not I should accept the Offer to Amend my eligible options and that I am not relying on any information or representation made by any such person in accepting or rejecting the Offer to Amend, other than any information contained in the Offer Documents.

7. I agree that participation in the offer is governed by the terms and conditions set forth in the Offer Documents and this Election Form. I have received the Offer Documents and have been afforded the opportunity to consult with my own investment, legal and/or tax advisors before making this election and that I have knowingly accepted or rejected the offer. I agree to accept as binding, conclusive and final all decisions or interpretations of Active Power upon any questions relating to the offer and this Election Form.

8. I further understand that Active Power intends to send me an Election Confirmation Statement via email at my Active Power email address within two business days after the submission of my Election Form. If I have not received such an email confirmation, I understand that it is my responsibility to ensure that my Election Form has been received before 5:00 p.m., Central Time, on December 11, 2007. I understand that only responses that are complete, signed and actually received by Active Power by the deadline will be accepted.

**Election**

Please select the appropriate box below to indicate your acceptance or rejection of the offer. If you wish to participate in the offer, you must accept the offer with respect to all of your eligible options listed on your Addendum. Any attempt to accept the offer with respect to only a portion of your eligible options will be null and void.

- ACCEPT OFFER:** I wish to participate in the offer. If I have previously rejected the offer, this will act as a withdrawal of that rejection and I will participate in the offer.
- REJECT OFFER:** I wish to reject the offer. If I have previously accepted the offer, this will act as a withdrawal of that acceptance and I will not participate in the offer.

To submit your Election Form, please sign and date below and either:

1. Fax the entire Election Form to Jennifer Crow at the fax number (512) 836-4511; or
2. Send an email to Jennifer Crow at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com) with the entire Election Form attached to your email.

\_\_\_\_\_  
Employee Signature

\_\_\_\_\_  
Employee Name (Please Print)

\_\_\_\_\_  
Corporate Email Address

\_\_\_\_\_  
Date

*Personalized Addendum Email*

Please find attached a personalized addendum containing information regarding your eligible option(s). The Offer to Amend will expire at 5:00 p.m., Central Time, on December 11, 2007 unless we extend the offer.

If you would like to participate in this offer, a properly completed and signed copy of the election form must be received by fax or email, by 5:00 p.m., Central Time, on December 11, 2007 by:

Jennifer Crow  
Finance Manager  
Active Power, Inc.  
Fax: (512) 836-4511  
Email: jennifercrow@activepower.com

Election forms submitted via email must contain your properly completed and signed election form as an attachment to your email. Only responses that are complete, signed and actually received by Active Power by the deadline will be accepted. Responses submitted by any other means, including hand delivery, United States mail (or other post) and Federal Express (or similar delivery service) are not permitted. If you have questions about any of the forms or would like to request additional copies of the Offer to Amend, contact Jennifer Crow at phone number (512) 744-9254. If you have questions about the terms of this offer affecting your options, please direct them to John K. Penver, our Chief Financial Officer, at:

John K. Penver  
Chief Financial Officer  
Active Power, Inc.  
Tel: (512) 744-9234  
Email: johnpenver@activepower.com

This notice does not constitute the Offer to Amend. The full terms of the offer are described in (1) the Offer to Amend; (2) the email from James Clissem, dated November 9, 2007; (3) the election form; and (4) your personalized addendum containing information regarding your eligible option(s). You may also access these documents, except your personalized addendum, through Active Power's intranet at [http://intranet/base/hr/hr\\_documents/Tender%20Offer.doc](http://intranet/base/hr/hr_documents/Tender%20Offer.doc), or through the U.S. Securities and Exchange Commission's website at <http://www.sec.gov>. You may access your personalized addendum by contacting Jennifer Crow at phone number (512) 744-9254 or by email at jennifercrow@activepower.com.

**Personalized Option Addendum**

[NAME]

<u>Name</u>	<u>Grant Date</u>	<u>Grant Number</u>	<u>Number of Shares Granted</u>	<u>Original Exercise Price per Share</u>	<u>New Exercise Price per Share</u>	<u>Number of Shares Subject to Eligible Option</u>	<u>Cash Payment per Share Subject to Eligible Cash Payment Option(1)</u>	<u>Total Cash Payment per Eligible Cash Payment Option(1)</u>
[NAME]	[DATE]	[NUMBER]	[SHARES]	[\$EXERCISE PRICE]	[\$EXERCISE PRICE]	[SHARES]	[\$AMOUNT]	\$ [AMOUNT]
[NAME]	[DATE]	[NUMBER]	[SHARES]	[\$EXERCISE PRICE]	[\$EXERCISE PRICE]	[SHARES]	[\$AMOUNT]	\$ [AMOUNT]
<b>Total Cash Payment:</b>							<b>\$</b>	<b>[TOTAL]</b>

(1) Only eligible options with original exercise prices less than \$2.50 per share are eligible for cash payment.

**Confirmation Email to Employees who Elect to Participate in the  
Offer to Amend the Exercise Price of Certain Options**

Active Power, Inc. has received your election form, by which you elected to have your eligible options amended and, to the extent applicable, to receive cash payments, subject to the terms and conditions of the offer.

If you change your mind, you may withdraw your election as to all of your eligible options by submitting a properly completed and signed election form indicating that you reject the offer, before 5:00 p.m., Central Time, on December 11, 2007, via fax or email to:

Jennifer Crow  
Finance Manager  
Active Power, Inc.  
Fax: (512) 836-4511  
Email: jennifercrow@activepower.com

Election forms submitted via email must contain your properly completed and signed election form as an attachment to your email. Only responses that are complete, signed and actually received by Active Power by the deadline will be accepted. Responses submitted by any other means, including hand delivery, United States mail (or other post) and Federal Express (or similar delivery service) are not permitted. If you have questions about any of the forms or would like to request additional copies of the Offer to Amend, contact Jennifer Crow at phone number (512) 744-9254. If you have questions about the terms of this offer affecting your options, please direct them to John K. Penver, our Chief Financial Officer, at:

John K. Penver  
Chief Financial Officer  
Active Power, Inc.  
Tel: (512) 744-9234  
Email: johnpenver@activepower.com

Please note that our receipt of your election form is not by itself an acceptance of the options for amendment. For purposes of the offer, Active Power will be deemed to have accepted options for amendment that are validly tendered and not properly withdrawn by you as of when Active Power gives oral or written notice to the option holders generally of its acceptance for amendment of such options, which notice may be made by press release, email, or other method of communication. Active Power's formal acceptance of the properly tendered options is expected to take place shortly after the end of the offer period.

This notice does not constitute the Offer to Amend. The full terms of the offer are described in (1) the Offer to Amend; (2) the email from James Clishem, dated November 9, 2007; (3) the election form; and (4) your personalized addendum containing information regarding your eligible option(s). You may also access these documents, except your personalized addendum, through Active Power's intranet at [http://intranet/base/hr/hr\\_documents/Tender%20Offer.doc](http://intranet/base/hr/hr_documents/Tender%20Offer.doc), or through the U.S. Securities and Exchange Commission's website at <http://www.sec.gov>. You may access your personalized addendum by contacting Jennifer Crow at phone number (512) 744-9254 or by email at jennifercrow@activepower.com.

**Confirmation Email to Employees who Withdraw their Stock Options from the  
Offer to Amend the Exercise Price of Certain Options**

Active Power, Inc. has received your election form, by which you withdrew your prior acceptance of Active Power's offer to amend your eligible outstanding options.

If you change your mind, you may once again elect to amend all of your eligible options by completing and signing the election form which was previously provided to you, and submitting it before 5:00 p.m., Central Time, December 11, 2007, via fax or email to:

Jennifer Crow  
Finance Manager  
Active Power, Inc.  
Fax: (512) 836-4511  
Email: jennifercrow@activepower.com

Election forms submitted via email must contain your properly completed and signed election form as an attachment to your email. Only responses that are complete, signed and actually received by Jennifer Crow by the deadline will be accepted. Responses submitted by any other means, including hand delivery, United States mail (or other post) and Federal Express (or similar delivery service) are not permitted. If you have questions about any of the forms or would like to request additional copies of the Offer to Amend, you may contact Jennifer Crow at phone number (512) 744-9254 or by email at jennifercrow@activepower.com. If you have questions about the terms of this offer affecting your options, please direct them to John K. Penver, our Chief Financial Officer, at:

John K. Penver  
Chief Financial Officer  
Active Power, Inc.  
Tel: (512) 744-9234  
Email: johnpenver@activepower.com

This notice does not constitute the Offer to Amend. The full terms of the offer are described in (1) the Offer to Amend; (2) the email from James Clissem, dated November 9, 2007; (3) the election form; and (4) your personalized addendum containing information regarding your eligible option(s). You may also access these documents, except your personalized addendum, through Active Power's intranet site at [http://intranet/base/hr/hr\\_documents/Tender%20Offer.doc](http://intranet/base/hr/hr_documents/Tender%20Offer.doc), or through the U.S. Securities and Exchange Commission's website at <http://www.sec.gov>. You may access your personalized addendum by contacting Jennifer Crow at phone number (512) 744-9254 or by email at jennifercrow@activepower.com.

**November 16, 2007 – One Week after Offer Commences**

We have completed week one of the Active Power, Inc. Offer to Amend the Exercise Price of Certain Options (referred to as the "Offer to Amend"). The Offer to Amend will expire at 5:00 p.m., Central Time, on December 11, 2007 unless we extend the offer.

If you would like to participate in this offer, a properly completed and signed copy of the election form must be received by fax or email, by 5:00 p.m., Central Time, on December 11, 2007 by:

Jennifer Crow  
Finance Manager  
Active Power, Inc.  
Fax: (512) 836-4511  
Email: jennifercrow@activepower.com

Election forms submitted via email must contain your properly completed and signed election form as an attachment to your email. Only responses that are complete, signed and actually received by Jennifer Crow by the deadline will be accepted. Responses submitted by any other means, including hand delivery, are not permitted. If you have questions about any of the forms or would like to request additional copies of the Offer to Amend, contact Jennifer Crow at phone number (512) 744-9254 or by email at jennifercrow@activepower.com. If you have questions about the terms of this offer affecting your options, please direct them to John K. Penver, our Chief Financial Officer, at:

John K. Penver  
Chief Financial Officer  
Active Power, Inc.  
Tel: (512) 744-9234  
Email: johnpenver@activepower.com

This notice does not constitute the Offer to Amend. The full terms of the offer are described in (1) the Offer to Amend; (2) the letter from James Clissem, dated November 9, 2007; (3) the election form; and (4) your personalized addendum containing information regarding your eligible option(s). You may also access these documents, except your personalized addendum, through Active Power's intranet at [http://intranet/base/hr/hr\\_documents/Tender%20Offer.doc](http://intranet/base/hr/hr_documents/Tender%20Offer.doc), or through the U.S. Securities and Exchange Commission's website at <http://www.sec.gov>. You may access your personalized addendum by contacting Jennifer Crow at phone number (512) 744-9254 or by email at jennifercrow@activepower.com.

**December 3, 2007 – Final Week**

We are entering the final week of the Active Power, Inc. Offer to Amend the Exercise Price of Certain Options (referred to as the “Offer to Amend”). After today, there are seven (7) days left to make your election. The Offer to Amend will expire at 5:00 p.m., Central Time, on December 11, 2007 unless we extend the offer.

If you would like to participate in this offer, a properly completed and signed copy of the election form must be received by fax or email, by 5:00 p.m., Central Time, on December 11, 2007 by:

Jennifer Crow  
Finance Manager  
Active Power, Inc.  
Fax: (512) 836-4511  
Email: [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com)

Election forms submitted via email must contain your properly completed and signed election form as an attachment to your email. Only responses that are complete, signed and actually received by Active Power by the deadline will be accepted. Responses submitted by any other means, including hand delivery, United States mail (or other post) and Federal Express (or similar delivery service) are not permitted. If you have questions about any of the forms or would like to request additional copies of the Offer to Amend, contact Jennifer Crow at phone number (512) 744-9254 or by email at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com). If you have questions about the terms of this offer affecting your options, please direct them to:

John K. Penver  
Chief Financial Officer  
Active Power, Inc.  
Tel: (512) 744-9234  
Email: [johnpenver@activepower.com](mailto:johnpenver@activepower.com)

This notice does not constitute the Offer to Amend. The full terms of the offer are described in (1) the Offer to Amend; (2) the letter from James Clissem, dated November 9, 2007; (3) the election form; and (4) your personalized addendum containing information regarding your eligible option(s). You may also access these documents, except your personalized addendum, through Active Power’s intranet at [http://intranet/base/hr/hr\\_documents/Tender%20Offer.doc](http://intranet/base/hr/hr_documents/Tender%20Offer.doc), or through the U.S. Securities and Exchange Commission’s website at <http://www.sec.gov>. You may access your personalized addendum by contacting Jennifer Crow at phone number (512) 744-9254 or by email at [jennifercrow@activepower.com](mailto:jennifercrow@activepower.com).

**December 11, 2007 – Last Day (Offer Expiration Date)**

Today is the last day to elect to exchange your eligible options as part of the Active Power, Inc. Offer to Amend the Exercise Price of Certain Options (referred to as the “Offer to Amend”). The Offer to Amend will expire at 5:00 p.m., Central Time, today, December 11, 2007.

If you would like to participate in this offer, a properly completed and signed copy of the election form must be received by fax or email, by 5:00 p.m., Central Time, today, December 11, 2007 by:

Jennifer Crow  
Finance Manager  
Active Power, Inc.  
Fax: (512) 836-4511  
Email: jennifercrow@activepower.com

Election forms submitted via email must contain your properly completed and signed election form as an attachment to your email. Only responses that are complete, signed and actually received by Jennifer Crow by the deadline will be accepted. Responses submitted by any other means, including hand delivery, United States mail (or other post) and Federal Express (or similar delivery service) are not permitted. If you have questions about any of the forms or would like to request additional copies of the Offer to Amend, contact Jennifer Crow at phone number (512) 744-9254 or by email at jennifercrow@activepower.com. If you have questions about the terms of this offer affecting your options, please direct them to John K. Penver, our Chief Financial Officer, at:

John K. Penver  
Chief Financial Officer  
Active Power, Inc.  
Tel: (512) 744-9234  
Email: johnpenver@activepower.com

This notice does not constitute the Offer to Amend. The full terms of the offer are described in (1) the Offer to Amend; (2) the letter from James Clisem, dated November 9, 2007; (3) the election form; and (4) your personalized addendum containing information regarding your eligible option(s). You may also access these documents, except your personalized addendum, through Active Power’s intranet at [http://intranet/base/hr/hr\\_documents/Tender%20Offer.doc](http://intranet/base/hr/hr_documents/Tender%20Offer.doc), or through the U.S. Securities and Exchange Commission’s website at <http://www.sec.gov>. You may access your personalized addendum by contacting Jennifer Crow at phone number (512) 744-9254 or by email at jennifercrow@activepower.com.

**ACTIVE POWER, INC.**  
**AMENDMENT(S) TO STOCK OPTION AGREEMENTS AND**  
**PROMISE TO MAKE CASH PAYMENT**

Active Power, Inc. (the "Company") and [OPTIONEE NAME] (the "Optionee") are parties to the stock option agreements listed on Exhibit A ("Agreements") granting Optionee options (the "Options") to purchase shares of the Company's common stock subject to the terms of the Company's 2000 Stock Incentive Plan.

1. Modification of Exercise Price. As of the date hereof, the Options set forth in the Agreements shall be exercisable at the amended exercise price per share as listed on the attached Exhibit A.

2. Payments. As of the Company's first payroll date in 2008, regardless of whether Optionee is employed by the Company on the date of payment, for each Option listed on the attached Exhibit A that had an original exercise price per share less than \$2.50, the Company shall pay to Optionee a cash payment in the total amount as listed on the attached Exhibit A.

3. Option Agreements. To the extent not expressly amended hereby, the Agreements remain in full force and effect.

4. Entire Agreement. This Amendment(s) to Stock Option Agreements and Promise to Make Cash Payment (the "Amendment"), taken together with the Agreements (to the extent not expressly amended hereby) and any duly authorized written agreement entered into by and between the Company and the Optionee relating to the stock option grants evidenced by the Agreements, represent the entire agreement of the parties, supersede any and all previous contracts, arrangements or understandings between the parties with respect to the stock option grants evidenced by the Agreements, and may be amended at any time only by mutual written agreement of the parties hereto. This Amendment amends your Agreements. Please read this Amendment carefully and keep it for future reference.

IN WITNESS WHEREOF, this instrument is executed as of \_\_\_\_\_, 2007.

ACTIVE POWER, INC.

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

**Exhibit A**

<u>Grant Date</u>	<u>Grant Number</u>	<u>Number of Shares Subject to Amended Option</u>	<u>Original Exercise Price per Share</u>	<u>New Exercise Price per Share</u>	<u>Cash Payment</u>
[DATE]	[NUMBER]	[SHARES]	\$(EXERCISE PRICE]	\$(EXERCISE PRICE]	\$(AMOUNT]
[DATE]	[NUMBER]	[SHARES]	\$(EXERCISE PRICE]	\$(EXERCISE PRICE]	\$(AMOUNT]
<b>Total Cash Payment:</b>					<b>\$ [TOTAL]</b>

## ACTIVE POWER, INC.

NOTICE OF GRANT OF STOCK OPTION

Notice is hereby given of the following option grant (the "Option") to purchase shares of the Common Stock of Active Power, Inc. (the "Corporation"):

Optionee:

Grant Date: August 2, 2007

Vesting Commencement Date: August 2, 2007

Exercise Price: \$ per share

Number of Option Shares: shares

Expiration Date: August 2, 2017

Type of Option: Incentive Stock Options

Exercise and Vesting Schedule: The Option Shares shall initially be unvested shares. The Option shall become exercisable and the Option Shares shall vest in a series of sixteen (16) equal quarterly installments, beginning on November 2, 2007 and with successive installments occurring thereafter on the 7th day of February, May, August and November through and until August 2, 2011 upon Optionee's completion of each additional three (3) months of Service measured from the Vesting Commencement Date. After Optionee's cessation of Service, in no event shall any then unvested Option Shares become vested nor shall the Option become exercisable with respect to any then unvested Option Shares.

Optionee understands and agrees that the Option is granted subject to and in accordance with the terms of the Active Power, Inc. 2000 Stock Incentive Plan (the "Plan"). Optionee further agrees to be bound by the terms of the Plan and the terms of the Option as set forth in the Stock Option Agreement attached hereto as Exhibit A. Optionee hereby acknowledges the receipt of a copy of the official prospectus for the Plan in the form attached hereto as Exhibit B. A copy of the Plan is available upon request made to the Corporate Secretary at the Corporation's principal offices.

Employment at Will. Nothing in this Notice or in the attached Stock Option Agreement or in the Plan shall confer upon Optionee any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any Parent or Subsidiary employing or retaining Optionee) or of Optionee, which rights are hereby expressly reserved by each, to terminate Optionee's Service at any time for any reason, with or without cause.

Definitions. All capitalized terms in this Notice shall have the meaning assigned to them in this Notice or in the attached Stock Option Agreement.

DATED: August 16, 2007

**ACTIVE POWER, INC.**

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

Name: John K. Penver

Title: Chief Financial Officer

\_\_\_\_\_  
**OPTIONEE**

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

\_\_\_\_\_

ATTACHMENTS

Exhibit A - Stock Option Agreement

Exhibit B - Plan Summary and Prospectus

**ACTIVE POWER, INC.**  
**STOCK OPTION AGREEMENT**

**RECITALS**

A. The Board has adopted the Plan for the purpose of retaining the services of selected Employees, non-employee members of the Board or of the board of directors of any Parent or Subsidiary and consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

B. Optionee is to render valuable services to the Corporation (or a Parent or Subsidiary), and this Agreement is executed pursuant to, and is intended to carry out the purposes of, the Plan in connection with the Corporation's grant of an option to Optionee.

C. All capitalized terms in this Agreement shall have the meaning assigned to them in the attached Appendix.

**NOW, THEREFORE**, it is hereby agreed as follows:

1. **Grant of Option.** The Corporation hereby grants to Optionee, as of the Grant Date, an option to purchase up to the number of Option Shares specified in the Grant Notice. The option shares shall be purchasable from time to time during the option term specified in Paragraph 2 at the Exercise Price.

2. **Option Term.** This option shall have a maximum term of ten (10) years measured from the Grant Date and shall accordingly expire at the close of business on the Expiration Date, unless sooner terminated in accordance with Paragraph 5 or 6.

3. **Limited Transferability.** This option shall be neither transferable nor assignable by Optionee other than by will or by the laws of descent and distribution following Optionee's death and may be exercised, during Optionee's lifetime, only by Optionee. However, if this option is designated a Non-Statutory Option in the Grant Notice, then this option may be assigned in whole or in part during Optionee's lifetime either as (i) a gift to one or more family members of Optionee's Immediate Family, to a trust in which Optionee and/or one or more such family members hold more than fifty percent (50%) of the beneficial interest or an entity in which more than fifty percent (50%) of the voting interests are owned by Optionee and/or one or more such family members, or (ii) pursuant to a domestic relations order. The assigned portion shall be exercisable only by the person or persons who acquire a proprietary interest in the option pursuant to such assignment. The terms applicable to the assigned portion shall be the same as those in effect for this option immediately prior to such assignment and shall be set forth in such documents issued to the assignee as the Plan Administrator may deem appropriate.

4. **Dates of Exercise.** This option shall become exercisable for the Option Shares in one or more installments as specified in the Grant Notice. As the option becomes exercisable for such installments, those installments shall accumulate, and the option shall remain exercisable for the accumulated installments until the Expiration Date or sooner termination of the option term under Paragraph 5 or 6.

5. **Cessation of Service.** The option term specified in Paragraph 2 shall terminate (and this option shall cease to be outstanding) prior to the Expiration Date should any of the following provisions become applicable:

(i) Should Optionee cease to remain in Service for any reason (other than death, Permanent Disability or Misconduct) while this option is outstanding, then this option shall remain exercisable until the earlier of (i) the expiration of the three (3)-month period measured from the date of such cessation of Service or (ii) the Expiration Date.

(ii) Should Optionee die while holding this option, then Optionee's Beneficiary shall have the right to exercise this option until the earlier of (A) the expiration of the twelve (12)-month period measured from the date of Optionee's death or (B) the Expiration Date.

(iii) Should Optionee cease Service by reason of Permanent Disability while this option is outstanding, then this option shall remain exercisable until the earlier of (i) the expiration of the twelve (12)-month period measured from the date of such cessation of Service or (ii) the Expiration Date.

(iv) During the applicable post-Service exercise period, this option may not be exercised in the aggregate for more than the number of vested Option Shares for which the option is exercisable on the date of Optionee's cessation of Service. Upon the expiration of the applicable exercise period or (if earlier) upon the Expiration Date, this option shall terminate and cease to be outstanding for any vested Option Shares for which the option has not been exercised. However, this option shall, immediately upon Optionee's cessation of Service for any reason, terminate and cease to be outstanding to the extent this option is not otherwise at that time exercisable for vested shares.

(v) Should Optionee's Service be terminated for Misconduct or should Optionee engage in Misconduct while this option is outstanding, then this option shall terminate immediately and cease to be outstanding.

**6. Special Acceleration of Option.**

(a) In the event of a Change in Control, this option, to the extent outstanding at that time but not otherwise fully exercisable, shall automatically accelerate so that this option shall, immediately prior to the effective date of the Change in Control, become exercisable for all of the Option Shares at the time subject to this option and may be exercised for any or all of those Option Shares as fully-vested shares of Common Stock. No such acceleration of this option, however, shall occur if and to the extent: (i) this option is, in connection with the Change in Control, assumed or otherwise continued in full force and effect by the successor corporation (or parent thereof) pursuant to the terms of the Change in Control or (ii) this option is replaced with a cash incentive program of the successor corporation which preserves the spread existing at the time of the Change in Control on the Option Shares for which this option is not otherwise at that time exercisable (the excess of the Fair Market Value of those

Option Shares over the aggregate Exercise Price payable for such shares) and provides for subsequent pay-out in accordance with the same option exercise schedule set forth in the Grant Notice.

(b) Immediately following the consummation of the Change in Control, this option shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof) or otherwise expressly continued in full force and effect pursuant to the terms of the Change in Control.

(c) If this option is assumed in connection with a Change in Control, then this option shall be appropriately adjusted, immediately after such Change in Control, to apply to the number and class of securities which would have been issuable to Optionee in consummation of such Change in Control had the option been exercised immediately prior to such Change in Control, and appropriate adjustments shall also be made to the Exercise Price, provided the aggregate Exercise Price shall remain the same. To the extent the holders of Common Stock receive cash consideration for their Common Stock in consummation of the Change in Control, the successor corporation may, in connection with the assumption of this option, substitute one or more shares of its own common stock with a fair market value equivalent to the cash consideration paid per share of Common Stock in such Change in Control.

(d) This Agreement shall not in any way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

7. **Adjustment in Option Shares.** Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the total number and/or class of securities subject to this option and (ii) the Exercise Price in order to reflect such change and thereby preclude a dilution or enlargement of benefits hereunder.

8. **Stockholder Rights.** The holder of this option shall not have any stockholder rights with respect to the Option Shares until such person shall have exercised the option, paid the Exercise Price and become a holder of record of the purchased shares.

9. **Manner of Exercising Option.** In order to exercise this option with respect to all or any part of the Option Shares for which this option is at the time exercisable, Optionee (or any other person or persons exercising the option) must take the following actions:

- (i) Execute and deliver to the Corporation a Notice of Exercise for the Option Shares for which the option is exercised.
- (ii) Pay the aggregate Exercise Price for the purchased shares in one or more of the following forms:
  - (A) cash or check made payable to the Corporation;

(B) a promissory note payable to the Corporation, but only to the extent authorized by the Plan Administrator in accordance with Paragraph 13;

(C) shares of Common Stock held by Optionee (or any other person or persons exercising the option) for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date; or

(D) through a special sale and remittance procedure pursuant to which Optionee (or any other person or persons exercising the option) shall concurrently provide irrevocable instructions (I) to a Corporation-approved brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate Exercise Price payable for the purchased shares plus all applicable income and employment taxes required to be withheld by the Corporation by reason of such exercise and (II) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent the sale and remittance procedure is utilized in connection with the option exercise, payment of the Exercise Price must accompany the Notice of Exercise delivered to the Corporation in connection with the option exercise.

(iii) Furnish to the Corporation appropriate documentation that the person or persons exercising the option (if other than Optionee) have the right to exercise this option.

(iv) Make appropriate arrangements with the Corporation (or Parent or Subsidiary employing or retaining Optionee) for the satisfaction of all income and employment tax withholding requirements applicable to the option exercise.

(b) As soon as practical after the Exercise Date, the Corporation shall issue to or on behalf of Optionee (or any other person or persons exercising this option) a certificate for the purchased Option Shares, with the appropriate legends affixed thereto.

(c) In no event may this option be exercised for any fractional shares.

**10. Compliance with Laws and Regulations.**

(a) The exercise of this option and the issuance of the Option Shares upon such exercise shall be subject to compliance by the Corporation and Optionee with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange (or the Nasdaq National Market, if applicable) on which the Common Stock may be listed for trading at the time of such exercise and issuance.

(b) The inability of the Corporation to obtain approval from any regulatory body having authority deemed by the Corporation to be necessary to the lawful issuance and sale of any Common Stock pursuant to this option shall relieve the Corporation of any liability with respect to the non-issuance or sale of the Common Stock as to which such approval shall not have been obtained. The Corporation, however, shall use its best efforts to obtain all such approvals.

11. **Successors and Assigns.** Except to the extent otherwise provided in Paragraphs 3 and 6, the provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and Optionee and Optionee's assigns and Beneficiaries.

12. **Notices.** Any notice required to be given or delivered to the Corporation under the terms of this Agreement shall be in writing and addressed to the Corporation at its principal corporate offices. Any notice required to be given or delivered to Optionee shall be in writing and addressed to Optionee at the address indicated below Optionee's signature line on the Grant Notice. All notices shall be deemed effective upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

13. **Financing.** The Plan Administrator may, in its absolute discretion and without any obligation to do so, permit Optionee to pay the Exercise Price for the purchased Option Shares by delivering a full-recourse promissory note payable to the Corporation. The terms of any such promissory note (including the interest rate, the requirements for collateral and the terms of repayment) shall be established by the Plan Administrator in its sole discretion.

14. **Construction.** This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the terms of the Plan. All decisions of the Plan Administrator with respect to any question or issue arising under the Plan or this Agreement shall be conclusive and binding on all persons having an interest in this option.

15. **Governing Law.** The interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of Texas without resort to that State's conflict-of-laws rules.

16. **Excess Shares.** If the Option Shares covered by this Agreement exceed, as of the Grant Date, the number of shares of Common Stock which may without stockholder approval be issued under the Plan, then this option shall be void with respect to those excess shares, unless stockholder approval of an amendment sufficiently increasing the number of shares of Common Stock issuable under the Plan is obtained in accordance with the provisions of the Plan.

17. **Additional Terms Applicable to an Incentive Option.** In the event this option is designated an Incentive Option in the Grant Notice, the following terms and conditions shall also apply to the grant:

(i) This option shall cease to qualify for favorable tax treatment as an Incentive Option if (and to the extent) this option is exercised for one or

more Option Shares: (A) more than three (3) months after the date Optionee ceases to be an Employee for any reason other than death or Permanent Disability or (B) more than twelve (12) months after the date Optionee ceases to be an Employee by reason of Permanent Disability.

(ii) No installment under this option shall qualify for favorable tax treatment as an Incentive Option if (and to the extent) the aggregate Fair Market Value (determined at the Grant Date) of the Common Stock for which such installment first becomes exercisable hereunder would, when added to the aggregate value (determined as of the respective date or dates of grant) of the Common Stock or other securities for which this option or any other Incentive Options granted to Optionee prior to the Grant Date (whether under the Plan or any other option plan of the Corporation or any Parent or Subsidiary) first become exercisable during the same calendar year, exceed One Hundred Thousand Dollars (\$100,000) in the aggregate. Should such One Hundred Thousand Dollar (\$100,000) limitation be exceeded in any calendar year, this option shall nevertheless become exercisable for the excess shares in such calendar year as a Non-Statutory Option.

(iii) Should the exercisability of this option be accelerated upon a Change in Control, then this option shall qualify for favorable tax treatment as an Incentive Option only to the extent the aggregate Fair Market Value (determined at the Grant Date) of the Common Stock for which this option first becomes exercisable in the calendar year in which the Change in Control occurs does not, when added to the aggregate value (determined as of the respective date or dates of grant) of the Common Stock or other securities for which this option or one or more other Incentive Options granted to Optionee prior to the Grant Date (whether under the Plan or any other option plan of the Corporation or any Parent or Subsidiary) first become exercisable during the same calendar year, exceed One Hundred Thousand Dollars (\$100,000) in the aggregate. Should the applicable One Hundred Thousand Dollar (\$100,000) limitation be exceeded in the calendar year of such Change in Control, the option may nevertheless be exercised for the excess shares in such calendar year as a Non-Statutory Option.

(iv) Should Optionee hold, in addition to this option, one or more other options to purchase Common Stock which become exercisable for the first time in the same calendar year as this option, then the foregoing limitations on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

18. **Leave of Absence.** The following provisions shall apply upon the Optionee's commencement of an authorized leave of absence:

(i) The exercise schedule in effect under the Grant Notice shall be frozen as of the first day of the authorized leave, and this option shall not become exercisable for any additional installments of the Option Shares during the period Optionee remains on such leave.

(ii) Should Optionee resume active Employee status within sixty (60) days after the start date of the authorized leave, Optionee shall, for purposes of the exercise schedule set forth in the Grant Notice, receive Service credit for the entire period of such leave. If Optionee does not resume active Employee status within such sixty (60)-day period, then no Service credit shall be given for the period of such leave.

(iii) If this option is designated as an Incentive Option in the Grant Notice, then the following additional provision shall apply:

(A) If the leave of absence continues for more than ninety (90) days, then this option shall automatically convert to a Non-Statutory Option at the end of the three (3)-month period measured from the ninety-first (91st) day of such leave, unless Optionee's reemployment rights are guaranteed by statute or by written agreement. Following any such conversion of this option, all subsequent exercises of this option, whether effected before or after Optionee's return to active Employee status, shall result in an immediate taxable event, and the Corporation shall be required to collect from Optionee the income and employment withholding taxes applicable to such exercise.

(iv) In no event shall this option become exercisable for any additional Option Shares or otherwise remain outstanding if Optionee does not resume Employee status prior to the Expiration Date of the option term.

**EXHIBIT I**

**NOTICE OF EXERCISE**

I hereby notify Active Power, Inc. (the "Corporation") that I elect to purchase \_\_\_\_\_ shares of the Corporation's Common Stock (the "Purchased Shares") at the option exercise price of \$ \_\_\_\_\_ per share (the "Exercise Price") pursuant to that certain option (the "Option") granted to me under the Corporation's 2000 Stock Incentive Plan on \_\_\_\_\_.

Concurrently with the delivery of this Exercise Notice to the Corporation, I shall hereby pay to the Corporation the Exercise Price for the Purchased Shares in accordance with the provisions of my agreement with the Corporation (or other documents) evidencing the Option and shall deliver whatever additional documents may be required by such agreement as a condition for exercise. Alternatively, I may utilize the special broker-dealer sale and remittance procedure specified in my agreement to effect payment of the Exercise Price.

\_\_\_\_\_  
Date

\_\_\_\_\_  
Optionee

Print name in exact manner it is to appear on the stock certificate:

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

Address to which certificate is to be sent, if different from address above:

Social Security Number:

\_\_\_\_\_

Employee Number

\_\_\_\_\_

## APPENDIX

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Stock Option Agreement.

B. **Beneficiary** shall mean, in the event the Plan Administrator implements a beneficiary designation procedure, the person designated by Optionee, pursuant to such procedure, to succeed to Optionee's rights under the option evidenced by this Agreement to the extent the option is held by Optionee at the time of death. In the absence of such designation or procedure, the Beneficiary shall be the personal representative of the estate of Optionee or the person or persons to whom the option is transferred by will or the laws of descent and distribution.

C. **Board** shall mean the Corporation's Board of Directors.

D. **Change in Control** shall mean a change in ownership or control of the Corporation effected through any of the following transactions:

(a) a merger, consolidation or reorganization approved by the Corporation's stockholders, unless securities representing more than fifty percent (50%) of the total combined voting power of the voting securities of the successor corporation are immediately thereafter beneficially owned, directly or indirectly and in substantially the same proportion, by the persons who beneficially owned the Corporation's outstanding voting securities immediately prior to such transaction.

(b) any stockholder-approved transfer or other disposition of all or substantially all of the Corporation's assets, or

(c) the acquisition, directly or indirectly by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's stockholders which the Board recommends such stockholders to accept.

E. **Code** shall mean the Internal Revenue Code of 1986, as amended.

F. **Common Stock** shall mean the Corporation's common stock.

G. **Corporation** shall mean Active Power, Inc., a Delaware corporation.

H. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

I. **Exercise Date** shall mean the date on which the option shall have been exercised in accordance with Paragraph 9 of the Agreement.

J. **Exercise Price** shall mean the exercise price per share as specified in the Grant Notice.

K. **Expiration Date** shall mean the date on which the option expires as specified in the Grant Notice.

L. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as the price is reported by the National Association of Securities Dealers on the Nasdaq National Market or any successor system. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

M. **Grant Date** shall mean the date of grant of the option as specified in the Grant Notice.

N. **Grant Notice** shall mean the Notice of Grant of Stock Option accompanying the Agreement, pursuant to which Optionee has been informed of the basic terms of the option evidenced hereby.

O. **Immediate Family** of Optionee shall mean Optionee's child, stepchild, grandchild, parent, stepparent, grandparent, spouse, former spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law or sister-in-law, including adoptive relationships.

P. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

Q. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by Optionee, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any intentional wrongdoing by Optionee, whether by omission or commission, which adversely

affects the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not limit the grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

R. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

S. **Notice of Exercise** shall mean the notice of exercise in the form attached hereto as Exhibit I.

T. **Option Shares** shall mean the number of shares of Common Stock subject to the option as specified in the Grant Notice.

U. **Optionee** shall mean the person to whom the option is granted as specified in the Grant Notice.

V. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

W. **Permanent Disability** shall mean the inability of Optionee to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which is expected to result in death or has lasted or can be expected to last for a continuous period of twelve (12) months or more.

X. **Plan** shall mean the Corporation's 2000 Stock Incentive Plan.

Y. **Plan Administrator** shall mean either the Board or a committee of the Board acting in its administrative capacity under the Plan.

Z. **Service** shall mean Optionee's performance of services for the Corporation (or any Parent or Subsidiary) in the capacity of an Employee, a non-employee member of the board of directors or a consultant or independent advisor.

AA. **Stock Exchange** shall mean the American Stock Exchange or the New York Stock Exchange.

BB. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

**ACTIVE POWER, INC.**

2000 STOCK INCENTIVE PLAN

DISCRETIONARY OPTION GRANT PROGRAM

PLAN SUMMARY AND PROSPECTUS

The date of this Prospectus is July 13, 2000

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**INFORMATION ON THE  
2000 STOCK INCENTIVE PLAN**

**DISCRETIONARY OPTION GRANT PROGRAM**

Active Power, Inc., a Delaware corporation (the "Corporation"), is offering shares of its common stock (the "Common Stock") to eligible individuals in the Corporation's service pursuant to option grants and direct stock issuances made under the Corporation's 2000 Stock Incentive Plan (the "Plan"). The purpose of the Plan is to offer the Corporation's employees, the non-employee members of the Board of Directors (the "Board"), and consultants and other independent advisors who provide services to the Corporation the opportunity to acquire an ownership interest in the Corporation as an incentive for such persons to continue in the Corporation's service. Unless the context indicates otherwise, all references to the Corporation in this Plan Summary and Prospectus include Active Power, Inc. and its parent and subsidiary corporations, whether now existing or subsequently established.

**QUESTIONS AND ANSWERS ABOUT THE PLAN**

This Plan Summary and Prospectus sets forth in question and answer format the principal terms of the option grants which may be made from time to time under the Discretionary Option Grant Program in effect under the Plan to individuals who are not officers or directors of the Corporation subject to the short-swing profit restrictions of the Federal securities laws.

**GENERAL PLAN PROVISIONS**

**1. What is the basic structure of the Discretionary Option Grant Program?**

The Discretionary Option Grant Program is one of several equity incentive programs in effect under the Plan. Under the Discretionary Option Grant Program, options may be granted to eligible persons which will provide them with the right to purchase shares of Common Stock during their period of service with the Corporation at a fixed price per share equal to the fair market value of the Common Stock on the grant date.

**2. When did the Plan become effective?**

The Plan was adopted by the Board and became effective on July 13, 2000 (the "Effective Date") to serve as the successor to the Corporation's existing 1993 Stock Option Plan (the "Predecessor Plan"). The Plan was subsequently approved by the Corporation's stockholders.

All options outstanding under the Predecessor Plan have been incorporated into the Plan, and no further option grants will be made under the Predecessor Plan. Each option so incorporated will continue to be governed by the terms of the agreement evidencing that option, and no provision of the Plan will adversely affect or otherwise modify the rights of the holders of such incorporated options with respect to their acquisition of shares of Common Stock thereunder.

**3. Who administers the Plan?**

The Plan will be administered by the Compensation Committee of the Board (the "Committee"). The Committee is composed of two (2) or more Board members appointed by the Board, and each member will serve for so long as the Board deems appropriate and may be removed by the Board at any time. The Committee in its capacity as administrator of the Plan will be referred to in this document as the "Plan Administrator."

The Plan Administrator will have full authority, with respect to the option grants made under the Discretionary Option Grant Program, to determine the persons who are to be granted options, the time or times when such option grants are to be made, the number of shares to be subject to each such grant, the time or times when each option is to become exercisable, the vesting schedule applicable to the option shares and the maximum period for which the option is to remain outstanding.

#### **4. Who is eligible to participate in the Discretionary Option Grant Program?**

Employees, non-employee Board members, consultants and other independent advisors in the Corporation's service are eligible to participate in the Discretionary Option Grant Program.

#### **5. How many shares of Common Stock may be issued under the Plan?**

The maximum number of shares of Common Stock issuable over the term of the Plan will initially be limited to 6,116,934 shares, subject to adjustment for certain changes in the Corporation's capital structure. Such authorized share reserve includes (i) the number of shares which remained available for issuance under the Predecessor Plan as of the initial public offering of the Common Stock and (ii) an additional increase of 2,592,000 shares authorized by the Board under the Plan and approved by the stockholders. The number of shares of Common Stock authorized for issuance under the Plan will automatically increase on the first trading day of each calendar year, beginning with the 2001 calendar year, by an amount equal to two percent (2%) of the total number of shares of Common Stock outstanding on the last trading day of the immediately preceding calendar year, but in no event will any such annual increase exceed 1,080,000 shares.

Should one or more outstanding options under the Plan expire or terminate for any reason prior to exercise in full, the shares of Common Stock subject to the portion of each option not so exercised will be available for subsequent issuance under the Plan. Unvested shares issued under the Plan and subsequently repurchased by the Corporation, at the original exercise or issue price paid per share, pursuant to the Corporation's repurchase rights under the Plan will be added back to the number of shares of Common Stock available for issuance under the Plan and may accordingly be reissued through one or more subsequent option grants or direct stock issuances under the Plan. However, shares subject to stock appreciation rights exercised under the Plan will not be available for subsequent issuance.

No individual participating in the Plan may receive options, and direct stock issuances for more than 1,080,000 shares of Common Stock per calendar year, beginning with the 2000 calendar year. Except for such restriction and certain other restrictions in connection with incentive stock option grants (see the "Incentive Options" section below), there are no limitations on the number of shares of Common Stock for which an eligible individual may be granted options under the Discretionary Option Grant Program.

The Common Stock will be made available either from authorized but unissued shares of Common Stock or from shares of Common Stock reacquired by the Corporation, including shares repurchased on the open market.

#### **6. What happens if there is a change in the Corporation's capital structure?**

In the event of a Recapitalization (as defined below), appropriate adjustments will automatically be made to (i) the maximum number and/or class of securities issuable under the Plan, (ii) the maximum number and/or class of securities by which the share reserve is to increase annually, (iii) the number and/or class of securities for which any one person may be granted options and direct stock issuances per calendar year and (iv) the number and/or class of securities and the exercise price per share in effect under each outstanding option. The adjustments to such outstanding options will preclude the dilution or enlargement of the rights and benefits available under those options.

For purposes of the Plan, a **Recapitalization** is any stock dividend, stock split, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration.

**7. Can the Plan be amended or terminated?**

Yes. The Board has exclusive authority to amend or modify the Plan in any and all respects. However, no amendment or modification may, without the holder's consent, adversely affect such individual's rights and obligations under his or her outstanding options or direct stock issuances under the Plan. In addition, certain amendments to the Plan may require approval of the Corporation's stockholders.

The Plan will terminate upon the earliest to occur of (i) July 12, 2010, (ii) the date on which all shares available for issuance under the Plan have been issued as fully-vested shares or (iii) the termination of all outstanding options in connection with a Change in Control (see the "Early Termination of Options" section below). Should the Plan terminate on July 12, 2010, then any option grants outstanding at that time under the Discretionary Option Grant Program will continue to have force and effect in accordance with the provisions of the agreements evidencing those grants.

**GRANT OF OPTIONS**

**8. How are options granted under the Discretionary Option Grant Program?**

The Plan Administrator will have complete discretion (subject to the limitations of the Plan) to determine when and to whom options will be granted under the Discretionary Option Grant Program and the terms of each such grant. Each option grant will be evidenced by one or more options documents (collectively, the "Option Agreement") executed by the Corporation and the optionee.

**9. What type of options may be granted under the Discretionary Option Grant Program?**

The Plan Administrator may grant incentive stock options ("Incentive Options") designed to meet the requirements of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or options which do not satisfy such requirements ("Non-Statutory Options"). For a discussion of the difference in tax treatment under the Code between Incentive Options and Non-Statutory Options, see the "Questions and Answers on Federal Tax Consequences" section below.

**10. How is the exercise price determined?**

The exercise price of an option will be determined by the Plan Administrator and may be less than, equal to or greater than the fair market value of the Common Stock on the grant date.

**11. How is the fair market value of the Common Stock determined?**

The fair market value per share of Common Stock on any relevant date under the Plan will be the closing selling price per share on that date, as reported on the Nasdaq National Market. If the Common Stock is not traded on that day, the fair market value will be the closing selling price per share on the last preceding date for which such quotation exists. Stock prices are reported daily in most major newspapers.

**12. Can the Corporation cancel my option and grant me a new option?**

Yes. The Plan Administrator has the authority to cancel outstanding options and to issue new options in replacement, but your consent will be required in connection with your participation in any such cancellation/regrant program. The new options can cover the same or a different number of shares of Common Stock and will have an exercise price per share based on the fair market value of the Common Stock on the new grant date. In addition, it is likely that the new options will have a vesting schedule based on the new grant date, without any credit provided for the period the cancelled options were outstanding.

**13. Can I assign or transfer my option?**

No. Your options generally cannot be assigned or transferred, except by the provisions of your will or the laws of inheritance following your death. However, one or more Non-Statutory Options may be structured so that those options will be assignable as a gift in whole or in part during your lifetime to one or more members of your immediate family, to a trust in which you and/or one or more such family members have a more than fifty percent (50%) beneficial ownership interest or to an entity in which more than fifty percent (50%) of the voting interests are owned by you and/or such family members or pursuant to a qualified domestic order. The assigned portion may only be exercised by the person or persons who acquire a proprietary interest in the option pursuant to the assignment.

**NOTE: Outstanding options under the Predecessor Plan which have been incorporated into the Plan may not be transferred, pledged, or otherwise encumbered or disposed of other than by will or by the laws of descent and distribution following your death.**

**14. When do I acquire the rights of a stockholder?**

You will not have any stockholder rights with respect to the option shares. You will not acquire stockholder rights until you exercise the option, pay the exercise price and become a holder of record of the purchased shares.

**EXERCISE OF OPTIONS**

**15. When may I exercise my option?**

Your option may be immediately exercisable for all of the option shares or may become exercisable for such shares in a series of installments over the period that you remain in the Corporation's service. The exercise schedule applicable to your option will be determined by the Plan Administrator at the time of grant and will be set forth in the Option Agreement. You may exercise your option at any time for the shares for which your option is exercisable, provided you do so before the option terminates. However, any shares purchased under an option in which you are not vested upon your termination of service will be subject to repurchase by the Corporation as discussed below.

**NOTE: Outstanding options under the Predecessor Plan which have been incorporated into the Plan are generally exercisable in installments for vested shares.**

**16. When will my option terminate?**

No option granted under the Discretionary Option Grant Program may have a term in excess of ten (10) years. The actual expiration date of your option will be set forth in the Option Agreement. Your option may, however, terminate prior to its designated expiration date in the event of your termination of service or upon the occurrence of certain other events. See the "Early Termination of Options" section below.

**17. How do I exercise my option?**

To exercise your option, you must provide the Corporation with written notice of the exercise in which you indicate the number of shares to be purchased under your option. The notice must be accompanied by payment of the exercise price for the purchased shares, together with appropriate proof that the person exercising the option (if other than yourself) has the right to effect such exercise. You will be required to satisfy all applicable income and employment tax withholding requirements at that time. For information about such tax withholding, see the "Questions and Answers on Federal Tax Consequences" section below.

**18. How do I pay the exercise price?**

The exercise price may be paid in cash or check payable to the Corporation or in shares of Common Stock. Any such shares will be valued at fair market value on the exercise date and must have been held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes (generally a six (6)-month period).

Cashless exercises are also permitted to the extent your option is exercised for vested shares of Common Stock. To use this procedure, you must provide irrevocable written instructions to a Corporation-designated brokerage firm to effect the immediate sale of the vested shares of Common Stock purchased under your option and to pay over to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate exercise price payable for the purchased shares plus all applicable withholding taxes. Concurrently with such instructions, you must also direct the Corporation to deliver the certificates for the purchased shares to the brokerage firm in order to complete the sale.

**19. Does the Corporation have the right to repurchase the shares acquired upon exercise of my option?**

The answer will depend upon the exercise and vesting schedules in effect for your option. If you are granted an option which becomes exercisable in a series of installments over your period of service, then the shares of Common Stock purchased under that option will be fully-vested when acquired and will not be subject to the Corporation's repurchase rights. However, if you are granted an option which is exercisable immediately, then the shares of Common Stock purchased under such option will normally be subject to a vesting schedule pursuant to which the Corporation may repurchase, at the original exercise price, any unvested shares you hold at the time of your termination of service. If you wait to exercise your option so that you purchase only vested shares, then the Corporation will not have any right to repurchase those shares.

The Corporation's repurchase rights will also cover any new, substituted or additional securities or other property subsequently distributed with respect to your unvested shares of Common Stock by reason of any Recapitalization. Appropriate adjustments to reflect the distribution will be made to the number and/or class of securities subject to the Corporation's repurchase rights and the price per share payable upon the exercise of those rights.

The Plan Administrator will have full discretion to establish the remaining terms upon which the Corporation's repurchase rights are to become exercisable (including the procedure for effecting such repurchase), and such terms will be included in the agreement evidencing the repurchase rights.

**20. Can I transfer shares subject to the Corporation's repurchase rights?**

You may not transfer, assign or encumber any unvested shares of Common Stock which are subject to the Corporation's repurchase rights, except for certain gifts approved by the Plan Administrator or transfers by will or inheritance following your death. The certificates representing such unvested shares may, in the Plan Administrator's discretion, bear a legend indicating the existence of such transfer restrictions, or the unvested shares (and any securities or other property distributed with respect to such shares) may be held in escrow by the Corporation (or any successor entity) until you vest in those shares.

**21. When will the Corporation's repurchase right lapse?**

The Corporation's repurchase right will lapse, and you will vest in your option shares, in one or more installments according to the vesting schedule established by the Plan Administrator and set forth in the agreement evidencing the repurchase right. In addition, the Corporation's repurchase right may under certain circumstances lapse, and the shares subject to the terminated right will thereupon vest, in connection with certain changes in ownership or control of the Corporation. (For further information, see the discussion below under the "Early Termination of Options" section.)

## 22. Does the Plan include any special programs?

The Plan includes two special programs: the Stock Appreciation Rights Program and the Tax Withholding Program which are explained more fully below. The Plan Administrator will have the discretion to extend the benefits of either of those programs to one or more eligible individuals under the Plan. You will be notified in writing should you be selected for participation in either program.

## 23. What is the Stock Appreciation Rights Program?

The Plan Administrator has the discretion to grant to selected optionees tandem stock appreciation rights (“SARs”) which provide the optionee with the right to elect between the normal exercise of the option for shares of Common Stock and the surrender of all or part of that option for a distribution from the Corporation equal to the excess of (i) the fair market value of the vested shares of Common Stock subject to the surrendered option over (ii) the exercise price payable for those shares. The distribution may, in the Plan Administrator’s discretion, be made in cash or in shares of Common Stock. The Plan Administrator will have full discretion to establish the remaining terms upon which the SARs are to become exercisable and such terms will be set forth in the agreement evidencing the SARs.

The Plan Administrator may also grant limited SARs to one or more Section 16 Insiders. Upon the occurrence of a Hostile Take-Over, each outstanding option with such a limited SAR may be surrendered by the Section 16 Insider to the Corporation, to the extent the option is at the time exercisable for vested shares. Any such option surrender must be effected within the thirty (30)-day period following the Hostile Take-Over, and the Section 16 Insider will in return receive a cash distribution from the Corporation in an amount equal to the excess of (i) the Option Surrender Value of the shares of Common Stock in which the Section 16 Insider is at the time vested under the surrendered option (or surrendered portion thereof) over (ii) the aggregate exercise price payable for those shares. The exercise of the limited SAR in accordance with the foregoing terms and conditions will be pre-approved by the Plan Administrator at the time the SAR is granted, and no additional approval of the Plan Administrator or the Board will be required at the time of the actual option surrender and cash distribution. The cash distribution to which the Section 16 Insider becomes entitled upon the exercise of the limited SAR will be made within five (5) business days following the option surrender date. The balance of the option (if any) will continue to remain outstanding and exercisable in accordance with the Option Agreement.

A **Hostile Take-Over** will be deemed to occur (i) in the event any person or related group of persons directly or indirectly acquires securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation’s outstanding securities pursuant to a tender or exchange offer made directly to the Corporation’s stockholders which the Board does not recommend such stockholders to accept or (ii) there is a change in the composition of the Board over a period of thirty-six (36) consecutive months or less such that a majority of the Board ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been Board members continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time such election or nomination was approved by the Board.

The **Option Surrender Value** per share will be deemed to be equal to the greater of (i) the fair market value per share of Common Stock on the option surrender date or (ii) the highest reported price per share paid by the tender offeror in effecting the Hostile Take-Over. However, if the surrendered option is an Incentive Option, the Option Surrender Value will not exceed the clause (i) price per share.

The shares of Common Stock subject to options surrendered in connection with the exercise of SARs will not be available for subsequent issuance under the Plan.

**NOTE: None of the options incorporated from the Predecessor Plan contain any SARs.**

#### **24. What is the Tax Withholding Program?**

The Plan Administrator may select one or more holders of Non-Statutory Options for participation in the Tax Withholding Program. Each selected individual may elect to have the Corporation withhold, from the shares of Common Stock purchased under his or her Non-Statutory Option, a portion of those shares with a fair market value equal to a designated percentage (not to exceed one hundred percent (100%)) of the Federal, state and local tax withholding liability incurred in connection with the exercise of that option. In lieu of such direct withholding, the Plan Administrator may allow such individual to deliver previously acquired shares of Common Stock in satisfaction of the tax liability. However, no shares of Common Stock will actually be withheld or accepted in satisfaction of such tax liability except to the extent approved by the Plan Administrator, and any such withheld or delivered shares will be valued at fair market value on the date of the option exercise.

### **INCENTIVE OPTIONS**

This section applies only to Incentive Options. Non-Statutory Options are not subject to these provisions.

#### **25. Who is eligible to receive an Incentive Option?**

Incentive Options may only be granted to individuals who are employees of the Corporation.

#### **26. What is the exercise price of an Incentive Option?**

Incentive Options must have an exercise price per share equal to at least one hundred percent (100%) of the fair market value per share of Common Stock on the option grant date.

#### **27. Is there a limitation on the number of shares for which an Incentive Option may become exercisable in any one calendar year?**

Yes. The aggregate fair market value of the shares of Common Stock (determined at the date of grant) for which an option may for the first time become exercisable in any calendar year as an Incentive Option under the Federal tax laws may not exceed \$100,000. To the extent you hold two (2) or more Incentive Options which become exercisable for the first time in the same calendar year, the \$100,000 limitation will be applied on the basis of the order in which those options were granted. Options which do not qualify for Incentive Option treatment under the Federal tax laws by reason of this dollar limitation may nevertheless be exercised as Non-Statutory Options in the calendar year in which they become exercisable for the excess number of shares.

**Example:** On April 3, 2000, Sam Smith is granted an Incentive Option to purchase 4,000 shares of Common Stock at an exercise price of \$80.00 per share, the fair market value of the Common Stock on that date. The option will become exercisable for the option shares in a series of four successive equal annual installments, beginning April 3, 2001. When the option becomes exercisable for the second annual installment on April 3, 2002, the fair market value of the Common Stock is assumed to be \$120.00 per share. On February 25, 2001, Sam is granted a second Incentive Option to purchase 4,000 shares of Common Stock at an exercise price of \$100.00 per share, the fair market value of the Common Stock on that date. This option will also become exercisable for the option shares in a series of four successive equal annual installments beginning on February 25, 2002. When the option becomes exercisable for the first annual installment on that date, the fair market value of the Common Stock is assumed to be \$120.00 per share.

The aggregate fair market value of the 1,000 shares of Common Stock (measured as of the grant date) which become exercisable under the first option in 2002 is \$80,000. The aggregate fair market value of the 1,000 shares of Common Stock (measured as of the grant date) which become exercisable under the second option in 2002 is \$100,000. Accordingly, 800 of the shares which first become purchasable in 2002 under the 2001 option will

not qualify for favorable tax treatment as Incentive Options because the aggregate value (as measured as of the grant date) of the shares of Common Stock for which the two options first become exercisable in the 2002 calendar year exceeds \$100,000 (\$80,000 + \$100,000 = \$180,000). The 800 shares which do not qualify for Incentive Option treatment under the 2000 option may be exercised as Non-Statutory Options.

**28. Can an Incentive Option lose its qualified status?**

Yes. An option granted as an Incentive Option will generally be taxed as a Non-Statutory Option if exercised more than three (3) months after you terminate employee status. Certain amendments or modifications to the option may also cause the loss of Incentive Option status, but no such amendment or modification may be made without your consent.

**29. What limitations apply to Incentive Options granted to a 10% stockholder?**

If an Incentive Option is granted to an individual who is at the time the owner of stock possessing ten percent (10%) or more of the total combined voting power of all classes of stock of the Corporation or any parent or subsidiary corporation, then the exercise price per share cannot be less than one hundred ten percent (110%) of the fair market value of the Common Stock on the grant date, and the option term may not exceed five (5) years from the grant date.

**EARLY TERMINATION OF OPTIONS**

**30. What happens to my options if my service terminates?**

After your termination of service for any reason other than death, disability or Misconduct (as defined below in Question 25), you will have a limited period of time in which to exercise your outstanding options for any shares of Common Stock for which those options are exercisable on the date your service terminates. The length of this period will be set forth in your Option Agreement and will generally not be in excess of three (3) months. However, your option will in all events terminate on the specified expiration date of the option term. To the extent your options are not exercisable for one or more shares at the time of your termination of service, your options will immediately terminate and cease to be outstanding with respect to those unexercisable shares.

Unless your Option Agreement specifically provides otherwise, you will be deemed to continue in service for so long as you render services on a periodic basis to the Corporation, whether as (i) an employee, subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance, (ii) a non-employee Board member or (iii) a consultant or independent advisor.

The Plan Administrator has the discretion to extend the period during which you may exercise one or more of your options following your termination of service and/or to permit such options to be exercised not only with respect to the number of shares of Common Stock for which your options are exercisable but also with respect to one or more additional installments for which your options would have become exercisable had you continued in service. You will be notified in writing in the event the Plan Administrator decides to provide you with any of these additional benefits.

**31. What happens to my options if I am discharged from service for Misconduct?**

Should you be discharged from service for Misconduct, all of your outstanding options will immediately terminate. For purposes of the Plan, **Misconduct** includes (i) any act of fraud, embezzlement or dishonesty, (ii) any unauthorized use or disclosure of confidential information or trade secrets of the Corporation or (iii) any other intentional misconduct adversely affecting the business or affairs of the Corporation in a material manner. However, the foregoing list is not inclusive of all the acts or omissions which may be considered as grounds for dismissal or discharge of any individual in the Corporation's service.

### 32. What happens to my options if I die or become disabled or take a leave of absence?

If you die while any of your options are outstanding, the personal representative of your estate or the person or persons to whom the options are transferred by the provisions of your will or the laws of inheritance following your death may exercise each of those options for any or all vested shares of Common Stock for which the option was exercisable on the date your service with the Corporation terminated, less any shares you may have subsequently purchased prior to your death. The right to exercise each such option will lapse upon the earlier to occur of (i) the expiration of the option term or (ii) the first anniversary of the date of your death.

If you terminate your service with the Corporation because you become permanently disabled, you will normally have a period of twelve (12) months from the date of such termination of service during which to exercise your options for any or all of the shares for which those options were exercisable at the time of such termination. In no event, however, may you exercise any option after the specified expiration of the option term. For purposes of the Plan, you will be deemed to be **permanently disabled** if you are unable to perform any substantial gainful activity by reason of any medically-determinable physical or mental impairment expected to result in death or to be of continuous duration of twelve (12) consecutive months or more.

Should you take an approved leave of absence from active service with the Corporation, then it is important that you review the provisions of the Option Agreement in effect for your outstanding options in order to determine the effect which your leave will have upon those options. For example, the duration of your leave will determine whether or not the vesting schedule for your options will be frozen so that no additional option shares vest under your options while you remain on leave. Under certain circumstances, a leave of absence of ninety (90) days may convert any Incentive Options you hold into Non-Statutory Options for income tax purposes.

### 33. What happens to my options if the Corporation is acquired or merged?

In the event of a Change in Control (as defined below), all options outstanding under the Discretionary Option Grant Program will automatically accelerate so that each such option will, immediately prior to the effective date of the Change in Control, become fully exercisable for the total number of shares of Common Stock at the time subject to that option and may be exercised for all or any portion of those shares as fully vested shares. However, an outstanding option will **not** become exercisable on such an accelerated basis if and to the extent: (i) the option is assumed by the successor corporation or otherwise continued in full force and effect, (ii) such option is replaced with a cash incentive program which preserves the option spread existing at the time of the Change in Control on any shares for which the option is not otherwise at that time exercisable and provides for subsequent payout in accordance with the same exercise/vesting schedule applicable to those option shares or (iii) acceleration of the option is subject to other limitations imposed by the Plan Administrator in the Option Agreement.

All outstanding options under the Discretionary Option Grant Program will, to the extent not assumed by the successor corporation or otherwise continued in full force and effect, terminate and cease to be outstanding immediately following the completion of the Change in Control.

Any Incentive Options accelerated upon the Change in Control will remain exercisable as Incentive Options under the Federal tax laws only to the extent the applicable \$100,000 limitation is not exceeded. If such limitation is exceeded, the option will be exercisable for the excess number of shares as a Non-Statutory Option.

A **Change in Control** will be deemed to occur upon (i) a merger or consolidation unless securities representing more than fifty percent (50%) of the total combined voting power of the voting securities of the successor corporation are immediately thereafter owned, directly or indirectly and in substantially the same proportion by the persons who beneficially owned those securities immediately prior to such transaction, (ii) a sale, transfer or other disposition of all or substantially all the assets of the Corporation in liquidation or dissolution of the Corporation or (iii) the acquisition by any person of securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's stockholders which the Board recommends such stockholders accept.

**NOTE: The outstanding options under the Predecessor Plan which have been incorporated into the Plan provide that upon an acquisition of the Corporation (whether through merger or sale of all or substantially all of the assets), the options will accelerate unless assumed. Immediately following the acquisition, the outstanding options will terminate except to the extent assumed by the acquiror.**

**34. What happens to my options that are assumed or otherwise continued upon a Change in Control?**

Each option under the Discretionary Option Grant Program which is assumed by the successor corporation will, immediately after the Change in Control, be appropriately adjusted to apply to the number and class of securities which would have been issued to the optionee in consummation of the Change in Control had the option been exercised immediately prior to the Change in Control. Appropriate adjustments will also be made to the exercise price payable per share, provided the aggregate exercise price for the option shares will remain the same. To the extent the holders of Common Stock receive cash consideration for their Common Stock in consummation with the Change in Control, the successor corporation may, in connection with the assumption of the option, substitute one or more shares of its common stock with a fair market equivalent to the cash consideration paid per share of Common Stock in such Change in Control.

The Plan Administrator may provide for the accelerated vesting of any outstanding option which the Change in Control does not otherwise vest at the time of the Change in Control, in the event the optionee's service terminates through an Involuntary Termination effected within a designated period (not to exceed eighteen (18) months) following the effective date of such Change in Control. Any option so accelerated will remain exercisable for fully-vested shares until the earlier of (i) the expiration of the option term or (ii) the end of the one (1)-year period measured from the date of the Involuntary Termination. You should review your Option Agreement to determine whether the option you hold will in fact accelerate upon such an Involuntary Termination.

**An Involuntary Termination** will be deemed to occur upon (i) the optionee's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct or (ii) such individual's voluntary resignation following (A) a change in his or her position with the Corporation which materially reduces his or her duties and level of responsibilities or the level of management to which he or she reports, (B) a reduction in his or her level of compensation (including base salary, fringe benefits and target bonus under any performance-based bonus or incentive programs) by more than fifteen percent (15%) or (C) a relocation of such individual's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected by the Corporation without the optionee's consent.

**35. What happens to my options if there is a Hostile Take-Over of the Corporation?**

The Plan Administrator may provide for the automatic acceleration of one or more outstanding options under the Plan upon a Hostile Take-Over or upon the termination of the optionee's service through an Involuntary Termination effected within a designated period (not to exceed eighteen (18) months) following the effective date of a Hostile Take-Over, so that each such option will, immediately prior to the occurrence of such transaction, become fully exercisable for the total number of shares of Common Stock at the time subject to that option and may be exercised for all or any portion of those shares as fully vested shares. You should review your Option Agreement to determine whether the option you hold will accelerate upon your Involuntary Termination following a Hostile Take-Over.

Except as otherwise provided in the Option Agreement, any option so accelerated will remain exercisable for fully-vested shares until the expiration of the option term. However, any Incentive Option accelerated upon the Hostile Take-Over will remain exercisable as an Incentive Option under the Federal tax laws only to the extent the applicable \$100,000 dollar limitation is not exceeded. If such limitation is exceeded, the option may be exercised for the excess number of shares as a Non-Statutory Option.

A **Hostile Take-Over** will be deemed to occur in the event (i) any person directly or indirectly acquires securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's stockholders which

the Board does not recommend such stockholders accept or (ii) there is a change in the composition of the Board over a period of thirty-six (36) consecutive months or less such that a majority of the Board ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been Board members continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time such election or nomination was approved by the Board.

**NOTE: None of the outstanding options under the Predecessor Plan which have been incorporated into the Plan contains any of the special acceleration features summarized in this question.**

#### **DISPOSITION OF OPTION SHARES**

**36. When can I sell my shares?**

You may sell the shares you purchase under the Plan at any time without restriction, provided you are **not** an officer or director of the Corporation subject to the short-swing profit limitations of the Federal securities laws.

#### **MISCELLANEOUS**

**37. Is financing available under the Plan?**

The Plan Administrator may elect to assist you in the acquisition of shares of Common Stock under the Discretionary Option Grant Program by permitting you to pay the purchase price for the shares through a promissory note payable in one or more installments. The terms of any such promissory note, including the interest rate and terms of repayment, will be established in the sole discretion of the Plan Administrator. Promissory notes will be made on a full-recourse basis, and the maximum credit available to you may not exceed the purchase price payable for the acquired shares plus any withholding tax liability incurred by you in connection with such acquisition. In addition, the Corporation will comply with all applicable requirements of Regulation U of the Board of Governors of the Federal Reserve System in connection with any financing extended under the Plan.

**38. Do I have the right to remain employed until my options under the Discretionary Option Grant Program vest?**

No. Nothing in the Plan or in any option grant under the Discretionary Option Grant Program is intended to provide any person with the right to remain in the Corporation's service for any specific period, and both you and the Corporation will each have the right to terminate your service at any time and for any reason, with or without cause.

**39. Are there any circumstances which would cause me to lose my rights with respect to an option or a stock issuance?**

Yes. The grant of options under the Discretionary Option Grant Program and the issuance of Common Stock under those options are subject to the Corporation's procurement of all approvals and permits required by regulatory authorities having jurisdiction over the Plan and the securities issuable thereunder. It is possible that the Corporation could be prevented from granting options or from issuing shares of Common Stock under the Discretionary Option Grant Program in the event one or more required approvals or permits were not obtained.

**40. Does the Plan restrict the authority of the Corporation to grant or assume options outside of the Plan?**

No. The Plan does not limit the authority of the Corporation to grant options outside of the Plan or to grant options to, or assume the options of, any person in connection with the acquisition of the business and assets of any firm, corporation or other business entity.

**41. Does the grant of an option or the issuance of shares under the Plan affect my eligibility to participate in other plans of the Corporation?**

No. Option grants made under the Discretionary Option Grant Program do not in any way affect, limit or restrict your eligibility to participate in any other stock plan or other compensation or benefit plan or program maintained by the Corporation.

**42. What is a parent corporation?**

A corporation is a parent corporation if such corporation owns, directly or indirectly, securities representing fifty percent (50%) or more of the total combined voting power of the Corporation's outstanding securities.

**43. What is a subsidiary corporation?**

A corporation is a subsidiary corporation if the Corporation owns, directly or indirectly, securities representing fifty percent (50%) or more of the total combined voting power of the outstanding securities of that corporation.

**44. Is the Plan subject to ERISA?**

The Plan is not subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) or Section 401(a) of the Code.

**QUESTIONS AND ANSWERS ON FEDERAL TAX CONSEQUENCES**

The following is a general description of the Federal income tax consequences of option grants made under the Discretionary Option Grant Program. State and local tax treatment, which is not discussed below, may vary from such Federal income tax treatment. You should consult with your own tax advisor as to the tax consequences of your particular transactions under the Plan.

The tax consequences of Incentive Options and Non-Statutory Options differ as described below.

**INCENTIVE OPTIONS**

**T1. Will the grant of an Incentive Option result in Federal income tax liability to me?**

No.

**T2. Will the exercise of an Incentive Option result in Federal income tax liability to me?**

No. You will not recognize taxable income at the time the Incentive Option is exercised. However, the amount by which the fair market value (at the time of exercise) of the purchased shares exceeds the exercise price paid for those shares will constitute an adjustment to your income for purposes of the alternative minimum tax (see the "Alternative Minimum Tax" section below). On or before January 31 of the calendar year following the calendar year in which you exercise your Incentive Option, you will receive an information statement from the Corporation indicating, among other items, the number of shares of Common Stock you purchased in connection with such exercise, the market price of the Common Stock on the exercise date and the price you paid for the purchased shares.

**T3. When will I be subject to Federal income tax on shares acquired under an Incentive Option?**

Generally, you will recognize income in the year in which you make a disposition of the shares purchased under your Incentive Option.

**T4. What constitutes a disposition of Incentive Option shares?**

A disposition of shares purchased under an Incentive Option will occur in the event you transfer legal title to those shares, whether by sale, exchange or gift, or you deliver such shares in payment of the exercise price of any other Incentive Option you hold. However, a disposition will not occur if you engage in any of the following transactions: a transfer of the shares to your spouse, a transfer into joint ownership with right of survivorship provided you remain one of the joint owners, a pledge of the shares as collateral for a loan, a transfer by bequest or inheritance upon your death or certain tax-free exchanges of the shares permitted under the Code.

**T5. How is my Federal income tax liability determined when I dispose of my shares?**

Your Federal income tax liability will depend upon whether you make a qualifying or disqualifying disposition of the shares purchased under your Incentive Option. A qualifying disposition will occur if the sale or other disposition of the shares takes place more than two (2) years after the date the Incentive Option was granted and more than one (1) year after the date the option was exercised for the particular shares involved in the disposition. A disqualifying disposition is any sale or other disposition made before both of these minimum holding periods are satisfied.

**T6. What if I make a qualifying disposition?**

You will recognize a long-term capital gain equal to the excess of (i) the amount realized upon the **sale or** disposition over (ii) the exercise price paid for the shares. You will recognize a long-term capital loss if the amount realized is lower than the exercise price paid for the shares. (For the tax rates applicable to capital gain, please see Question T17.)

Example: On April 3, 2000, you are granted an Incentive Option for 1,000 shares with an exercise price of \$80.00 per share. On April 4, 2002, you exercise the option for 500 vested shares when the market price is \$100.00 per share. The purchased shares are held until December 15, 2003, when you sell them for \$120.00 per share.

Because the disposition of the shares is made more than two (2) years after the grant date of the 2000 Incentive Option and more than one (1) year after the option was exercised, the sale represents a qualifying disposition of such shares, and for Federal income tax purposes, there will be a long-term capital gain of \$40.00 per share.

**T7. What are the normal tax rules for a disqualifying disposition?**

Normally, when you make a disqualifying disposition of shares purchased under an Incentive Option, you will recognize ordinary income at the time of the disposition in an amount equal to the excess of (i) the fair market value of the shares on the option exercise date over (ii) the exercise price paid for those shares. If the disqualifying disposition is effected by means of an arm's length sale or exchange with an unrelated party, the ordinary income will be limited to the amount by which (i) the amount realized upon the disposition of the shares or (ii) their fair market value on the exercise date, whichever is less, exceeds the exercise price paid for the shares. The amount of your disqualifying disposition income will be reported by the Corporation on your W-2 wage statement for the year of disposition, and any applicable withholding taxes which arise in connection with the disqualifying disposition will be deducted from your wages or otherwise collected from you.

Any additional gain recognized upon the disqualifying disposition will be capital gain, which will be long-term if the shares have been held for more than one (1) year following the exercise date of the option. (See Question T17 below for the tax rates applicable to capital gain.)

Example: On April 3, 2000, you are granted an Incentive Option for 1,000 shares with an exercise price of \$80.00 per share. On April 4, 2002, you exercise this option for 500 vested shares when the market price is \$100.00 per share. The purchased shares are held until June 1, 2002, when you sell them for \$120.00 per share.

Because the disposition of the shares is made less than one (1) year after the exercise date of the 2000 Incentive Option, the sale represents a disqualifying disposition of the shares, and for Federal income tax purposes, the gain upon the sale will be divided into two (2) components:

Ordinary Income: You will recognize ordinary income in the amount of \$20.00 per share, the excess of the \$100.00 per share market price of the shares on the date the option was exercised over the \$80.00 per share exercise price.

Capital Gain: You will also recognize a short-term capital gain of \$20.00 per share with respect to each share sold.

In the event the shares purchased under an Incentive Option are sold in a disqualifying disposition for less than the exercise price paid for those shares, you will not recognize any income but will recognize a capital loss equal to the excess of (i) the exercise price paid for the shares over (ii) the amount realized upon the disposition of those shares. For example, if the shares in the above Example are sold for \$60.00 per share in the disqualifying disposition, you would simply recognize a short-term capital loss of \$20.00 per share.

#### **T8. What are the Federal tax consequences to the Corporation?**

If you make a qualifying disposition of shares acquired upon the exercise of an Incentive Option, then no income tax deduction may be taken by the Corporation with respect to such shares. Should you make a disqualifying disposition of such shares, then the Corporation will be entitled to an income tax deduction equal to the amount of ordinary income you recognize in connection with the disposition. The deduction will, in general, be allowed to the Corporation in the taxable year in which the disposition occurs.

#### **T9. What are the consequences of paying the exercise price of an Incentive Option in the form of shares of Common Stock acquired upon the exercise of an earlier-granted Incentive Option if the delivery of the shares results in a disqualifying disposition?**

If the delivery of the shares acquired under an earlier granted Incentive Option results in a disqualifying disposition, then you will be subject to ordinary income taxation on the excess of (i) the fair market value of the delivered shares at the time of their original purchase over (ii) the exercise price paid for the delivered shares.

The tax basis and capital gain holding periods for the shares of Common Stock purchased upon exercise of the Incentive Option will be determined as follows:

(i) To the extent the purchased shares equal in number the delivered shares as to which there is a disqualifying disposition, the basis for the new shares will be equal to the fair market value of the delivered shares at the time they were originally purchased, (or at the time any forfeiture restrictions applicable to those share lapsed), and the capital gain holding period for these shares will include the period for which the delivered shares were held (measured from their original purchase date or (if later) from the lapse date of any forfeiture restriction applicable to those shares).

(ii) To the extent the number of purchased shares exceeds the number of delivered shares, the additional shares will have a zero basis and a capital gain holding period measured (in general) from the exercise date.

**T10. What are the consequences of paying the exercise price of an Incentive Option in the form of shares of Common Stock (i) acquired under an Incentive Option and held for the requisite holding periods, (ii) acquired under a Non-Statutory Option or (iii) acquired through open-market purchases?**

If the exercise price for the Incentive Option is paid with shares of Common Stock (i) acquired under an Incentive Option and held for the requisite minimum holding periods for a qualifying disposition, (ii) acquired under a Non-Statutory Option or (iii) acquired through open-market purchases, you will not recognize any taxable income (other than as described in the "Alternative Minimum Tax" section below) with respect to the shares of Common Stock purchased upon exercise of the Incentive Option. To the extent the purchased shares equal in number the shares of Common Stock delivered in payment of the exercise price, the new shares will have the same basis and holding period for capital gain purposes as the delivered shares. To the extent the number of purchased shares exceeds the number of delivered shares, the additional shares will have a zero basis and a capital gain holding period measured (in general) from the exercise date.

**T11. What are the consequences of a subsequent disposition of shares purchased under an Incentive Option with shares of Common Stock?**

If the Incentive Option is exercised with shares of Common Stock, then those shares purchased under the Incentive Option which have a zero basis will be treated as the first shares sold or otherwise transferred in a disqualifying disposition. Accordingly, upon such a disqualifying disposition, you will recognize ordinary income with respect to the zero basis shares in an amount equal to their fair market value on the date the option was exercised for those shares. Any additional gain will in most instances be taxed as short-term capital gain.

**NON-STATUTORY OPTIONS**

**T12. Will the grant of a Non-Statutory Option result in Federal income tax liability to me?**

No.

**T13. Will the exercise of a Non-Statutory Option result in Federal income tax liability to me?**

Normally, you will recognize ordinary income in the year in which the Non-Statutory Option is exercised in an amount equal to the excess of (i) the fair market value of the purchased shares on the exercise date over (ii) the exercise price paid for those shares. This income will be reported by the Corporation on your W-2 wage statement for the year of exercise (or on a Form 1099 if you are not an employee), and you will be required to satisfy the tax withholding requirements applicable to this income.

**T14. Will I recognize additional income when I sell shares acquired under a Non-Statutory Option?**

Yes. You will recognize a capital gain to the extent the amount realized upon the sale of such shares exceeds their fair market value at the time you recognized the ordinary income with respect to their acquisition. A capital loss will result to the extent the amount realized upon the sale is less than such fair market value. The gain or loss will be long-term if the shares are held for more than one (1) year prior to the disposition. (Please see Question T17 below for tax rates applicable to capital gain.) The holding period will normally start at the time the Non-Statutory Option is exercised.

**T15. What are the consequences of paying the exercise price of a Non-Statutory Option in the form of shares of Common Stock previously acquired upon the exercise of employee options or through open-market purchases?**

You will not recognize any taxable income to the extent the shares of Common Stock received upon the exercise of the Non-Statutory Option equal in number the shares of Common Stock delivered in payment of the exercise price. For Federal income tax purposes, these newly-acquired shares will have the same basis and capital gain holding period as the delivered shares. To the extent the delivered shares were acquired under an Incentive Option, the new shares received upon the exercise of the Non-Statutory Option will continue to be subject to taxation as Incentive Option shares in accordance with the Incentive Option principles discussed above.

The additional shares of Common Stock received upon the exercise of the Non-Statutory Option will, in general, have to be reported as ordinary income for the year of exercise in an amount equal to their fair market value on the exercise date. These additional shares will have a tax basis equal to such fair market value and a capital gain holding period measured (in general) from the exercise date.

**T16. What are the Federal tax consequences to the Corporation?**

The Corporation will be entitled to an income tax deduction equal to the amount of ordinary income you recognize in connection with the exercise of the Non-Statutory Option. The deduction will, in general, be allowed for the taxable year of the Corporation in which you recognize such ordinary income.

**FEDERAL TAX RATES**

**T17. What are the applicable Federal tax rates?**

Effective for the 2000 calendar year, the maximum federal tax rate on ordinary income in excess of \$288,350 (\$144,175 for a married taxpayer filing a separate return) is 39.6%. The applicable \$288,350 (\$144,175) threshold is subject to cost-of-living adjustments in taxable years beginning after December 31, 2000. Certain limitations are imposed upon a taxpayer's itemized deductions, and the personal exemptions claimed by the taxpayer are subject to phase-out. These limitations may result in the taxation of ordinary income at an effective top marginal rate in excess of 39.6%.

Short-term capital gains are subject to the same tax rates as ordinary income. Long-term capital gain is subject to a maximum federal income tax rate of 20%, provided the capital asset is held for more than one (1) year.

Beginning in 2001, capital gain recognized on the sale or disposition of capital assets held for more than five (5) years by individuals not subject to the 28% tax rate on their ordinary income will be subject to tax at a rate of 8%.

Beginning in 2006, capital gain recognized on the sale or disposition of capital assets held for more than five (5) years by individuals subject to the 28% tax rate on their ordinary income will be taxed at a rate of 18% provided the holding period for such property begins after December 31, 2000. However, any capital gain recognized on the sale or disposition of shares acquired under the Plan will not be eligible for the 18% tax rate unless the option is granted after December 31, 2000.

For the tax year ending December 31, 2000, itemized deductions are reduced by 3% of the amount by which the taxpayer's adjusted gross income for the year exceeds \$128,950 (\$64,475 for a married taxpayer filing a separate return). However, the reduction may not exceed 80% of the total itemized deductions (excluding medical expenses, casualty and theft losses, and certain investment interest expense) claimed by the taxpayer. The applicable \$128,950 or \$64,475 threshold is subject to cost-of-living adjustments in taxable years beginning after December 31, 2000.

In addition, the deduction for personal exemptions claimed by the taxpayer is reduced by 2% for each \$2,500 (\$1,250 for a married taxpayer filing a separate return) or fraction thereof by which the taxpayer's adjusted gross income for the year exceeds a specified threshold amount. The applicable thresholds for 2000 are \$193,400 for married taxpayers filing joint returns (and in certain instances, surviving spouses), \$161,150 for heads of households, \$128,950 for single taxpayers and \$96,700 for married taxpayers filing separate returns. Accordingly, the deduction is completely eliminated for any taxpayer whose adjusted gross income for the year exceeds the applicable threshold amount by more than \$122,500. The threshold amounts will be subject to cost-of-living adjustments in taxable years beginning after December 31, 2000.

### **ALTERNATIVE MINIMUM TAX**

#### **T18. What is the alternative minimum tax ?**

The alternative minimum tax is an alternative method of calculating the income tax you must pay each year in order to assure that a minimum amount of tax is paid for the year. In general, the first \$175,000 (\$87,500 for a married taxpayer filing a separate return) of your alternative minimum taxable income for the year over the allowable exemption amount is subject to alternative minimum taxation at the rate of 26%. The balance of your alternative minimum taxable income is subject to alternative minimum taxation at the rate of 28%. However, the portion of your alternative minimum taxable income attributable to capital gain recognized upon the sale or disposition of capital assets held for more than twelve (12) months will be subject to a reduced alternative minimum tax rate of 20% (10% for individuals not subject to the regular 28% tax rate on their ordinary income). Beginning in 2001, the alternative minimum tax rate applicable to capital gain recognized upon the sale or disposition of capital assets held for more than five (5) years will be equal to the capital gain tax rate in effect for such gain for regular tax purposes (see Question T17 above). The alternative minimum tax will, however, be payable only to the extent that it exceeds your regular federal income tax for the year (computed without regard to certain credits and special taxes).

#### **T19. What is the allowable exemption amount?**

The allowable exemption amount is \$45,000 for a married taxpayer filing a joint return, \$33,750 for an unmarried taxpayer and \$22,500 for a married taxpayer filing a separate return. The allowable exemption amount is, however, to be reduced by \$0.25 for each \$1.00 by which the individual's alternative minimum taxable income for the year exceeds \$150,000 for a married taxpayer filing a joint return, \$112,500 for an unmarried taxpayer, and \$75,000 for a married taxpayer filing a separate return.

#### **T20. How is the alternative minimum taxable income calculated?**

Your alternative minimum taxable income is based upon your regular taxable income for the year, adjusted to (i) include certain additional items of income and tax preference and (ii) disallow or limit certain deductions otherwise allowable for regular tax purposes. The spread on the shares purchased under an Incentive Option (the excess of the fair market value of the purchased shares at the time of exercise over the aggregate exercise price paid for those shares) is normally included in the optionee's alternative minimum taxable income at the time of exercise, whether or not the shares are subsequently made the subject of a disqualifying disposition.

#### **T21. Is the spread on an Incentive Option at the time of exercise normally includible in alternative minimum taxable income?**

Yes. The spread on the shares purchased under an Incentive Option (the excess of the fair market value of the purchased shares at the time of exercise over the aggregate exercise price paid for those shares) is normally included in the optionee's alternative minimum taxable income at the time of exercise, whether or not the shares are subsequently made the subject of a disqualifying disposition.

**T22. How will the payment of alternative minimum taxes in one year affect the calculation of my tax liability in a later year?**

If alternative minimum taxes are paid for one or more taxable years, a portion of those taxes (subject to certain adjustments and reductions) will be applied as a partial credit against your regular tax liability (but not alternative minimum tax liability) for subsequent taxable years. In addition, upon the sale or other disposition of the purchased shares, whether in the year of exercise or in any subsequent taxable year, your basis for computing the gain for purposes of alternative minimum taxable income (but not regular taxable income) will include the amount of the Incentive Option spread previously included in your alternative minimum taxable income.

**CORPORATION INFORMATION AND ANNUAL PLAN INFORMATION**

Active Power, Inc. is a Delaware corporation which maintains its principal executive offices at 11525 Stonehollow Drive, Suite 110, Austin, TX 78758. The telephone number at the executive offices is (512) 836-6464. You may contact the Corporation at this address or telephone number for further information concerning the Plan and its administration.

A copy of the Corporation's Annual Report to Stockholders for the most recent fiscal year of the Corporation will be furnished to each participant in the Plan, and additional copies will be furnished without charge to each participant upon written or oral request to the Corporate Secretary of the Corporation at its principal executive offices or upon telephoning the Corporation at its principal executive offices. In addition, any person receiving a copy of this Prospectus may obtain without charge, upon written or oral request to the Corporate Secretary, a copy of any of the documents listed below, which are hereby incorporated by reference into this Prospectus, other than certain exhibits to such documents:

- (a) The Corporation's Prospectus filed with the SEC pursuant to Rule 424(b) promulgated under the Securities Act of 1933, as amended, filed with the SEC on August 8, 2000, in connection with the Corporation's Registration Statement No. 333-36946, in which there is set forth the audited financial statements for the Corporation's fiscal year ended December 31, 1999;
- (b) The Corporation's Registration Statement No. 000-30939 on Form 8-A12G/A filed with the SEC on June 30, 2000, in which there is described the terms, rights and provisions applicable to the Corporation's outstanding Common Stock.

The Corporation will also deliver to each participant in the Discretionary Option Grant Program who does not otherwise receive such materials a copy of all reports, proxy statements and other communications distributed to the Corporation's stockholders.