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

FORM 10-K/A
(Amendment No. 1)

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from to

Commission file number: 000-30939

ACTIVE POWER, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**74-2961657** (I.R.S. Employer Identification No.)
2128 W. Braker Lane, BK 12, Austin, Texas (Address of principal executive offices)	**78758** (Zip Code)

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

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

Title of Class	Name of Exchange on Which Registered
Common Stock, $0.001 per share	**The Nasdaq Stock Market LLC (Nasdaq Global Market)**

Securities registered pursuant to Section 12(g) of the Act:
Preferred Share Purchase Rights
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☒ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. ☐ Yes ☒ No

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

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

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

Large accelerated filer ☐		Accelerated filer ☒
Non-accelerated filer ☐	(Do not check if a smaller reporting company)	Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) ☐ Yes ☒ No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based upon the closing sale price of its common stock on the last day of registrant's most recently completed second fiscal quarter, June 30, 2008, as reported on The Nasdaq Stock Market, was approximately $69.5 million (affiliates being, for these purposes only, directors and executive officers).

As of February 27, 2009, the Registrant had 60,458,311 shares of Common Stock outstanding.

Documents Incorporated by Reference

Certain information required by Part III of Form 10-K is incorporated by reference to the Registrant's proxy statement for the 2009 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the Registrant's fiscal year ended

December 31, 2008.

Active Power, Inc.

Unless otherwise indicated, “we,” “us,” “our,” and “Active Power” mean Active Power, Inc., including our predecessor Texas corporation. References in this report to “$” or “dollars” are to United States of America currency.

Explanatory Note

This Amendment No. 1 on Form 10-K/A (this “Amendment”), which amends and restates items identified below with respect to the Form 10-K, filed by Active Power with the Securities and Exchange Commission on March 3, 2009 (the “Original Filing”), is being filed to amend information in (i) Item 7 (Management’s Discussion and Analysis of Financial Condition and Results of Operations) to remove references to or discussion of non-GAAP financial measures, including EBITDA, Adjusted EBITDA and gross profit margin before impairment, and to clarify that cost of product revenue includes depreciation of our manufacturing property and equipment, and (ii) Item 9A (Controls and Procedures) to clarify the disclosure of the conclusions of our chief executive and chief financial officers regarding the effectiveness of our disclosure controls and procedures as of the end of the period covered by the Original Filing. The other Items are as presented in the Original Filing and are not being restated. As a result of this Amendment, the Certification of Principal Executive Officer and Certification of Principal Financial Officer required by Rule 13a-14(a) and the 18 U.S.C. Section 1350 Certification of Principal Executive Officer and Principal Financial Officer, filed as exhibits to our Original Filing, have been revised, re-executed and re-filed as of the date of this Amendment.

This Form 10-K, as amended, continues to describe conditions as of the date of the Original Filing, and the disclosures contained herein, including forward-looking statements, have not been updated to reflect events, results or developments that have occurred or facts that have become known to us after the date of the Original Filing, and such disclosures should be read in their historical context.

This Amendment should be read in conjunction with the Company’s filings made with the Securities and Exchange Commission subsequent to the Original Filing, including any amendments to those filings. The filing of this Form 10-K/A shall not be deemed an admission that the Original Filing, when made, included any untrue statement of material fact or omitted to state a material fact necessary to make a statement not misleading.

Table of Contents

Special Note Regarding Forward-Looking Statements

This report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements about historical or current facts, including, without limitation, statements about our business strategy, plans and objectives of management and our future prospects, are forward-looking statements. Although we believe that the expectations reflected in such forward-looking statements are reasonable, such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from these expectations. Such risks and uncertainties include, without limitation, the following:

- strategic relationships with third parties, including suppliers and channel partners;
- customer demand for our products;
- growth and future operating results;
- developments in our markets;
- expansion of our product offerings and sales channels;
- customer benefits attributable to our products;
- technologies and operations;
- industry trends; and
- future economic, business and regulatory conditions.

You can identify these statements by forward-looking words such as “may,” “will,” “expect,” “intend,” “anticipate,” “believe,” “estimate,” “continue” and other similar words. You should read statements that contain these words carefully because they discuss our future expectations, make projections of our future results of operations or financial condition, or state other “forward-looking” information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to accurately predict or control. The factors listed in the section captioned “Risk Factors” in Item 1A of this report, as well as any cautionary language in this report, provide examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we described in our forward-looking statements.

PART II.

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

The following discussion should be read in conjunction with the financial statements appearing elsewhere in this Form 10-K. This report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, that involve risks and uncertainties. Our expectations with respect to future results of operations that may be embodied in oral and written forward-looking statements, including any forward looking statements that may be included in this report, are subject to risks and uncertainties that must be considered when evaluating the likelihood of our realization of such expectations. Our actual results could differ materially. The words "believe," "expect," "intend," "plan," "project," "will" and similar phrases as they relate to us are intended to identify such forward-looking statements. In addition, please see the risk factors section above for a discussion of items that may affect our future results.

Executive Level Overview

Active Power is a manufacturer and provider of critical power solutions incorporating UPS systems that provide business continuity to enterprises requiring protection against electrical power disturbances. Our products are designed to deliver continuous clean power, protecting customers from voltage fluctuations, such as surges and sags, and frequency fluctuations, and also to provide ride-through, or temporary, power to bridge the gap between a power outage and the restoration of utility power. Our target customers are those global enterprises requiring "power insurance" because they have zero tolerance for downtime in their mission critical operations. The UPS products we manufacture utilize green technology to create a renewable energy source. These products are highly reliable, are energy and space efficient, and significantly reduce client electricity expenses. As of December 31, 2008, we have shipped more than 2,100 flywheels in UPS system installations, delivering more than 525 megawatts of power to customers in more than 40 countries around the world. We are headquartered in Austin, Texas, with international offices in the U.K., Germany and Japan.

Our primary sales channels in North America have traditionally been through our OEM partners, Caterpillar, Inc. and Eaton Electrical (formerly known as PowerWare). Since 2005, we have developed additional sales channels in North America including direct sales employees and a network of manufacturer's representatives. Direct sales tend to improve our relationships with clients, improve our gross margins and add service and other revenue opportunities. Our direct sales channel contributed 58%, 68% and 59% of our revenues during 2006, 2007 and 2008, respectively. Our primary sales channels in Europe, Middle East and Africa (EMEA) and Asia include selling directly to end users and indirectly through select value added resellers and distributors.

We also provide services including engineering, installation, start-up, monitoring, and repair for our products under contracts with our customers.

Total revenue in 2008 increased 28% from 2007 due to continuing and increased market acceptance of our flywheel-based products, especially our 250-900 kVA product line. We achieved strong growth in both of our primary markets of North America, EMEA and Asia. We believe revenues will continue to grow in 2009 from new product sales as we become more systems focused. In particular, we expect higher sales volume of our megawatt-class UPS products, and of additional variations of our flywheel-based products, including containerized versions such as our PowerHouse product, that we intend to sell in 2009 to industrial manufacturers and IT customers globally. We believe that the investments we made during 2007 and 2008 in our sales organization to increase our level of direct sales staff, particularly in Europe and North America, will contribute to improve sales results in 2009.

Our revenue derived from customers located outside of the United States was $10.5 million, $15.2 million and $16.9 million in 2006, 2007 and 2008, respectively, representing 42%, 45% and 39%, respectively, of our total revenues. During 2008, in an effort to expand the territories in which we sell our Active Power branded products, we continued to increase our direct sales organization and add new distribution arrangements, particularly in EMEA. Revenues in EMEA and Asia increased by 13% in 2008 as a result of these efforts and we anticipate higher sales levels from this region in 2009. In 2007, we also opened a sales office in Japan and began selling directly in the Asia Pacific area. This is still a small part of our total foreign sales, and our revenues in Asia increased by 114%

in 2008 from 2007 levels. Sales of Active Power branded products through our direct sales and manufacturers' representative channels were 58%, 68%, and 59% of our revenue for the years ended December 31, 2006, 2007, and 2008, respectively.

We were able to improve our gross profit in 2008 and for the third consecutive year report a positive gross margin. Our gross profit margin in 2008 was 19%, which represents an improvement from the 10% we achieved in 2007 and the 3% we achieved in 2006. During 2008 we recorded an impairment charge for CoolAir inventory of $1.5 million, which represented approximately 3% of our revenue. During our fourth quarter of 2008 we recorded a gross profit margin of 32%, which was our highest to date. This improvement was due primarily to higher sales volumes, higher direct sales and higher product pricing. Direct sales typically generate higher margins for us than sales that are made through our distribution channels.

Our operating losses were $22.9 million, $21.4 million and $14.1 million in 2006, 2007 and 2008, respectively. Excluding the CoolAir related inventory impairment charges of $1.5 million and $2.1 million in 2008 and 2007, respectively, we were able to reduce our operating losses by $6.7 million, or 35%, in 2008 after having reduced them 28% in 2007 from 2006. This is primarily due to the gross margin improvements offset slightly by higher sales and marketing expenses due to the increase in our sales organization and lower operating expenses in development and administration. Non-cash stock based compensation expense included in the operating losses was $3.1 million, $2.1 million and $1.7 million in 2006, 2007 and 2008, respectively.

Net cash used in operations increased slightly in 2008 to $11.8 million, compared to $10.4 million in 2007, despite the lower operating losses. This was primarily due to the additional investments that we made in working capital to finance the continued growth of the business, particularly in higher receivables and lower deferred revenues. We were able to offset this use of cash by lowering our levels of inventory and increasing payables. We also drew down $2.0 million against our bank revolving line of credit facility during 2008 to help finance these working capital requirements. We have a history of operating losses and have not yet reached operating profitability. We believe that the success of our flywheel products and our new product developments combined with our focus on direct sales and solution selling to customers will help us to reduce our level of operating losses and the amount of cash that we consume in our operations. This is exemplified by the improvement in net cash used in operations in the second half of 2008, which was $3.7 million, compared to $8.1 million in the first half of 2008. This improvement was driven by higher sales volume and lower operating losses. However, we do expect to continue to incur operating losses for at least the next several quarters and for 2009. This will continue to consume our cash and investments. Our total cash and investments at December 31, 2008 were $11.2 million, compared to $22.5 million at December 31, 2007. Due to the improvements in our operations in the second half of 2008 we believe that our cash and investments are sufficient to meet our operational needs for at least the next twelve months.

Critical Accounting Policies and Estimates

We consider an accounting policy to be critical if:

- the accounting estimate requires us to make assumptions about matters that are highly uncertain or require the use of judgment at the time we make that estimate; and
- changes in the estimate that are reasonably likely to occur from period to period, or use of different estimates that we could have reasonably used instead in the current period, would have a material impact on our financial condition or results of operations.

Management has reviewed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors, and the Audit Committee has reviewed these disclosures. In addition, there are other items within our financial statements that require estimation, but are not deemed critical as defined above. Changes in these and other items could still have a material impact upon our financial statements.

Allowance for Doubtful Accounts

Trade receivables are recorded at the stated amount, less an allowance for doubtful accounts. The allowance represents estimated uncollectible receivables associated with potential customer defaults on contractual obligations, usually due to the customer's potential insolvency. The allowance includes amounts for certain customers where a risk of default has been specifically identified. In addition, the allowance includes a provision for customer defaults on a general formula basis when it is determined the risk of some default is probable and estimable, but cannot yet be associated with certain customers. The assessment of the likelihood of customer defaults is based on various factors, including the length of time the receivables are past due, risks unique to particular geographic regions, historical experience and existing economic conditions. Historically, a large portion of our sales have been made through OEM channels to a few large customers, and so our credit losses have been minimal. As we integrate additional distribution channels into our business and increase our direct sales to more and smaller customers, the risk of credit loss may increase.

Inventories

Inventories are priced at the lower of cost (using the first-in, first-out method) or market. We estimate inventory reserves on a quarterly basis and record reserves for obsolescence or slow-moving inventory based on assumptions about future demand and marketability of products, the impact of new product introductions, inventory turns and specific identification of items, such as product discontinuance, damaged goods or engineering/material changes.

Accrued Warranty Liability

The estimated warranty liability costs are accrued for each of our products at the time of sale. Our estimates are principally based on assumptions regarding the lifetime warranty costs of each product, including where little or no claims experience may exist. Due to the uncertainty and potential volatility of these estimates, changes in our assumptions could have a material effect on our reported operating results. Our estimate of warranty liability is reevaluated on a quarterly basis. Experience has shown that initial data for a new product can be very volatile due to factors such as product failure rates, material usage and service delivery costs in correcting product failures; therefore our process relies upon long-term historical averages until sufficient data is available. As actual experience becomes available, it is used to modify the historical averages to ensure that the forecast is within the range of likely outcomes. The resulting balances are then compared to current spending rates to ensure that the accruals are adequate to meet expected future obligations.

Revenue Recognition

In general, revenue for product sales is recognized when title has transferred to the customer as stipulated by the delivery terms in a sales contract. In addition, prior to revenue recognition we require persuasive written evidence of the arrangement, a fixed or determinable price, and a determination that collectibility is reasonably assured.

We also offer various services to customers depending on the type of product the customer has purchased, which may include on-site services or installation and integration services. Such services are not essential to the functionality of the delivered product. Revenue for services is recognized at the time services are provided. When products and services are contracted under a single arrangement, we allocate the total sales price to the multiple deliverables based on their relative fair values. The fair value of our equipment is based on our average historical selling prices, while the fair value of services is based upon the rates that we charge customers in separately negotiated transactions or based on the market price an independent third party would charge to provide these services. Revenue associated with the sale of extended warranties is recognized ratably over the contract period.

Stock-based Compensation

Beginning in 2006 we adopted SFAS No. 123(R), *Accounting for Stock-Based Compensation*, using the modified prospective application method and began accounting for our stock-based compensation using a fair-value based recognition method. Under the provisions of SFAS No. 123(R), stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as an expense ratably over the requisite service period of the award. Determining the appropriate fair-value model and calculating the fair value of stock-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates. We develop our estimates based on historical data and market information that can change significantly over time. A small change in estimates used can have a relatively large change in the estimated valuation.

We use the Black-Scholes option valuation model to value employee stock awards. We estimate stock price volatility based upon our historical volatility. Estimated option life and forfeiture rate assumptions are derived from historical data. For stock-based compensation awards with graded vesting that were granted after 2005, we recognize compensation expense using the straight-line amortization method.

Through 2005, we accounted for our stock plans using the intrinsic value method prescribed by APB 25 and related interpretations and provided the required pro forma income and per share data as if a fair value method had been used to account for stock-based compensation.

Results of Operations

Comparison of 2008 to 2007

Product revenue

Product revenue primarily consists of sales of our CleanSource power quality products, comprising both UPS and DC product lines, and sales of Continuous Power Systems (CPS) which are comprised of our UPS systems and some combination of third party ancillary equipment, such as engine generators and switchgear. The CPS products may be sold in a containerized solution or as separate equipment. Product revenue also includes sales of our CoolAir DC product and CoolAir UPS products. The following table summarizes for the periods indicated, a year-over-year comparison of our product revenue (in thousands):

Year	Annual Amount	Change from Prior Year	Percent Change
2008	$ 35,772	$ 6,937	24%
2007	28,835	6,451	29%
2006	22,384	—	—

Product revenue represented 86% and 83% of total revenue for 2007 and 2008, respectively. The increase in product revenue from 2007 was due to $4.7 million in increased sales of our 250-900 kVA product line, $3.3 million in increased sales of our megawatt-class product line, as well as $1.0 million in increased sales of ancillary equipment that we sold to customers along with our UPS products. These increases were offset by a decrease in sales of our DC product line, 65-150 kVA product line and CoolAir product line, of $0.9 million, $0.5 million and $0.4 million, respectively, from 2007. The decrease in sales of those product lines was the result of decreased emphasis and channel development of the DC product line compared to our UPS products and a decreased emphasis on sales in the other product lines as we have concentrated on our UPS sales. In 2008, we sold 363 flywheel product units, a 24% increase over the 292 units that we sold in 2007. The average sales price per flywheel increased by 5% to approximately $80,000 in 2008 from approximately $76,000 in 2007. The increase in average selling price is due to price increases, the product mix and proportionately more wheels sold through our direct sales channel. Our direct sales channel typically has higher sales prices and profit margins compared to our OEM channel as we do not have to offer channel discounts on our direct sales. We expect this trend in mix and average selling price to continue.

The frequency and timing of our larger system sales, including megawatt-class UPS products and our containerized products, is more volatile and can result in material changes in period-to-period revenue. Such revenues also can occur in periods other than when originally anticipated, which can add to the potential volatility and affect our ability to meet forecasted targets. Larger system sales may also involve higher amounts of ancillary products upon which we typically generate lower profits when compared to sale of our UPS products only. Therefore, a significant increase in product revenues that was caused by higher sales of ancillary products may not result in a commensurate increase in our gross or operating profit levels.

North America sales were 61% of our total revenue for 2008, compared to 55% for 2007. We continued to expand the sales territories where we sell our Active Power branded products in 2008, as we increased our sales distribution capabilities, particularly in Europe and Asia. We also increased the size of our sales and service organization in the U.K. and Europe. We anticipate higher revenues from these locations in 2009 as a result.

Sales to Caterpillar represented 40% of our revenue in 2008 as compared to 31% of our revenue in 2007 and Caterpillar remains our largest single customer as well as our largest OEM customer. Our revenue from Caterpillar increased by 64% in 2008. This increase was driven by a number of large sales of our megawatt class UPS products through this channel. We expect further growth in sales to Caterpillar in 2009 as they enjoy success with their large engine generators, particularly in the megawatt and larger power applications. We also have seen and anticipate a further increase in capital spending in datacenters where there is a requirement for higher-density power solutions such as flywheels. We believe that we may be able to capitalize on this trend.

Our products perform well in harsh environments where power quality or reliability is particularly poor, which makes them a good fit for countries with a poor power infrastructure or in harsh manufacturing or process environments, or situations where reliability is paramount, such as mission-critical business applications. Therefore we have traditionally focused our direct sales efforts to these types of customer situations. Due to the large size of some of our customer orders relative to our current total revenue levels, our quarterly total revenue trend and the proportion of sales made directly by us can be expected to fluctuate.

Service and other revenue

Service and other revenue primarily relates to revenue generated from both traditional (after-market) service work and from customer-specific system engineering. This includes revenue from design, installation, startup, repairs or reconfigurations of our products and the sale of spare or replacement parts to our OEM and end-user customers. It also includes revenue associated with the costs of travel of our service personnel and revenues or fees received upon contract deferment or cancellation. The following table summarizes for the periods indicated a year-over-year comparison of our service and other revenue (in thousands):

Year	Annual Amount	Change from Prior Year	Percent Change
2008	$ 7,213	$ 2,447	51%
2007	4,766	2,121	80%
2006	2,645	—	—

The increase in our installed base of customers, particularly those arising from direct sales made by us, is driving the trend of higher service and spares revenue. Our service and other revenue in 2008 was also helped by our improved level of direct sales and large multi-megawatt sales that affords us the ability to generate higher startup service revenues. We also recorded $0.4 million of fees related to contract cancellation in 2008 by one customer. We anticipate that service and other revenue will continue to grow as our product revenue increases and as our installed base of product expands because as more units are sold to customers, more installation, startup and maintenance services will be required. Where sales are made through an OEM channel, our OEM partner would typically provide these services to their end-user customers. Thus, increasing direct sales gives us a greater opportunity to grow our service and other revenue.

Cost of product revenue

Cost of product revenue includes the cost of component parts of our products, ancillary equipment that is sourced from external suppliers, personnel, equipment, -and other costs associated with our assembly and test operations, including costs from having underutilized facilities, depreciation of our manufacturing property and equipment, shipping costs, warranty costs, and the costs of manufacturing support functions such as logistics and quality assurance. The following table summarizes for the periods indicated, a year-over-year comparison of our cost of product revenue (in thousands):

Year	Annual Amount	Change from Prior Year	Percent Change	Gross Margin
2008	$ 29,380	$ 2,978	11%	18%
2007	26,402	4,463	20%	8%
2006	21,939	—	—	3%

The 11% increase in cost of product revenue was driven by the 24% increase in product revenues that we experienced in 2008. The cost of product revenue did not increase at the same rate as product revenue, as we had lower product costs reflecting the results of product cost reduction programs we have implemented. The 2007 cost of product revenue also included a $2.1 million charge for excess inventory and impairment of manufacturing assets related to our CoolAir product family that was based on the then-current assessment of product demand for CoolAir. In September 2008, we recorded an additional reserve of $1.5 million against the CoolAir inventory as a result of our further diminished expectations of future product demand that potentially would result in excess quantities of CoolAir inventory. Net of current product sales backlog and future spares and support requirements, the CoolAir inventory value was reduced to its salvageable value.

We have been able to improve our gross product margins by increasing the average selling price of our products that we sell as well as by lowering our product cost. As a result, our product revenue increased more than the increase in the cost of product revenue. This has been part of our strategy to improve the profitability of individual transactions and the profitability of the company as a whole. We believe that as our direct sales and our total revenues continue to increase, our product margins will improve. In 2008, we increased sales of higher margin product options and features with the UPS systems we sold, which lead to a further increase in our average selling price.

We have also continued to improve the efficiency and utilization of our manufacturing facility, which has a large portion of fixed costs. We incur approximately $4.7 million per year in fixed costs for our manufacturing facility that has a capacity in excess of our current business requirements. We expense the excess costs of the underutilization of this facility as part of our cost of product revenues. We now produce more goods with less overhead than in previous years. Some of this efficiency is driven by higher product volumes that allow for better utilization of our test facility and our manufacturing space. We also have ongoing programs within our engineering and manufacturing departments to lower product costs, to identify alternative and cheaper vendors if possible, to reduce our absolute level of overhead spending and headcount, and to improve the manufacturability of our products. During 2008 these efforts have helped reduce our cost of product revenue in spite of the pressures of higher raw material and commodity price increases. For 2009 we anticipate further cost reductions from these ongoing programs.

Cost of service and other revenue

Cost of service and other revenue includes the cost of component parts that we use in service or sell as spare parts to customers, as well as the labor and overhead costs of our service organization, including travel and related costs incurred in fulfilling our service obligations to our customers. The following table summarizes for the periods indicated a year-over-year comparison of our cost of service and other revenue (in thousands):

Year	Annual Amount	Change from Prior Year	Percent Change	Gross Margin
2008	$ 5,617	$ 1,644	41%	22%
2007	3,973	1,569	65%	17%
2006	2,404	—	—	9%

The increase of 41% in the cost of service and other revenue in 2008 is driven by the 51% increase in service and other revenue. The increase also reflects the higher headcount and related expenses that we put in place during the year to expand our service capabilities around the world. As our direct sales organization has expanded we have added service and technical personnel, including in many foreign markets, in order to support our selling efforts and to meet our customer responsibilities. Balancing our labor requirements to our customer needs will continue to be a business challenge for our service organization in 2009, as we seek to ensure that we do not incur additional fixed labor costs in advance of anticipated service revenues. Achieving the efficient utilization of our service labor will be key to profitably growing this area of our business. Many of the costs of the service organization are fixed in nature, and higher volume of installation, startup and service work is resulting in improved efficiency and operating results for this group. We expect this trend to continue in 2009.

Research and development

Research and development expense primarily consists of compensation and related costs of employees engaged in research, development and engineering activities, third party consulting and development activities, as well as an allocated portion of our occupancy costs. The following table summarizes for the periods indicated, a year-over-year comparison of our research and development expense (in thousands):

Year	Annual Amount	Change from Prior Year	Percent Change
2008	$ 5,116	$ (633)	(11)%
2007	5,749	(2,102)	(27)%
2006	7,851	—	—

Our research and development efforts in 2008 were largely focused on new configurations of our existing flywheel technology under development, as well as enhancements to our megawatt-class UPS products and refinement of our containerized product solutions. The decrease in spending compared to 2007 is primarily a result of lower headcount. The 2008 expense included approximately $0.4 million of stock-based compensation. We believe that research and development expenses will remain at current levels in 2009 although this will represent a smaller percentage of our total revenue, and that the spending will be focused on enhancements and cost reductions to our flywheel products.

Selling and marketing

Selling and marketing expenses primarily comprise compensation and related costs for selling and marketing personnel, and related travel, selling and marketing expenses, as well as an allocated portion of our occupancy costs. The following table summarizes for the periods indicated, a year-over-year comparison of our selling and marketing expense (in thousands):

Year	Annual Amount	Change from Prior Year	Percent Change
2008	$ 11,839	$ 869	8%
2007	10,970	745	7%
2006	10,225	—	—

The increase in selling and marketing expenses in 2008 largely reflects higher variable compensation that was paid to our sales employees on higher revenue levels. Although the total headcount has not changed significantly since 2007, we have changed the composition of our sales organization from supporting OEM partners to supporting more direct selling. We have also increased our marketing department staffing as we concentrate on developing and improving the Active Power brand, and supporting our direct selling activities. The 2008 expense also includes approximately $0.3 million of stock-based compensation. We anticipate that selling and marketing expenses will continue to increase in 2009 but reduce as a percentage of revenues as we expand our direct sales force into new geographies and due to higher variable compensation as our revenues continue to increase.

General and administrative

General and administrative expense is primarily comprised of compensation and related costs for executive and administrative personnel, professional fees, taxes, and the allowance for doubtful accounts expense. The following table summarizes for the periods indicated, a year-over-year comparison of our selling, general and administrative expense (in thousands):

Year	Annual Amount	Change from Prior Year	Percent Change
2008	$ 5,119	$ (2,741)	(35)%
2007	7,860	610	8%
2006	7,250	—	—

The decrease in general and administrative expense from 2007 to 2008 was primarily attributable to the absence of $2.9 million in expenses incurred in 2007 related to an investigation into our historical stock option granting procedures that resulted in restatement of prior year financials. We are currently in the process of negotiating to settle outstanding tax matters resulting from the option investigation with the Internal Revenue Service and do not anticipate any further expenses from this investigation. We anticipate that the level of general and administrative expenses in 2009 should remain at similar absolute levels to those in 2008.

Interest income

The following table summarizes the yearly changes in our interest income (in thousands):

Year	Annual Amount	Change from Prior Year	Percent Change
2008	$ 348	$ (425)	(55)%
2007	773	(614)	(44)%
2006	1,387	—	—

The decrease in interest income from 2007 to 2008 is primarily attributable to the decrease in the amount of available funds that we had for investment as our operating losses decreased our cash reserves and to the decline in interest rates during 2008. During the year, as part of our investment strategy, we moved more investments into short-term instruments in reaction to the declining interest rate environment. We expect interest income to fluctuate depending on cash and investment balances and trends in interest rates.

Income tax expense

Due to operating losses, we have not recorded any income tax expenses, other than minimum or statutory costs. As of December 31, 2008, our accumulated net operating loss carryforward was $205.3 million and our research and development credit carryforwards were $3.1 million. We anticipate that these loss carryforward amounts may offset future taxable income that we may achieve and future tax liabilities. However, because of uncertainty regarding our ability to use these carryforwards and the potential limitations due to ownership changes, we have established a valuation allowance for the full amount of our net deferred tax assets.

Comparison of 2007 to 2006

Product revenue

Product revenue represented 89% and 86% of total revenue for 2006 and 2007, respectively. The increase in product revenue from 2006 was due to $4.2 million in increased sales of our 250-900 kVA product lines, as well as $3.8 million in increased sales of ancillary equipment that we sold along with our UPS products and $0.9 million from increased CoolAir sales. This was offset by a decrease in sales of our 1200 kVA products of $2.2 million from 2006. In 2007, we sold 292 flywheel product units, a 5% decrease over the 308 units that we sold in 2006. This decrease in volume was offset by an increase in average sales price per 250 kVA flywheel by 13% to approximately $76,000 in 2007 from approximately $67,000 in 2006. The increase in average selling price was due to price increases and proportionately more wheels sold through our direct sales channel.

North America sales were 55% of our total revenue for 2007 compared to 58% for 2006. We continued to expand the sales territories in which our Active Power branded products are sold in 2007 as we increased our direct sales organization, particularly in Europe and Asia. We opened new offices in Japan during the year as part of this effort. We also increased the size of our sales and service organization in the U.K. and Europe. Caterpillar represented 31% of our revenues in 2007 as compared to 35% of our revenue in 2006 and remains our largest single customer as well as our largest OEM customer. Our revenue from Caterpillar increased by 20% in 2007, however this increase was smaller than the 56% increase in our direct business in 2007 compared to 2006. As a result, Caterpillar represented a smaller portion of our total revenue in 2007.

In 2006, we began to offer our CoolAir DC product for commercial sale. Sales of this new technology reached $1.0 million in 2007.

Service and other revenue

The increase in our installed base of customers from 2006 to 2007, particularly those arising from direct sales made by us, contributed to higher service and other revenue in 2007. Our service and other revenue in 2007 was also helped by our improved level of direct sales and large multi-megawatt sales that affords us the ability to generate higher startup service revenues.

Cost of product revenue

The 20% increase in cost of product revenue in 2007 was driven by the 29% increase in product revenues that we experienced in 2007. During the fourth quarter of 2007, we evaluated our level of CoolAir inventory compared to our historic and projected product demand and in light of planned future development efforts for the TACAS technology as we migrate a DC-only product into a more compelling customer solution with increased capability and marketability. As a result of this review we reserved $1.8 million for excess inventory charges and recorded a $0.3 million impairment charge against specific CoolAir manufacturing assets.

Our gross product margins improved in 2007 when compared to 2006 as a result of increases in the average selling price of our products that we sell. As a result, our product revenue increased more than the increase in the cost of product revenue. This has been part of our strategy to improve the profitability of individual transactions and the profitability of the company as a whole. We achieved a positive gross margin for the Company for the first time in 2006, and with higher product volume and higher product pricing in 2007, we were able to improve our positive gross margin in 2007 to 10%. In 2007, we increased sales of higher margin product options and features with the UPS systems we sold, which lead to a further increase in our average selling price.

We have also continued to improve the efficiency and utilization of our manufacturing facility, which has a large portion of fixed costs. These benefits have been mitigated during 2007 by higher raw material and commodity price increases, but have allowed us to maintain prices despite the higher incoming costs of materials.

Cost of service and other revenue

The increase of 65% in the cost of service and other revenue in 2007 is driven by the 80% increase in service and other revenue. The increase also reflects the higher headcount and related expenses that we put in place during the year to expand our service capabilities around the world. As our direct sales organization has expanded we have added service and technical personnel, including in many foreign markets, in order to support our selling efforts and to meet our customer responsibilities. This increase in costs compares to the 80% increase in service and other revenue that we achieved in 2007.

Research and development

Our research and development efforts in 2007 were largely focused on new configurations of our existing flywheel technology under development, as well as enhancements to our megawatt-class UPS products. The decrease in spending compared to 2006 is a result of significantly lower prototype expenses with the CoolAir product development as it neared production, and from lower salary expenses following a reduction in headcount that we made in the third quarter of 2006. This 2007 research and development expense included approximately $581,000 of stock-based compensation.

Selling and marketing

The increase in selling and marketing expenses in 2007 reflects the higher headcount and related costs as we have expanded our direct sales force in EMEA and North America and from higher variable compensation as our total revenues increase. Although the total headcount has not changed significantly, we have changed the composition of our sales organization from supporting OEM partners to one supporting more direct selling during 2007. We have also increased our marketing department staffing as we concentrate on improving the Active Power brand, and supporting our direct selling activities. The 2007 expense also includes approximately $0.4 million of stock-based compensation.

General and administrative

The increase in general and administrative expense from 2006 to 2007 was primarily attributable to $2.9 million in expenses related to an investigation into our historical stock option granting procedures that resulted in restatement of prior year financial statements. Absent these expenses, our general and administrative expenses would have been 32% lower than 2006, reflecting our efforts to control costs and headcount and the resolution of our prior legal issues resulting in lower legal expenses.

Litigation (settlement) expense

In November 2006, we reached a settlement of the litigation with Greenwich Insurance Company whereby Greenwich agreed to pay us $3.0 million in exchange for a full settlement of this case. Accordingly, after $1.2 million was paid to our former Chairman and CEO, pursuant to the reimbursement agreement, we received gross proceeds of $1.8 million.

Interest income

The decrease in interest income from 2006 to 2007 is primarily attributable to the decrease in the amount of available funds that we had for investment as our operating losses decreased our cash reserves. During the year, as part of our investment strategy, we moved more investments into short-term instruments in reaction to the declining interest rate environment.

Income tax expense

Due to operating losses, we have not recorded any income tax expenses, other than minimum or statutory costs.

Liquidity and Capital Resources

Our primary sources of liquidity at December 31, 2008 are our cash and investments on hand, our bank credit facilities and projected cash flows from operating activities. If we meet our cash flow projections in our current business plan, we expect that we will not require additional financing in order to continue operating and growing our business during 2009. Our business plan and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, there are scenarios in which our revenues may not meet our projections or our costs may exceed our estimates. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in 2009 or significantly affect our level of liquidity, which may require us to seek additional financing or take other measures to reduce our operating costs in order to continue operating. Our cash and investments at December 31, 2008 totaled $11.2 million.

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

In October 2007, we entered into a Loan and Security Agreement (the “Loan Agreement”) with Silicon Valley Bank (“SVB”). The Loan Agreement provides for a secured revolving line of credit in an amount of up to $5.0 million, subject to a borrowing base formula. In 2008 we modified the Loan Agreement to provide for a U.S. export-import credit facility that would add a U.S. government guarantee to the payments for these foreign shipments and make more of our foreign shipments eligible as security for the credit facility. Prior to this modification, export revenues were not eligible to be included as part of the borrowing base, which may have limited our ability to utilize the revolving credit facility. All amounts borrowed under this facility are subject to a borrowing base formula based on eligible receivables and inventory. During the year ended December 31, 2008, we borrowed $2.0 million under this credit facility and this balance remained outstanding at December 31, 2008. Based on the borrowing base formula, we had an additional $1.9 million available for use at December 31, 2008 under this credit facility.

The Loan Agreement requires us to maintain a minimum liquidity ratio of unrestricted cash to the outstanding amounts under the Loan Agreement of at least 1.35 to 1. In addition, the Loan Agreement contains customary affirmative covenants, including covenants that require, among other things, the delivery of financial statements, compliance with laws, the maintenance of insurance and the protection and registration of intellectual property rights. Further, the Loan Agreement contains customary negative covenants, including covenants that limit or restrict our ability to, among other things, dispose of assets, change our business, change our CEO or CFO, make acquisitions, be acquired, incur indebtedness, grant liens, make investments, make distributions, repurchase stock, and enter into certain transactions with our affiliates, in each case subject to customary exceptions for a credit facility of this size and type.

Revolving loans under this credit facility may be borrowed, repaid and re-borrowed until October 5, 2010, at which time all amounts borrowed must be repaid and all outstanding letters of credit must be cash collateralized. Revolving loans bear interest at a floating per annum rate equal to the greater of SVB’s prime rate plus 0.25% or 5.25% . A default interest rate shall apply during an event of default at a rate per annum equal to 5.0% above the otherwise applicable interest rate. The revolving loans are secured by a first priority lien on substantially all of our assets, provided that such security interest is limited to no more than 65% of the outstanding capital stock held by us of each of our subsidiaries.

Significant uses of cash

Operating Activities

The following table summarizes the yearly changes in cash used in operating activities (in thousands):

Year	Annual Amount	Change from Prior Year	Percent Change
2008	$ (11,832)	$ 1,409	14%
2007	(10,423)	(11,892)	(53)%
2006	(22,315)	—	—

Cash used in operating activities in 2008 was $11.8 million, compared to $10.4 million in 2007, an increase of 14%, or $1.4 million, despite a $7 million reduction in operating loss in 2008. This change in cash used in operating activities was primarily due to changes in operating assets and liabilities, or our working capital, resulting in cash used of $3.4 million in 2008, compared to cash provided of $4.7 million in 2007. In 2008, we had a significant increase in receivables of $4.3 million compared to the prior year, attributable to the higher revenues we achieved in 2008, with an increase in our fourth quarter sales of 59% compared to the fourth quarter of 2007. Receivables at December 31, 2008 were 83% higher than at the end of 2007. We were able to offset this increase in higher receivables with a $1 million decrease in our inventory in 2008, as we shipped more products at the end of the year and were more efficient in our manufacturing operations. Our deferred revenue (customer deposits and advance payments) balance decreased by $0.2 million as compared to 2007. We have not had any material change in the payment cycles for our payables or for our collections in 2008 despite a challenging external environment but will be monitoring this closely in 2009. We do continue to request deposits and periodic payments from large customers where commercially possible, particularly for projects with multiple deliverables. However, the amount of such advance payments can fluctuate significantly on a quarterly basis, depending on the size and scope of customer orders at any point in time. Having now grown our quarterly revenues to over $16 million in the fourth quarter of 2008, we anticipate cash used in operating activities for 2009 will decrease from the level in 2008. Having made the necessary investments in inventory and receivables, we believe that we can fund further increases in revenues without having to make significantly more investments in funding working capital. Net cash used in operations decreased from $8.1 million in the first half of 2008 to $3.7 million in the second half of 2008. This marked improvement was the result of an increase in sales volume. This was after consuming $8.1 million in net cash used in operations in the first half of 2008 on lower sales volume. We also anticipate further reductions in operating losses in 2009 which will also alleviate and reduce the cash that we use in operations.

We used $10.4 million of cash in funding our operating activities during 2007, which was $11.9 million, or 53%, lower than the $22.3 million used in 2006. This decrease was primarily attributable to lower operating losses, non-cash impairment charges expensed in 2008, lower levels of stock-based compensation, and better working capital management as reflected in a decrease in outstanding accounts receivable, and higher deferred revenue from maintenance contracts and customer deposits. These were partially offset by decreases in accounts payable as we paid for the expenses of our historical stock option review and higher inventory levels.

Investing Activities

Investing activities primarily consist of sales and purchases of investments and purchases of property and equipment. Fluctuations in the sale and purchase of investments generally reflect our use of these investment funds to finance our ongoing operations. Overall, the cash provided from investing activities remained at $5.4 million in 2008, the same level as in 2007. Capital expenditures were approximately $0.9 million in both 2008 and 2007, increasing less than $0.1 million in 2008 as compared to 2007. This increase was primarily due to investments in our infrastructure to support increased growth, including the upgrade of our current ERP system and equipment for demonstration and sales offices globally.

Financing Activities

Funds provided by financing activities during 2008 were $2.0 million, which reflects the amount that we borrowed from SVB in 2008 under our revolving credit facility. The funds from financing activities in 2007 of $13.1 million reflected the net proceeds we received from a private placement of our common stock in August 2007. We have not sold any equity securities since that transaction. We do not anticipate any new financing from the sale of equities at this time. We are considering further borrowings, including an equipment financing facility, for 2009 to help finance certain property and equipment purchases that are planned for 2009, but we have not yet entered into any borrowing arrangements. To the extent possible, we may further draw down on our credit facility during 2009 to preserve our cash and investments.

Table of Contents

Contractual Commitments

In our day-to-day operations, we incur commitments to make future payments for goods and services. These arise from entering into operating leases and as we make commitments to vendors to provide us materials and services. The following table summarizes our significant contractual obligations and commitments at December 31, 2008 (in thousands):

	2009	2010	2011	2012	2013 and thereafter
Operating lease obligations	$1,383	$304	$ 98	$ 70	$ 322
Purchase obligations	4,687	—	—	—	—
Other long-term obligations	25	25	25	25	125

Our principal lease commitments consist of our lease for our corporate headquarters and engineering facilities and our global sales offices.

In 2007, we entered into a secured revolving line of credit facility of up to $5 million, subject to a borrowing base formula, with SVB. There was $2.0 million and $0 outstanding under this facility at December 31, 2008 and 2007, respectively.

Future uses of cash

We believe that our cash and investments on hand will be sufficient to fund our operations for at least the next twelve months We have prepared multiple scenarios for anticipated revenues in 2009, both favorable and unfavorable, to reflect a high level of uncertainty about the future macroeconomic environment in which we operate our business. Our sales cycle is such that we have visibility 2-3 quarters in advance into future orders that allows us to predict revenues over this period of time with some degree of confidence. This window also provides us with some opportunity to adjust expenditures or take other measures to reduce our cash consumption if we can see and anticipate a shortfall in revenues. Based on the different scenarios we modeled for 2009, we believe that we can continue to manage operations and manage our working capital with the cash and investments that we have on hand as at December 31, 2008 without the need for a further capital raise.

We expect the level of capital investments to remain similar in 2009 to those in 2008. We currently intend to invest in several PowerHouse systems to use for demonstration purposes in the U.S. and in the U.K. to help our sales efforts, but are not planning any other major capital investments. We still have outstanding liabilities for tax obligations from the stock option investigation that we expensed in 2007 but that will be paid in 2009.

Beyond the next twelve months, our cash requirements will depend on many factors, including the rate of sales growth, the market acceptance of our products, the gross profit we are able to generate with our sales, the timing and level of development funding, the rate of expansion of our sales and marketing activities, the rate of expansion of our manufacturing processes, and the timing and extent of research and development projects. Although we are not a party to any agreement or letter of intent with respect to a potential acquisition or merger, we may enter into acquisitions or strategic arrangements in the future, which could also require us to seek additional equity or debt financing.

Other factors that may affect liquidity

As noted above, we believe our existing cash and investments balances at December 31, 2008 will be sufficient to meet our cash requirements through at least the next 12 months. Beyond the next 12 months, our cash requirements will depend on many factors, including the rate of sales growth, the success of our direct selling strategy, the continued market acceptance of our products, including in particular the PowerHouse product family, the timing and level of development funding, the rate of expansion of our sales and marketing activities, the efficiency of our manufacturing processes, and the timing and extent of research and development projects. Should additional funding be required, we may need to raise the required funds through borrowings or public or private sales of debt or equity securities. If we raise additional funds through the issuance of debt or equity securities, the percentage ownership of our stockholders could be significantly diluted. If we obtain additional debt financing, a substantial portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, and the terms of the debt securities issued could impose significant restrictions on our operations. We do not know whether we will be able to secure additional funding, or funding on terms acceptable to us, to continue our operations as planned. If financing is not available, we may be required to reduce, delay or eliminate certain activities or to license or sell to others some of our proprietary technology.

Off-Balance Sheet Arrangements

During the years ended December 31, 2006, 2007 and 2008, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

New Accounting Pronouncements

In September 2006, the FASB issued SFAS 157, Fair Value Measurements. This standard defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States, and expands disclosure about fair value measurements. This pronouncement applies under other accounting standards that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurement. This statement is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. However, SFAS 157 is amended by FSP FAS 157-1, Application of FASB Statement 157 to FASB Statement 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13, which excludes from the scope of this provision arrangements accounted for under SFAS 13, Accounting for Leases. SFAS 157 is also amended by FSP FAS 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). This FSP partially defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. In October 2008, SFAS 157 was amended again by FSP 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active, which clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The FSP is effective upon issuance, including prior periods for which financial statements have not been issued. We adopted SFAS 157 on January 1, 2008, except as it applies to those nonfinancial assets and nonfinancial liabilities as noted in FSP FAS 157-2. The partial adoption of SFAS 157 did not have a material impact on our consolidated financial position or results of operations. We also adopted FSP 157-3 on September 30, 2008 as required and concluded it did not have a significant impact on our consolidated financial position or results of operations.

In February 2007, the FASB issued FAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115” (FAS 159). FAS 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. FAS 159 is effective for fiscal years beginning after November 15, 2007. The implementation of this standard did not have a material impact on our consolidated financial position and results of operations.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141R (revised 2007), Business Combinations, or SFAS 141(R), which establishes the acquisition method to account for business combinations. SFAS 141(R) requires the acquiring entity to recognize all of the assets acquired and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. These rules will be effective for transactions closing after January 1, 2009.

ITEM 9A. Controls and Procedures.

Effectiveness of Disclosure Controls and Procedures.

Our Chief Executive Officer and our Chief Financial Officer, based on the evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, have concluded that, as of December 31, 2008, our disclosure controls and procedures were effective to ensure that the information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934, as amended, (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management's Report on Internal Control over Financial Reporting.

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act rules 13a-15(f) and 15d-15(f). Internal control over financial reporting is a process, designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and effected by our Board, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting, and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the authorizations of our management and directors; and (3) provide reasonable assurance regarding prevention of timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria set forth in Internal Control – Integrated Framework issued by COSO. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Based on our assessment, management concluded that, as of December 31, 2008, the Company's internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Our independent registered public accounting firm, Ernst & Young LLP, audited our consolidated financial statements, and independently assessed the effectiveness of our internal control over financial reporting. Ernst & Young LLP has issued their report, which is included in Part IV of the previously filed Form 10-K.

Changes in Internal Control over Financial Reporting.

There have been no changes in our internal control over financial reporting during the quarter ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Forward looking statements regarding the effectiveness of internal controls during future periods are subject to the risk that controls may become inadequate because of change in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

PART IV.

ITEM 15. Exhibits and Financial Statement Schedules.

(a)

1. *Financial Statements*.

The following financial statements of Active Power, Inc. were filed as a part of the original Annual Report on Form 10-K for the fiscal year ending December 31, 2008, that was filed with the Securities and Exchange Commission on March 3, 2009:

2. *Schedules*.

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

3. *Exhibits*.

The exhibits listed on the accompanying index to exhibits immediately following the financial statements are filed herewith, or are incorporated by reference as indicated below.

(b) Exhibits

Exhibit Number	Description
3.1*	Amended and Restated Certificate of Incorporation (filed as Exhibit 3.1 to Active Power’s IPO Registration Statement on Form S-l (SEC File No. 333-36946) (the “IPO Registration Statement”))
3.2*	Second Amended and Restated Bylaws (filed as Exhibit 3.2 to Active Power’s Current Report on Form 8-K filed on February 2, 2007)
4.1*	Specimen certificate for shares of Common Stock (filed as Exhibit 4.1 to the IPO Registration Statement)
4.2*	Rights Agreement, dated as of December 13, 2001, between the Active Power and EquiServe Trust N.A., which includes the form of Certificate of Designation for the Series A Junior Participating Preferred Stock as Exhibit A, the form of Rights Certificate as Exhibit B and the Summary of Rights to Purchase Series A Preferred Stock as Exhibit C (filed as Exhibit 4.1 to Active Power’s Current Report on Form 8-K filed on December 14, 2001)
4.3	See Exhibits 3.1 and 3.2 for provisions of the Certificate of Incorporation and Bylaws of the registrant defining the rights of holders of common stock
10.1*	Form of Indemnity Agreement (filed as Exhibit 10.1 to the IPO Registration Statement)
10.2*	Active Power, Inc. 2000 Stock Incentive Plan (filed as Exhibit 10.2 to the IPO Registration Statement) †

Table of Contents

Exhibit Number	Description
10.3*	Second Amended and Restated Investors' Rights Agreement by and between Active Power, Inc. and certain of its stockholders (filed as Exhibit 10.4 to the IPO Registration Statement)
10.4*	Lease Agreement by and between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.9 to the IPO Registration Statement)
10.5*	First Amendment to Lease Agreement by and between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.10 to the IPO Registration Statement)
10.6*	Second Amendment to Lease Agreement by and between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.11 to the IPO Registration Statement)
10.7*	Third Amendment to Lease Agreement by and between Active Power, Inc. and Braker Phase III, Ltd. (filed as Exhibit 10.12 to the IPO Registration Statement)
10.8*	Fourth Amendment to Lease Agreement by and between Active Power, Inc. and Metropolitan Life Insurance Company (filed as Exhibit 10.13 to the IPO Registration Statement)
10.9*	Fifth Amendment to Lease Agreement by and between Active Power, Inc. and Metropolitan Life Insurance Company (filed as Exhibit 10.14 to the IPO Registration Statement)
10.10*	Sixth Amendment to Lease Agreement by and between Active Power, Inc. and Metropolitan Life Insurance Company (filed as Exhibit 10.18 to Active Power's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 (the "2000 10-K"))
10.11*	Seventh Amendment to Lease Agreement by and between Active Power, Inc. and Metropolitan Life Insurance Company (filed as Exhibit 10.19 to the 2000 10-K)
10.12*	Lease Agreement by and between Active Power, Inc. and BC12 99, Ltd. (filed as Exhibit 10.17 to the 2000 10-K)
10.13*+	Distributor Agreement by and between Active Power, Inc. and Eaton Electical, Inc. dated May 22, 2006 (filed as Exhibit 10.1 to Active Power's Current Report on Form 8-K filed on May 24, 2006)
10.14*+	Purchase and Sale Agreement between Active Power, Inc. and Fuji Electric Co., Ltd. dated July 23, 2003 (filed as Exhibit 10.1 to Active Power's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003)
10.15*	Long-Term Supply Agreement between Active Power, Inc. and GE Zenith Controls, Inc., dated March 16, 2005 (filed as Exhibit 10.1 to Active Power's Current Report on Form 8-K filed on March 21, 2005)
10.16*	Stock Issuance Agreement with Jim Clishem (filed as Exhibit 99.1 to Registrant's Current Report on Form 8-K filed on March 14, 2006) †
10.17*	Stock Issuance Agreement with Jim Clishem (filed as Exhibit 99.2 to Registrant's Current Report on Form 8-K filed on March 14, 2006) †
10.18*	Securities Purchase Agreement dated August 13, 2007 (filed as Exhibit 10.19 to Registrant's Registration Statement on Form S-1 filed on September 12, 2007)
10.19*	Loan and Security Agreement (filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed on October 21, 2007)
10.20*+	Purchase Agreement effective as of January 1, 2008 between Active Power, Inc. and Caterpillar, Inc. (filed as Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008)
10.21*	Form of Change of Control Severance Agreement (filed as Exhibit 10.2 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008) †

Table of Contents

Exhibit Number	Description
10.22**	Severance Benefits Agreement with Jim Clishem dated October 29, 2008 †
10.23**	Severance Benefits Agreement with John Penver dated October 29, 2008 †
21.1**	Subsidiaries of the Registrant
23.1**	Consent of Ernst & Young LLP
24.1**	Power of Attorney, pursuant to which amendments to this Form 10-K may be filed, is included on the signature page contained in Part IV of this Form 10-K
31.1	Certification of Principal Executive Officer as required by Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer as required by Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Principal Executive Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Principal Financial Officer as required by Section 906 of the Sarbanes-Oxley Act of 2002

* Incorporated by reference to the indicated filing.

** Previously filed as part of the original Annual Report on Form 10-K for the fiscal year ending December 31, 2008, that was filed with the Securities and Exchange Commission on March 3, 2009.

\+ Portions of this exhibit have been omitted pursuant to a confidential treatment previously granted.

† Management contract or compensatory plan or arrangement.

Table of Contents

SIGNATURES

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

ACTIVE POWER, INC.

Dated: October 27, 2009

By: /S/ JAMES A. CLISHEM
James A. Clishem
Chief Executive Officer and Director

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

Name	Title	Date
/S/ JAMES A. CLISHEM **James A. Clishem**	Chief Executive Officer and Director (principal executive officer)	October 27, 2009
/S/ JOHN K. PENVER **John K. Penver**	Vice President—Finance, Chief Financial Officer and Secretary (principal financial and accounting officer)	October 27, 2009
* **Benjamin L. Scott**	Chairman of the Board, Director	
* **Ake Almgren**	Director	
* **Richard E. Anderson**	Director	
* **James E. deVenny III**	Director	
* **Jan H. Lindelow**	Director	

* By: /S/ JAMES A. CLISHEM — October 27, 2009
James A. Clishem
Attorney in Fact

Exhibit 31.1

CERTIFICATION
PURSUANT TO 17 CFR 240.13a -14
PROMULGATED UNDER
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James A. Clishem, certify that:

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

Date: October 27, 2009

/S/ JAMES A. CLISHEM

James A. Clishem
President and Chief Executive Officer

CERTIFICATION
PURSUANT TO 17 CFR 240.13a -14
PROMULGATED UNDER
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, John K. Penver, certify that:

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

Date: October 27, 2009

/S/ JOHN K. PENVER

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

Exhibit 32.1

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

In connection with the Annual Report of Active Power, Inc. (the "*Company*") on Form 10-K for the period ending December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "*Report*"), I, James A. Clishem, President and Chief Executive Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 27, 2009

/S/ JAMES A. CLISHEM

James A. Clishem
President and Chief Executive Officer

Exhibit 32.2

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

In connection with the Annual Report of Active Power, Inc. (the "*Company*") on Form 10-K for the period ending December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "*Report*"), I, John K. Penver, Vice President of Finance, Chief Financial Officer and Secretary of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 27, 2009

/S/ JOHN K. PENVER

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