

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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, BK12, Austin, Texas
(Address of principal executive offices)

78758
(Zip Code)

(512) 836-6464

(Registrant's telephone number, including area code)

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

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company)

Smaller Reporting Company

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

The number of shares of common stock, par value of \$0.001 per share, outstanding at October 25, 2010 was 79,750,031.

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PART I – FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements.

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

	<u>September 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	<u>(unaudited)</u>	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,439	\$ 7,489
Accounts receivable, net of allowance for doubtful accounts of \$311 and \$353 at September 30, 2010 and December 31, 2009, respectively	12,657	11,529
Inventories	6,329	6,629
Prepaid expenses and other	625	418
Total current assets	34,050	26,065
Property and equipment, net	1,917	2,903
Deposits and other	422	376
Total assets	<u>\$ 36,389</u>	<u>\$ 29,344</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 4,622	\$ 5,155
Accrued expenses	5,766	4,957
Deferred revenue	1,703	1,713
Revolving line of credit	3,535	2,559
Total current liabilities	15,626	14,384
Long-term liabilities	606	468
Stockholders' equity:		
Common stock	80	66
Treasury stock	(103)	(73)
Additional paid-in capital	274,317	264,554
Accumulated deficit	(253,946)	(249,876)
Other accumulated comprehensive loss	(191)	(179)
Total stockholders' equity	20,157	14,492
Total liabilities and stockholders' equity	<u>\$ 36,389</u>	<u>\$ 29,344</u>

See accompanying notes.

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Active Power, Inc.
Condensed Consolidated Statements of Operations and Comprehensive Loss

(in thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenues:				
Product revenue	\$16,663	\$ 6,947	\$39,356	\$21,863
Service and other revenue	<u>1,793</u>	<u>1,587</u>	<u>6,264</u>	<u>4,444</u>
Total revenue	18,456	8,534	45,620	26,307
Cost of goods sold:				
Cost of product revenue	11,287	5,751	28,323	16,874
Cost of service and other revenue	<u>1,691</u>	<u>901</u>	<u>4,606</u>	<u>2,814</u>
Total cost of goods sold	12,978	6,652	32,929	19,688
Gross profit	5,478	1,882	12,691	6,619
Operating expenses:				
Research and development	833	1,095	2,517	3,254
Selling and marketing	3,539	2,572	10,323	8,562
General and administrative	<u>1,075</u>	<u>1,201</u>	<u>3,825</u>	<u>3,517</u>
Total operating expenses	5,447	4,868	16,665	15,333
Operating profit (loss)	31	(2,986)	(3,974)	(8,714)
Interest expense, net	(30)	(20)	(82)	(48)
Other income (expense), net	<u>13</u>	<u>46</u>	<u>(55)</u>	<u>(31)</u>
Income (loss) before income taxes	14	(2,960)	(4,111)	(8,793)
Income tax benefit	<u>41</u>	<u>—</u>	<u>41</u>	<u>—</u>
Net income (loss)	<u>\$ 55</u>	<u>\$ (2,960)</u>	<u>\$ (4,070)</u>	<u>\$ (8,793)</u>
Net income (loss) per share, basic	\$ 0.00	\$ (0.04)	\$ (0.05)	\$ (0.14)
Net income (loss) per share, diluted	\$ 0.00	\$ (0.04)	\$ (0.05)	\$ (0.14)
Shares used in computing net loss per share, basic	79,674	66,316	76,982	63,020
Shares used in computing net loss per share, diluted	80,366	66,316	76,982	63,020
Comprehensive income (loss):				
Net income (loss)	\$ 55	\$ (2,960)	\$ (4,070)	\$ (8,793)
Translation gain (loss) on subsidiaries denominated in foreign currencies	247	(359)	(12)	(124)
Change in unrealized gain on investments in marketable securities	<u>—</u>	<u>(2)</u>	<u>—</u>	<u>—</u>
Comprehensive income (loss)	<u>\$ 302</u>	<u>\$ (3,321)</u>	<u>\$ (4,082)</u>	<u>\$ (8,917)</u>

See accompanying notes.

Active Power, Inc.
Condensed Consolidated Statements of Cash Flows

(in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2010	2009
Operating activities		
Net loss	\$ (4,070)	\$ (8,793)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation expense	1,510	1,441
Bad debt expense	(42)	(60)
Accretion of premium/discount on investments	—	2
Loss on disposal of fixed assets	8	384
Stock-based compensation	716	1,041
Changes in operating assets and liabilities:		
Accounts receivable	(1,086)	2,459
Inventories	300	(1,878)
Prepaid expenses and other assets	(253)	32
Accounts payable	(533)	825
Accrued expenses	809	(937)
Deferred revenue	(10)	(81)
Long-term liabilities	138	46
Net cash used in operating activities	(2,513)	(5,519)
Investing activities		
Sales/maturities of marketable securities	—	700
Purchases of property and equipment	(532)	(498)
Net cash (used in) provided by investing activities	(532)	202
Financing activities		
Proceeds from private placement of common stock	9,923	2,945
Issuance costs of private placement	(886)	—
Proceeds from draw on revolving line of credit	1,008	60
Payments on revolving line of credit	(32)	—
Proceeds from employee stock purchases	24	—
Purchases of treasury stock	(30)	—
Net cash provided by financing activities	10,007	3,005
Translation gain (loss) on subsidiaries denominated in foreign currencies	(12)	(123)
Change in cash and cash equivalents	6,950	(2,435)
Cash and cash equivalents, beginning of period	7,489	10,468
Cash and cash equivalents, end of period	<u>\$14,439</u>	<u>\$ 8,033</u>

See accompanying notes.

Active Power, Inc.
Notes to Condensed Consolidated Financial Statements
September 30, 2010
(Unaudited)

1. Organization and Basis of Presentation

Active Power, Inc. and its subsidiaries (hereinafter referred to as “we”, “us”, “Active Power” or the “Company”) manufacture and provide critical power quality solutions that provide business continuity and protect customers in the event of an electrical power disturbance. 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 Uninterruptible Power Supply (“UPS”) products we manufacture use kinetic energy to provide short-term power as a cleaner alternative to electro-chemical battery-based energy. We sell stand alone UPS products as well as complete continuous power solutions, including a containerized version that we brand as PowerHouse. We also sell other containerized power infrastructure solutions that can be used on a stand-alone basis or with our continuous power solutions. We sell our products globally through direct sales, manufacturer’s representatives, Original Equipment Manufacturer (“OEM”) and IT partner channels. Our current principal markets are Europe, Middle East and Africa (“EMEA”), Asia and North America.

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles and include the accounts of the Company and its consolidated subsidiaries. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring items) necessary to present fairly the consolidated financial position of the Company and its consolidated results of operations and cash flows. These interim financial statements should be read in conjunction with the financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2009.

2. Recently Issued Accounting Standards

On January 1, 2010, we adopted amendments to authoritative literature that modifies the revenue recognition guidance for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable in the arrangement based on relative selling price of the elements. The selling price for each deliverable is based on vendor-specific objective evidence (“VSOE”) if available, third-party evidence (“TPE”) if VSOE is not available, or best estimate of selling price (“BESP”) if neither VSOE nor TPE is available. BESP must be determined in a manner that is consistent with that used to determine the price to sell the specific elements on a standalone basis. The authoritative literature permits prospective or retrospective adoption, and we elected prospective adoption. Other than the increased disclosure requirements of adoption of this policy, the adoption of these amendments did not change our units of accounting, allocation of arrangement consideration, or pattern or timing of revenue recognition. It also did not have a significant impact on our financial position, results of operations, or cash flows for the nine months ended September 30, 2010, nor do we anticipate a significant impact for the year ended December 31, 2010. See Note 3 for additional discussion of the Company’s revenue recognition policy.

3. Supplemental Balance Sheet Information

Receivables

Accounts receivable consist of the following (in thousands):

	September 30, 2010	December 31, 2009
Trade receivables	\$ 12,968	\$ 11,882
Allowance for doubtful accounts	(311)	(353)
	<u>\$ 12,657</u>	<u>\$ 11,529</u>

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

	September 30, 2010	December 31, 2009
Raw materials	\$ 5,147	\$ 5,238
Work in process	2,293	1,253
Finished goods	1,195	2,448
Allowances for obsolescence	(2,306)	(2,310)
	<u>\$ 6,329</u>	<u>\$ 6,629</u>

Property and Equipment

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

	September 30, 2010	December 31, 2009
Equipment	\$ 9,476	\$ 9,321
Demonstration units	1,310	1,436
Computers and purchased software	3,296	3,076
Furniture and fixtures	362	355
Leasehold improvements	7,328	7,305
Construction in progress	44	44
	<u>21,816</u>	<u>21,537</u>
Accumulated depreciation	<u>(19,899)</u>	<u>(18,634)</u>
	<u>\$ 1,917</u>	<u>\$ 2,903</u>

Accrued Expenses

Accrued expenses consist of the following (in thousands):

	September 30, 2010	December 31, 2009
Compensation and benefits	\$ 3,215	\$ 1,549
Warranty liability	628	620
Property, income, state, sales and franchise tax	684	1,427
Professional fees	435	495
Other	804	866
	<u>\$ 5,766</u>	<u>\$ 4,957</u>

Warranty Liability

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

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

Balance at December 31, 2009	\$ 663
Warranty expense	512
Warranty charges incurred	(496)
Balance at September 30, 2010	<u>\$ 679</u>
Warranty liability included in accrued expenses	\$ 628
Long term warranty liability	<u>51</u>
Balance at September 30, 2010	<u>\$ 679</u>

Revenue Recognition

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

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

Multiple element arrangements (“MEAs”). Arrangements to sell products to customers frequently include multiple deliverables. Our most significant MEAs include the sale of one or more of our CleanSource UPS, PowerHouse or data center infrastructure products, combined with one or more of the following products: design services, project management, commissioning and installation services, spare parts or consumables, and EMAs. Delivery of the various products or performance of services within the arrangement may or may not coincide. Certain services related to design and consulting may occur prior to delivery of product and commissioning and installation typically take place within 6 months of product delivery, depending upon customer requirements. EMAs, consumables, and repair, maintenance or consulting services generally are delivered over a period of one to five years. In certain arrangements revenue recognized is limited to the amount invoiced or received that is not contingent on the delivery of future products and services.

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

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

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4. Net Income (Loss) Per Share

Basic net income (loss) per share is computed based on the weighted average number of common shares outstanding for each period presented. Diluted net income per share reflects the potential dilution that would have occurred if securities or other contracts to issue common stock were exercised, converted, or resulted in the issuance of common stock. The following table reconciles the numerator and denominator used in the basic and diluted net income (loss) per share (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Numerator:				
Net income (loss)	\$ 55	\$ (2,960)	\$ (4,070)	\$ (8,793)
Denominator:				
Weighted-average shares of common stock outstanding	79,674	66,316	76,982	63,020
Dilutive effect of employee stock options and restricted stock awards	692	—	—	—
Weighted average shares for diluted net income per share	80,366	66,316	76,982	63,020
Basic net income (loss) per share	\$ 0.00	\$ (0.04)	\$ (0.05)	\$ (0.14)
Diluted income (loss) per share:	\$ 0.00	\$ (0.04)	\$ (0.05)	\$ (0.14)
Common stock equivalents that were not included in the calculation because the option price was greater than the average market price of the common shares or the net loss would cause the effect of the options to be anti-dilutive:				
Employee stock options	5,363	5,766	7,160	5,766
Performance-based options	2,100	—	2,100	—
Restricted stock awards	9	123	19	123
	7,472	5,889	9,279	5,889

As of September 30, 2010 and 2009, there was no common stock subject to repurchase.

5. Fair Value of Financial Instruments

Investments in marketable securities currently consist of money-market funds, although at times we do invest in commercial paper and debt securities with readily determinable fair values. Active Power accounts for investments that are reasonably expected to be realized in cash, sold or consumed during the year as short-term investments. We classify investments in marketable securities as available-for-sale and all reclassifications made from unrealized gains/losses to realized gains/losses are determined based on the specific identification method. We had no such short-term investments at September 30, 2010 or at December 31, 2009.

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

We have established a framework for measuring fair value as well as guidelines for required disclosures regarding fair value measurements.

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

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

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

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

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

The fair value of our cash equivalents was determined using the aforementioned inputs as of September 30, 2010 (in thousands):

	Fair Value Measurements at Reporting Date Using			Total
	Level 1	Level 2	Level 3	
Money Market funds	\$ 3,093	\$ —	\$ —	\$ 3,093
Total	\$ 3,093	\$ —	\$ —	\$ 3,093
Amounts included in:				
Cash and cash equivalents	\$ 3,093	\$ —	\$ —	\$ 3,093
Total	\$ 3,093	\$ —	\$ —	\$ 3,093

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

6. Guarantees

In certain geographical regions, particularly Europe and Africa, we are sometimes required to issue performance guarantees to our customers as a condition of sale. These guarantees usually provide financial protection to our customers in the event that we fail to fulfill our warranty obligations. We secure these guarantees with standby letters of credit through our bank. At both September 30, 2010, and December 31, 2009, we had \$754 and \$48, respectively, of performance guarantees outstanding to customers that were secured with letters of credit.

7. Revolving Credit Facility

On August 5, 2010, we entered into a Second Amended and Restated Loan and Security Agreement (the “Loan Agreement”) with Silicon Valley Bank (“SVB”). This new two-year loan facility provides for a secured revolving line of credit in an aggregate amount of up to eighty percent (80%) of the facility amount of \$15.625 million, or \$12.5 million, subject to certain borrowing bases. In the event we have maintained cash and cash equivalents of at least \$6.25 million with SVB for at least 30 consecutive days, which is referred to as being in a “Streamline Period”, the borrowing base formula is based on eligible accounts receivable, eligible purchase orders and eligible inventory, subject to a sublimit of \$5 million for U.K. accounts receivable, \$3.5 million for inventory and \$1.5 million for purchase orders. When we are not in a Streamline Period, our borrowings are limited based on accounts receivable and purchase orders that SVB has specifically agreed to finance and a borrowing base for eligible inventory. We may also request that SVB issue letters of credit on our behalf, of up to \$1.5 million, as a portion of our total loan facility.

On August 5, 2010 we borrowed approximately \$2.5 million in revolving loans, all of which was used to refinance all indebtedness owing from the Company to SVB pursuant to our previous revolving credit facility. The new credit facility increases the total credit available from our previous loan facility with SVB, which was \$6.0 million, and enables us to borrow against eligible inventory, foreign receivables and customer purchase orders in addition to eligible accounts receivable. During the quarter ended September 30, 2010, we borrowed an additional \$1.0 million under this credit facility. Based on the borrowing base formula, we had an additional \$3.1 million available for use at September 30, 2010 under this credit facility.

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The Company will pay a finance charge on each account receivable financed by SVB at a per annum rate equal to SVB's prime rate, subject to a minimum prime rate of four percent (4.00%), plus one and one-half percent (1.50%). The Company will pay a finance charge on each purchase order financed by SVB at a per annum rate equal to SVB's prime rate, subject to a minimum prime rate of four percent (4.00%), plus one and one-quarter percent (1.25%) when a Streamline Period is not in effect or two percent (2.00%) when a Streamline Period is in effect. When we are not in a Streamline Period, these finance charges will be based on the face amount of the receivable or the purchase order, and otherwise, will be based on the amount financed by SVB.

Each advance based upon inventory accrues interest at a per annum rate equal to SVB's prime rate, subject to a minimum prime rate of four percent (4.00%), plus (i) one and one-half percent (1.50%) when we are in a Streamline Period and (ii) three and five-eighths percent (3.625%) when we are not in a Streamline Period.

Finance charges and interest are payable monthly, and all principal and interest is due on the maturity date of August 5, 2012. However, when we are not in a Streamline Period, we must repay advances based on receivables when we receive payment on the receivable that has been financed, and we must repay advances based on purchase orders within 120 days of the date of the purchase order, together with all finance charges on such advances.

The revolving loans made to us under this loan facility will be secured by a lien on substantially all of our assets. In addition, on August 5, 2010, Active Power Solutions Limited, a wholly-owned United Kingdom subsidiary of the Company, entered into a Guarantee and Debenture with SVB (the "Guarantee and Debenture"), pursuant to which Active Power Solutions Limited guaranteed all of the obligations of the Company under the Loan Agreement and secured its obligations under the Guarantee and Debenture with a security interest on substantially all of its assets.

The Loan Agreement includes customary affirmative covenants for a credit facility of this size and type, including delivery of financial statements, compliance with laws, maintenance of insurance and protection of intellectual property rights. Further, the Loan Agreement contains customary negative covenants for a credit facility of this size and type, including covenants that limit or restrict the Company's ability to, among other things, dispose of assets, change its business, change its CEO or CFO without replacing such person within 120 days, have a change in control, make acquisitions, be acquired, incur indebtedness, grant liens, make investments, make distributions, repurchase stock, and enter into certain transactions with affiliates. The Loan Agreement also requires the Company to maintain a minimum liquidity ratio of 1.25:1. The Company is currently in compliance with all loan covenants under the Loan Agreement.

The Loan Agreement contains customary events of default that include, among other things, non-payment defaults, covenant defaults, material adverse change defaults, insolvency defaults, material judgment defaults and inaccuracy of representations and warranty defaults. The occurrence of an event of default could result in the acceleration of obligations under the Loan Agreement, in which case the Company must repay all loans and related charges, fees and amounts then due and payable, and our subsidiary may be required to pay any such amounts under the Guarantee and Debenture. At the election of SVB, upon the occurrence and during the continuance of an event of default, finance charges or interest rates, as applicable, will increase an additional five percentage points (5.00%) per annum above the rate that is otherwise applicable thereto upon the occurrence of such event of default, and the collateral handling fees will increase by one-half percent (0.50%).

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

The following discussion should be read in conjunction with, and is qualified in its entirety by reference to, the financial statements and notes thereto included in Item 1 of this Form 10-Q and the financial statements and notes thereto and our Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2009 included in our 2009 Annual Report on Form 10-K. This report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, that involve risks and uncertainties. Our expectations with respect to future results of operations that may be embodied in oral and written forward-looking statements, including any forward-looking statements that may be included in this report, are subject to risks and uncertainties that must be considered when evaluating the likelihood of our realization of such expectations. Our actual results could differ materially. The words "believe," "expect," "intend," "plan," "project," "will" and similar phrases as they relate to us are intended to identify such forward-looking statements. In addition, please see the "Risk Factors" in Part 1, Item 1A of our 2009 Annual Report on Form 10-K and in Part II, Item 1A of this Form 10-Q for a discussion of items that may affect our future results.

Overview

Active Power is a manufacturer and provider of efficient, reliable and green continuous power solutions incorporating uninterruptible power supply ("UPS") systems that ensure business continuity for enterprises in the event of power disturbances. Our products and solutions are designed to deliver continuous clean power, protecting customers from voltage fluctuations, such as surges and sags, and frequency fluctuations and 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 global enterprises requiring "power insurance" because they have zero tolerance for downtime in their mission critical operations. The UPS products we manufacture use kinetic energy to provide short-term power as a cleaner alternative to electro-chemical battery-based energy. These products are highly reliable, are energy and space efficient and significantly reduce client electricity expenses.

As of September 30, 2010, we have shipped more than 2,700 flywheels in UPS system installations, delivering more than 675 megawatts of power to customers in 44 countries around the world. We are headquartered in Austin, Texas, with international offices in the United Kingdom, Germany, China and Japan.

Our patented flywheel-based UPS 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 either utility power is restored or a backup electric generator starts and takes over generating longer-term power in the case of an extended electrical outage. We believe our flywheel products provide many competitive advantages over conventional battery-based UPS systems, including substantial space savings, higher power densities, "green" energy storage, and higher power efficiencies up to 98%. This high energy efficiency reduces operating costs and provides customers a lower total cost of ownership. We offer our flywheel products with load capabilities from 130kVA to 8,400kVA. We typically target higher power applications of 200kVA and above, largely because the majority of customers in this market segment have backup generators. Our flywheel-based UPS systems are marketed under the brand name CleanSource®.

Our containerized continuous power systems ("CPS"), which incorporate our UPS products with switchgear and a generator to provide complete short- and long-term protection in the event of a power disturbance, are marketed under the brand name PowerHouse™. PowerHouse can be deployed in either a 20-foot or 40-foot-long ISO container depending upon the customer's power load requirements. These systems are specifically designed to handle the demands of high-tech facilities requiring the highest power integrity available while maximizing up time, useable floor space and operational efficiency. Designed to offer a highly flexible architecture to a customer's constantly changing environment, our systems are offered in four standard modular power configurations, enabling sizing for infrastructure on demand. These systems are highly differentiated as they offer flexibility in placement, space savings, fast deployment time after receipt of order, high energy efficiency, and prompt capital deployment to meet current demands. They also deliver significant value to customers as the entire system is integrated and tested prior to delivery for a repeatable simple solution.

Leveraging our manufacturing, containerization and product packaging capabilities, we also work with our IT channel partners to produce portable data center infrastructure solutions. These solutions provide power distribution, cooling capabilities, security systems, fire suppression and monitoring capabilities for our IT channel partners. Our IT channel partners are then able to add their IT equipment and deliver a complete portable or modular data center package to their customers.

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

- Ever-increasing demands placed on the public utility infrastructure;
- An inadequate investment in global utility infrastructure;
- Rising costs of energy worldwide;
- Increasing business costs of downtime;
- A rapidly expanding need for data centers that provide reliable, efficient power; and
- An increasing demand for economically green solutions.

We have evolved significantly since our founding in 1992 as an engineering business focused on research, development and invention. The technological foundation of Active Power has yielded more than 100 worldwide patents and a highly differentiated, cost-efficient product platform. Since 2005, our management team has implemented a commercialization strategy focused on:

- building the Active Power brand in the marketplace;
- expanding our distribution channels;
- creating innovative solutions; and
- focusing on operating and product cost reduction.

As a result of this strategy, we have been successful in improving our operating and financial performance, broadening our global footprint, diversifying our customer base, broadening our sales channels and partners and moving higher up the customer value chain with innovative developments of our core underlying product technology. This is most recently illustrated by our newest product offering, PowerHouse, a containerized, portable, complete continuous power solution.

We sell our products to a wide array of commercial and industrial customers across a variety of vertical markets, including data centers, manufacturing, technology, broadcast and communications, financial, utilities, healthcare, government and airports. We have expanded our global sales channels and direct sales force, selling in all major geographic regions of the world, but particularly in North America, Europe and Asia.

Results of Operations

(\$ in thousands)	Three months ended September 30,				Variance 2010 vs. 2009	
	2010	% of total revenue	2009	% of total revenue	\$	%
	Product revenue	\$16,663	90%	\$ 6,947	81%	\$9,716
Service and other revenue	1,793	10%	1,587	19%	206	13%
Total revenue	18,456	100%	8,534	100%	9,922	116%
Cost of product revenue	11,287	61%	5,751	67%	5,536	96%
Cost of service and other revenue	1,691	9%	901	11%	790	88%
Total cost of goods sold	12,978	70%	6,652	78%	6,326	95%
Gross profit	5,478	30%	1,882	22%	3,596	191%
Operating expenses:						
Research and development	833	5%	1,095	13%	(262)	(24)%
Selling and marketing	3,539	19%	2,572	30%	967	38%
General and administrative	1,075	6%	1,201	14%	(126)	(10)%
Total operating expenses	5,447	30%	4,868	57%	579	12%
Operating profit (loss)	31	0%	(2,986)	(35)%	3,017	101%
Interest expense, net	(30)	—	(20)	—	10	50%
Other expense, net	13	—	46	—	(33)	(72)%
Income (loss) before income taxes	14	—	(2,960)	—	2,974	100%
Income tax benefit	41	—	—	—	41	—%
Net income (loss)	\$ 55	0%	\$(2,960)	(35)%	\$3,015	102%

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(\$ in thousands)	Nine months ended September 30,				Variance 2010 vs. 2009	
	2010		2009		\$	%
		% of total revenue		% of total revenue		
Product revenue	\$39,356	86%	\$21,863	83%	\$17,493	80%
Service and other revenue	6,264	14%	4,444	17%	1,820	41%
Total revenue	45,620	100%	26,307	100%	19,313	73%
Cost of product revenue	28,323	62%	16,874	64%	11,449	68%
Cost of service and other revenue	4,606	10%	2,814	11%	1,792	64%
Total cost of goods sold	32,929	72%	19,688	75%	13,241	67%
Gross profit	12,691	28%	6,619	25%	6,072	92%
Operating expenses:						
Research and development	2,517	6%	3,254	12%	(737)	(23)%
Selling and marketing	10,323	23%	8,562	33%	1,761	21%
General and administrative	3,825	8%	3,517	13%	308	9%
Total operating expenses	16,665	37%	15,333	58%	1,332	9%
Operating loss	(3,974)	(9)%	(8,714)	(33)%	4,740	54%
Interest expense, net	(82)	—	(48)	—	34	71%
Other expense, net	(55)	—	(31)	—	24	77%
Loss before income taxes	(4,111)	—	(8,793)	—	4,682	53%
Income tax benefit	41	—	—	—	41	—%
Net loss	<u>\$ (4,070)</u>	<u>(9)%</u>	<u>\$ (8,793)</u>	<u>(33)%</u>	<u>\$ 4,723</u>	<u>54%</u>

Product revenue. Product revenue primarily consists of sales of our CleanSource power quality products, our CPS and other data center infrastructure solutions. Our CleanSource power quality products are comprised of both UPS and DC product lines and our CPS 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 that we call PowerHouse, or as separate equipment. Our data center infrastructure solutions provide power distribution, cooling capabilities, security systems, fire suppression and monitoring capabilities for our IT channel partners. We have recently begun to produce our data center infrastructure solutions for our IT channel partners, leveraging our manufacturing, containerization and product packaging capabilities.

(\$ in thousands)	Three Months Ended September 30,		Variance		Nine Months Ended September 30,		Variance	
	2010	2009	\$	%	2010	2009	\$	%
	Product revenue:							
UPS product revenue	\$ 8,358	\$4,897	\$3,461	71%	\$23,210	\$19,813	\$ 3,397	17%
Continuous Power Systems	1,210	1,879	(669)	(36)%	6,298	1,879	4,419	235%
Data center infrastructure solutions	7,095	171	6,924	4049%	9,848	171	9,677	5659%
Total product revenue	\$16,663	\$6,947	\$9,716	140%	\$39,356	\$21,863	\$17,493	80%

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Product revenue for the three-month period ended September 30, 2010 increased by 140%, or \$9.7 million, compared to the third quarter of 2009. \$6.9 million of this increase was from the sale of data center infrastructure solutions for one of our IT channel partners, a new revenue source for the Company. Substantially all of the remaining increase was from a higher volume of sales of our CleanSource flywheel-based UPS products, which was offset partially by a decrease in sales of continuous power systems. The number of flywheels contained in UPS systems sold increased to 97 in this quarter compared to 56 in the third quarter of 2009 which drove the increase in UPS product revenue. Continuous power systems product revenues were down by \$669,000 for the three-month period ended September 30, 2010 compared to the same quarter in 2009, due to a lower number of PowerHouse related projects.

For the nine-month period ended September 30, 2010, our product revenue was \$39.4 million, which was \$17.5 million, or 80%, higher than the comparable period of 2009. Of this increase \$9.7 million was from the sale of data center infrastructure solutions and \$4.4 million was from increased sale of continuous power solution products. UPS product revenues also increased by \$3.4 million due to higher unit sales of product compared to 2009.

Product revenue increased sequentially by 25% compared to the second quarter of 2010. The increase in data center infrastructure solutions contributed the majority of this increase, but UPS product revenues were 26% higher than the second quarter of 2010 and continuous power systems revenues decreased by 73% from the previous quarter. Our revenue related to production of our data center infrastructure products and our continuous power systems tend to be larger in value and from a small number of customers compared to sales of our UPS products. This smaller number of customers with greater transaction value can contribute to large quarterly fluctuations in revenue from each product family, due to the timing of orders and shipments in any particular accounting period. This quarter, revenue from data center infrastructure solutions represented 43% of total product revenue, up from 16% in the prior quarter.

Product sales from our OEM channels for the three-month period ended September 30, 2010 increased by 111%, or \$773,000, compared to the third quarter of 2009 and represented 9% of our total product revenue for the period compared to 10% of total product revenue in the third quarter of 2009. For the nine-month period ended September 30, 2010 product sales from our OEM channels increased 4%, or \$275,000 as compared to the same period in 2009 and represented 20% of our total product revenue for this period as compared to 34% of revenue in 2009. The growth in sales during 2010 from our OEM channel has been less than growth from our direct sales and our IT channel. Sales of our UPS products are a much smaller part of our OEM partner's total business and subject to more volatility in quarterly sales, particularly during difficult economic periods as the OEM focuses on its core business. We do believe that sales from this channel will continue to increase as general conditions improve and due to the marketing commitment of the OEM partners to promote our UPS products over the last year. Caterpillar remains our largest OEM customer but is no longer the largest single customer of the Company.

During the three-month period ended September 30, 2010, we sold 97 flywheel units in UPS products, comparable to the 99 units that we sold in the second quarter of 2010. This was a 73% increase from the 56 units we sold in the third quarter of 2009. The average selling price per flywheel for the third quarter of 2010 was approximately \$87,500 per flywheel, which compared to an average selling price of approximately \$79,000 in the second quarter of 2010 and \$78,000 in the third quarter of 2009. The higher average selling price is driven by higher non-OEM revenues, which historically generate higher average selling prices than our OEM channel sales.

During the nine-month period ended September 30, 2010, we sold 291 flywheel units in UPS products, a 27% increase over the 230 units that we sold in the same period of 2009. The average sales price per flywheel for the nine-month period ended September 30, 2010 was approximately \$84,000, which compared to an average selling price of approximately \$77,500 for the same period of 2009.

Our continuous power systems, including PowerHouse, and our data center infrastructure solutions contracts tend to be larger in value than our sales of UPS products, and this will contribute to more volatility on a quarterly basis based on the number and timing of such orders on hand for the relatively low number of transactions that we currently have each quarter. For the three months ended September 30, 2010, we completed one large order for data center infrastructure products that was over \$7 million. Large contracts also can significantly affect our cash flows as we have significantly larger receivables per customer order. While this order and customer concentration does increase liquidity risk for us, we continue to improve and refine the payment terms of these sales opportunities as part of our working capital management. As our solutions business grows, the composition of our sales will likely change and fluctuate on a quarterly basis. We have experienced an increase in third party systems and components and data center infrastructure solutions that are being packaged and resold to our customers, that we believe will continue to help increase our total revenue. Margins on sales of third party equipment and portable data center infrastructure solutions are lower than the margins that we generate on our own manufactured goods.

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Therefore, a significant increase in product revenues that was caused by higher sales of non-UPS products may not result in a commensurate percentage increase in our gross or operating profit levels. Further, the frequency and timing of our larger sales, including megawatt-class UPS products and our CPS, including PowerHouse, 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.

North America sales were 82% of our total revenue for the three-month period ended September 30, 2010, compared to 40% for the same period in 2009 and 69% in the three-month period ended June 30, 2010. For the nine-month period ended September 30, 2010, our North America sales were 73% of total revenue, which compared to 65% of total revenue in the same period of 2009. In total, our North America sales increased by 94% for the nine-month period ended September 30, 2010 compared to the same period of 2009, reflecting the overall growth in the market for our products in total and in particular for our data center infrastructure solutions, and the improvement in overall market conditions within the U.S. data center market.

We also sell products directly to customers in Asia and Western Europe and we have a network of international distributors in other territories to sell products for us. In these markets, customers are more likely to purchase a total power solution from us rather than a stand-alone UPS system. This usually results in a longer selling cycle and makes quarterly results from these regions more volatile and dependent upon a smaller number of transactions. Thus the amount of revenue from our international markets can fluctuate significantly on a quarterly basis. Sales of Active Power branded products through our direct and manufacturer's representative channels were 50% of our total revenue for the three-month period ended September 30, 2010, compared to 88% for the same period of 2009, and 60% of our total revenue for the three-month period ended June 30, 2010. Sales of Active Power branded products through our direct and manufacturer's representative channels were 57% of our total revenue for the nine-month period ended September 30, 2010, compared to 68% for the same period of 2009. As direct sales typically have higher profit margins than sales through our OEM channels, we will continue to focus on our direct sales channel to increase revenue and improve profit margins and to decrease our dependency upon our OEM channel. We believe sales of our Active Power branded products in markets that were not covered by our OEMs will continue to increase over time and will continue to become a larger percentage of our total revenue.

We continue to expand the sales territories where we sell our Active Power branded products as we increase our sales distribution capabilities, particularly in Europe and Asia. In August we opened our first sales office in China as part of our efforts to add sales and service capabilities to this market in anticipation of future revenues. There is usually a gap between adding sales and service capability and generating meaningful revenue from a new territory. As a result, the investments that we have made during 2009 and 2010 in Europe and Asia will not generate higher revenues, if at all, from these regions until at least the fourth quarter of 2010. We continue to invest in sales, service and marketing capabilities in each of these regions.

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, particularly data center applications. Therefore we have traditionally focused our direct sales efforts on these types of customer situations.

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 deferral or cancellation. Revenue from extended maintenance contracts with our customers is also included in this revenue category.

Service and other revenue increased by 13% for the three-month period ended September 30, 2010, compared to the same quarter of 2009 and increased by 41% for the nine-month period ended September 30, 2010 as compared to the same period in 2009. This increase is primarily due to higher levels of service and contract work from direct product sales made in prior quarters and from professional fees associated with PowerHouse and other continuous power system sales. For these customers we provide a full power solution, including site preparation, installation of an entire power solution and provision of all products required to provide a turnkey product to the end user often including maintenance services. Where we make sales through our OEM channel, it is typical for the OEM to provide these types of services to their end-user customers. We anticipate that service and other revenue will continue to grow with product revenue, particularly as our PowerHouse system revenue grows, and as our installed base of UPS product expands, because as more units are sold to customers, more installation, startup and maintenance services will be required.

Cost of product revenue. Cost of product revenue includes the cost of component parts of our products, ancillary equipment that is sourced from external suppliers, personnel, equipment and other costs associated with our assembly and test operations, including costs from having underutilized facilities, depreciation of our manufacturing property and

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equipment, shipping costs, warranty costs, and the costs of manufacturing support functions such as logistics and quality assurance. The cost of product revenue as a percentage of total product revenue was 68% in the three-month periods ended September 30, 2010, as compared to 83% for the comparable period of 2009, and was 72% and 77% in the nine-month periods ended September 30, 2010 and September 30, 2009, respectively. This decrease in cost as a percentage of revenue compared to 2009 is due primarily to increased sales volumes, which resulted in more efficient utilization of our manufacturing facility and a lower level of unabsorbed overhead costs. We continue to operate a manufacturing facility that has a manufacturing and testing capacity significantly greater than our current product revenue levels. A large portion of the costs involved in operating this manufacturing facility are fixed in nature and we typically incur approximately \$300,000 to \$500,000 in unabsorbed overhead each quarter. We continue to work on reducing our product costs through design enhancements and modifications, and vendor management programs and increasing our sales volume to absorb these expenses.

Cost of service and other revenue. Cost of service and other revenue includes the cost of component parts that we use in service or sell as spare parts, as well as labor and overhead costs of our service organization, including travel and related costs incurred in fulfilling our service obligations to our customers. The cost of service and other revenue increased to 94% of service and other revenue in the three-month period ended September 30, 2010, compared to 57% of service and other revenue in the same period of 2009. For the nine-month period ended September 30, 2010, the cost of service and other revenue was 74% of revenue as compared to 63% in the same period of 2009. This increase reflects higher costs relative to the increase in service and other revenues as we continue to expand the service team to broaden the geographic regions where we have service capability as our total business grows. Operationally we are challenged to manage the growth of our service organization congruent with the growth in total revenues so that we can meet customer requirements without growing our service organization cost structure too rapidly. During the current quarter we also did not have as many implementation projects for our continuous power systems, which contributed to lower utilization of our service personnel and decreased margins in our service business. A large portion of the costs involved in operating our service organization are fixed in nature and we incur approximately \$300,000 to \$600,000 in unabsorbed overhead each quarter. We continue to work on reducing our service overhead through better utilization of our service employees and cost control measures.

Gross profit. For the three month period ended September 30, 2010, our gross profit margin was 30% of revenue, compared to a 22% gross margin for the third quarter in 2009. For the nine-month period ended September 30, 2010 our gross margin was 28% of revenue, compared to 25% for the same period of 2009. The improvement in third quarter margin, combined with higher revenue levels resulted in a \$3.6 million, or 191%, increase in gross profit for the quarter compared to the same period of the previous year. For the nine months ended September 30, 2010 our gross profits increased by \$6.1 million, or 92%, compared to the same period in 2009. Higher average selling prices for our products, higher volumes of sales, new product introductions such as the data center infrastructure solutions, and the resulting greater utilization of our manufacturing facilities are the primary drivers behind this increase in gross profit compared to 2009. Our ability to continue to improve our gross profit will depend, in part, on our ability to continue to reduce material costs, improve our sales channel mix in favor of direct sales versus OEM, increase sales of higher margin products such as our UPS products, increase product prices and increasing our total revenues to a level that will allow us to improve the utilization of our manufacturing and service operations.

Research and development. Research and development expense primarily consists of compensation and related costs for employees engaged in research, development and engineering activities, third party consulting and development activities, as well as an allocated portion of our occupancy costs. Overall our research and development expenses were approximately \$262,000, or 24%, lower in the third quarter of 2010 compared to the third quarter of 2009 and remained steady with the second quarter of 2010. Our research and development efforts in 2009 were largely focused on new configurations of our existing flywheel technology under development, as well as enhancements to parallel our UPS products and refinement and standardization of our containerized product solutions. The decrease in spending compared to 2009 reflects lower project related development costs this year as well as lower headcount costs. The prior year expenses also included higher prototype and development costs for paralleling our megawatt-class UPS products. We believe research and development expenses in the fourth quarter will remain at similar levels to those recorded in the third quarter.

Selling and marketing. Selling and marketing expense primarily consists of compensation, including variable sales compensation, and related costs, for sales and marketing personnel, and related travel, selling and marketing expenses, as well as an allocated portion of our occupancy costs and the cost of our foreign sales operations. Selling and marketing costs were approximately \$967,000, or 38%, higher in the third quarter of 2010 compared to the amount recorded in the third quarter of 2009 and remained steady with the expense level of the second quarter of 2010. The increase from 2009 primarily reflects higher variable sales compensation and performance-based compensation as a result of higher revenue and improving results. Our increase in total revenues has driven higher sales compensation expense, including payments we made to third party representatives, and is the most significant cause of the increase in selling and marketing expenses. The increase also reflects increased headcount as we concentrate on building and improving the Active Power brand, and expanding our sales

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organization, particularly in Europe and Asia, to support our direct selling and channel sales activities. We have added specific sales resources to support each of our OEM and IT sales channels during 2010, which we believe is contributing to the improved performance from each of these channels in 2010. We believe that fixed sales and marketing expenses will remain consistent in the fourth quarter of 2010 compared to those recorded in the third quarter of 2010.

General and administrative. General and administrative expense is primarily comprised of compensation and related costs for executive and administrative personnel, professional fees, and taxes, including sales, property and franchise taxes. General and administrative expenses for the third quarter of 2010 decreased approximately \$126,000, or 10%, compared to the same period in 2009 and decreased approximately \$358,000, or 25%, as compared to the immediately preceding quarter. The decrease primarily reflects lower professional and consulting services fees and lower performance-based compensation expenses.

Interest expense, net. Net interest expense has increased from approximately \$20,000 in the three-month period ended September 30, 2009 to approximately \$30,000 in the three-month period ended September 30, 2010. This increase is due to the overall decline in interest rates since 2008 that lowered our investment returns, and higher interest expense paid on balances outstanding under our revolving credit arrangement as we have increased the amount outstanding under our credit facilities compared to 2009. Our average cash and investments balance over the three-month period ending September 30, 2010 has increased by \$5.4 million, or 56%, compared to the average balance over the comparable period ending September 30, 2009 and has increased by approximately \$1.7 million, or 19%, for the nine-month period ended September 30, 2010, compared to the average balance over the comparable period of 2009.

Other expense, net. Net other expense in the third quarter of 2010 and 2009 reflects foreign exchange gains (losses) on a bank account held in foreign currencies by our subsidiary companies.

Liquidity and Capital Resources

Our primary sources of liquidity at September 30, 2010 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 have adequate capital resources in order to continue operating our business for at least the next 12 months. Our business plan and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, there are scenarios in which our revenues may not meet our projections, our costs may exceed our estimates or our working capital needs may be greater than anticipated. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in 2010 and beyond or significantly affect our level of liquidity.

In February 2010, we sold approximately 13.25 million shares of common stock at a purchase price of \$0.75 per share, for proceeds, net of fees and expenses, of approximately \$9.0 million, in a firm-commitment underwritten offering made under a shelf registration statement that we had filed with the Securities and Exchange Commission and that had been declared effective in December 2009. The proceeds from this offering were designed to strengthen our balance sheet and to help fund our working capital requirements during 2010 and for general corporate purposes.

In August 2010, we entered into a Second Amended and Restated Loan and Security Agreement (the "Loan Agreement" with our existing bank, Silicon Valley Bank ("SVB"). This new facility increased the total liquidity available from \$6.0 million to \$12.5 million subject to certain borrowing bases. This new facility expanded our ability to borrow funds from U.S. receivables to also include qualifying receivables from our U.K. operations, increased our ability to use inventory as collateral for borrowing against, and also added an ability to borrow against purchase orders. These additional bases of borrowing were designed to allow us to use the credit facility to fund inventory purchases in the event we received large or multiple sales orders that would require a major investment in inventory and work in progress, to help fund continued growth in our business.

This new two-year loan facility provides for a secured revolving line of credit in an aggregate amount of up to eighty percent (80%) of the facility amount of \$15.625 million, or \$12.5 million, subject to certain borrowing bases. In the event we have maintained cash and cash equivalents of at least \$6.25 million with SVB for at least 30 consecutive days, which is referred to as being in a "Streamline Period", the borrowing base formula is based on eligible accounts receivable, eligible purchase orders and eligible inventory, subject to a sublimit of \$5 million for U.K. accounts receivable, \$3.5 million for inventory and \$1.5 million for purchase orders. When we are not in a Streamline Period, our borrowings are limited based on accounts receivable and purchase orders that SVB has specifically agreed to finance and a borrowing base for eligible inventory. We may also request that SVB issue letters of credit on our behalf, of up to \$1.5 million, as a portion of our total loan facility.

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On August 5, 2010, the Company borrowed approximately \$2.5 million in revolving loans, all of which was used to refinance all indebtedness owing from the Company to SVB under our previous credit facility. The new credit facility increases the total credit available from our previous loan facility with SVB, which was \$6.0 million, and enables us to borrow against eligible inventory, foreign receivables and customer purchase orders in addition to eligible accounts receivable.

During the quarter ended September 30, 2010, we borrowed an additional \$1.0 million under this credit facility. Based on the borrowing base formula, we had an additional \$3.1 million available for use at September 30, 2010 under this credit facility.

The Company will pay a finance charge on each account receivable financed by SVB at a per annum rate equal to SVB's prime rate, subject to a minimum prime rate of four percent (4.00%), plus one and one-half percent (1.50%). The Company will pay a finance charge on each purchase order financed by SVB at a per annum rate equal to SVB's prime rate, subject to a minimum prime rate of four percent (4.00%), plus one and one-quarter percent (1.25%) when a Streamline Period is not in effect or two percent (2.00%) when a Streamline Period is in effect. When we are not in a Streamline Period, these finance charges will be based on the face amount of the receivable or the purchase order, and otherwise, will be based on the amount financed by SVB.

Each advance based upon inventory accrues interest at a per annum rate equal to SVB's prime rate, subject to a minimum prime rate of four percent (4.00%), plus (i) one and one-half percent (1.50%) when we are in a Streamline Period and (ii) three and five-eighths percent (3.625%) when we are not in a Streamline Period.

Finance charges and interest are payable monthly, and all principal and interest is due on the maturity date of August 5, 2012. However, when we are not in a Streamline Period, we must repay advances based on receivables when we receive payment on the receivable that has been financed, and we must repay advances based on purchase orders within 120 days of the date of the purchase order, together with all finance charges on such advances.

The revolving loans made to us under this loan facility will be secured by a lien on substantially all of our assets. In addition, on August 5, 2010, Active Power Solutions Limited, a wholly-owned United Kingdom subsidiary of the Company, entered into a Guarantee and Debenture with SVB (the "Guarantee and Debenture"), pursuant to which Active Power Solutions Limited guaranteed all of the obligations of the Company under the Loan Agreement and secured its obligations under the Guarantee and Debenture with a security interest on substantially all of its assets.

The Loan Agreement includes customary affirmative covenants for a credit facility of this size and type, including delivery of financial statements, compliance with laws, maintenance of insurance and protection of intellectual property rights. Further, the Loan Agreement contains customary negative covenants for a credit facility of this size and type, including covenants that limit or restrict the Company's ability to, among other things, dispose of assets, change its business, change its CEO or CFO without replacing such person within 120 days, have a change in control, make acquisitions, be acquired, incur indebtedness, grant liens, make investments, make distributions, repurchase stock, and enter into certain transactions with affiliates. The Loan Agreement also requires the Company to maintain a minimum liquidity ratio of 1.25:1. The Company is currently in compliance with all loan covenants under the Loan Agreement.

The Loan Agreement contains customary events of default that include, among other things, non-payment defaults, covenant defaults, material adverse change defaults, insolvency defaults, material judgment defaults and inaccuracy of representations and warranty defaults. The occurrence of an event of default could result in the acceleration of obligations under the Loan Agreement, in which case the Company must repay all loans and related charges, fees and amounts then due and payable, and our subsidiary may be required to pay any such amounts under the Guarantee and Debenture. At the election of SVB, upon the occurrence and during the continuance of an event of default, finance charges or interest rates, as applicable, will increase an additional five percentage points (5.00%) per annum above the rate that is otherwise applicable thereto upon the occurrence of such event of default, and the collateral handling fees will increase by one-half percent (0.50%).

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

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As discussed, should additional funding be required, we would expect to raise the required funds through borrowings or public or private sales of debt or equity securities. If we raise additional funds through the issuance of debt or equity securities, the ownership of our stockholders could be significantly diluted. If we obtain additional debt financing, a substantial portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, and the terms of the debt securities issued could impose significant restrictions on our operations.

The following table summarizes the quarterly changes in cash provided by (used in) operating activities:

<i>(\$ in thousands)</i>	Nine months ended		Variance	
	September 30,		2010 vs. 2009	
	2010	2009	\$	%
Cash used in operating activities	\$(2,513)	\$(5,519)	\$(3,006)	(54)%

Cash used in operating activities decreased by \$3 million, or 54%, in the nine-month period ended September 30, 2010 compared to the same period of 2009. This was primarily due to a \$4.8 million reduction in operating losses compared to 2009, offset by a \$1.8 million increase in our working capital requirements. Increased sales in the third quarter resulted in an increase in our receivables by approximately \$1.1 million compared to year end and an increase of \$2 million compared to June 30, 2010 levels. While we were able to reduce our finished goods inventory by \$1.3 million during the nine-month period ended September 30, 2010, this was offset by an increase of \$1.0 million in work-in-process inventory due to in-process order fulfillment for future PowerHouse orders. We also decreased our accounts payable by approximately \$500,000 compared to year end due to normal vendor payment schedules and consistent with the decrease in inventory. We anticipate that the level of cash used in operating activities will decrease in the fourth quarter of 2010 as we collect these outstanding receivables. However, the size and timing of orders and shipments during the fourth quarter may require us to invest in inventory or receivables to support the anticipated revenue growth.

The following table summarizes the quarterly changes in cash (used in) provided by investing activities:

<i>(\$ in thousands)</i>	Nine months ended		Variance	
	September 30,		2010 vs. 2009	
	2010	2009	\$	%
Cash (used in) provided by investing activities	\$ (532)	\$ 202	\$(734)	(363)%

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 funds to finance our ongoing operations. Capital expenditures were approximately \$532,000 in the nine-month period ending September 30, 2010, compared to approximately \$498,000 in the same period of 2009. Cash provided by sales and purchases of investments were \$0 in the nine-month period ending September 30, 2010, compared to approximately \$700,000 in the same period of 2009.

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

<i>(\$ in thousands)</i>	Nine months ended		Variance	
	September 30,		2010 vs. 2009	
	2010	2009	\$	%
Cash provided by financing activities	\$10,007	\$3,005	7,002	233%

The increases in funds provided by financing activities during the nine-month period ended September 30, 2010 primarily reflect the sale of common stock in February 2010 in a firm-commitment underwritten offering pursuant to which we sold approximately 13.25 million shares of common stock at a purchase price of \$0.75 per share, for proceeds, net of fees and expenses, of \$9.0 million. These proceeds were designed to strengthen our balance sheet and used to help fund our working capital requirements during 2010 and for general corporate purposes. We also drew \$1.0 million on our revolving line of credit in the nine-month period ended September 30, 2010, as compared to \$60,000 in the comparable period of 2009. Funds provided by financing activities during the nine-month period ended September 30, 2009 reflect the sale of common stock through a private placement to an institutional investor pursuant to which we sold 6.0 million shares of common stock at \$0.50 per share.

We believe that our cash and investments will be sufficient to fund our operations for at least the next 12 months. Our sales cycle is such that we generally have visibility 2-3 quarters in advance for future orders that allows us to predict revenues over this period of time with some degree of confidence. However, a sudden change in business volume, positive or negative,

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from any of our business or channel partners or in our direct business could significantly impact our expected revenues. The recent global economic downturn has reduced our confidence at predicting future revenues, and even with improving economic conditions, there is still uncertainty and risk in our forecasting. This 2-3 quarter window of sales visibility does provide us with some opportunity to adjust expenditures or take other measures to reduce our cash consumption if we can see and anticipate a shortfall in revenue or give us time to identify additional sources of funding if we anticipate an increase in our working capital requirements due to increased revenues or changes in our revenue mix. If there is a significant increase especially in our PowerHouse or our data center infrastructure solutions business, this could potentially impact the amount of working capital that we may require, due to the longer production time and cash cycle of sales of these products.

We expect the level of capital investments to remain similar in 2010 to those in 2009. We currently intend to invest in several PowerHouse systems to use for demonstration purposes in the U.S., China and the U.K. to help our sales efforts, but we are not planning any other major capital investments during the remainder of 2010.

Recent Accounting Pronouncements

In October 2009, the FASB updated FASB ASC 605, *Revenue Recognition* ("FASB ASC 605") that amended the criteria for separating consideration in multiple-deliverable arrangements. The amendments establish a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. The amendments will change the application of the residual method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. The relative selling price method allocates any discount in the arrangement proportionally to each deliverable on the basis of each deliverable's selling price. This update will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted and so we adopted this policy with effect from the beginning of our financial year on January 1, 2010. Other than increased disclosure requirements, adoption of this policy did not have any material impact on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

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

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

Our international business is subject to the typical risks of any international business, including, but not limited to, the risks described in Item 1A—"Risk Factors" in our 2009 Annual Report on Form 10-K. Accordingly, our future results could be materially harmed by the actual occurrence of any of these or other risks.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures.

Our Chief Executive Officer and our Chief Financial Officer, based on the evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, have concluded that, as of September 30, 2010, our disclosure controls and procedures were effective to ensure that the information we are required to disclose in reports that we file or submit under the Exchange Act, (i) is recorded, processed, summarized and reported within the time periods

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specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in internal control over financial reporting.

During the three months ended September 30, 2010, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and Rule 15d-15(d) under the Exchange Act that have materially affected, or that we believe are reasonably likely to materially affect, our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

You should carefully consider the risks described in Item 1A of our 2009 Annual Report on Form 10-K before making a decision to invest in our common stock or in evaluating Active Power and our business. The risks and uncertainties described in our 2009 Annual Report on Form 10-K are not the only ones we face. Additional risks and uncertainties that we do not presently know, or that we currently view as immaterial, may also impair our business operations. This report is qualified in its entirety by these risk factors.

The actual occurrence of any of the risks described in our 2009 Annual Report on Form 10-K could materially harm our business, financial condition and results of operations. In that case, the trading price of our common stock could decline.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Reserved.

Item 5. Other Information.

None.

Item 6. Exhibits.

The following documents are filed as exhibits to this report:

- 3.1* Restated Certificate of Incorporation (filed as Exhibit 3.1 to Active Power's Quarterly Report on Form 10-Q filed on July 28, 2006)
- 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)
- 3.3* Amendment to Second Amended and Restated Bylaws (filed as Exhibit 3.01 to Active Power's Current Report on Form 8-K filed on December 7, 2007)
- 4.1* Specimen certificate for shares of Common Stock (filed as Exhibit 4.1 to Active Power's IPO Registration Statement on Form S-1 (SEC File No. 333-36946))
- 4.2* Rights Agreement, dated as of December 13, 2001, between 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)

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- 4.3* See Exhibits 3.1, 3.2 and 3.3 for provisions of the Certificate of Incorporation and Bylaws of the registrant defining the rights of holders of common stock.
- 10.1 Second Amended and Restated Loan and Security Agreement dated August 5, 2010
- 10.2 Guarantee and Debenture dated August 5, 2010
- 31.1 Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
- 31.2 Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003

* Incorporated by reference to the indicated filing.

SIGNATURES

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

ACTIVE POWER, INC.
(Registrant)

October 26, 2010
(Date)

/s/ JAMES A. CLISHEM

James A. Clishe
President and Chief Executive Officer
(Principal Executive Officer)

October 26, 2010
(Date)

/s/ JOHN K. PENVER

John K. Penver
Vice President of Finance, Chief Financial Officer and Secretary
(Principal Financial and Accounting Officer)

SECOND AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT

This **SECOND AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT** (this “Agreement”) dated as of the Effective Date is between **SILICON VALLEY BANK**, a California corporation (“Bank”), with its principal place of business at 3003 Tasman Drive, Santa Clara, California 95054 (FAX (408) 654-1099) and **ACTIVE POWER, INC.**, a Delaware corporation (“Borrower”), with its principal place of business at 2128 W Braker Lane BK 12, Austin, TX 78758 (FAX (512) 836-4511), amends and restates the terms of that certain Amended and Loan and Security Agreement by and between Bank and Borrower dated as of October 31, 2008, as amended from time to time (the “Original Agreement”), and provides the terms on which Bank shall lend to Borrower and Borrower shall repay Bank. The parties agree as follows:

1 ACCOUNTING AND OTHER TERMS

Accounting terms not defined in this Agreement shall be construed following GAAP. Calculations and determinations must be made following GAAP. The term “financial statements” includes the notes and schedules. The terms “including” and “includes” always mean “including (or includes) without limitation,” in this or any Loan Document. Capitalized terms not otherwise defined in this Agreement shall have the meanings set forth in Section 13. All other terms contained in this Agreement, unless otherwise indicated, shall have the meanings provided by the Code, to the extent such terms are defined therein.

2 LOAN AND TERMS OF PAYMENT

2.1 Promise to Pay. Borrower hereby unconditionally promises to pay Bank the unpaid principal amount of all Advances hereunder with all interest, fees and finance charges due thereon as and when due in accordance with this Agreement.

2.1.1 Financing of Accounts.

(a) Availability.

(i) Subject to the terms of this Agreement, so long as no Advances with respect to Aggregate Eligible Receivables are outstanding, Borrower may request that Bank finance specific Eligible Accounts and Eligible Purchase Orders. Bank may, in its good faith business discretion, finance such Eligible Accounts and Eligible Purchase Orders by extending credit to Borrower in an amount equal to the result of the applicable Advance Rate multiplied by the face amount of the Eligible Account or Eligible Purchase Order. Bank may, in its sole discretion, change the Advance Rate for a particular Eligible Account and/or Eligible Purchase Order on a case by case basis.

(ii) Subject to the terms of this Agreement, so long as no Advances with respect to Eligible Accounts and/or Eligible Purchase Orders are outstanding pursuant to Section 2.1.1(a)(i), and provided that a Streamline Period is in effect, Borrower may request that Bank finance Eligible Accounts and Eligible Purchase Orders on an aggregate basis (the “**Aggregate Eligible Receivables**”). Bank may, in its good faith business discretion, finance Aggregate Eligible Receivables by extending credit to Borrower in an amount equal to the result of (i) the applicable Advance Rate for Eligible Accounts multiplied by the face amount of that portion of the Aggregate Eligible Receivables that constitutes Eligible Accounts plus (ii) the applicable Advance Rate for Eligible Purchase Orders multiplied by the face amount of that portion of the Aggregate Eligible Receivables that constitutes Eligible Purchase Orders. Bank may, in its sole discretion, change the Advance Rate for the Aggregate Eligible Receivables on a case by case basis.

(iii) Any extension of credit made pursuant to the terms of subsections (i) or (ii) above shall hereinafter be referred to as an "Advance". When Bank makes an Advance, the Eligible Account, Eligible Purchase Order, or Aggregate Eligible Receivable each become a separate "Financed Receivable".

(iv) On the Effective Date, Bank shall make a single Advance to Borrower which shall refinance all Indebtedness owing from Borrower to Bank pursuant to the Original Agreement.

(v) For sake of clarity, Borrower may not have Advances based upon Eligible Accounts and/or Eligible Purchase Orders outstanding at the same time that Advances based upon Aggregate Eligible Receivables are outstanding.

(b) Maximum Advances. The aggregate amount of all Advances outstanding at any time may not exceed the lesser of (A) Twelve Million Five Hundred Thousand Dollars (\$12,500,000) or (B) the applicable Advance Rate multiplied by the face amount of Eligible Accounts and Eligible Purchase Orders plus the Inventory Availability Amount less the sum of all outstanding Advances and Inventory Advances, less the Dollar Equivalent of the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve), less the amount of any Cash Management Services. The aggregate amount of Advances made with respect to Eligible Foreign Accounts shall not exceed Five Million Dollars (\$5,000,000) at any time. The aggregate amount of Advances made with respect to Eligible Purchase Orders shall not exceed One Million Five Hundred Thousand Dollars (\$1,500,000) at any time. If, at any time, the outstanding Credit Extensions exceed the foregoing limitations, Borrower shall immediately pay such excess to Bank.

(c) Borrowing Procedure. Borrower will deliver an Advance Request and Invoice Transmittal in the form attached hereto as **Exhibit C** signed by a Responsible Officer for each Advance it requests, accompanied by an accounts receivable aging, a purchase order report and a Borrowing Base Certificate in the form attached hereto as **Exhibit D**, with respect to requests for Advances based upon Aggregate Eligible Receivables (with the amount of such Aggregate Eligible Receivables to be calculated as of the last day of the most recent Reconciliation Period), or by invoices, with respect to requests for Advances based upon Eligible Accounts and Eligible Purchase Orders. Bank may rely on information set forth in or provided with the Advance Request and Invoice Transmittal. In addition, upon Bank's request, Borrower shall deliver to Bank any contracts, purchase orders, or other underlying supporting documentation with respect to such Eligible Account or Eligible Purchase Order.

(d) Credit Quality: Confirmations. At any time when a Streamline Period is not in effect (or, if a Streamline Period is in effect, at any time when Advances are outstanding or have been requested pursuant to Section 2.1.1(a)(i)), Bank may, at its option, conduct a credit check of the Account Debtor for each Account or Purchase Order requested by Borrower for financing hereunder in order to approve any such Account Debtor's credit before agreeing to finance such Account or Purchase Order. At any time when a Streamline Period is not in effect, or, if a Streamline Period is in effect at any time when Advances are outstanding or have been requested pursuant to Section 2.1.1(a)(i)), Bank may also verify directly with the respective Account Debtors the validity, amount and other matters relating to the Accounts or the Purchase Orders (including confirmations of Borrower's representations in Section 5.3) by means of mail, telephone or otherwise, either in the name of Borrower or Bank from time to time in its sole discretion.

(e) Accounts Notification/Collection. At any time when a Streamline Period is not in effect (or, if a Streamline Period is in effect, at any time when Advances are outstanding or have been requested pursuant to Section 2.1.1(a)(i)), Bank may notify any Person owing Borrower money of Bank's security interest in the funds and verify and/or collect the amount of the Account or Purchase Order.

(f) Maturity. This Agreement shall terminate and all Obligations outstanding hereunder shall be immediately due and payable on the Maturity Date.

(g) Suspension of Advances. Borrower's ability to request that Bank finance Eligible Accounts and Eligible Purchase Orders hereunder will terminate if, in Bank's sole discretion, there has been a material adverse change in the general affairs, management, results of operation, condition (financial or otherwise) or the prospect of repayment of the Obligations, or there has been any material adverse deviation by Borrower from the most recent business plan of Borrower presented to and accepted by Bank prior to the execution of this Agreement.

In addition, at any time when a Streamline Period is not in effect, any and all Advances made by Bank thereafter shall be made by Bank in its sole discretion in each instance, and Bank shall have no commitment or obligation to finance any Accounts or Purchase Orders during such time. Accordingly, there shall not be any recourse to Bank, nor liability of Bank, on account of any delay in Bank's making of, and/or any decline by Bank to make, any loan or advance requested hereunder.

2.1.2 Inventory Sublimit.

(a) Availability. Subject to the terms and conditions of this Agreement, Bank shall make Inventory Advances to Borrower not exceeding the lesser of (i) the Inventory Sublimit or the (ii) Inventory Availability Amount. Inventory Advances may be repaid and, prior to the Maturity Date, reborrowed, subject to the applicable terms and conditions precedent herein.

(b) Termination; Repayment. Interest with respect to Inventory Advances shall be due and payable on the first (1st) day of each month. The Inventory Sublimit terminates on the Maturity Date, when the principal amount of all Inventory Advances, the unpaid interest thereon, and all other Obligations relating to the Inventory Sublimit shall be immediately due and payable.

(c) Interest Rate for Inventory Sublimit. The Financed Inventory Balance shall accrue interest at a per annum rate equal to (i) one and one half percent (1.50%) above the Prime Rate at all times when a Streamline Period is in effect and (ii) three and five eighths percent (3.625%) above the Prime Rate at all times when a Streamline Period is not in effect. Notwithstanding the foregoing, at Bank's election upon the occurrence and during the continuance of an Event of Default, the Inventory Advances shall bear interest at a rate per annum which is five percentage points (5.0%) above the rate that is otherwise applicable thereto. Payment or acceptance of the increased interest rate provided in this Section is not a permitted alternative to timely payment and shall not constitute a waiver of any Event of Default or otherwise prejudice or limit any rights or remedies of Bank.

2.1.3 Letters of Credit Sublimit

(a) Bank shall, at Borrower's request, issue or have issued Letters of Credit denominated in Dollars or a Foreign Currency for Borrower's account. At all times when a Streamline Period is in effect, the aggregate Dollar Equivalent of the face amount of outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve) may not exceed the lesser of (I) One Million Five Hundred Thousand Dollars (\$1,500,000), minus the sum of all amounts used for Cash Management Services, or (II) the lesser of (A) Twelve Million Five Hundred Thousand Dollars (\$12,500,000) or (B) the applicable Advance Rate multiplied by the face amount of Eligible Accounts and Eligible Purchase Orders plus the Inventory Availability Amount minus the sum of all outstanding Advances and Inventory Advances and any amounts used for Cash Management Services. At all times when a Streamline Period is not in effect, the aggregate Dollar Equivalent of the face amount of outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve) may not exceed One Million Five Hundred Thousand Dollars (\$1,500,000), minus the sum of all amounts used for Cash Management Services and any amounts in excess thereof must be cash secured pursuant to subsection (b) below.

(b) If, on (i) the Maturity Date, (ii) the effective date of any termination of this Agreement or (iii) the date any Streamline Period ceases to be in effect, there are any outstanding Letters of Credit, then on such date Borrower shall provide to Bank cash collateral in an amount equal to one hundred five percent (105%) of the Dollar Equivalent of the face amount of all such Letters of Credit plus all interest, fees, and costs due or to become due in connection therewith (as estimated by Bank in its good faith business judgment), to secure all of the Obligations relating to such Letters of Credit. All Letters of Credit shall be in form and substance acceptable to Bank in its sole discretion and shall be subject to the terms and conditions of Bank's standard Application and Letter of Credit Agreement (the "**Letter of Credit Application**"). Borrower agrees to execute any further documentation in connection with the Letters of Credit as Bank may reasonably request. Borrower further agrees to be bound by the regulations and interpretations of the issuer of any Letters of Credit guaranteed by Bank and opened for

Borrower's account or by Bank's interpretations of any Letter of Credit issued by Bank for Borrower's account, and Borrower understands and agrees that Bank shall not be liable for any error, negligence, or mistake, whether of omission or commission, in following Borrower's instructions or those contained in the Letters of Credit or any modifications, amendments, or supplements thereto.

(c) The obligation of Borrower to immediately reimburse Bank for drawings made under Letters of Credit shall be absolute, unconditional, and irrevocable, and shall be performed strictly in accordance with the terms of this Agreement, such Letters of Credit, and the Letter of Credit Application.

(d) Borrower may request that Bank issue a Letter of Credit payable in a Foreign Currency. If a demand for payment is made under any such Letter of Credit, Bank shall treat such demand as an Advance to Borrower of the Dollar Equivalent of the amount thereof (plus fees and charges in connection therewith such as wire, cable, SWIFT or similar charges).

(e) To guard against fluctuations in currency exchange rates, upon the issuance of any Letter of Credit payable in a Foreign Currency, Bank shall create a reserve (the "**Letter of Credit Reserve**") in an amount equal to ten percent (10%) of the face amount of such Letter of Credit. The amount of the Letter of Credit Reserve may be adjusted by Bank from time to time to account for fluctuations in the exchange rate. The availability of funds under the Revolving Line shall be reduced by the amount of such Letter of Credit Reserve for as long as such Letter of Credit remains outstanding.

2.1.4 Cash Management Services Sublimit. Borrower may use Bank's cash management services, which may include merchant services, direct deposit of payroll, business credit card, and check cashing services identified in Bank's various cash management services agreements (collectively, the "**Cash Management Services**"), in an aggregate amount not to exceed (I) when a Streamline Period is in effect, the lesser of (A) One Million Five Hundred Thousand Dollars (\$1,500,000), minus the Dollar Equivalent of the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve) or (B) the lesser of (x) Twelve Million Five Hundred Thousand Dollars (\$12,500,000) or (z) the applicable Advance Rate multiplied by the face amount of Eligible Accounts and Eligible Purchase Orders plus the Inventory Availability Amount minus the sum of all outstanding principal amounts of any Advances and the Dollar Equivalent of the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve) or (II) when a Streamline Period is not in effect, Five Hundred Thousand Dollars (\$500,000), minus the Dollar Equivalent of the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve) and must be cash secured pursuant to the following sentence. If, on (i) the Maturity Date, (ii) the effective date of any termination of this Agreement or (iii) the date any Streamline Period ceases to be in effect, there are any outstanding Cash Management Services in use, then on such date Borrower shall provide to Bank cash collateral in an amount equal to one hundred five percent (105%) of the Cash Management Services then in use, plus all interest, fees, and costs due or to become due in connection therewith (as estimated by Bank in its good faith business judgment), to secure all of the Obligations relating to such Cash Management Services.

2.1.5 Aggregate Advance Limits. Notwithstanding the foregoing and any other provisions of this Agreement to the contrary, the aggregate amount of Advances made with respect to Eligible Purchase Orders plus the aggregate amount of Inventory Advances shall not exceed the gross face amount of Financed Receivables that constitute Eligible Accounts at any time.

2.2 Collections, Finance Charges, Remittances and Fees. The Obligations shall be subject to the following fees and Finance Charges. Unpaid fees and Finance Charges may, in Bank's discretion, accrue interest and fees as described in Section 9.2 hereof.

2.2.1 Collections. When a Streamline Period is not in effect, Collections will be credited to the Financed Receivable Balance for such Financed Receivable, but if an Event of Default has occurred and is continuing, Bank may apply Collections to the Obligations in any order it chooses. If Bank receives a payment for both a Financed Receivable and a non-Financed Receivable, the funds will first be applied to the Financed Receivable and, if there is no Event of Default then existing, the excess will be remitted to Borrower, subject to Section 2.2.7.

2.2.2 Facility Fee. A fully earned, non-refundable facility fee of Fifty Seven Thousand Five Hundred Dollars (\$57,500) is due upon execution of this Agreement and a fully earned, non-refundable facility fee of Sixty Two Thousand Five Hundred Dollars (\$62,500) is due upon the first anniversary of the execution of this Agreement (the “**Facility Fees**”).

2.2.3 Finance Charges. In computing Finance Charges on the Obligations under this Agreement (other than Inventory Advances), all Collections received by Bank shall be deemed applied by Bank on account of the Obligations (i) three (3) Business Days after receipt of the Collections when a Streamline Period is not in effect or (ii) on the same day as receipt of Collections when a Streamline Period is in effect. Borrower will pay a finance charge (the “Finance Charge”) on each Financed Receivable which is equal to the Applicable Rate divided by 360 multiplied by the number of days each such Financed Receivable is outstanding multiplied by the outstanding Financed Receivable Balance. If a Streamline Period is in effect, the Finance Charge for all Eligible Accounts and Eligible Purchase Orders is payable on the first day of each month. If a Streamline Period is not in effect, the Finance Charge is payable (i) with respect to an Eligible Account, when the Advance made based on such Financed Receivable is payable in accordance with Section 2.3 hereof and (ii) with respect to an Eligible Purchase Order, upon the earlier of (a) such Eligible Purchase Order becoming an Eligible Account or otherwise ceasing to be an Eligible Purchase Order or (b) the date one hundred twenty (120) days after the date of such Eligible Purchase Order. Upon the occurrence and during the continuance of an Event of Default, the Applicable Rate will increase an additional five percent (5.0%) per annum effective at Bank’s election upon the occurrence of such Event of Default. In the event that the aggregate amount of Finance Charges earned by Bank in any Reconciliation Period is less than the Minimum Finance Charge, Borrower shall pay to Bank an additional Finance Charge equal to (i) the Minimum Finance Charge minus (ii) the aggregate amount of all Finance Charges earned by Bank in such Reconciliation Period. Such additional Finance Charge shall be payable on the first day of the next Reconciliation Period.

2.2.4 Collateral Handling Fee. During any month when a Streamline Period is not in effect at all times, Borrower will pay to Bank a collateral handling fee equal to one twentieth of one percent (0.05%) per month of the Financed Receivable Balance for each Financed Receivable that constitutes an Eligible Account outstanding based upon a 360 day year (the “**Collateral Handling Fee**”). This fee is charged on a daily basis which is equal to the Collateral Handling Fee divided by 30, multiplied by the number of days each such Financed Receivable is outstanding, multiplied by the outstanding applicable Financed Receivable Balance. The Collateral Handling Fee is payable when the Advance made based on such Financed Receivable is payable in accordance with Section 2.3 hereof. In computing Collateral Handling Fees under this Agreement, all Collections received by Bank shall be deemed applied by Bank on account of Obligations (i) three (3) Business Days after receipt of the Collections when a Streamline Period is not in effect or (ii) on the same day as receipt of Collections when a Streamline Period is in effect. At Bank’s election, after an Event of Default, the Collateral Handling Fee will increase an additional 0.50% effective immediately upon such Event of Default.

2.2.5 Accounting. After each Reconciliation Period, Bank will provide an accounting of the transactions for that Reconciliation Period, including the amount of all Financed Receivables, Financed Inventory, all Collections, Adjustments, Finance Charges, Collateral Handling Fee and the Facility Fee. If Borrower does not object to the accounting in writing within thirty (30) days it shall be considered accurate. All Finance Charges and other interest and fees are calculated on the basis of a 360 day year and actual days elapsed.

2.2.6 Deductions. Bank may deduct fees, Finance Charges, Advances which become due pursuant to Section 2.3, and other amounts due pursuant to this Agreement from any Advances made or Collections received by Bank.

2.2.7 Lockbox; Account Collection Services.

(a) Borrower shall direct each domestic Account Debtor to remit payments with respect to domestic Accounts to a lockbox account established with Bank or to wire transfer payments to a cash collateral account that Bank controls (collectively, the “**Lockbox**”). It will be considered an immediate Event of Default if the Lockbox is not set-up and operational on the Effective Date.

(b) Provided no Event of Default exists or an event that with notice or lapse of time will be an Event of Default, if a Streamline Period is in effect, on the same day of receipt of such amounts by Bank, Bank

will turn over to Borrower the proceeds of the Accounts. Provided no Event of Default exists or an event that with notice or lapse of time will be an Event of Default, if a Streamline Period is not in effect, within three (3) days of receipt of such amounts by Bank, Bank will turn over to Borrower the proceeds of the Accounts (other than Collections with respect to Financed Receivables) in excess of the amounts for which Bank has made an Advance to Borrower, less any amounts due to Bank, such as the Finance Charge, the Facility Fee, payments due to Bank, other fees and expenses, or otherwise; provided, however, Bank may hold such excess amount with respect to Financed Receivables as a reserve until the end of the applicable Reconciliation Period if Bank, in its discretion, determines that other Financed Receivable(s) may no longer qualify as an Eligible Account at any time prior to the end of the subject Reconciliation Period. This Section does not impose any affirmative duty on Bank to perform any act other than as specifically set forth herein. All Accounts and the proceeds thereof are Collateral and if an Event of Default occurs, Bank may apply the proceeds of such Accounts to the Obligations.

(c) Borrower and Guarantor shall direct each foreign Account Debtor to remit payments with respect to foreign Accounts to a blocked account established with RBS that Bank controls (the “**RBS Account**”). It will be considered an immediate Event of Default if the RBS Accounts is not set-up and operational on the Effective Date. Provided no Event of Default exists or an event that with notice or lapse of time will be an Event of Default, if a Streamline Period is in effect, on the same day of receipt (or as agreed to by Borrower and Bank) of such amounts by Bank, Bank will turn over to Borrower or Guarantor the proceeds of such Accounts. Provided no Event of Default exists or an event that with notice or lapse of time will be an Event of Default, if a Streamline Period is not in effect, within three (3) days of receipt (or as agreed to by Borrower and Bank) of such amounts by Bank, Bank will turn over to Borrower or Guarantor the proceeds of such Accounts (other than Collections with respect to Financed Receivables) in excess of the amounts for which Bank has made an Advance to Borrower, less any amounts due to Bank, such as the Finance Charge, the Facility Fee, payments due to Bank, other fees and expenses, or otherwise; provided, however, Bank may hold such excess amount with respect to Financed Receivables as a reserve until the end of the applicable Reconciliation Period if Bank, in its discretion, determines that other Financed Receivable(s) may no longer qualify as an Eligible Account at any time prior to the end of the subject Reconciliation Period. This Section does not impose any affirmative duty on Bank to perform any act other than as specifically set forth herein. All Accounts and the proceeds thereof are Collateral and if an Event of Default occurs Bank may apply the proceeds of such Accounts to the Obligations.

2.2.8 Bank Expenses. Borrower shall pay all Bank Expenses (including reasonable attorneys’ fees and expenses, plus expenses, for documentation and negotiation of this Agreement) incurred through and after the Effective Date, when due.

2.3 Repayment of Obligations; Adjustments.

2.3.1 Repayment. If a Streamline Period is in effect, Borrower will repay each Advance on the Maturity Date. If a Streamline Period is not in effect, Borrower will repay each Advance on the earliest of: (a) the date on which payment is credited by the Bank for the Financed Receivable with respect to which the Advance was made, (b) the date on which the Financed Receivable is no longer an Eligible Account or an Eligible Purchase Order, (c) the date on which any Adjustment is asserted to the Financed Receivable (but only to the extent of the Adjustment if the Financed Receivable remains otherwise an Eligible Account or an Eligible Purchase Order), (d) the date on which there is a breach of any warranty or representation set forth in Section 5.3, (e) the Maturity Date (including any early termination), or (f) with respect to Financed Receivables that were Eligible Purchase Orders, the day one hundred twenty (120) days from the date of the Purchase Order. Each payment will also include all accrued Finance Charges and Collateral Handling Fees with respect to such Advance and all other amounts then due and payable hereunder. Borrower may prepay any Advances hereunder at any time without premium or penalty.

2.3.2 Repayment on Event of Default. When an Event of Default has occurred and is continuing, Borrower will, if Bank demands (or, upon the occurrence of an Event of Default under Section 8.5, immediately without notice or demand from Bank) repay all of the Advances and Inventory Advances. The demand may, at Bank’s option, include the Advance for each Financed Receivable then outstanding, each Inventory Advance then outstanding and all accrued Finance Charges, Collateral Handling Fee, attorneys’ and professional fees, court costs and expenses, and any other Obligations.

2.3.3 Debit of Accounts. Bank may debit any of Borrower's deposit accounts for payments or any amounts Borrower owes Bank hereunder. Bank shall promptly notify Borrower when it debits Borrower's accounts. These debits shall not constitute a set-off.

2.3.4 Adjustments. If, at any time during the term of this Agreement, any Account Debtor asserts an Adjustment, Borrower issues a credit memorandum, or any of the representations and warranties in Sections 5.3 and/or 5.11 or covenants in this Agreement are no longer true in all material respects with respect to any Financed Receivable or Financed Inventory, Borrower will promptly advise Bank.

2.4 Power of Attorney. Borrower irrevocably appoints Bank and its successors and assigns as attorney-in-fact and authorizes Bank, to: (a) following the occurrence and during the continuance of an Event of Default, (i) sell, assign, transfer, pledge, compromise, or discharge all or any part of the Financed Receivables; (ii) demand, collect, sue, and give releases to any Account Debtor for monies due and compromise, prosecute, or defend any action, claim, case or proceeding about the Financed Receivables, including filing a claim or voting a claim in any bankruptcy case in Bank's or Borrower's name, as Bank chooses; and (iii) prepare, file and sign Borrower's name on any notice, claim, assignment, demand, draft, or notice of or satisfaction of lien or mechanics' lien or similar document; and (b) at all times when a Streamline Period is not in effect, (i) notify all Account Debtors to pay Bank directly; (ii) receive, open, and dispose of mail addressed to Borrower; (iii) endorse Borrower's name on checks or other instruments (to the extent necessary to pay amounts owed pursuant to this Agreement); and (iv) execute on Borrower's behalf any instruments, documents, financing statements to perfect Bank's interests in the Financed Receivables and Collateral and do all acts and things necessary or expedient, as determined solely and exclusively by Bank, to protect or preserve, Bank's rights and remedies under this Agreement, as directed by Bank.

3 CONDITIONS OF LOANS

3.1 Conditions Precedent to Initial Credit Extension. Bank's agreement to make the initial Credit Extension is subject to the condition precedent that Bank shall have received, in form and substance satisfactory to Bank, such documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate, including, without limitation:

- (a) a certificate of the Secretary of Borrower with respect to articles, bylaws, incumbency and resolutions authorizing the execution and delivery of this Agreement;
- (b) a Second Amended and Restated Intellectual Property Security Agreement;
- (c) Perfection Certificate by Borrower;
- (d) Account Control Agreement/ Investment Account Control Agreement;
- (e) evidence satisfactory to Bank that the insurance policies required by Section 6.4 hereof are in full force and effect, together with appropriate evidence showing lender loss payable and/or additional insured clauses or endorsements in favor of Bank;
- (f) payment of the fees and Bank Expenses then due and payable;
- (g) Certificate of Foreign Qualification (if applicable);
- (h) Certificate of Good Standing/Legal Existence; and
- (i) such other documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate.

3.2 Conditions Precedent to all Credit Extensions. Bank's agreement to make each Credit Extension, including the initial Credit Extensions, is subject to the following:

- (a) receipt of (i) with respect to requests for Advances, the Advance Request and Invoice Transmittal, or (ii) with respect to the request for Inventory Advances, timely receipt of an executed Invoice Transmittal;

(b) Bank shall have (at its option), if a Streamline Period is not in effect, conducted the confirmations and verifications as described in Section 2.1.1 (d);

(c) each of the representations and warranties in Section 5.3 shall be true on the date of the Advance Request and Invoice Transmittal, as applicable, and on the effective date of each Credit Extension and no Event of Default shall have occurred and be continuing, or result from the Credit Extension. Each Credit Extension is Borrower's representation and warranty on that date that the representations and warranties in Section 5.3 remain true; and

(d) each of the representations and warranties in Section 5 (other than Section 5.3) shall be true in all material respects on the date of the Advance Request and Invoice Transmittal, as applicable, and on the effective date of each Credit Extension and no Event of Default shall have occurred and be continuing, or result from the Credit Extension. Each Credit Extension is Borrower's representation and warranty on that date that the representations and warranties in Section 5 (other than Section 5.3) remain true in all material respects.

4 CREATION OF SECURITY INTEREST

4.1 Grant of Security Interest. Borrower hereby grants Bank, to secure the payment and performance in full of all of the Obligations, a continuing security interest in, and pledges to Bank, the Collateral, wherever located, whether now owned or hereafter acquired or arising, and all proceeds and products thereof. Borrower represents, warrants, and covenants that the security interest granted herein shall be a first priority security interest in the Collateral, subject only to Permitted Liens. If Borrower shall at any time, acquire a commercial tort claim, with a value in excess of One Hundred Thousand Dollars (\$100,000), Borrower shall promptly notify Bank in a writing signed by Borrower of the general details thereof and grant to Bank in such writing a security interest therein and in the proceeds thereof, all upon the terms of this Agreement, with such writing to be in form and substance satisfactory to Bank.

If this Agreement is terminated, Bank's Lien in the Collateral shall continue until the Obligations (other than inchoate indemnity obligations) are repaid in full in cash. Upon payment in full in cash of the Obligations and at such time as Bank's obligation to make Advances has terminated, Bank shall, at Borrower's sole cost and expense, release its Liens in the Collateral and all rights therein shall revert to Borrower.

4.2 Authorization to File Financing Statements. Borrower hereby authorizes Bank to file financing statements, without notice to Borrower, with all appropriate jurisdictions to perfect or protect Bank's interest or rights hereunder, including a notice that any disposition of the Collateral, by either Borrower or any other Person, shall be deemed to violate the rights of Bank under the Code. Any such financing statements may indicate the Collateral as "all assets of the Debtor" or words of similar effect, or as being of an equal or lesser scope, or with greater detail, all in Bank's discretion.

5 REPRESENTATIONS AND WARRANTIES

Borrower represents and warrants as follows:

5.1 Due Organization and Authorization. Borrower and each of its Subsidiaries are duly existing and in good standing as a Registered Organization in their respective jurisdictions of formation and are qualified and licensed to do business and are in good standing in any jurisdiction in which the conduct of their respective business or ownership of property requires that they be qualified except where the failure to do so could not reasonably be expected to have a material adverse effect on Borrower's business. In connection with this Agreement, Borrower has delivered to Bank a completed certificate signed by Borrower, entitled "Perfection Certificate". Borrower represents and warrants to Bank that (a) Borrower's exact legal name is that indicated on the Perfection Certificate and on the signature page hereof; (b) Borrower is an organization of the type and is organized in the jurisdiction set

forth in the Perfection Certificate; (c) the Perfection Certificate accurately sets forth Borrower's organizational identification number or accurately states that Borrower has none; (d) the Perfection Certificate accurately sets forth Borrower's place of business, or, if more than one, its chief executive office as well as Borrower's mailing address (if different than its chief executive office); (e) Borrower (and each of its predecessors) has not, in the past five (5) years, changed its jurisdiction of formation, organizational structure or type, or any organizational number assigned by its jurisdiction; and (f) all other information set forth on the Perfection Certificate pertaining to Borrower and each of its Subsidiaries is accurate and complete in all material respects (it being understood and agreed that Borrower may from time to time update certain information in the Perfection Certificate after the Effective Date to the extent permitted by one or more specific provisions in this Agreement). If Borrower is not now a Registered Organization but later becomes one, Borrower shall promptly notify Bank of such occurrence and provide Bank with Borrower's organizational identification number.

The execution, delivery and performance by Borrower of the Loan Documents to which it is a party have been duly authorized, and do not (i) conflict with any of Borrower's organizational documents, (ii) contravene, conflict with, constitute a default under or violate any material Requirement of Law, (iii) contravene, conflict or violate any applicable order, writ, judgment, injunction, decree, determination or award of any Governmental Authority by which Borrower or any its Subsidiaries or any of their property or assets may be bound or affected, (iv) require any action by, filing, registration, or qualification with, or Governmental Approval from, any Governmental Authority (except for filings in connection with Bank's security interest and for such Governmental Approvals which have already been obtained and are in full force and effect or (v) constitute an event of default under any material agreement by which Borrower is bound. Borrower is not in default under any agreement to which it is a party or by which it is bound in which the default could reasonably be expected to have a material adverse effect on Borrower's business.

5.2 Collateral. Borrower has good title to or has rights in, and the power to transfer each item of the Collateral upon which it purports to grant a Lien hereunder, free and clear of any and all Liens except Permitted Liens. Borrower has no deposit accounts other than the deposit accounts with Bank, the deposit accounts, if any, described in the Perfection Certificate delivered to Bank in connection herewith, or of which Borrower has given Bank notice and taken such actions as are necessary to give Bank a perfected security interest therein. To the best of Borrower's knowledge, the Accounts are bona fide, existing obligations of the Account Debtors. All Inventory is in all material respects of good and marketable quality, free from material defects.

The Collateral is not in the possession of any third party bailee (such as a warehouse) except as otherwise provided in the Perfection Certificate, or as permitted pursuant to Section 7.2. None of the components of the Collateral shall be maintained at locations other than as provided in the Perfection Certificate or as permitted pursuant to Section 7.2. In the event that Borrower, after the date hereof, intends to store or otherwise deliver any portion of the Collateral with a value in excess of One Hundred Thousand Dollars (\$100,000) to a bailee, then such bailee must execute and deliver a bailee agreement in form and substance satisfactory to Bank in its sole discretion.

Borrower is the sole owner of its intellectual property, except for non-exclusive licenses granted to its customers in the ordinary course of business. To the best of Borrower's knowledge, each patent is valid and enforceable, and no part of the intellectual property has been judged invalid or unenforceable, in whole or in part, and to the best of Borrower's knowledge, no claim has been made that any part of the intellectual property violates the rights of any third party except to the extent such claim could not reasonably be expected to have a material adverse effect on Borrower's business. Except as noted on the Perfection Certificate, Borrower is not a party to, nor is bound by, any material license or other agreement with respect to which Borrower is the licensee (a) that prohibits or otherwise restricts Borrower from granting a security interest in Borrower's interest in such license or agreement or any other property, or (b) for which a default under or termination of could interfere with the Bank's right to sell any Collateral. Without prior consent from Bank, Borrower shall not enter into, or become bound by, any such license or agreement which is reasonably likely to have a material impact on Borrower's business or financial condition. Borrower shall take such steps as Bank requests to obtain the consent of, or waiver by, any person whose consent or waiver is necessary for all such licenses or contract rights to be deemed "Collateral" and for Bank to have a security interest in it that might otherwise be restricted or prohibited by law or by the terms of any such license or agreement, whether now existing or entered into in the future.

5.3 Financed Receivables. Borrower represents and warrants for each Financed Receivable:

- (a) Such Financed Receivable is an Eligible Account or an Eligible Purchase Order;

(b) Borrower is the owner of and has the legal right to sell, transfer, assign and encumber such Financed Receivable;

(c) The correct amount is on the Advance Request and Invoice Transmittal and is not disputed;

(d) With respect to Eligible Accounts, payment of the amount financed is not contingent on any obligation or contract and Borrower has fulfilled all its obligations to receive such payment as of the Advance Request and Invoice Transmittal date;

(e) Each Financed Receivable is based on an actual Purchase Order or sale and delivery of goods and/or services rendered, is due to Borrower, is not past due or in default, has not been previously sold, assigned, transferred, or pledged and is free of any liens, security interests and encumbrances other than Permitted Liens;

(f) There are no defenses, offsets, counterclaims or agreements for which the Account Debtor may claim any deduction or discount with the exception of customary credits, adjustments and/or discounts given to an Account Debtor by Borrower that have been disclosed to Bank in writing.

(g) Borrower reasonably believes no Account Debtor is insolvent or subject to any Insolvency Proceedings;

(h) Borrower has not filed or had filed against it Insolvency Proceedings and does not anticipate any filing;

(i) Bank has the right to endorse and/ or require Borrower to endorse all payments received on Financed Receivables and all proceeds of Collateral; and

(j) No representation, warranty or other statement of Borrower in any certificate or written statement given to Bank contains any untrue statement of a material fact or omits to state a material fact necessary to make the statement contained in the certificates or statement not misleading.

5.4 Litigation. There are no actions or proceedings pending or, to the knowledge of Borrower's Responsible Officers, threatened in writing by or against Borrower or any Subsidiary which could reasonably be expected to cause a Material Adverse Change.

5.5 No Material Deviation in Financial Statements. All consolidated financial statements for Borrower and any Subsidiaries delivered to Bank fairly present in all material respects Borrower's consolidated financial condition and Borrower's consolidated results of operations as of the dates and for the periods presented. There has not been any material deterioration in Borrower's consolidated financial condition since the date of the most recent financial statements submitted to Bank.

5.6 Solvency. The fair salable value of Borrower's assets (including goodwill minus disposition costs) exceeds the fair value of its liabilities; Borrower is not left with unreasonably small capital after the transactions in this Agreement; and Borrower is able to pay its debts (including trade debts) as they mature.

5.7 Regulatory Compliance. Borrower is not an "investment company" or a company "controlled" by an "investment company" under the Investment Company Act of 1940, as amended. Borrower is not engaged as one of its important activities in extending credit for margin stock (under Regulations X, T and U of the Federal Reserve Board of Governors). Neither Borrower nor any of its Subsidiaries is a "holding company" or an "affiliate" of a "holding company" or a "subsidiary company" of a "holding company" as each term is defined and used in the Public Utility Holding Company Act of 2005. Borrower has complied in all material respects with the Federal Fair Labor Standards Act. Borrower has not violated any laws, ordinances or rules, the violation of which could

reasonably be expected to cause a Material Adverse Change. None of Borrower's or any Subsidiary's properties or assets has been used by Borrower or any Subsidiary or, to the best of Borrower's knowledge, by previous Persons, in disposing, producing, storing, treating, or transporting any hazardous substance other than in material compliance with laws. Borrower and each of its Subsidiaries have obtained all consents, approvals and authorizations of, made all declarations or filings with, and given all notices to, all Government Authorities that are necessary to continue their respective businesses as currently conducted except where the failure to obtain or make such consents, declarations, notices or filings would not reasonably be expected to cause a Material Adverse Change.

5.8 Subsidiaries. Borrower does not own any stock, partnership interest or other equity securities except for Permitted Investments.

5.9 Tax Returns and Payments; Pension Contributions. Borrower and each Subsidiary have timely filed all required material tax returns and reports, and Borrower and each Subsidiary have timely paid all material foreign, federal, state and local taxes, assessments, deposits and contributions owed by Borrower and each Subsidiary. Borrower may defer payment of any contested taxes, provided that Borrower (a) in good faith contests its obligation to pay the taxes by appropriate proceedings promptly and diligently instituted and conducted, (b) notifies Bank in writing of the commencement of, and any material development in, the proceedings, (c) posts bonds or takes any other steps required to prevent the governmental authority levying such contested taxes from obtaining a Lien upon any of the Collateral that is other than a "Permitted Lien". Borrower is unaware of any claims or adjustments proposed for any of Borrower's prior tax years which could result in additional material taxes becoming due and payable by Borrower. Borrower has paid all amounts necessary to fund all present pension, profit sharing and deferred compensation plans in accordance with their terms, and Borrower has not withdrawn from participation in, and has not permitted partial or complete termination of, or permitted the occurrence of any other event with respect to, any such plan which could reasonably be expected to result in any liability of Borrower, including any liability to the Pension Benefit Guaranty Corporation or its successors or any other governmental agency.

5.10 Full Disclosure. No written representation, warranty or other statement of Borrower in any certificate or written statement given to Bank, as of the date such representation, warranty, or other statement was made, taken together with all such written certificates and written statements given to Bank, contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements contained in the certificates or statements not misleading (it being recognized by Bank that projections and forecasts provided by Borrower in good faith and based upon reasonable assumptions are not viewed as facts and that actual results during the period or periods covered by such projections and forecasts may differ from the projected or forecasted results).

5.11 Eligible Inventory. For any item of Inventory consisting of "Eligible Inventory" in any Borrowing Base Certificate, such Inventory (a) consists of raw materials or finished goods, in good, new, and commercially re-sellable condition, which is not perishable, returned, consigned, obsolete, not sellable, damaged, or defective, and is not comprised of demonstrative or custom inventory, works in progress, packaging or shipping materials, or supplies; (b) meets all applicable governmental standards; (c) has been manufactured in compliance with the Fair Labor Standards Act; (d) is not subject to any Liens, except the first priority Liens granted or in favor of Bank under this Agreement or any of the other Loan Documents; and (e) is located at the address set forth in Section 10 hereof or another address where Bank has obtained a Landlord Consent or Bailee Agreement from the owner thereof

6 AFFIRMATIVE COVENANTS

Borrower shall do all of the following:

6.1 Government Compliance.

(a) Maintain its and, except in a transaction permitted under Section 7.3, all its Subsidiaries' legal existence and good standing in their respective jurisdictions of formation and maintain qualification in each jurisdiction in which the failure to so qualify would reasonably be expected to have a material adverse effect on Borrower's business or operations. Borrower shall comply, and have each Subsidiary comply, with all laws, ordinances and regulations to which it is subject, noncompliance with which could have a material adverse effect on Borrower's business.

(b) Obtain all of the Governmental Approvals necessary for the performance by Borrower of its obligations under the Loan Documents to which it is a party and the grant of a security interest to Bank in all of its property. Borrower shall promptly provide copies of any such obtained Governmental Approvals to Bank.

6.2 Financial Statements, Reports, Certificates.

(a) Deliver to Bank: (i) as soon as available, but no later than thirty (30) days after the last day of each month, a company prepared consolidated and consolidating balance sheet and income statement covering Borrower and each of its Subsidiary's operations during the period certified by a Responsible Officer and in a form acceptable to Bank; (ii) as soon as available, but no later than one hundred fifty (150) days after the last day of Borrower's fiscal year, audited consolidated financial statements prepared under GAAP, consistently applied, together with an unqualified opinion on the financial statements from an independent certified public accounting firm reasonably acceptable to Bank; (iii) within five (5) days of filing, copies of all statements, reports and notices made available to Borrower's security holders or to any holders of Subordinated Debt and all reports on Form 10-K, 10-Q and 8-K filed with the Securities and Exchange Commission (provided that delivery of such reports may be made by providing Bank an electronic link to such filings); (iv) a prompt report of any legal actions pending or threatened against Borrower or any Subsidiary that could reasonably be expected to result in damages or costs to Borrower or any Subsidiary of Two Hundred Fifty Thousand Dollars (\$250,000.00) or more; (v) prompt notice of knowledge of an event that materially adversely affects the value of the Intellectual Property Collateral; (vi) as soon as available, but not later than December 31 of each year, annual financial projections submitted to Borrower's board of directors; (vii) as soon as available, but not later than sixty (60) days after the end of each calendar year, annual financial projections approved by Borrower's board of directors and (viii) such other budgets, sales projections, operating plans or other financial information reasonably requested by Bank.

(b) Within thirty (30) days after the last day of each month, deliver to Bank with the monthly financial statements a Compliance Certificate signed by a Responsible Officer in the form of **Exhibit B**.

(c) Allow Bank to audit Borrower's Collateral, including, but not limited to, Borrower's Accounts at Borrower's expense, upon reasonable notice to Borrower; provided, however, prior to the occurrence and continuance of an Event of Default, Borrower shall be obligated to pay for not more than two (2) audits per year. After the occurrence and during the continuance of an Event of Default, Bank may audit Borrower's Collateral, including, but not limited to, Borrower's Accounts at Borrower's expense and at Bank's sole and exclusive discretion and without notification and authorization from Borrower.

(d) Upon Bank's request, provide a written report respecting any Financed Receivable, if payment of any Financed Receivable does not occur by its due date and include the reasons for the delay.

(e) Provide Bank with, as soon as available, but no later than thirty (30) following each Reconciliation Period, an aged listing of accounts receivable and accounts payable by invoice date, an inventory report, a Deferred Revenue Report and a report of Purchase Orders in form acceptable to Bank.

(f) Provide Bank with, as soon as available, but no later than (i) thirty (30) days following the last day of each month when a Streamline Period is not in effect or (ii) fifteen (15) days after the fifteenth (15th) and last day of each month when a Streamline Period is in effect, a Borrowing Base Certificate in the form attached hereto as **Exhibit C**.

(g) Immediately upon a Streamline Period terminating, provide Bank with a current aging of Accounts and Purchase Orders and, to the extent not previously delivered to Bank, a copy of the invoice for each Eligible Account and Eligible Purchase Order and an Advance Request and Invoice Transmittal with respect to each such Account and Purchase Order.

6.3 Taxes. Borrower shall make, and cause each Subsidiary to make, timely payment of all material federal, state, and local taxes or assessments (other than taxes and assessments which Borrower is contesting in good faith, with adequate reserves maintained in accordance with GAAP) and will deliver to Bank, on demand, appropriate certificates attesting to such payments.

6.4 Insurance. Keep its business and the Collateral insured for risks and in amounts standard for companies in Borrower's industry and location, and as Bank may reasonably request. Insurance policies shall be in a form, with companies, and in amounts that are satisfactory to Bank. All property policies shall have a lender's loss payable endorsement showing Bank as lender loss payee and waive subrogation against Bank, and all liability policies shall show, or have endorsements showing, Bank as an additional insured. All policies (or the loss payable and additional insured endorsements) shall provide that the insurer shall endeavor to give Bank at least twenty (20) days notice before canceling, amending, or declining to renew its policy. At Bank's request, Borrower shall deliver certified copies of policies and evidence of all premium payments. Proceeds payable under any property policy shall, at Bank's option, be payable to Bank on account of the Obligations. Notwithstanding the foregoing, so long as no Event of Default has occurred and is continuing, Borrower shall have the option of applying the proceeds of any casualty policy toward the replacement or repair of destroyed or damaged property; provided that any such replaced or repaired property (i) shall be of equal or like value as the replaced or repaired Collateral and (ii) shall be deemed Collateral in which Bank has been granted a security interest. If Borrower fails to obtain insurance as required under this Section 6.4 or to pay any amount or furnish any required proof of payment to third persons and Bank, Bank may make all or part of such payment or obtain such insurance policies required in this Section 6.4, and take any action under the policies Bank deems prudent.

6.5 Accounts. To permit Bank to monitor Borrower's financial performance and condition, Borrower, shall maintain all of Borrower's domestic depository and operating accounts at Bank and all of Borrowers' securities accounts with Bank or Bank's affiliates. Guarantor shall maintain depository and operating accounts at Bank or Bank's affiliates which shall represent a percentage of Guarantor's GBP excess funds agreed upon by Borrower and Bank. Guarantor shall at all times maintain the RBS Account at RBS.

6.6 Inventory; Returns. Keep all Inventory in good and marketable condition, free from material defects. Returns and allowances between Borrower and its Account Debtors shall follow Borrower's customary practices as they exist at the Effective Date. Borrower must promptly notify Bank of all returns, recoveries, disputes and claims with respect to Inventory that involve more than One Hundred Thousand Dollars (\$100,000).

6.7 Liquidity. Borrower shall maintain at all times, to be tested as of the last day of each month, a ratio of (i) unrestricted cash, cash equivalents and marketable securities plus Eligible Accounts to (ii) all Indebtedness owing from Borrower to Bank of not less than 1.25 to 1.00.

6.8 Protection and Registration of Intellectual Property Rights. Borrower shall: (a) protect, defend and maintain the validity and enforceability of its intellectual property; (b) promptly advise Bank in writing of material infringements of its intellectual property; and (c) not allow any intellectual property material to Borrower's business to be abandoned, forfeited or dedicated to the public without Bank's written consent. If Borrower (i) obtains any patent, registered trademark or servicemark, registered copyright, registered mask work, or any pending application for any of the foregoing, whether as owner, licensee or otherwise, or (ii) applies for any patent or the registration of any trademark or servicemark, then Borrower shall immediately provide written notice thereof to Bank and shall execute such intellectual property security agreements and other documents and take such other actions as Bank shall request in its good faith business judgment to perfect and maintain a first priority perfected security interest in favor of Bank in such property, subject to Permitted Liens. If Borrower decides to register any copyrights or mask works in the United States Copyright Office, Borrower shall: (x) provide Bank with at least fifteen (15) days prior written notice of Borrower's intent to register such copyrights or mask works together with a copy of the application it intends to file with the United States Copyright Office (excluding exhibits thereto); (y) execute an intellectual property security agreement and such other documents and take such other actions as Bank may request in its good faith business judgment to perfect and maintain a first priority perfected security interest in favor of Bank in the copyrights or mask works intended to be registered with the United States Copyright Office, subject to Permitted Liens; and (z) record such intellectual property security agreement with the United States Copyright Office contemporaneously with filing the copyright or mask work application(s) with the United States Copyright Office. Borrower shall promptly provide to Bank copies of all applications that it files for patents or for the registration of trademarks, servicemarks, copyrights or mask works, together with evidence of the recording of the intellectual property security agreement necessary for Bank to perfect and maintain a first priority perfected security interest in such property, subject to Permitted Liens.

6.9 Litigation Cooperation. From the date hereof and continuing through the termination of this Agreement, make available to Bank, without expense to Bank, Borrower and its officers, employees and agents and Borrower's books and records, to the extent that Bank may deem them reasonably necessary to prosecute or defend any third-party suit or proceeding instituted by or against Bank with respect to any Collateral or relating to Borrower.

6.10 Further Assurances. Borrower shall execute any further instruments and take further action as Bank reasonably requests to perfect or continue Bank's security interest in the Collateral or to effect the purposes of this Agreement.

7 NEGATIVE COVENANTS

Borrower shall not do any of the following without Bank's prior written consent.

7.1 Dispositions. Convey, sell, lease, assign, transfer or otherwise dispose of (collectively, "**Transfer**"), or permit any of its Subsidiaries to Transfer, all or any part of its business or property, except for Transfers (a) of Inventory in the ordinary course of business; (b) of worn-out or obsolete Equipment; and (c) in connection with Permitted Liens and Permitted Investments.

7.2 Changes in Business, Management, Ownership, Control, or Business Locations. (a) Engage in or permit any of its Subsidiaries to engage in any business other than the businesses currently engaged in by Borrower and such Subsidiary, as applicable, or reasonably related thereto; (b) liquidate or dissolve; or (c) (i) if any Key Person ceases to hold such offices with Borrower and both (a) Borrower does not provide notice thereof to Bank within five (5) Business Days and (b) such key Person is not replaced by Borrower's board of directors within one hundred twenty (120) days or (ii) permit or suffer any Change in Control. Borrower shall not, without at least thirty (30) days prior written notice to Bank: (1) add any new offices or business locations, including warehouses (unless such new offices or business locations contain less than One Hundred Thousand Dollars (\$100,000) in Borrower's assets or property), (2) change its jurisdiction of organization, (3) change its organizational type from a corporation to another entity type, (4) change its legal name, or (5) change any organizational number (if any) assigned by its jurisdiction of organization.

7.3 Mergers or Acquisitions. Merge or consolidate, or permit any of its Subsidiaries to merge or consolidate, with any other Person, or acquire, or permit any of its Subsidiaries to acquire, all or substantially all of the capital stock or property of another Person; provided that a (i) Subsidiary may merge or consolidate into another Subsidiary or into Borrower.

7.4 Indebtedness. Create, incur, assume, or be liable for any Indebtedness, or permit any Subsidiary to do so, other than Permitted Indebtedness.

7.5 Encumbrance. Create, incur, allow or suffer any Lien on any of the Collateral, or assign or convey any right to receive income, including the sale of any Accounts, or permit any of its Subsidiaries to do so, except for Permitted Liens, permit any Collateral not to be subject to the first priority security interest granted herein, except for Permitted Liens, or enter into any agreement, document, instrument or other arrangement (except with or in favor of Bank) with any Person which directly or indirectly prohibits or has the effect of prohibiting Borrower or any Subsidiary from assigning, mortgaging, pledging, granting a security interest in or upon, or encumbering any of Borrower's or any Subsidiary's intellectual property, except as is otherwise permitted in Section 7.1 hereof and the definition of "Permitted Lien" herein.

7.6 Distributions; Investments. (a) Pay any dividends or make any distribution or payment or redeem, retire or purchase any capital stock provided that (i) Borrower may convert any of its convertible securities into other securities pursuant to the terms of such convertible securities or otherwise in exchange thereof, (ii) Borrower may pay dividends solely in common stock; and (iii) Borrower may repurchase the stock of former employees or consultants pursuant to stock repurchase agreements so long as an Event of Default does not exist at the time of such repurchase and would not exist after giving effect to such repurchase, provided such repurchase does not exceed in the aggregate of One Hundred Thousand Dollars (\$100,000) per fiscal year; or (b) make any Investment other than Permitted Investments, or permit any of its Subsidiaries to do so.

7.7 Transactions with Affiliates. Enter into or permit to exist any material transaction with any Affiliate of Borrower, except for transactions that are in the ordinary course of Borrower's business, upon fair and reasonable terms that are no less favorable to Borrower than would be obtained in an arm's length transaction with a non-affiliated Person; provided that the foregoing restriction shall not apply to (i) any transaction between Borrower and any of its Subsidiaries or between any Subsidiaries that is not otherwise prohibited by this Agreement, (ii) reasonable and customary fees paid to members of the board of directors of Borrower and its Subsidiaries, and (iii) compensation arrangements and benefit plans for officers and other employees of Borrower and its Subsidiaries entered into or maintained in the ordinary course of business.

7.8 Subordinated Debt. (a) Make or permit any payment on any Subordinated Debt, except under the terms of the subordination, intercreditor, or other similar agreement to which such Subordinated Debt is subject, or (b) amend any provision in any document relating to the Subordinated Debt which would increase the amount thereof or adversely affect the subordination thereof to Obligations owed to Bank.

7.9 Compliance. Become an "investment company" or a company controlled by an "investment company", under the Investment Company Act of 1940 or undertake as one of its important activities extending credit to purchase or carry margin stock (as defined in Regulation U of the Board of Governors of the Federal Reserve System), or use the proceeds of any Credit Extension for that purpose; fail to meet the minimum funding requirements of ERISA, permit a Reportable Event or Prohibited Transaction, as defined in ERISA, to occur; fail to comply with the Federal Fair Labor Standards Act or violate any other law or regulation, if the violation could reasonably be expected to have a material adverse effect on Borrower's business, or permit any of its Subsidiaries to do so; withdraw or permit any Subsidiary to withdraw from participation in, permit partial or complete termination of, or permit the occurrence of any other event with respect to, any present pension, profit sharing and deferred compensation plan which could reasonably be expected to result in any liability of Borrower, including any liability to the Pension Benefit Guaranty Corporation or its successors or any other governmental agency.

8 EVENTS OF DEFAULT

Any one of the following shall constitute an event of default (an "Event of Default") under this Agreement:

8.1 Payment Default. Borrower fails to pay any of the Obligations when due;

8.2 Covenant Default.

(a) Borrower fails or neglects to perform any obligation in Section 6.2, 6.3, 6.4, 6.5, 6.6, 6.7, or 6.8 or violates any covenant in Section 7;

(b) Borrower fails or neglects to perform, keep, or observe any other material term, provision, condition, covenant or agreement contained in this Agreement, any Loan Documents and as to any default under such other term, provision, condition, covenant or agreement that can be cured, has failed to cure the default within fifteen (15) days after the occurrence thereof; provided, however, grace and cure periods provided under this section shall not apply to financial covenants or any other covenants that are required to be satisfied, completed or tested by a date certain;

8.3 Material Adverse Change. A Material Adverse Change occurs;

8.4 Attachment; Levy; Restraint on Business. (a) (i) The service of process seeking to attach, by trustee or similar process, any funds of Borrower or of any entity under control of Borrower (including a Subsidiary) on deposit with Bank or any Bank Affiliate, or (ii) a notice of lien, levy, or assessment is filed against any of Borrower's assets by any government agency, and the same under subclauses (i) and (ii) hereof are not, within ten (10) days after the occurrence thereof, discharged or stayed (whether through the posting of a bond or otherwise); provided, however, no Credit Extensions shall be made during any ten (10) day cure period; and (b) (i) any material portion of Borrower's assets is attached, seized, levied on, or comes into possession of a trustee or receiver, or (ii) any court order enjoins, restrains, or prevents Borrower from conducting any part of its business;

8.5 Insolvency. (a) Borrower is unable to pay its debts (including trade debts) as they become due or otherwise becomes insolvent; (b) Borrower begins an Insolvency Proceeding; or (c) an Insolvency Proceeding is begun against Borrower and not dismissed or stayed within forty-five (45) days (but no Advances shall be made while of any of the conditions described in clause (a) exist and/or until any Insolvency Proceeding is dismissed);

8.6 Other Agreements. If there is a default in any agreement to which Borrower is a party with a third party or parties resulting in a right by such third party or parties, whether or not exercised, to accelerate the maturity of any Indebtedness in an amount in excess of Two Hundred Fifty Thousand Dollars (\$250,000) or that could result in a Material Adverse Change;

8.7 Judgments. One or more judgments, orders, or decrees for the payment of money in an amount, individually or in the aggregate, of at least Two Hundred Fifty Thousand Dollars (\$250,000) (not covered by independent third-party insurance as to which liability has been accepted by such insurance carrier) shall be rendered against Borrower and shall remain unsatisfied, unvacated, or unstayed for a period of fifteen (15) days after the entry thereof (provided that no Advances will be made prior to the satisfaction, vacation, or stay of such judgment, order, or decree);

8.8 Misrepresentations. Borrower or any Person acting for Borrower makes any representation, warranty, or other statement now or later in this Agreement, any Loan Document or in writing delivered to Bank or to induce Bank to enter this Agreement or any Loan Document, and such representation, warranty, or other statement is incorrect in any material respect when made;

8.9 Subordinated Debt. A default or breach occurs under any agreement between Borrower and any creditor of Borrower that signed a subordination agreement, intercreditor agreement, or other similar agreement with Bank, or any creditor that has signed such an agreement with Bank breaches any terms of the agreement;

8.10 Guaranty. (a) Any guaranty of any Obligations terminates or ceases for any reason to be in full force and effect; (b) Guarantor does not perform any material obligation or covenant under any guaranty of the Obligations; (c) any circumstance described in Sections 8.3, 8.4, 8.5, 8.7, or 8.8. occurs with respect to Guarantor, or (d) the liquidation, winding up, or termination of existence of Guarantor;

8.11 Governmental Approvals. Any Governmental Approval shall have been (a) revoked, rescinded, suspended, modified in an adverse manner or not renewed in the ordinary course for a full term or (b) subject to any decision by a Governmental Authority that designates a hearing with respect to any applications for renewal of any of such Governmental Approval or that could result in the Governmental Authority taking any of the actions described in clause (a) above, and such decision or such revocation, rescission, suspension, modification or non-renewal (i) has, or could reasonably be expected to have, a Material Adverse Change, or (ii) adversely affects the legal qualifications of Borrower or any of its Subsidiaries to hold such Governmental Approval in any applicable jurisdiction and such revocation, rescission, suspension, modification or non-renewal could reasonably be expected to affect the status of or legal qualifications of Borrower or any of its Subsidiaries to hold any Governmental Approval in any other jurisdiction which could reasonably be expected to result in a Material Adverse Change.

9 BANK'S RIGHTS AND REMEDIES

9.1 Rights and Remedies. When an Event of Default occurs and continues Bank may, without notice or demand, do any or all of the following:

(a) Declare all Obligations immediately due and payable (but if an Event of Default described in Section 8.5 occurs all Obligations are immediately due and payable without any action by Bank);

(b) Stop advancing money or extending credit for Borrower's benefit under this Agreement or under any other agreement between Borrower and Bank;

(c) Demand that Borrower (i) deposits cash with Bank in an amount equal to the aggregate amount of any Letters of Credit remaining undrawn, as collateral security for the repayment of any future drawings under such Letters of Credit, and Borrower shall forthwith deposit and pay such amounts, and (ii) pay in advance all Letter of Credit fees scheduled to be paid or payable over the remaining term of any Letters of Credit;

(d) Settle or adjust disputes and claims directly with Account Debtors for amounts, on terms and in any order that Bank considers advisable and notify any Person owing Borrower money of Bank's security interest in such funds and verify the amount of such account. Borrower shall collect all payments in trust for Bank and, if requested by Bank, immediately deliver the payments to Bank in the form received from the Account Debtor, with proper endorsements for deposit;

(e) Make any payments and do any acts it considers necessary or reasonable to protect its security interest in the Collateral. Borrower shall assemble the Collateral if Bank requests and make it available as Bank designates. Bank may enter premises where the Collateral is located, take and maintain possession of any part of the Collateral, and pay, purchase, contest, or compromise any Lien which appears to be prior or superior to its security interest and pay all expenses incurred. Borrower grants Bank a license to enter and occupy any of its premises, without charge, to exercise any of Bank's rights or remedies;

(f) Apply to the Obligations any (i) balances and deposits of Borrower it holds, or (ii) any amount held by Bank owing to or for the credit or the account of Borrower;

(g) Ship, reclaim, recover, store, finish, maintain, repair, prepare for sale, advertise for sale, and sell the Collateral. Bank is hereby granted a non-exclusive, royalty-free license or other right to use, without charge, Borrower's labels, patents, copyrights, mask works, rights of use of any name, trade secrets, trade names, trademarks, service marks, and advertising matter, or any similar property as it pertains to the Collateral, in completing production of, advertising for sale, and selling any Collateral and, in connection with Bank's exercise of its rights under this Section, Borrower's rights under all licenses and all franchise agreements inure to Bank's benefit;

(h) Place a "hold" on any account maintained with Bank and/or deliver a notice of exclusive control, any entitlement order, or other directions or instructions pursuant to any control agreement or similar agreements providing control of any Collateral;

(i) Demand and receive possession of Borrower's Books; and

(j) Exercise all rights and remedies available to Bank under the Loan Documents or at law or equity, including all remedies provided by the Code (including disposal of the Collateral pursuant to the terms thereof).

9.2 Protective Payments. If Borrower fails to obtain insurance called for by Section 6.4 or fails to pay any premium thereon or fails to pay any other amount which Borrower is obligated to pay under this Agreement or by any other Loan Document, Bank may obtain such insurance or make such payment, and all amounts so paid by Bank are Bank Expenses and immediately due and payable, bearing interest at the then highest applicable rate, and secured by the Collateral. Bank will make reasonable effort to provide Borrower with notice of Bank obtaining such insurance at the time it is obtained or within a reasonable time thereafter. No payments by Bank are deemed an agreement to make similar payments in the future or Bank's waiver of any Event of Default.

9.3 Bank's Liability for Collateral. So long as Bank complies with reasonable banking practices and the Code regarding the safekeeping of Collateral in possession or under the control of Bank, Bank shall not be liable or responsible for: (a) the safekeeping of the Collateral; (b) any loss or damage to the Collateral; (c) any diminution in the value of the Collateral; or (d) any act or default of any carrier, warehouseman, bailee, or other Person. Except as set forth above, Borrower bears all risk of loss, damage or destruction of the Collateral.

9.4 Remedies Cumulative. Bank's failure, at any time or times, to require strict performance by Borrower of any provision of this Agreement or any other Loan Document shall not waive, affect, or diminish any

right of Bank thereafter to demand strict performance and compliance herewith or therewith. No waiver hereunder shall be effective unless signed by Bank and then is only effective for the specific instance and purpose for which it is given. Bank's rights and remedies under this Agreement and the other Loan Documents are cumulative. Bank has all rights and remedies provided under the Code, by law, or in equity. Bank's exercise of one right or remedy is not an election, and Bank's waiver of any Event of Default is not a continuing waiver. Bank's delay in exercising any remedy is not a waiver, election, or acquiescence.

9.5 Demand Waiver. Borrower waives demand, notice of default or dishonor, notice of payment and nonpayment, notice of any default, nonpayment at maturity, release, compromise, settlement, extension, or renewal of accounts, documents, instruments, chattel paper, and guarantees held by Bank on which Borrower is liable.

10 NOTICES.

All notices, consents, requests, approvals, demands, or other communication by any party to this Agreement or any other Loan Document must be in writing and shall be deemed to have been validly served, given, or delivered: (a) upon the earlier of actual receipt and three (3) Business Days after deposit in the U.S. mail, first class, registered or certified mail return receipt requested, with proper postage prepaid; (b) upon transmission, when sent by facsimile transmission; (c) one (1) Business Day after deposit with a reputable overnight courier with all charges prepaid; or (d) when delivered, if hand-delivered by messenger, all of which shall be addressed to the party to be notified and sent to the address or facsimile number provided at the beginning of this Agreement. Bank or Borrower may change its address or facsimile number by giving the other party written notice thereof in accordance with the terms of this Section 10.

11 CHOICE OF LAW, VENUE, JURY TRIAL WAIVER AND JUDICIAL REFERENCE

California law governs the Loan Documents without regard to principles of conflicts of law. Borrower and Bank each submit to the exclusive jurisdiction of the State and Federal courts in Santa Clara County, California; provided, however, that nothing in this Agreement shall be deemed to operate to preclude Bank from bringing suit or taking other legal action in any other jurisdiction to realize on the Collateral or any other security for the Obligations, or to enforce a judgment or other court order in favor of Bank. Borrower expressly submits and consents in advance to such jurisdiction in any action or suit commenced in any such court, and Borrower hereby waives any objection that it may have based upon lack of personal jurisdiction, improper venue, or forum non conveniens and hereby consents to the granting of such legal or equitable relief as is deemed appropriate by such court. Borrower hereby waives personal service of the summons, complaints, and other process issued in such action or suit and agrees that service of such summons, complaints, and other process may be made by registered or certified mail addressed to Borrower at the address set forth in Section 10 of this Agreement and that service so made shall be deemed completed upon the earlier to occur of Borrower's actual receipt thereof or three (3) days after deposit in the U.S. mails, proper postage prepaid.

TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, BORROWER AND BANK EACH WAIVE THEIR RIGHT TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION ARISING OUT OF OR BASED UPON THIS AGREEMENT, THE LOAN DOCUMENTS OR ANY CONTEMPLATED TRANSACTION, INCLUDING CONTRACT, TORT, BREACH OF DUTY AND ALL OTHER CLAIMS. THIS WAIVER IS A MATERIAL INDUCEMENT FOR BOTH PARTIES TO ENTER INTO THIS AGREEMENT. EACH PARTY HAS REVIEWED THIS WAIVER WITH ITS COUNSEL.

WITHOUT INTENDING IN ANY WAY TO LIMIT THE PARTIES' AGREEMENT TO WAIVE THEIR RESPECTIVE RIGHT TO A TRIAL BY JURY, if the above waiver of the right to a trial by jury is not enforceable, the parties hereto agree that any and all disputes or controversies of any nature between them arising at any time shall be decided by a reference to a private judge, mutually selected by the parties (or, if they cannot agree, by the Presiding Judge of the Santa Clara County, California Superior Court) appointed in accordance with California Code of Civil Procedure Section 638 (or pursuant to comparable provisions of federal law if the dispute falls within the exclusive jurisdiction of the federal courts), sitting without a jury, in Santa Clara County, California; and the parties hereby submit to the jurisdiction of such court. The reference proceedings shall be conducted pursuant to and in accordance with the provisions of California Code of Civil Procedure §§ 638 through 645.1, inclusive. The private judge shall have the power, among others, to grant provisional relief, including without limitation, entering

temporary restraining orders, issuing preliminary and permanent injunctions and appointing receivers. All such proceedings shall be closed to the public and confidential and all records relating thereto shall be permanently sealed. If during the course of any dispute, a party desires to seek provisional relief, but a judge has not been appointed at that point pursuant to the judicial reference procedures, then such party may apply to the Santa Clara County, California Superior Court for such relief. The proceeding before the private judge shall be conducted in the same manner as it would be before a court under the rules of evidence applicable to judicial proceedings. The parties shall be entitled to discovery which shall be conducted in the same manner as it would be before a court under the rules of discovery applicable to judicial proceedings. The private judge shall oversee discovery and may enforce all discovery rules and order applicable to judicial proceedings in the same manner as a trial court judge. The parties agree that the selected or appointed private judge shall have the power to decide all issues in the action or proceeding, whether of fact or of law, and shall report a statement of decision thereon pursuant to the California Code of Civil Procedure § 644(a). Nothing in this paragraph shall limit the right of any party at any time to exercise self-help remedies, foreclose against collateral, or obtain provisional remedies. The private judge shall also determine all issues relating to the applicability, interpretation, and enforceability of this paragraph.

12 GENERAL PROVISIONS

12.1 Successors and Assigns. This Agreement binds and is for the benefit of the successors and permitted assigns of each party. Borrower may not assign this Agreement or any rights or obligations under it without Bank's prior written consent which may be granted or withheld in Bank's discretion. Bank has the right, without the consent of or notice to Borrower, to sell, transfer, negotiate, or grant participation in all or any part of, or any interest in, Bank's obligations, rights and benefits under this Agreement, the Loan Documents or any related agreement.

12.2 Indemnification. Borrower agrees to indemnify, defend, and hold Bank and its officers, directors, employees, agents, attorneys or any other Person affiliated with or representing Bank (each, an "Indemnified Person") harmless against: (a) all obligations, demands, claims, and liabilities (collectively, "Claims") asserted by any other party in connection with the transactions contemplated by the Loan Documents; and (b) all losses or Bank Expenses incurred, or paid by such Indemnified Person from, following, or arising from transactions between Bank and Borrower (including reasonable attorneys' fees and expenses), except for Claims and/or losses directly caused by such Indemnified Person's gross negligence or willful misconduct.

12.3 Right of Set-Off. Borrower hereby grants to Bank, a lien, security interest and right of setoff as security for all Obligations to Bank, whether now existing or hereafter arising upon and against all deposits, credits, collateral and property, now or hereafter in the possession, custody, safekeeping or control of Bank or any entity under the control of Bank (including a Bank subsidiary) or in transit to any of them. At any time after the occurrence and during the continuance of an Event of Default, without demand or notice, Bank may set off the same or any part thereof and apply the same to any liability or obligation of Borrower even though unmatured and regardless of the adequacy of any other collateral securing the Obligations. ANY AND ALL RIGHTS TO REQUIRE BANK TO EXERCISE ITS RIGHTS OR REMEDIES WITH RESPECT TO ANY OTHER COLLATERAL WHICH SECURES THE OBLIGATIONS, PRIOR TO EXERCISING ITS RIGHT OF SETOFF WITH RESPECT TO SUCH DEPOSITS, CREDITS OR OTHER PROPERTY OF BORROWER, ARE HEREBY KNOWINGLY, VOLUNTARILY AND IRREVOCABLY WAIVED.

12.4 Time of Essence. Time is of the essence for the performance of all Obligations in this Agreement.

12.5 Severability of Provisions. Each provision of this Agreement is severable from every other provision in determining the enforceability of any provision.

12.6 Correction of Loan Documents. Bank may correct patent errors and fill in any blanks in this Agreement and the other Loan Documents consistent with the agreement of the parties, so long as Bank provides Borrower with written notice of such correction and allows Borrower at least ten (10) days to object to such correction. In the event of such objection, such correction shall not be made except by an amendment signed by both Bank and Borrower.

12.7 Amendments in Writing; Integration. All amendments to this Agreement must be in writing signed by both Bank and Borrower. This Agreement and the Loan Documents represent the entire agreement about this subject matter, and supersede prior negotiations or agreements. All prior agreements, understandings, representations, warranties, and negotiations between the parties about the subject matter of this Agreement and the Loan Documents merge into this Agreement and the Loan Documents.

12.8 Counterparts. This Agreement may be executed in any number of counterparts and by different parties on separate counterparts, each of which, when executed and delivered, are an original, and all taken together, constitute one Agreement.

12.9 Survival. All covenants, representations and warranties made in this Agreement continue in full force until this Agreement has terminated pursuant to its terms and all Obligations (other than inchoate indemnity obligations and any other obligations which, by their terms, are to survive the termination of this Agreement) have been satisfied. The obligation of Borrower in Section 12.2 to indemnify Bank shall survive until the statute of limitations with respect to such claim or cause of action shall have run.

12.10 Confidentiality. In handling any confidential information, Bank shall exercise the same degree of care that it exercises for its own proprietary information, but disclosure of information may be made: (a) to Bank's Subsidiaries or Affiliates that have agreed to the terms of this provision; (b) to prospective transferees or purchasers of any interest in the Credit Extensions (provided, however, Bank shall obtain such prospective transferee's or purchaser's agreement to the terms of this provision); (c) as required by law, regulation, subpoena, or other order; (d) to Bank's regulators or as otherwise required in connection with Bank's examination or audit; (e) as Bank considers appropriate in exercising remedies under the Loan Documents; and (f) to third-party service providers of Bank so long as such service providers have executed a confidentiality agreement with Bank with terms no less restrictive than those contained herein. Confidential information does not include information that either: (i) is in the public domain or in Bank's possession when disclosed to Bank, or becomes part of the public domain after disclosure to Bank through no fault of Bank; or (ii) is disclosed to Bank by a third party, if Bank does not know that the third party is prohibited from disclosing the information.

Bank may use confidential information for any purpose, including, without limitation, for the development of client databases, reporting purposes, and market analysis, so long as Bank does not disclose Borrower's identity or the identity of any person associated with Borrower unless otherwise expressly permitted by this Agreement. The provisions of the immediately preceding sentence shall survive the termination of this Agreement.

12.11 Attorneys' Fees, Costs and Expenses. In any action or proceeding between Borrower and Bank arising out of or relating to the Loan Documents, the prevailing party shall be entitled to recover its reasonable attorneys' fees and other costs and expenses incurred, in addition to any other relief to which it may be entitled.

12.12 Effect of Amendment and Restatement. Except as otherwise set forth herein, this Agreement is intended to and does completely amend and restate, without novation, the Original Agreement. All security interests granted under the Original Agreement are hereby confirmed and ratified and shall continue to secure all Obligations under this Agreement.

13 DEFINITIONS

13.1 Definitions. In this Agreement:

"Account" is any "account" as defined in the Code with such additions to such term as may hereafter be made, and includes, without limitation, all accounts receivable and other sums owing to Borrower.

"Account Debtor" is as defined in the Code and shall include, without limitation, any person liable on any Financed Receivable, such as, a guarantor of the Financed Receivable and any issuer of a letter of credit or banker's acceptance and shall also include, with respect to Purchase Orders, Borrower's customers for such Purchase Orders.

“Adjustments” are all discounts, allowances, returns, disputes, counterclaims, offsets, defenses, rights of recoupment, rights of return, warranty claims, or short payments, asserted by or on behalf of any Account Debtor for any Financed Receivable.

“Advance” is defined in Section 2.1.1.

“Advance Rate” is (i) with respect to Eligible Accounts, eighty percent (80.0%), net of any offsets related to each specific Account Debtor and (ii) with respect to Eligible Purchase Orders, fifty percent (50.0%).

“Advance Request and Invoice Transmittal” shows Eligible Accounts, Eligible Purchase Orders and/or Aggregate Eligible Receivables, which Bank may finance, and (a) with respect to requests for Advances based upon Eligible Accounts and Eligible Purchase Orders, includes the Account Debtor’s name, address, invoice amount, invoice date and invoice number, and (b) with respect to requests for Advances based upon Aggregate Eligible Receivables, includes (i) the current outstanding amount of Advances made based upon Aggregate Eligible Receivables, and (ii) the amount of Aggregate Eligible Receivables available to be financed.

“Affiliate” of any Person is a Person that owns ten percent (10%) or more of or controls directly or indirectly the Person, any Person that controls or is controlled by or is under common control with the Person, and each of that Person’s senior executive officers, directors, partners and, for any Person that is a limited liability company, that Person’s managers and members.

“Aggregate Eligible Receivables” is defined in Section 2.1.1.

“Applicable Rate” is (A) for Advances made with respect to Eligible Accounts a per annum rate equal to the Prime Rate plus one and one half percent (1.50%) and (B) for Advances made with respect to Eligible Purchase Orders a per annum rate equal to (I) the Prime Rate plus one and one quarter percent (1.25%) when a Streamline Period is not in effect or (II) the Prime Rate plus two percent (2.00%) when a Streamline Period is in effect.

“Bank Expenses” are all audit fees and expenses, costs, and expenses (including reasonable attorneys’ fees and expenses) for preparing, amending, negotiating, administering, defending and enforcing the Loan Documents (including, without limitation, those incurred in connection with appeals or Insolvency Proceedings) or otherwise incurred with respect to Borrower.

“Borrower’s Books” are all Borrower’s books and records including ledgers, federal and state tax returns, records regarding Borrower’s assets or liabilities, the Collateral, business operations or financial condition, and all computer programs or storage or any equipment containing such information.

“Business Day” is any day that is not a Saturday, Sunday or a day on which Bank is closed.

“Change in Control” means any event, transaction, or occurrence as a result of which (a) any “person” (as such term is defined in Sections 3(a)(9) and 13(d)(3) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), other than a trustee or other fiduciary holding securities under an employee benefit plan of Borrower, is or becomes a beneficial owner (within the meaning Rule 13d-3 promulgated under the Exchange Act), directly or indirectly, of securities of Borrower, representing twenty-five percent (25%) or more of the combined voting power of Borrower’s then outstanding securities; or (b) during any period of twelve consecutive calendar months, individuals who at the beginning of such period constituted the Board of Directors of Borrower (together with any new directors whose nomination for election by the Board of Directors of Borrower was approved by a vote of at least a majority of the directors then still in office who either were directors at the beginning of such period or whose election or nomination for election was previously so approved, in each case, either by specific vote or by approval of a proxy statement issued by Borrower on behalf of its entire Board of Directors in which such individual is named as nominee for director) cease for any reason other than death or disability to constitute a majority of the directors then in office.

“Code” is the Uniform Commercial Code, as the same may, from time to time, be enacted and in effect in the State of California; provided, that, to the extent that the Code is used to define any term herein or in any Loan

Document and such term is defined differently in different Articles or Divisions of the Code, the definition of such term contained in Article or Division 9 shall govern; provided further, that in the event that, by reason of mandatory provisions of law, any or all of the attachment, perfection, or priority of, or remedies with respect to, Bank's Lien on any Collateral is governed by the Uniform Commercial Code in effect in a jurisdiction other than the State of California, the term "**Code**" shall mean the Uniform Commercial Code as enacted and in effect in such other jurisdiction solely for purposes on the provisions thereof relating to such attachment, perfection, priority, or remedies and for purposes of definitions relating to such provisions.

"**Collateral**" is any and all properties, rights and assets of Borrower described on Exhibit A.

"**Collateral Handling Fee**" is defined in Section 2.2.4.

"**Collections**" are all funds received by Bank from or on behalf of an Account Debtor for Financed Receivables.

"**Compliance Certificate**" is attached as Exhibit B.

"**Contingent Obligation**" is, for any Person, any direct or indirect liability, contingent or not, of that Person for (a) any indebtedness, lease, dividend, letter of credit or other obligation of another such as an obligation directly or indirectly guaranteed, endorsed, co-made, discounted or sold with recourse by that Person, or for which that Person is directly or indirectly liable; (b) any obligations for undrawn letters of credit for the account of that Person; and (c) all obligations from any interest rate, currency or commodity swap agreement, interest rate cap or collar agreement, or other agreement or arrangement designated to protect a Person against fluctuation in interest rates, currency exchange rates or commodity prices; but "Contingent Obligation" does not include endorsements in the ordinary course of business. The amount of a Contingent Obligation is the stated or determined amount of the primary obligation for which the Contingent Obligation is made or, if not determinable, the maximum reasonably anticipated liability for it determined by the Person in good faith; but the amount may not exceed the maximum of the obligations under any guarantee or other support arrangement.

"**Credit Extension**" is any Advance, Inventory Advance, Letter of Credit, amount utilized for Cash Management Services or any other extension of credit by Bank for Borrower's benefit.

"**Deferred Revenue**" is all amounts received or invoiced, as appropriate, in advance of performance under contracts and not yet recognized as revenue.

"**Dollars**," "**dollars**" or use of the sign "\$" means only lawful money of the United States and not any other currency, regardless of whether that currency uses the "\$" sign to denote its currency or may be readily converted into lawful money of the United States.

"**Effective Date**" is the date Bank executes this Agreement as indicated on the signature page hereof.

"**Eligible Accounts**" are billed Accounts in the ordinary course of Borrower's business that meet all Borrower's representations and warranties in Section 5.3, have been, at the option of Bank, if a Streamline Period is not in effect, confirmed in accordance with Section 2.1.1 (d), and are due and owing from Account Debtors deemed creditworthy by Bank in its sole discretion. Without limiting the fact that the determination of which Accounts are eligible hereunder is a matter of Bank discretion in each instance, Eligible Accounts shall not include the following Accounts (which listing may be amended or changed in Bank's discretion with notice to Borrower):

- (a) Accounts that the Account Debtor has not paid within ninety (90) days of invoice date regardless of invoice payment period terms;
- (b) Accounts billed and payable outside of the United States, other than Eligible Foreign Accounts;

(c) Accounts owing from an Account Debtor to the extent that Borrower is indebted or obligated in any manner to the Account Debtor (as creditor, lessor, supplier or otherwise - sometimes called “contra” accounts, accounts payable, customer deposits or credit accounts), with the exception of customary credits, adjustments and/or discounts given to an Account Debtor by Borrower in the ordinary course of its business;

(d) At all times when a Streamline Period is in effect, Accounts owing from an Account Debtor, including Affiliates, whose total obligations to Borrower exceed thirty-five (35%) of all Accounts, for the amounts that exceed that percentage, unless Bank approves in writing;

(e) Accounts for which the Account Debtor is Borrower’s Affiliate, officer, employee, or agent;

(f) Accounts owing from an Account Debtor which is a United States government entity or any department, agency, or instrumentality thereof unless Borrower has assigned its payment rights to Bank and the assignment has been acknowledged under the Federal Assignment of Claims Act of 1940, as amended;

(g) Accounts for demonstration or promotional equipment, or in which goods are consigned, or sold on a “sale guaranteed”, “sale or return”, “sale on approval”, or other terms if Account Debtor’s payment may be conditional;

(h) Accounts owing from an Account Debtor that has not been invoiced or where goods or services have not yet been rendered to the Account Debtor (sometimes called memo billings or pre-billings);

(i) Accounts owing from an Account Debtor the amount of which may be subject to withholding based on the Account Debtor’s satisfaction of Borrower’s complete performance (but only to the extent of the amount withheld; sometimes called retainage billings);

(j) Accounts subject to trust provisions, subrogation rights of a bonding company, or a statutory trust;

(k) Accounts owing from an Account Debtor that has been invoiced for goods that have not been shipped to the Account Debtor unless Bank, Borrower, and the Account Debtor have entered into an agreement acceptable to Bank in its sole discretion wherein the Account Debtor acknowledges that (i) it has title to and has ownership of the goods wherever located, (ii) a bona fide sale of the goods has occurred, and (iii) it owes payment for such goods in accordance with invoices from Borrower (sometimes called “bill and hold” accounts);

(l) Accounts that represent non-trade receivables or that are derived by means other than in the ordinary course of Borrower’s business;

(m) Accounts subject to chargebacks or others payment deductions taken by an Account Debtor (but only to the extent of the chargeback, unless it is determined invalid and subsequently collected by Borrower);

(n) Accounts owing from an Account Debtor with respect to which Borrower has received Deferred Revenue (but only to the extent of such Deferred Revenue);

(o) Accounts in which the Account Debtor disputes liability or makes any claim (but only up to the disputed or claimed amount), or if the Account Debtor is subject to an Insolvency Proceeding, or becomes insolvent, or goes out of business; and

(p) Accounts for which Bank in its good faith business judgment determines collection to be doubtful.

“Eligible Foreign Accounts” are Accounts of Guarantor which are billed and payable in the United Kingdom from Accounts Debtors located in the United States or the United Kingdom, but that are otherwise Eligible Accounts, and that are Accounts in which Bank has a perfected, first priority security interest.

“Eligible Inventory” means Inventory that meets all of Borrower’s representations and warranties in Section 5.1.1 and is otherwise acceptable to Bank in all respects but specifically excluding finished flywheels and excluding any Inventory relating to a Financed Purchase Order.

“Eligible Purchase Orders” are Purchase Orders aged less than one hundred twenty (120) days received by Borrower in the ordinary course of Borrower’s business that are approved by Bank in Bank’s sole discretion but specifically excluding any Purchase Orders which include Inventory for which Bank has made an Inventory Advance; an Eligible Purchase Order stops being a Eligible Purchase Order upon the earliest of the following: (i) such Eligible Purchase Order becomes an Eligible Account (in which case such Eligible Purchase Order remains a Financed Receivable) (ii) Bank determines in its sole discretion that such Eligible Purchase Order no longer qualifies as an Eligible Purchase Order, or (iii) one hundred twenty (120) days elapses from the date of such Eligible Purchase Order.

“ERISA” is the Employee Retirement Income Security Act of 1974, and its regulations.

“Events of Default” are set forth in Article 8.

“Facility Amount” is Fifteen Million Six Hundred Twenty Five Thousand Dollars (\$15,625,000).

“Facility Fees” is defined in Section 2.2.2.

“Finance Charges” is defined in Section 2.2.3.

“Financed Inventory” is all Eligible Inventory which Bank finances and makes an Inventory Advance, as set forth in Section 2.1.2.

“Financed Inventory Balance” is the total net principal amount of Inventory Advances made with respect to any Financed Inventory.

“Financed Purchase Order Balance” is (i) at all times when a Streamline Period is not in effect the total outstanding gross face amount, at any time, of any Financed Receivable which is an Eligible Purchase Order and (ii) at all times when a Streamline Period is in effect the total net principal amount of Advances made with respect to any Financed Receivable which is an Eligible Purchase Order.

“Financed Receivables” are those Eligible Accounts and those Eligible Purchase Orders, including their proceeds which Bank finances and makes an Advance, as set forth in Section 2.1.1. A Financed Receivable stops being a Financed Receivable (but remains Collateral) when the Advance made for the Financed Receivable has been fully paid.

“Financed Receivable Balance” is (i) at all times when a Streamline Period is not in effect the total outstanding gross face amount, at any time, of any Financed Receivable which is an Eligible Account and (ii) at all times when a Streamline Period is in effect the total net principal amount of Advances made with respect to any Financed Receivable which is an Eligible Account.

“Foreign Currency” means lawful money of a country other than the United States.

“GAAP” is generally accepted accounting principles set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or in such other statements by such other Person as may be approved by a significant segment of the accounting profession, which are applicable to the circumstances as of the date of determination.

“General Intangibles” is all “general intangibles” as defined in the Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation, all copyright rights, copyright applications, copyright registrations and like protections in each work of authorship and derivative work, whether published or unpublished, any patents, trademarks, service marks and, to the extent permitted under applicable law, any applications therefor, whether registered or not, any trade secret rights, including any rights to unpatented inventions, payment intangibles, royalties, contract rights, goodwill, franchise agreements, purchase orders, customer lists, route lists, telephone numbers, domain names, claims, income and other tax refunds, security and other deposits, options to purchase or sell real or personal property, rights in all litigation presently or hereafter pending (whether in contract, tort or otherwise), insurance policies (including without limitation key man, property damage, and business interruption insurance), payments of insurance and rights to payment of any kind.

“Good Faith Deposit” is defined in Section 2.2.8.

“Governmental Approval” is any consent, authorization, approval, order, license, franchise, permit, certificate, accreditation, registration, filing or notice, of, issued by, from or to, or other act by or in respect of, any Governmental Authority.

“Governmental Authority” is any nation or government, any state or other political subdivision thereof, any agency, authority, instrumentality, regulatory body, court, central bank or other entity exercising executive, legislative, judicial, taxing, regulatory or administrative functions of or pertaining to government, any securities exchange and any self-regulatory organization.

“Guarantor” is any present or future guarantor of the Obligations, including Active Power Solutions Limited (UK).

“Indebtedness” is (a) indebtedness for borrowed money or the deferred price of property or services, such as reimbursement and other obligations for surety bonds and letters of credit, (b) obligations evidenced by notes, bonds, debentures or similar instruments, (c) capital lease obligations and (d) Contingent Obligations.

“Indemnified Person” is defined in Section 12.2.

“Insolvency Proceeding” is any proceeding by or against any Person under the United States Bankruptcy Code, or any other bankruptcy or insolvency law, including assignments for the benefit of creditors, compositions, extensions generally with its creditors, or proceedings seeking reorganization, arrangement, or other relief.

“Intellectual Property Collateral” is defined in the IP Agreement.

“Inventory” is all “inventory” as defined in the Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products, including without limitation such inventory as is temporarily out of Borrower’s custody or possession or in transit and including any returned goods and any documents of title representing any of the above.

“Inventory Advance” or **“Inventory Advances”** means an advance (or advances) under the Inventory Sublimit.

“Inventory Advance Rate” is, with respect to Eligible Inventory, fifty percent (50.0%).

“Inventory Availability Amount” is the lesser of (i) the Inventory Advance Rate multiplied by the forced liquidation value of all Eligible Inventory or (ii) Three Million Five Hundred Thousand Dollars (\$3,500,000).

“Inventory Sublimit” is an Inventory Advance or Inventory Advances in an amount equal to Three Million Five Hundred Thousand Dollars (\$3,500,000).

“Investment” is any beneficial ownership of (including stock, partnership interest or other securities) any Person, or any loan, advance or capital contribution to any Person.

“Invoice Transmittal” shows Eligible Accounts and Eligible Purchase Orders which Bank may finance and, for each such Eligible Account or Eligible Purchase Order, includes the Account Debtor’s name, address, invoice amount, invoice date and invoice number or Purchase Order number (as applicable).

“IP Agreement” is that certain Second Amended and Restated Intellectual Property Security Agreement executed and delivered by Borrower to Bank.

“Key Person” means each of Borrower’s Chief Executive Officer and Chief Financial Officer.

“Letter of Credit” means a standby letter of credit issued by Bank or another institution based upon an application, guarantee, indemnity or similar agreement on the part of Bank as set forth in Section 2.1.3.

“Letter of Credit Application” is defined in Section 2.1.3(b).

“Letter of Credit Reserve” has the meaning set forth in Section 2.1.3(e).

“Lien” is a claim, mortgage, deed of trust, levy, charge, pledge, security interest or other encumbrance of any kind, whether voluntarily incurred or arising by operation of law or otherwise against any property.

“Loan Documents” are, collectively, this Agreement, the UK Secured Guaranty Documents, the Perfection Certificate, the IP Agreement, any note, or notes or guaranties executed by Borrower or any Guarantor, and any other present or future agreement between Borrower any Guarantor and/or for the benefit of Bank in connection with this Agreement, all as amended, restated, or otherwise modified from time to time.

“Lockbox” is defined in Section 2.2.7.

“Material Adverse Change” is: (a) a material impairment in the perfection or priority of Bank’s security interest in the Collateral or in the value of such Collateral; (b) a material adverse change in the business, operations, or condition (financial or otherwise) of Borrower; or (c) a material impairment of the prospect of repayment of any portion of the Obligations.

“Maturity Date” is August 5, 2012.

“Minimum Finance Charge” is Ten Thousand Dollars (\$10,000).

“Net Cash” is unrestricted cash, cash equivalents and marketable securities held at Bank or in the RBS Account.

“Obligations” are Borrower’s obligation to pay when due any debts, principal, interest, Bank Expenses, and other amounts Borrower owes Bank now or later, whether under this Agreement, the Loan Documents, or otherwise, including, without limitation, any interest accruing after Insolvency Proceedings begin and debts, liabilities, or obligations of Borrower assigned to Bank, and the performance of Borrower’s duties under the Loan Documents.

“Perfection Certificate” is a certain Perfection Certificate completed and delivered by Borrower to Bank in connection with this Agreement.

“Permitted Indebtedness” is:

- (a) Borrower’s indebtedness to Bank;
- (b) Subordinated Debt;

-
- (c) Indebtedness to trade creditors incurred in the ordinary course of business;
 - (d) Indebtedness secured by Permitted Liens;
 - (e) Indebtedness incurred as a result of endorsing negotiable instruments received in the ordinary course of business;
 - (f) Indebtedness existing at Closing and disclosed on the Perfection Certificate;
 - (g) Intercompany Indebtedness otherwise permitted under clause (ix) of the definition of Permitted Investments; and
 - (h) extensions, refinancings, modifications, amendments and restatements of any item of Permitted Indebtedness (a) through (g) above.

“Permitted Investments” are: (i) marketable direct obligations issued or unconditionally guaranteed by the United States or its agency or any state maturing within 1 year from its acquisition, (ii) commercial paper maturing no more than 1 year after its creation and having the highest rating from either Standard & Poor’s Corporation or Moody’s Investors Service, Inc., (iii) certificates of deposit issued maturing no more than 1 year after issue, (iv) any other investments administered through Bank. (v) Investments existing on the date hereof and disclosed on the Perfection Certificate, (vi) Investments consisting of (A) travel advances, employee relocation loans and other employee loans and advances in the ordinary course of business not to exceed One Hundred Fifty Thousand Dollars (\$150,000) outstanding at any time and (B) non-cash loans to employees, officers or directors relating to the purchase of equity securities of Borrower pursuant to employee stock purchase plans or arrangements approved by Borrower’s board of directors, (vii) Investments (including debt obligations) received in connection with the bankruptcy or reorganization of customers or suppliers and in settlement of delinquent obligations of, and other disputes with, customers or suppliers arising in the ordinary course of business, (viii) Investments accepted in connection with transfers permitted under Section 7.1, (viii) Investments consisting of notes receivable of, or prepaid royalties from and other credit obligations of, customers, suppliers and debtors of Borrower, who are not Affiliates, in the ordinary course of business, (ix)(A) Investments by Borrower in any Guarantor or any Guarantor in Borrower or another Guarantor and (B) Investments by Borrower or a Guarantor in any Subsidiary that is not a Guarantor in an aggregate amount not to exceed One Million Dollars (\$1,000,000) in the aggregate in any fiscal year, (x) Investments consisting of the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of Borrower, (xi) Investments consisting of foreign deposit accounts in which Bank has a perfected security interest, and (xii) joint ventures or strategic alliances in the ordinary course of Borrower’s business consisting of the non-exclusive licensing of technology, the development of technology or the providing of technical support, provided that any cash investments by Borrower do not exceed One Hundred Thousand Dollars (\$100,000) in the aggregate in any fiscal year.

“Permitted Liens” are:

- (a) Liens arising under this Agreement or other Loan Documents;
- (b) Liens for taxes, fees, assessments or other government charges or levies, either not delinquent or being contested in good faith and for which Borrower maintains adequate reserves on its Books, if they have no priority over any of Bank’s security interests;
- (c) Purchase money Liens securing no more than One Hundred Thousand Dollars (\$100,000) in the aggregate amount outstanding (i) on equipment acquired or held by Borrower incurred for financing the acquisition of the equipment, or (ii) existing on equipment when acquired, if the Lien is confined to the property and improvements and the proceeds of the equipment;
- (d) Leases or subleases and non-exclusive licenses or sublicenses granted in the ordinary course of Borrower’s business, if the leases, subleases, licenses and sublicenses permit granting Bank a security interest;

(e) Liens incurred in the extension, renewal or refinancing of the indebtedness secured by Liens described in (a) through (d), but any extension, renewal or replacement Lien must be limited to the property encumbered by the existing Lien and the principal amount of the indebtedness may not increase.

(f) Liens existing at Closing and disclosed in the Perfection Certificate;

(g) Liens securing Subordinated Debt;

(h) Liens of carriers, warehousemen, mechanics, materialmen, vendors, and landlords incurred in the ordinary course of business for sums not overdue or being contested in good faith, provided provision is made to the reasonable satisfaction of Bank for the eventual payment thereof if subsequently found payable;

(i) Liens to secure payment of workers' compensation, employment insurance, old-age pensions, social security and other like obligations incurred in the ordinary course of business;

(j) Bankers' liens, rights of setoff and similar Liens incurred on deposits or securities accounts made in the ordinary course of business to the extent Bank has a security interest in such accounts; and

(k) Liens arising from judgments, decrees or attachments in circumstances not constituting an Event of Default.

"Person" is any individual, sole proprietorship, partnership, limited liability company, joint venture, company, trust, unincorporated organization, association, corporation, institution, public benefit corporation, firm, joint stock company, estate, entity or government agency.

"Prime Rate" is the greater of (i) four percent (4.00%) or (ii) Bank's most recently announced "prime rate," even if it is not Bank's lowest rate.

"Purchase Orders" are committed orders from Borrower's customers to provide such customers with Borrower's products or services for which there is a supporting contract or statement of work and for which there is no Financed Inventory.

"Reconciliation Period" is each calendar month.

"Registered Organization" is any "registered organization" as defined in the Code with such additions to such term as may hereafter be made.

"Requirement of Law" is as to any Person, the organizational or governing documents of such Person, and any law (statutory or common), treaty, rule or regulation or determination of an arbitrator or a court or other Governmental Authority, in each case applicable to or binding upon such Person or any of its property or to which such Person or any of its property is subject.

"Responsible Officer" is each of the Chief Executive Officer, President, Chief Financial Officer and Controller of Borrower.

"RBS Account" is defined in Section 2.2.7.

"Subordinated Debt" is indebtedness incurred by Borrower subordinated to all of Borrower's now or hereafter indebtedness to Bank (pursuant to a subordination, intercreditor, or other similar agreement in form and substance satisfactory to Bank entered into between Bank and the other creditor), on terms acceptable to Bank.

"Subsidiary" is, with respect to any Person, any Person of which more than 50.0% of the voting stock or other equity interests (in the case of Persons other than corporations) is owned or controlled directly or indirectly by such Person.

“Streamline Period” means any period of time during which Borrower maintained Net Cash of at least Six Million Two Hundred Fifty Thousand Dollars (\$6,250,000) at all times for at least thirty (30) consecutive days.

“UK Secured Guaranty Documents” is those certain (i) charge over shares; (ii) guarantee and debenture; (iii) board resolutions for Guarantor in respect of the guarantee and debenture; (iv) shareholder resolutions of Guarantor in respect of the guarantee and debenture, (v) officer’s certificate in relation to the charge over shares and (vi) any other document required to be executed by Borrower and/or Guarantor in connection therewith.

[Signature page follows.]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the Effective Date.

BORROWER:

ACTIVE POWER, INC.

By: _____ /s/ John Penver
Name: John Penver
Title: Chief Financial Officer

BANK:

SILICON VALLEY BANK

By _____ /s/ Krista Hall
Name: Krista Hall
Title: Relationship Manager
Effective Date: August 5, 2010

EXHIBIT A

The Collateral consists of all of Borrower's right, title and interest in and to the following personal property:

All goods, Accounts (including health-care receivables), Equipment, Inventory, contract rights or rights to payment of money, leases, license agreements, franchise agreements, General Intangibles, commercial tort claims, documents, instruments (including any promissory notes), chattel paper (whether tangible or electronic), cash, deposit accounts, fixtures, letters of credit rights (whether or not the letter of credit is evidenced by a writing), securities, and all other investment property, supporting obligations, and financial assets, whether now owned or hereafter acquired, wherever located; and

all Borrower's Books relating to the foregoing, and any and all claims, rights and interests in any of the above and all substitutions for, additions, attachments, accessories, accessions and improvements to and replacements, products, proceeds and insurance proceeds of any or all of the foregoing.

Notwithstanding the foregoing, the Collateral shall not include more than 65% of the voting securities of any Subsidiary that is not organized under the laws of the United States or any of its states, other than a Guarantor.

EXHIBIT B



**SPECIALTY FINANCE DIVISION
Compliance Certificate**

I, an authorized officer of ACTIVE POWER, INC. ("Borrower") certify under the Second Amended and Restated Loan and Security Agreement (the "Agreement") between Borrower and Silicon Valley Bank ("Bank") as follows (all capitalized terms used herein shall have the meaning set forth in the Agreement):

Borrower represents and warrants for each Financed Receivable:

Each Financed Receivable is an Eligible Account or an Eligible Purchase Order.

Borrower is the owner with legal right to sell, transfer, assign and encumber such Financed Receivable;

The correct amount is on the Advance Request and Invoice Transmittal and is not disputed;

Payment of the amount financed is not contingent on any obligation or contract and Borrower has fulfilled all its obligations to receive such payment as of the Advance Request and Invoice Transmittal date;

Each Financed Receivable is based on an actual Purchase Order or an actual sale and delivery of goods and/or services rendered, is due to Borrower, is not past due or in default, has not been previously sold, assigned, transferred, or pledged and is free of any liens, security interests and encumbrances other than Permitted Liens;

There are no defenses, offsets, counterclaims or agreements for which the Account Debtor may claim any deduction or discount with the exception of customary credits, adjustments and/or discounts given to an Account Debtor by Borrower that have been disclosed to Bank in writing;

It reasonably believes no Account Debtor is insolvent or subject to any Insolvency Proceedings;

It has not filed or had filed against it Insolvency Proceedings and does not anticipate any filing;

Bank has the right to endorse and/ or require Borrower to endorse all payments received on Financed Receivables and all proceeds of Collateral.

No representation, warranty or other statement of Borrower in any certificate or written statement given to Bank contains any untrue statement of a material fact or omits to state a material fact necessary to make the statement contained in the certificates or statement not misleading.

Additionally, Borrower represents and warrants as follows:

Borrower and each Subsidiary is duly existing and in good standing in its state of formation and qualified and licensed to do business in, and in good standing in, any state in which the conduct of its business or its ownership of property requires that it be qualified except where the failure to do so could not reasonably be expected to cause a Material Adverse Change. The execution, delivery and performance of the Loan Documents have been duly authorized, and do not conflict with Borrower's organizational documents, nor constitute an event of default under any material agreement by which Borrower is bound. Borrower is not in default under any agreement to which or by which it is bound in which the default could reasonably be expected to cause a Material Adverse Change.

Borrower has good title to the Collateral, free of Liens except Permitted Liens. All inventory is in all material respects of good and marketable quality, free from material defects.

Borrower is not an "investment company" or a company "controlled" by an "investment company" under the Investment Company Act. Borrower is not engaged as one of its important activities in extending credit for margin stock (under Regulations X, T and U of the Federal Reserve Board of Governors). Borrower has complied in all material respects with the Federal Fair Labor Standards Act. Borrower has not violated any laws, ordinances or rules, the violation of which could reasonably be expected to cause a Material Adverse Change. None of Borrower's or any Subsidiary's properties or assets has been used by Borrower or any Subsidiary or, to the best of Borrower's knowledge, by previous Persons, in disposing, producing, storing, treating, or transporting any hazardous substance other than in material compliance with laws. Borrower and each Subsidiary has timely filed all required material tax returns and paid, or made adequate provision to pay, all material taxes, except those being contested in good faith with adequate reserves under GAAP. Borrower and each Subsidiary has obtained all consents, approvals and authorizations of, made all declarations or filings with, and given all notices to, all government authorities that are necessary to continue its business as currently conducted except where the failure to obtain or make such consents, declarations, notices or filings would not reasonably be expected to cause a Material Adverse Change.

All representations and warranties in the Agreement are true and correct in all material respects on this date, and the Borrower represents that there is no existing Event of Default.

Please indicate compliance status by circling Yes/No under "Complies" column.

<u>Reporting Covenant</u>	<u>Required</u>	<u>Complies</u>
Monthly financial statements with Compliance Certificate	Monthly within 30 days	Yes No
Annual financial statement (CPA Audited)	FYE within 150 days	Yes No
10-Q, 10-K and 8-K	Within 5 days after filing with SEC	Yes No
Board approved financial projections	On or prior to 12/31	Yes No
A/R and A/P Aging, inventory report, Deferred Revenue Report, report of purchase orders	Monthly within 30 days	Yes No
Borrowing Base Certificate	Monthly within 30 days when not on Streamline, Bi-monthly within 15 days when on Streamline	Yes No

<u>Financial Covenant</u>	<u>Required</u>	<u>Actual</u>	<u>Complies</u>
Liquidity Ratio	1.25 to 1.00	_____ to 1.00	Yes No

Cash at Bank as of period ending _____ Net Cash Calculation under the Revolving Line of Credit
 \$ _____

The following are the exceptions with respect to the certification above: (If no exceptions exist, state "No exceptions to note.")

ACTIVE POWER, INC.

AGENT USE ONLY

By: _____
 Name: _____
 Title: _____

Received by: _____
 AUTHORIZED SIGNER

Date: _____

Verified: _____
 AUTHORIZED SIGNER

Date: _____

Compliance Status: Yes No

EXHIBIT C

[To be provided by Bank]

EXHIBIT D

BORROWING BASE CERTIFICATE

[to be provided by Bank]

5 August 2010

DATED

(1) ACTIVE POWER SOLUTIONS LIMITED
as Chargor

- and -

(2) SILICON VALLEY BANK
as Lender

GUARANTEE AND
DEBENTURE

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THIS GUARANTEE AND DEBENTURE is made on 5 August 2010

BETWEEN:

- (1) **ACTIVE POWER SOLUTIONS LIMITED** (the “**Chargor**”), a company incorporated in England and Wales with registration number 6351428 whose registered office is at Taylor Wessing LLP, 5 New Street Square, London EC4A 3TW; and
- (2) **SILICON VALLEY BANK** (the “**Lender**”) a California corporation with its principal place of business at 3003 Tasman Drive, Santa Clara, California 95054, United States of America.

IT IS AGREED:

1. DEFINITIONS AND INTERPRETATION

1.1 Definitions

In this Deed:

- (a) terms defined in, or construed for the purposes of, the Loan and Security Agreement (as defined below) have the same meanings when used in this Deed (unless the same are otherwise defined in this Deed); and
- (b) at all times the following terms have the following meanings:

“**Account Bank**” means:

- (a) The Royal Bank of Scotland of 36 St Andrew Square, Edinburgh, EH2 2YB; and/or
- (b) such other bank with which any Security Account is maintained from time to time;

“**Act**” means the Law of Property Act 1925;

“**Assigned Assets**” means the Security Assets expressed to be assigned pursuant to clause 5.2 (*Security assignments*);

“**Authorisation**” means an authorisation, consent, approval, resolution, licence, exemption, filing, notarisation or resignation;

“**Borrower**” has the meaning given to that term in the Loan and Security Agreement;

“**Charged Investments**” means the Charged Securities and all present and future Related Rights accruing to all or any of the Charged Securities;

“**Charged Securities**” means all stocks, shares, debentures, bonds, warrants, coupons, negotiable instruments, certificates of deposit or other securities or “*investments*” (as defined in part II of schedule II to the Financial Services and Markets Act 2000 as in force at the date of this Deed) now or in future owned (legally or beneficially) by the Chargor or in which the Chargor has an interest at any time;

“Debenture Security” means the Security created or evidenced by or pursuant to this Deed;

“Default Rate” means the rate of interest which is 5% per annum above the rate which would otherwise apply in accordance with the Loan Documents;

“Delegate” means any delegate, sub-delegate, agent, attorney or co-trustee appointed by the Lender or by a Receiver;

“Event of Default” means any event or circumstance set out in Article 8 of the Loan and Security Agreement and an Event of Default is “continuing” if it has not been remedied to the satisfaction of the Lender or waived by it in writing;

“Group” means Active Power, Inc. and its subsidiaries from time to time, including the Chargor;

“Guarantee” means the guarantee and indemnity contained in clause 2 (*Guarantee and Indemnity*) as extended by schedule 1 (*The Guarantee*);

“Insurances” means all policies of insurance which are at any time held by, or written in favour of, the Chargor or in which the Chargor from time to time has an interest;

“Intellectual Property” means all legal and/or equitable interests (including, without limitation, the benefit of all licences in any part of the world) of the Chargor in, or relating to:

- (a) any patents, trade marks, service marks, designs, business names, copyrights, database rights, design rights, domain names, moral rights, inventions, confidential information, know-how and other intellectual property rights and interests (which may now or in the future subsist), whether registered or unregistered; and
- (b) the benefit of all applications and rights to use such assets of the Chargor (which may now or in the future subsist);

“Loan and Security Agreement” means the second amended loan and security agreement dated on or about the date of this Deed and made between (1) Active Power, Inc. as Borrower and (2) Silicon Valley Bank as Bank (as defined therein) pursuant to which the Lender agreed to make certain loan facilities available to the Borrower;

“Loan Documents” means this Deed, the other UK Secured Guaranty Documents, the Loan and Security Agreement, the IP Agreement, any note, or notes or guaranties executed by Borrower or any Guarantor, and any other present or future agreement between Borrower and/or any Guarantor for the benefit of the Lender in connection with the Loan and Security Agreement, all as amended, supplemented, extended, restated, novated and/or replaced from time to time;

“Party” means a party to this Deed;

“Permitted Security” means:

- (a) a lien arising in the ordinary course of business by operation of law and discharged as soon as possible;
- (b) any Permitted Lien;
- (b) any security in favour of the Lender under the Loan Documents; and

(c) the two separate rent deposit deeds dated 2 March 2009 granted by the Chargor in favour of Reinhold Properties Limited;

“Planning Acts” means (A) the Town and Country Planning Act 1990, (B) the Planning (Listed Buildings and Conservation Areas) Act 1990, (C) the Planning (Hazardous Substances) Act 1990, (D) the Planning (Consequential Provisions) Act 1990, (E) the Planning and Compensation Act 1991, (F) any regulations made pursuant to any of the foregoing and (G) any other legislation of a similar nature;

“Quasi-Security” means an arrangement or transaction whereby a person:

- (a) sells, transfers or otherwise disposes of any of its assets on terms whereby they are or may be leased to or reacquired by such person or an Affiliate of such person;
- (b) sells, transfers or otherwise disposes of any of its receivables on recourse terms;
- (c) enters into any arrangement under which money or the benefit of a bank or other account may be applied, set off or made subject to a combination of accounts; or
- (d) enters into any other preferential arrangement having a similar effect, in circumstances where the arrangement or transaction is entered into primarily as a method of raising financial indebtedness;

“Real Property” means all estates and interests in freehold, leasehold and other immovable property (wherever situated) now or in future belonging to the Chargor, or in which the Chargor has an interest at any time, together with:

- (a) all buildings and fixtures (including trade fixtures) and fixed plant and machinery at any time thereon;
- (b) all easements, rights and agreements in respect thereof; and
- (c) the benefit of all covenants given in respect thereof;

“Receivables” means all present and future book debts and other debts, rentals, royalties, fees and monetary claims and all other amounts at any time recoverable or receivable by, or due or owing to, the Chargor (whether actual or contingent and whether arising under contract or in any other manner whatsoever) together with:

- (a) the benefit of all rights, guarantees, Security and remedies relating to any of the foregoing (including, without limitation, negotiable instruments, indemnities, reservations of property rights, rights of tracing and unpaid vendor’s liens and similar associated rights); and
- (b) all proceeds of any of the foregoing;

“Receiver” means a receiver, or receiver and manager or administrative receiver of the whole or any part of the Security Assets appointed by the Lender under this Deed;

“Related Rights” means, in relation to any Charged Security:

- (a) all dividends, distributions and other income paid or payable on the relevant Charged Security or on any asset referred to in paragraph (b) of this definition; and

(b) all rights, monies or property accruing or offered at any time in relation to such Charged Security whether by way of redemption, substitution, exchange, bonus or preference, under option rights or otherwise;

“Relevant Contract” means each agreement specified in part 2 of schedule 2 (*Details of Security Assets*) as a *“Relevant Contract”* and any other agreement designated as a *“Relevant Contract”* by the Parties after the date of this Deed, together with each other agreement supplementing or amending or novating or replacing the same;

“Secured Obligations” means all present and future obligations and liabilities (whether actual or contingent and whether owed jointly or severally or alone or in any other capacity whatsoever) of any present or future member of the Group to the Lender under or pursuant to any Loan Document (including all monies covenanted to be paid under this Deed);

“Security Accounts” has the meaning given to that term in clause 12.6(a)(iii);

“Security Assets” means all property and assets from time to time mortgaged, charged or assigned (or expressed to be mortgaged, charged or assigned) by or pursuant to this Deed;

“Security Period” means the period beginning on the date of this Deed and ending on the date on which:

(a) all the Secured Obligations have been unconditionally and irrevocably paid and discharged in full; and

(b) the Lender has no further commitment, obligation or liability under or pursuant to the Loan Documents;

“Tax” means any tax, levy, impost, duty or other charge or withholding of a similar nature (including any penalty or interest payable in connection with any failure to pay or any delay in paying any of the same).

1.2 Interpretation

(a) Unless a contrary indication appears in this Deed, terms defined in the Loan and Security Agreement shall have the same meaning in this Deed.

(b) Unless a contrary indication appears, any reference in this Deed to:

(i) the **“Chargor”**, the **“Borrower”** or the **“Lender”** or any other person shall be construed so as to include its successors in title, permitted assigns and permitted transferees;

(ii) **“this Deed”**, the **“Loan and Security Agreement”**, any other **“Loan Document”** or any other agreement or instrument is a reference to this Deed, the Loan and Security Agreement, that other Loan Document or that other agreement or instrument as amended, supplemented, extended, restated, novated and/or replaced in any manner from time to time (however fundamentally and even if any of the same increases the obligations of any member of the Group or provides for further advances);

(iii) **“Secured Obligations”** includes obligations and liabilities which would be treated as such but for the liquidation, administration or dissolution of or similar event affecting any member of the Group;

-
- (c) Each undertaking of the Chargor (other than a payment obligation) contained in this Deed:
 - (i) must be complied with at all times during the Security Period; and
 - (ii) is given by the Chargor for the benefit of the Lender.
 - (d) The terms of the other Loan Documents and of any side letters between any of the parties to them in relation to any Loan Document are incorporated in this Deed to the extent required to ensure that any disposition of the Real Property contained in this Deed is a valid disposition in accordance with section 2(1) of the Law of Property (Miscellaneous Provisions) Act 1989.
 - (e) If the Lender reasonably considers that an amount paid by the Borrower, the Chargor or any other member of the Group to it under a Loan Document is capable of being avoided or otherwise set aside on the liquidation or administration of such company, then that amount shall not be considered to have been irrevocably paid for the purposes of this Deed.
 - (f) The Parties intend that this document shall take effect as a deed notwithstanding the fact that a Party may only execute this document under hand.

1.3 Third party rights

A person who is not a Party has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce or enjoy the benefit of any term of this Deed.

2. GUARANTEE AND INDEMNITY

2.1 Guarantee and indemnity

The Chargor irrevocably and unconditionally jointly and severally:

- (a) guarantees to the Lender punctual performance by the Borrower and each member of the Group of all the Borrower's and each such member's obligations under the Loan Documents;
- (b) undertakes with the Lender that whenever the Borrower or another member of the Group does not pay any amount when due under or in connection with any Loan Document, the Chargor shall immediately on demand pay that amount as if it were the principal obligor; and
- (c) agrees with the Lender that if any obligation guaranteed by it is or becomes unenforceable, invalid or illegal, it will, as an independent and primary obligation, indemnify the Lender immediately on demand against any costs, loss or liability it incurs as a result of the Borrower or a member of the Group not paying any amount which would, but for such unenforceability, invalidity or illegality, have been payable by it under any Loan Document on the date when it would have been due. The amount payable by the Chargor under this indemnity will not exceed the amount it would have had to pay under this Deed if the amount claimed had been recoverable on the basis of a guarantee.

2.2 Extension of guarantee

The guarantee set out in this clause 2 (*Guarantee and Indemnity*) is given subject to and with the benefit of the provisions set out in schedule 1 (*The Guarantee*).

3. COVENANT TO PAY

3.1 Covenant to pay

- (a) The Chargor, as principal obligor and not merely as surety, covenants in favour of the Lender that it will pay and discharge the Secured Obligations from time to time when they fall due.
- (b) Every payment by the Chargor of a Secured Obligation which is made to or for the benefit of the Lender to which that Secured Obligation is due and payable in accordance with the Loan Document under which such sum is payable to the Lender, shall operate in satisfaction to the same extent of the covenant contained in clause 3.1(a).

3.2 Default interest

- (a) Any amount which is not paid under this Deed when due shall bear interest (both before and after judgment and payable on demand) from the due date until the date on which such amount is unconditionally and irrevocably paid and discharged in full on a daily basis at the rate and in the manner agreed in the Loan Document under which such amount is payable and, in the absence of such agreement, at the Default Rate from time to time.
- (b) Default interest will accrue from day to day on a year of 360 days and actual days elapsed and will be compounded at such intervals as the Lender states are appropriate.

4. GRANT OF SECURITY

4.1 Nature of security

All Security and dispositions created or made by or pursuant to this Deed are created or made:

- (a) in favour of the Lender;
- (b) with full title guarantee in accordance with the Law of Property (Miscellaneous Provisions) Act 1994; and
- (c) as continuing security for payment of the Secured Obligations.

4.2 Qualifying floating charge

Paragraph 14 of Schedule B1 to the Insolvency Act 1986 applies to any floating charge created by or pursuant to this Deed (and each such floating charge is a qualifying floating charge for the purposes of the Insolvency Act 1986).

5. FIXED SECURITY

5.1 Fixed charges

The Chargor charges and agrees to charge all of its present and future right, title and interest in and to the following assets which are at any time owned by the Chargor, or in which it from time to time has an interest:

- (a) by way of first fixed charge:
 - (i) all Real Property and all interests in Real Property;
 - (ii) all licences to enter upon or use land and the benefit of all other agreements relating to land; and
 - (iii) the proceeds of sale of all Real Property;
- (b) by way of first fixed charge all plant and machinery (not charged by clause 5.1(a)) and the benefit of all contracts, licences and warranties relating to the same (to the extent chargeable);
- (c) by way of first fixed charge:
 - (i) all computers, vehicles, office equipment and other equipment (not charged by clause 5.1(b)); and
 - (ii) the benefit of all contracts, licences and warranties relating to the same (to the extent chargeable),
 - (iii) by way of first fixed charge all Charged Securities;
in each case, together with (A) all Related Rights from time to time accruing to those Charged Securities and (B) all rights which the Chargor may have at any time against any clearance or settlement system or any custodian in respect of any Charged Investments;
- (d) by way of first fixed charge the Security Accounts and all monies at any time standing to the credit of the Security Accounts, together with all interest from time to time accrued or accruing on such monies, any investment made out of such monies or account and all rights to repayment of any of the foregoing;
- (e) by way of first fixed charge all Intellectual Property (if any);
- (f) to the extent that any Assigned Asset is not effectively assigned under clause 5.2 (*Security assignments*), by way of first fixed charge such Assigned Asset (to the extent chargeable);
- (g) by way of first fixed charge (to the extent not otherwise charged or assigned in this Deed):
 - (i) the benefit of all licences, consents, agreements and Authorisations held or used in connection with the business of the Chargor or the use of any of its assets; and

-
- (ii) any letter of credit issued in favour of the Chargor and all bills of exchange and other negotiable instruments held by it; and
 - (h) by way of first fixed charge all of the goodwill and uncalled capital of the Chargor.

5.2 Security assignments

The Chargor assigns and agrees to assign absolutely (subject to a proviso for reassignment on redemption) all of its present and future right, title and interest in and to:

- (a) the Relevant Contracts, all rights and remedies in connection with the Relevant Contracts and all proceeds and claims arising from them;
- (b) each of the following:
 - (i) each present and future Key-man Policy; and
 - (ii) all other Insurances (not assigned by clause 5.2(b)(i));and all claims under the Insurances and all proceeds of the Insurances; and
- (c) the Security Accounts and all monies at any time standing to the credit of the Security Accounts, together with all interest from time to time accrued or accruing on such monies, any investment made out of such monies or account and all rights to repayment of any of the foregoing; and
- (d) all other Receivables (not assigned under clauses 5.2(a) or 5.2(b)).

To the extent that any Assigned Asset described in clause 5.2(b) is not assignable, the assignment which that clause purports to effect shall operate as an assignment of all present and future rights and claims of the Chargor to any proceeds of such Insurances.

5.3 Notice of assignment and/or charge - immediate notice

- (a) Within 5 Business Days of obtaining any Insurance, the Chargor shall deliver a duly completed notice of assignment to each other party to that Insurance, and shall use its reasonable endeavours to procure that each such party executes and delivers to the Lender an acknowledgement, in each case in the respective forms set out in schedule 5 (*Form of notice to and acknowledgement by insurers*); and
- (b) Within 5 Business Days of request by the Lender, the Chargor shall, in respect of each Relevant Contract, deliver a duly completed notice of assignment to each other party to that Relevant Contract, and procure that each such party executes and delivers to the Lender an acknowledgement, in each case in the respective forms set out in schedule 4 (*Form of notice to and acknowledgement by party to Relevant Contract*); and
- (c) Within 5 Business Days of the execution of this Deed, the Chargor shall, in respect of the Security Accounts, deliver a duly completed notice to the Account Bank and use reasonable endeavours to procure that the Account Bank executes and delivers to the Lender an acknowledgement, in each case in the respective forms set out in schedule 3 (*Form of notice to and acknowledgement from Account Bank*), or, in each case, in such other form as the Lender shall agree.

5.4 Assigned Assets

The Lender is not obliged to take any steps necessary to preserve any Assigned Asset, to enforce any term of a Relevant Contract against any person or to make any enquiries as to the nature or sufficiency of any payment received by it pursuant to this Deed.

6. FLOATING CHARGE

The Chargor charges and agrees to charge by way of first floating charge all of its present and future:

- (a) assets and undertaking (wherever located) not otherwise effectively charged by way of first fixed mortgage or charge or assigned pursuant to clause 5.1 (*Fixed charges*), clause 5.2 (*Security assignments*) or any other provision of this Deed; and
- (b) (whether or not effectively so charged or assigned) heritable property and all other property and assets in Scotland.

7. CONVERSION OF FLOATING CHARGE

7.1 Conversion by notice

The Lender may, by written notice to the Chargor, convert the floating charge created under this Deed into a fixed charge as regards all or any of the assets of the Chargor specified in the notice if:

- (a) an Event of Default has occurred and is continuing; or
- (b) the Lender (acting reasonably) considers any Security Assets to be in danger of being seized or sold under any form of distress, attachment, execution or other legal process.

7.2 Small companies

The floating charge created under this Deed by the Chargor shall not convert into a fixed charge solely by reason of a moratorium being obtained under the Insolvency Act 2000 (or anything done with a view to obtaining such a moratorium) in respect of the Chargor.

7.3 Automatic conversion

The floating charge created under this Deed shall (in addition to the circumstances in which the same will occur under general law) automatically convert into a fixed charge:

- (a) in relation to any Security Asset which is subject to a floating charge if:
 - (i) the Chargor creates (or attempts or purports to create) any Security on or over the relevant Security Asset without the prior written consent of the Lender; or
 - (ii) any third party levies or attempts to levy any distress, execution, attachment or other legal process against any such Security Asset; and
 - (b) over all Security Assets of the Chargor which are subject to a floating charge if an administrator is appointed in respect of the Chargor or the Lender receives notice of intention to appoint such an administrator (as contemplated by the Insolvency Act 1986).
-

7.4 Scottish property

Clause 7.3 (*Automatic conversion*) will not apply to any assets situated in Scotland if, and to the extent that, a Receiver would not be capable of exercising his powers in Scotland pursuant to section 72 of the Insolvency Act 1986 by reason of such automatic conversion.

7.5 Partial conversion

The giving of a notice by the Lender pursuant to clause 7.1 (*Conversion by notice*) in relation to any class of assets of the Chargor shall not be construed as a waiver or abandonment of the rights of the Lender to serve similar notices in respect of any other class of assets or of any other right of the Lender.

8. CONTINUING SECURITY

8.1 Continuing security

The Debenture Security is continuing and will extend to the ultimate balance of the Secured Obligations regardless of any intermediate payment or discharge in whole or in part. This Deed shall remain in full force and effect as a continuing security for the duration of the Security Period.

8.2 Additional and separate security

This Deed is in addition to, without prejudice to, and shall not merge with, any other right, remedy, guarantee or Security which the Lender may at any time hold for any Secured Obligation.

8.3 Right to enforce

This Deed may be enforced against the Chargor without the Lender first having recourse to any other right, remedy, guarantee or Security held by or available to it.

9. LIABILITY OF THE CHARGOR RELATING TO SECURITY ASSETS

Notwithstanding anything contained in this Deed or implied to the contrary, the Chargor remains liable to observe and perform all conditions and obligations assumed by it in relation to the Security Assets. The Lender is under no obligation to perform or fulfil any such condition or obligation or to make any payment in respect of any such condition or obligation.

10. ACCOUNTS

During the Security Period, no monies at any time standing to the credit of any account (of any type and however designated) of the Chargor with the Lender or in which the Chargor has an interest (and no rights and benefits relating thereto) shall be capable of being assigned to any person other than the Lender.

11. REPRESENTATIONS

11.1 General

The Chargor makes the representations and warranties set out in this clause 11 (*Representations*) to the Lender.

11.2 No Security Interests

No Security or Quasi-Security exists over all or any of the present or future Security Assets of the Chargor other than as created by this Deed or any Permitted Security.

11.3 Ranking

Subject to applicable laws and regulations affecting creditors generally, the Debenture Security will once registered have first ranking priority and is not subject to any prior ranking or *pari passu* ranking Security other than Permitted Security.

11.4 Ownership of Security Assets

The Chargor is the sole legal and beneficial owner of all the Security Assets identified in schedule 2 (*Details of Security Assets*).

11.5 No proceedings pending or threatened

There are no actions or proceedings pending or, to the knowledge of the Chargor, threatened in writing by or against the Chargor which would reasonably be expected to cause a Material Adverse Change (as defined in the Loan and Security Agreement, provided that references to “Borrower” in such definition shall be construed as references to the Chargor).

11.6 Charged Securities

As at the date of this Deed, the Chargor does not beneficially own any Charged Securities.

11.7 Real Property

As at the date of this Deed, the Chargor does not beneficially own any freehold or leasehold Real Property.

11.8 Time when representations made

- (a) All the representations and warranties in this clause 11 (*Representations*) are made by the Chargor on the date of this Deed and (except for those in clauses 11.6 (*Charged Securities*) and 11.7 (*Real Property*)) are also deemed to be made by the Chargor on the date of each Advance.
- (b) Each representation or warranty deemed to be made after the date of this Deed shall be deemed to be made by reference to the facts and circumstances existing at the date the representation or warranty is deemed to be made.

12. UNDERTAKINGS BY THE CHARGOR

12.1 Negative pledge and Disposals

The Chargor shall not do or agree to do any of the following without the prior written consent of the Lender, except as otherwise permitted under the Loan and Security Agreement:

- (a) create or permit to subsist any Security or Quasi-Security on any Security Asset other than as created by this Deed; or
- (b) sell, transfer, lease, lend or otherwise dispose of (whether by a single transaction or a number of transactions and whether related or not) the whole or any part of its interest in any Security Asset other than in the ordinary course of business.

12.2 Security Assets generally

The Chargor shall:

- (a) notify the Lender within 14 days of receipt of every notice, order, application, requirement or proposal given or made in relation to, the Security Assets by any competent authority, and (if required by the Lender):
 - (i) within 5 Business Days of a request from the Lender, provide it with a copy of the same; and
 - (ii) either (A) comply with all material obligations under such notice, order, application, requirement or proposal or (B) make such objections to the same as the Lender may reasonably require or approve;
 - (b) pay all material rates, rents, and other outgoings owed by it in respect of the Security Assets;
 - (c) comply with:
 - (i) all obligations in relation to the Security Assets under any present or future regulation or requirement of any competent authority or any Authorisation; and
 - (ii) all material covenants and obligations affecting any Security Asset (or its manner of use);
 - (d) not, except with the prior written consent of the Lender, such consent not to be unreasonably withheld, enter into any onerous or restrictive obligation affecting any Security Assets, except as otherwise permitted under the Loan and Security Agreement;
 - (e) provide the Lender with all information which it may reasonably request in relation to the Security Assets; and
 - (f) not do, cause or permit to be done anything which may to a material extent depreciate, jeopardise or otherwise prejudice the value or marketability of any Security Asset (or make any omission which has such an effect).
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12.3 Deposit of documents and notices

The Chargor shall unless the Lender otherwise confirms in writing, deposit with the Lender:

- (a) all deeds and documents of title relating to the Security Assets; and
- (b) all local land charges, land charges and HM Land Registry search certificates and similar documents received by or on behalf of the Chargor, (each of which the Lender may hold throughout the Security Period).

12.4 Real Property undertakings - acquisitions and notices to HM Land Registry

- (a) The Chargor shall notify the Lender within 5 Business Days of the acquisition of any estate or interest in any material freehold or leasehold property.
- (b) The Chargor shall, in respect of any freehold or leasehold Real Property which is acquired by it after the date of this Deed, the title which is registered at HM Land Registry or the title to which is required to be so registered:
 - (i) give HM Land Registry written notice of this Deed; and
 - (ii) procure that notice of this Deed is clearly noted in the Register to each such title.

12.5 Insurance

- (a) The Chargor shall at all times insure and keep insured the Security Assets which are of an insurable nature with reputable and responsible insurers in a manner and extent as is reasonable and customary for an enterprise engaged in the same business and in similar localities and in full reinstatement cost of such Security Assets and otherwise upon such terms as the Lender may reasonably require.
- (b) If at any time the Chargor defaults in:
 - (i) effecting or keeping up the insurances required; or
 - (ii) producing any insurance policy or receipt to the Lender on demand,the Lender may (without prejudice to its rights under clause 13 (*Power to remedy*)) take out or renew such policies of insurance in any sum which the Lender may reasonably think expedient. All monies which are expended by the Lender in doing so shall be deemed to be properly paid by the Lender and shall be reimbursed by the Chargor on demand.
- (c) The Chargor shall notify the Lender if any claim arises or may be made under the Insurances.
- (d) The Chargor shall, subject to the rights of the Lender under clause 12.5(e), diligently pursue its rights under the Insurances.

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- (e) In relation to the proceeds of Insurances:
 - (i) the Lender shall be loss payee under and have the sole right to settle or sue for any such claim and to give any discharge for insurance monies; and
 - (ii) all claims and monies received or receivable under any Insurances shall (subject to the rights or claims of any lessor or landlord of any part of the Security Assets) be applied in repairing, replacing, restoring or rebuilding the property damaged or destroyed or, after the occurrence of an Event of Default which is continuing, in permanent reduction of the Secured Obligations.

12.6 Dealings with and realisation of Receivables and operation of Security Accounts

- (a) The Chargor shall:
 - (i) without prejudice to clause 12.1 (*Negative pledge and Disposals*) (but in addition to the restrictions in that clause), not, without the prior written consent of the Lender, sell, assign, charge, factor or discount or in any other manner deal with any Receivable other than as set out in this Deed;
 - (ii) collect all Receivables promptly in the ordinary course of trading as agent for the Lender; and
 - (iii) immediately upon receipt pay all monies which it receives in respect of the Receivables into the accounts specified in Part 1 of schedule 2 (*Details of Security Assets*) as Security Accounts (each such account(s) together with all additions to or renewals or replacements thereof (in whatever currency) being a “**Security Account**”); and
 - (iv) pending such payment, hold all monies so received upon trust for the Lender.
- (b) The Chargor shall deal with the Receivables (both collected and uncollected) and the Security Accounts in accordance with any directions given in writing from time to time by the Lender and, in default of and subject to such directions, in accordance with this Deed.
- (c) The Chargor shall deliver to the Lender such information as to the amount and nature of its Receivables as the Lender may from time to time reasonably require (taking into account the requirements of the Loan Documents).

12.7 Operation of Security Accounts

- (a) The Chargor shall not withdraw, attempt or be entitled to withdraw (or direct any transfer of) all or any part of the monies in any Security Account without the prior written consent of the Lender and the Lender shall be entitled (in its absolute discretion) to refuse to permit any such withdrawal or transfer.
- (b) If the right of the Chargor to withdraw the proceeds of any Receivables standing to the credit of a Security Account results in the charge over that Security Account being characterised as a floating charge, that will not affect the nature of any other fixed security created by the Chargor under this Deed on all its outstanding Receivables.

12.8 Account Bank and notices

- (a) The initial Account Bank is The Royal Bank of Scotland unless the Lender specifies otherwise.

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- (b) Where any Security Account of the Chargor is changed or a new Security Account is opened the Chargor shall deliver to the relevant Account Bank a duly completed notice and use its reasonable endeavours to procure that such Account Bank executes and delivers to the Lender an acknowledgement, in each case in the respective forms set out in schedule 3 (*Form of notice to and acknowledgement from Account Bank*).

12.9 Change of Account Bank

- (a) The Account Bank may only be changed to another bank or financial institution with the consent of the Lender.
- (b) A change only becomes effective when the proposed new Account Bank agrees with the Lender and the Chargor (in a manner satisfactory to the Lender) to fulfil the role of the Account Bank under this Deed.
- (c) If there is a change of Account Bank, the net amount (if any) standing to the credit of the relevant Security Accounts maintained with the old Account Bank will be transferred to the corresponding Security Accounts maintained with the new Account Bank immediately upon the appointment taking effect. By this Deed the Chargor irrevocably gives all authorisations and instructions necessary for any such transfer to be made.
- (d) The Chargor shall take any action which the Lender requires to facilitate a change of Account Bank and any transfer of credit balances (including the execution of bank mandate forms) and irrevocably appoints the Lender as its attorney to take any such action if it should fail to do so.

12.10 Relevant Contracts

- (a) The Chargor shall not, except with the prior written consent of the Lender (such consent not to be unreasonably withheld or delayed), amend or waive any material term of any Relevant Contract, terminate any Relevant Contract or release any other party from its obligations under any Relevant Contract in each case other than in accordance with its ordinary course of business.
- (b) The Chargor shall duly perform its obligations under each Relevant Contract where non performance could lead to a Material Adverse Change, shall notify the Lender of any material default by it or any other party under any Relevant Contract and shall not take any action which will reduce or impede recoveries in respect of any Assigned Asset other than in the ordinary course of business.
- (c) The Chargor shall provide to the Lender, as soon as practicable upon receipt, copies of all material notices and information received by it from any other party to any Relevant Contract.

Subject to clause 12.11 (*Gross-up*), all payments to be made by the Chargor in respect of this Deed shall be made:

- (d) in immediately available funds to the credit of such account as the Lender may designate; and
- (e) without (and free and clear of, and without any deduction for, or on account of):
- (i) any set-off or counterclaim; or

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- (ii) except to the extent compelled by law, any deduction or withholding for or on account of Tax.

12.11 Gross-up

- (a) If the Chargor is compelled by law to make any deduction or withholding from any sum payable under this Deed to the Lender, the sum so payable by the Chargor shall be increased so as to result in the receipt by the Lender of a net amount equal to the full amount expressed to be payable under this Deed.
- (b) If the Chargor makes a tax payment in accordance with clause 12.11(a) and the Lender determines that:
 - (i) a tax credit is attributable either to an increased payment of which that tax payment forms part, or to that tax payment; and
 - (ii) the Lender has obtained, utilised and retained that tax credit,the Lender shall pay an amount to the Chargor which the Lender determines will leave it (after that payment) in the same after-tax position as it would have been in had the tax payment not been required to be made by the Chargor.

12.12 Taxation

- (a) The Chargor shall pay and discharge all Taxes imposed upon it or its assets within the time period allowed without incurring penalties unless and only to the extent that:
 - (i) such payment is being contested in good faith;
 - (ii) adequate reserves are being maintained for those Taxes and the costs required to contest them; and
 - (iii) such payment can be lawfully withheld and failure to pay those Taxes does not have or is not reasonably likely to have a material adverse effect on the Chargor.
- (b) The Chargor shall not change its residence for Tax purposes.

12.13 Costs and Expenses

- (a) Transaction expenses
The Chargor shall, to the extent such costs and expenses have not been paid by the Borrower pursuant to the Loan and Security Agreement, within 3 Business Days of demand, pay the Lender the amount of all costs and expenses (including legal fees) reasonably incurred by it or any Receiver or Delegate in connection with the negotiation, preparation, printing, execution, syndication and perfection of:
 - (i) this Deed and any other documents referred to in this Deed; and
 - (ii) any other Loan Documents executed after the date of this Deed.

(b) Amendment costs

If the Chargor requests an amendment, waiver or consent, the Chargor shall, within three Business Days of demand, reimburse the Lender for the amount of all costs and expenses (including legal fees) reasonably incurred by the Lender and any Receiver or Delegate in responding to, evaluating, negotiating or complying with that request or requirement.

(c) Enforcement and preservation costs

The Chargor shall to the extent such costs and expenses have not been paid by the Borrower pursuant to the Loan Security Agreement, within three Business Days of demand, pay to the Lender the amount of all costs and expenses (including legal fees) properly incurred by it in connection with the enforcement of or the preservation of any rights under any Loan Document and any proceedings instituted by or against the Lender as a consequence of taking or holding or enforcing these rights.

13. POWER TO REMEDY

13.1 Power to remedy

If at any time the Chargor does not comply with any of its obligations under this Deed, the Lender (without prejudice to any other rights arising as a consequence of such non-compliance) shall be entitled (but not bound) to rectify that default. The Chargor irrevocably authorises the Lender and its employees and agents by way of security to do all such things (including entering the property of the Chargor) which are necessary to rectify that default.

13.2 Mortgagee in possession

The exercise of the powers of the Lender under this clause 13 (*Power to remedy*) shall not render it liable as a mortgagee in possession.

13.3 Monies expended

The Chargor shall pay to the Lender on demand any monies which are properly expended by the Lender in exercising its powers under this clause 13 (*Power to remedy*), together with interest at the Default Rate from the date on which those monies were expended by the Lender (both before and after judgment) and otherwise in accordance with clause 3.2 (*Default interest*).

14. WHEN SECURITY BECOMES ENFORCEABLE

14.1 When enforceable

This Debenture Security shall become immediately enforceable upon the occurrence of an Event of Default and shall remain so for so long as such Event of Default is continuing.

14.2 Statutory powers

The power of sale and other powers conferred by section 101 of the Act (as amended or extended by this Deed) shall be immediately exercisable upon and at any time after the occurrence of any Event of Default and for so long as such Event of Default is continuing.

14.3 Enforcement

After this Debenture Security has become enforceable pursuant to clause 14.1 of this Deed, the Lender may in its absolute discretion enforce all or any part of the Debenture Security in such manner as it sees fit.

15. ENFORCEMENT OF SECURITY

15.1 General

For the purposes of all rights and powers implied by statute, the Secured Obligations are deemed to have become due and payable on the date of this Deed. Sections 93 and 103 of the Act shall not apply to the Debenture Security.

15.2 Powers of leasing

The statutory powers of leasing conferred on the Lender are extended so as to authorise the Lender to lease, make agreements for leases, accept surrenders of leases and grant options as the Lender may think fit and without the need to comply with section 99 or 100 of the Act.

15.3 Powers of Lender

- (a) At any time after the Debenture Security becomes enforceable in accordance with clause 14.1 of this Deed (or if so requested by the Chargor by written notice at any time), the Lender may without further notice (unless required by law):
 - (i) appoint any person (or persons) to be a receiver, receiver and manager or administrative receiver of all or any part of the Security Assets and/or of the income of the Security Assets; and/or
 - (ii) appoint or apply for the appointment of any person who is appropriately qualified as administrator of the Chargor; and/or
 - (iii) exercise all or any of the powers conferred on mortgagees by the Act (as amended or extended by this Deed) and/or all or any of the powers which are conferred by this Deed on a Receiver, in each case without first appointing a Receiver or notwithstanding the appointment of any Receiver; and/or
 - (iv) exercise (in the name of the Chargor and without any further consent or authority of the Chargor) any voting rights and any powers or rights which may be exercised by any person(s) in whose name any Charged Investment is registered or who is the holder of any of them.
- (b) The Lender is not entitled to appoint a Receiver in respect of any Security Assets which are subject to a charge which (as created) was a floating charge solely by reason of a moratorium being obtained under the Insolvency Act 2000 (or anything done with a view to obtaining such a moratorium) in respect of the Chargor.

15.4 Redemption of prior mortgages

At any time after the Debenture Security has become enforceable in accordance with clause 14.1 of this Deed, the Lender may:

- (a) redeem any prior Security against any Security Asset; and/or

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- (b) procure the transfer of that Security to itself; and/or
 - (c) settle and pass the accounts of the holder of any prior Security and any accounts so settled and passed shall be conclusive and binding on the Chargor.

All principal, interest, costs, charges and expenses of and incidental to any such redemption and/or transfer shall be paid by the Chargor to the Lender on demand.

15.5 Privileges

- (a) Each Receiver and the Lender is entitled to all the rights, powers, privileges and immunities conferred by the Act on mortgagees and receivers when such receivers have been duly appointed under the Act, except that section 103 of the Act does not apply.
- (b) To the extent that the Security Assets constitute “*financial collateral*” and this Deed and the obligations of the Chargor under this Deed constitute a “*security financial collateral arrangement*” (in each case for the purpose of and as defined in the Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003 No. 3226)) each Receiver and the Lender shall have the right after this Security has become enforceable to appropriate all or any part of that financial collateral in or towards the satisfaction of the Secured Obligations.
- (c) For the purpose of clause 15.5(b) above, the value of the financial collateral appropriated shall be such amount as the Receiver or Lender reasonably determines having taken into account advice obtained by it from an independent investment or accountancy firm of national standing selected by it.

15.6 No liability

- (a) Neither the Lender nor any Receiver shall be liable (A) in respect of all or any part of the Security Assets or (B) for any loss or damage which arises out of the exercise or the attempted or purported exercise of, or the failure to exercise any of, its or his respective powers (unless such loss or damage is caused by its or his gross negligence or wilful misconduct).
- (b) Without prejudice to the generality of clause 15.6(a), neither the Lender nor any Receiver shall be liable, by reason of entering into possession of a Security Asset, to account as mortgagee in possession or for any loss on realisation or for any default or omission for which a mortgagee in possession might be liable.

15.7 Protection of third parties

No person (including a purchaser) dealing with the Lender or any Receiver or Delegate will be concerned to enquire:

- (a) whether the Secured Obligations have become payable; or
- (b) whether any power which the Lender or the Receiver is purporting to exercise has become exercisable; or
- (c) whether any money remains due under any Loan Document; or
- (d) how any money paid to the Lender or to the Receiver is to be applied.

16. RECEIVER

16.1 Removal and replacement

The Lender may from time to time remove any Receiver appointed by it (subject, in the case of an administrative receivership, to section 45 of the Insolvency Act 1986) and, whenever it may deem appropriate, may appoint a new Receiver in the place of any Receiver whose appointment has terminated.

16.2 Multiple Receivers

If at any time there is more than one Receiver of all or any part of the Security Assets and/or the income of the Security Assets, each Receiver shall have power to act individually (unless otherwise stated in the appointment document).

16.3 Remuneration

Any Receiver shall be entitled to remuneration for his services at a rate to be fixed by agreement between him and the Lender (or, failing such agreement, to be fixed by the Lender).

16.4 Payment by Receiver

Only monies actually paid by a Receiver to the Lender in relation to the Secured Obligations shall be capable of being applied by the Lender in discharge of the Secured Obligations.

16.5 Agent of Chargor

Any Receiver shall be the agent of the Chargor in respect of which it is appointed. The Chargor shall (subject to the Companies Act 2006 and the Insolvency Act 1986) be solely responsible for his acts and defaults and for the payment of his remuneration. The Lender shall incur no liability (either to the Chargor or to any other person) by reason of the appointment of a Receiver or for any other reason.

17. POWERS OF RECEIVER

17.1 General powers

Any Receiver shall have:

- (a) all the powers which are conferred on the Lender by clause 15.3 (*Powers of Lender*);
- (b) all the powers which are conferred by the Act on mortgagees in possession and receivers appointed under the Act;
- (c) (whether or not he is an administrative receiver) all the powers which are listed in schedule 1 of the Insolvency Act 1986; and
- (d) all powers which are conferred by any other law conferring power on receivers.

17.2 Additional powers

In addition to the powers referred to in clause 17.1 (*General powers*), a Receiver shall have the following powers:

- (a) to take possession of, collect and get in all or any part of the Security Assets and/or income in respect of which he was appointed;

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- (b) to manage the Security Assets and the business of the Chargor as he thinks fit;
 - (c) to redeem any Security and to borrow or raise any money and secure the payment of any money in priority to the Secured Obligations for the purpose of the exercise of his powers and/or defraying any costs or liabilities incurred by him in such exercise;
 - (d) to sell or concur in selling, leasing or otherwise disposing of all or any part of the Security Assets in respect of which he was appointed without the need to observe the restrictions imposed by section 103 of the Act and without limitation:
 - (i) fixtures may be severed and sold separately from the Real Property containing them, without the consent of the Chargor;
 - (ii) the consideration for any such transaction may consist of cash, debentures or other obligations, shares, stock or other valuable consideration (and the amount of such consideration may be dependent upon profit or turnover or be determined by a third party); and
 - (iii) any such consideration may be payable in a lump sum or by instalments spread over such period as he thinks fit;
 - (e) to alter, improve, develop, complete, construct, modify, refurbish or repair any building or land and to complete or undertake or concur in the completion or undertaking (with or without modification) of any project in which the Chargor was concerned or interested before his appointment (being a project for the alteration, improvement, development, completion, construction, modification, refurbishment or repair of any building or land);
 - (f) to carry out any sale, lease or other disposal of all or any part of the Security Assets by conveying, transferring, assigning or leasing the same in the name of the Chargor and, for that purpose, to enter into covenants and other contractual obligations in the name of, and so as to bind, the Chargor;
 - (g) to take any such proceedings (in the name of any of the Chargor or otherwise) as he shall think fit in respect of the Security Assets and/or income in respect of which he was appointed (including proceedings for recovery of rent or other monies in arrears at the date of his appointment);
 - (h) to enter into or make any such agreement, arrangement or compromise as he shall think fit;
 - (i) to insure, and to renew any insurances in respect of, the Security Assets as he shall think fit (or as the Lender shall direct);
 - (j) to appoint and employ such managers, officers and workmen and engage such professional advisers as he shall think fit (including, without prejudice to the generality of the foregoing power, to employ his partners and firm);
 - (k) to form one or more Subsidiaries of the Chargor, and to transfer to any such Subsidiary all or any part of the Security Assets;
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- (l) to operate any rent review clause in respect of any Real Property in respect of which he was appointed (or any part thereof) and to apply for any new or extended lease; and
 - (m) to:
 - (i) give valid receipts for all monies and to do all such other things as may seem to him to be incidental or conducive to any other power vested in him or necessary or desirable for the realisation of any Security Asset;
 - (ii) exercise in relation to each Security Asset all such powers and rights as he would be capable of exercising if he were the absolute beneficial owner of the Security Assets; and
 - (iii) use the name of the Chargor for any of the above purposes.

18. APPLICATION OF PROCEEDS

18.1 Application

All monies received by the Lender or any Receiver after the Debenture Security has become enforceable in accordance with clause 14.1 shall (subject to the rights and claims of any person having a security ranking in priority to the Debenture Security) be applied in the following order:

- (a) *first*, in satisfaction of, or provision for, all costs, charges and expenses incurred, and payments made by the Lender or any Receiver or Delegate and of all remuneration due to the Receiver in connection with this Deed or the Security Assets;
- (b) *secondly*, in or towards satisfaction of the remaining Secured Obligations in accordance with clause 18.3 (*Appropriation and suspense account*); and
- (c) *thirdly*, in payment of any surplus to the Chargor or other person entitled to it.

18.2 Contingencies

If the Debenture Security is enforced at a time when no amounts are due under the Loan Documents (but at a time when amounts may become so due), the Lender or a Receiver may pay the proceeds of any recoveries effected by it into a blocked suspense account (bearing interest at such rate (if any) as the Lender may determine, acting reasonably).

18.3 Appropriation and suspense account

- (a) Subject to clause 18.1 (*Application*), the Lender shall apply all payments received in respect of the Secured Obligations in reduction of any part of the Secured Obligations in any order or manner which it may determine.
- (b) Any such appropriation shall override any appropriation by the Chargor.
- (c) All monies received, recovered or realised by the Lender under or in connection with this Deed may at the discretion of the Lender be credited to a separate interest-bearing suspense account for so long as the Lender determines (with interest accruing thereon at such rate (if any) as the Lender may determine, acting reasonably, without the Lender having any obligation to apply such monies and interest or any part of it in or towards the discharge of any of the Secured Obligations).

19. SET-OFF

19.1 Set-off rights

- (a) The Lender may (but shall not be obliged to) set off any matured obligation which is due and payable by the Chargor and unpaid (whether under the Loan Documents or which has been assigned to the Lender by the Chargor) against any material matured obligation owed by the Lender to the Chargor, regardless of the place of payment, booking branch or currency of either obligation.
- (b) At any time after the Debenture Security has become enforceable (and in addition to its rights under clause 19.1(a)), the Lender may (but shall not be obliged to) set-off any contingent liability owed by the Chargor under any Loan Document against any obligation (whether or not matured) owed by the Lender to the Chargor, regardless of the place of payment, booking branch or currency of either obligation.
- (c) If the obligations are in different currencies, the Lender may convert either obligation at a market rate of exchange in its usual course of business for the purpose of the set-off.
- (d) If either obligation is unliquidated or unascertained, the Lender may set off in an amount estimated by it in good faith to be the amount of that obligation.

19.2 Time deposits

Without prejudice to clause 19.1 (*Set-off*), if any time deposit matures on any account which the Chargor has with the Lender at a time within the Security Period when:

- (a) this Debenture Security has become enforceable in accordance with clause 14.1; and
- (b) no Secured Obligation is due and payable,

such time deposit shall automatically be renewed for such further maturity as the Lender in its absolute discretion considers appropriate unless the Lender agrees in writing.

20. DELEGATION

Each of the Lender and any Receiver may delegate, by power of attorney (or in any other manner) to any person, any right, power or discretion exercisable by them under this Deed upon any terms (including power to sub-delegate) which it may think fit. Neither the Lender nor any Receiver shall be in any way liable or responsible to the Chargor for any loss or liability arising from any act, default, omission or misconduct on the part of any Delegate.

21. FURTHER ASSURANCES

21.1 Further action

The Chargor shall, at its own expense, within 5 Business Days of demand do all acts and execute all documents as the Lender or a Receiver may reasonably specify (and in such form as the Lender or a Receiver may reasonably require) for:

- (a) creating, perfecting or protecting the Security intended to be created by this Deed; and

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- (b) facilitating the realisation of any Security Asset in accordance with this Deed; or
 - (c) facilitating the exercise of any rights, powers and remedies exercisable by the Lender, or any Receiver or any Delegate in respect of any Security Asset or provided by or pursuant to the Loan Documents or by law;

This includes:

- (i) the re-execution of this Deed or such Loan Document;
 - (ii) the execution of any legal mortgage, charge, transfer, conveyance, assignment, assignation or assurance of any property, whether to the Lender or to its nominee; and
 - (iii) the giving of any notice, order or direction and the making of any filing or registration,
- which, in any such case, the Lender may think necessary.

21.2 Loan Documents

The Chargor shall take all such action as is available to it (including making all filings and registrations) as may be necessary for the purpose of the creation, perfection, protection or maintenance of any Security conferred or intended to be conferred on the Lender by or pursuant to the Loan Documents.

21.3 Specific security

Without prejudice to the generality of clause 21.1 (*Further action*), the Chargor will within 5 Business Days of reasonable request by the Lender execute any document contemplated by that clause over any Security Asset which is subject to or intended to be subject to any fixed security under this Deed (including any fixed security arising or intended to arise pursuant to clause 7 (*Conversion of floating charge*)).

22. POWER OF ATTORNEY

The Chargor, by way of security, irrevocably and severally appoints the Lender, each Receiver and any Delegate to be its attorney to take any action whilst an Event of Default is continuing or enforcement of the Debenture Security has occurred which the Chargor is obliged to take under this Deed, including under clause 21 (*Further assurances*) or, if no Event of Default is continuing, which the Chargor has failed to take within any applicable grace period. The Chargor ratifies and confirms whatever any attorney does or purports to do pursuant to its appointment under this clause.

23. CURRENCY CONVERSION

All monies received or held by the Lender or any Receiver under this Deed may be converted from their existing currency into such other currency as the Lender or the Receiver considers necessary or desirable to cover the obligations and liabilities comprised in the Secured Obligations in that other currency at the Lender's spot rate of exchange. The Chargor shall indemnify the Lender against all costs, charges and expenses incurred in relation to such conversion. Neither the Lender nor any Receiver shall have any liability to the Chargor in respect of any loss resulting from any fluctuation in exchange rates after any such conversion.

24. CHANGES TO THE PARTIES

24.1 Charging Companies

The Chargor shall not assign any of its rights or obligations under this Deed.

24.2 Lender

- (a) The Lender may assign or transfer all or any part of its rights under this Deed to any person who takes an assignment or transfer.
- (b) The Chargor shall, promptly upon being requested to do so by the Lender, enter into such documents as may be necessary or desirable to effect such assignment or transfer.

25. MISCELLANEOUS

25.1 New accounts

- (a) If the Lender receives, or is deemed to be affected by, notice, whether actual or constructive, of any subsequent Security affecting any Security Asset and/or the proceeds of sale of any Security Asset or any guarantee under the Loan Documents ceases to continue in force and/or the proceeds of sale of any Security Asset, it may open a new account or accounts for the Chargor. If it does not open a new account, it shall nevertheless be treated as if it had done so at the time when it received or was deemed to have received such notice.
- (b) As from that time all payments made to the Lender will be credited or be treated as having been credited to the new account and will not operate to reduce any amount of the Secured Obligations.

25.2 Tacking

- (a) The Lender shall perform its obligations under the Loan and Security Agreement (including any obligation to make available further advances).
- (b) This Deed secures advances already made and further advances to be made.

25.3 Articles of association

The Chargor certifies that the Debenture Security does not contravene any of the provisions of the articles of association of the Chargor.

25.4 Protective clauses

The Chargor is deemed to be a principal debtor in relation to this Deed. The obligations of the Chargor under, and the security intended to be created by, this Deed shall not be impaired by any forbearance, neglect, indulgence, extension or time, release, surrender or loss of securities, dealing, amendment or arrangement by the Lender which would otherwise have reduced, released or prejudiced this Debenture Security or any surety liability of the Chargor (whether or not known to it).

26. NOTICES

Article 10 of the Loan and Security Agreement (*Notices*) is incorporated into this Deed as if fully set out in this Deed, save that the address and fax numbers of each Party for all communications or documents given under or in connection with this Deed are those identified with its name in the execution pages to this Deed or subsequently notified from time to time by the relevant Party for the purposes of this Deed.

27. CALCULATIONS AND CERTIFICATES

Any certificate of or determination by the Lender specifying the amount of any Secured Obligation due from the Chargor (including details of any relevant calculation thereof) is in the absence of manifest error, prima facie evidence against the Chargor of the matters to which it relates.

28. PARTIAL INVALIDITY

All the provisions of this Deed are severable and distinct from one another and if at any time any provision is or becomes illegal, invalid or unenforceable in any respect under any law of any jurisdiction, neither the legality, validity or enforceability of any of the remaining provisions nor the legality, validity or enforceability of such provision under the law of any other jurisdiction will in any way be affected or impaired.

29. REMEDIES AND WAIVERS

No failure to exercise, nor any delay in exercising, on the part of the Lender, any right or remedy under this Deed shall operate as a waiver, nor shall any single or partial exercise of any right or remedy prevent any further or other exercise, or the exercise of any other right or remedy. The rights and remedies provided are cumulative and not exclusive of any rights or remedies provided by law.

30. AMENDMENTS AND WAIVERS

Any provision of this Deed may be amended only if the Lender and the Chargor so agree in writing and any breach of this Deed may be waived before or after it occurs only if the Lender so agrees in writing. A waiver given or consent granted by the Lender under this Deed will be effective only if given in writing and then only in the instance and for the purpose for which it is given.

31. COUNTERPARTS

This Deed may be executed in any number of counterparts, and this has the same effect as if the signatures (and seals, if any) on the counterparts were on a single copy of this Deed.

32. RELEASE

32.1 Release

Upon the expiry of the Security Period (but not otherwise) the Lender shall, at the request and cost of the Chargor, take whatever action is necessary to release or re-assign (without recourse or warranty) the Security Assets from the Security.

32.2 Reinstatement

Where any discharge (whether in respect of the obligations of the Chargor or any security for those obligations or otherwise) is made in whole or in part or any arrangement is made on the faith of any payment, security or other disposition which is avoided or must be restored on insolvency, liquidation or otherwise (without limitation), the liability of the Chargor under this Deed shall continue as if the discharge or arrangement had not occurred. The Lender may concede or compromise any claim that any payment, security or other disposition is liable to avoidance or restoration.

33. GOVERNING LAW

This Deed and any non-contractual obligations arising out of or in connection with it shall be governed by English law.

34. ENFORCEMENT

34.1 Jurisdiction of English courts

- (a) The courts of England have exclusive jurisdiction to settle any dispute arising out of or in connection with this Deed (including a dispute relating to the existence, validity or termination of this Deed or any non-contractual obligation arising out of or in connection with this Deed) (a “Dispute”).
- (b) The Parties agree that the courts of England are the most appropriate and convenient courts to settle Disputes and accordingly no Party will argue to the contrary.
- (c) This clause 34.1 (*Jurisdiction of English courts*) is for the benefit of the Lender only. As a result, the Lender shall not be prevented from taking proceedings relating to a Dispute in any other courts with jurisdiction. To the extent allowed by law, the Lender may take concurrent proceedings in any number of jurisdictions.

IN WITNESS of which this Deed has been duly executed by the Chargor as a deed and duly executed by the Lender and has been delivered on the first date specified on page 1 of this Deed by the Chargor.

SCHEDULE 1: THE GUARANTEE

1. Continuing guarantee

This guarantee is a continuing guarantee and will extend to the ultimate balance of sums payable by the Borrower, the Chargor or any other member of the Group under the Loan Documents, regardless of any intermediate payment or discharge in whole or in part.

2. Reinstatement

If any discharge, release or arrangement (whether in respect of the obligations of the Borrower, the Chargor or any other member of the Group or any security for those obligations or otherwise) made by the Lender in whole or in part on the basis of any payment, security or other disposition which is avoided or must be restored in insolvency, liquidation, administration or otherwise, without limitation, then the liability of the Chargor under this Deed will continue or be reinstated as if the discharge, release or arrangement had not occurred.

3. Waiver of defences

The obligations of the Chargor under this Deed will not be affected by an act, omission, matter or thing which, but for this Deed, would reduce, release or prejudice any of its obligations under this Deed (without limitation and whether or not known to it or to the Lender) including:

- (a) any time, waiver or consent granted to, or composition with, the Borrower, the Chargor or other person;
- (b) the release of the Borrower, the Chargor or any other person under the terms of any composition or arrangement with any creditor of any member of the Group;
- (c) the taking, variation, compromise, exchange, renewal or release of, or refusal or neglect to perfect, take up or enforce, any rights against, or security over assets of, the Borrower, the Chargor or other person or any non-presentation or non-observance of any formality or other requirement in respect of any instrument or any failure to realise the full value of any security;
- (d) any incapacity or lack of power, authority or legal personality of or dissolution or change in the members or status of the Borrower, the Chargor or any other person;
- (e) any amendment, novation, supplement, extension, restatement (however fundamental and whether or not more onerous) or replacement of a Loan Document or any other document or security including, without limitation, any change in the purpose of, any extension or increase in any facility or the addition of any new facility under any Loan Document or other document or security;
- (f) any unenforceability, illegality or invalidity of any obligation of any person under any Loan Document or any other document or security; or
- (g) any insolvency, administration or similar proceedings.

4. Guarantor Intent

Without prejudice to the generality of clause 3 (*Waiver of Defences*), the Chargor expressly confirms that it intends that this guarantee shall extend from time to time to any (however fundamental) variation, increase, extension or addition of or to any of the Loan Documents and/or any facility or amount made available under any of the Loan Documents for the purposes of or in connection with any of the following: business acquisitions of any nature; increasing working capital; enabling investor distributions to be made; carrying out restructurings; refinancing existing facilities, refinancing any other indebtedness; making facilities available to new borrowers; any other variation or extension of the purposes for which any such facility or amount might be made available from time to time; and any fees, costs and/or expenses associated with any of the foregoing.

5. Immediate recourse

The Chargor waives any right it may have of first requiring the Lender to proceed against or enforce any other rights or security or claim payment from any person before claiming from the Chargor under this Deed. This waiver applies irrespective of any law or any provision of a Loan Document to the contrary.

6. Appropriations

Until all amounts which may be or become payable by the Borrower, any other member of the Group and/or the Chargor under or in connection with the Loan Documents have been irrevocably paid in full, the Lender (or any trustee or agent on its behalf) may:

- (a) refrain from applying or enforcing any other monies, security or rights held or received by the Lender (or any trustee or agent on its behalf) in respect of those amounts, or apply and enforce the same in such manner and order as it sees fit (whether against those amounts or otherwise) and the Chargor shall not be entitled to the benefit of the same; and
- (b) hold in an interest-bearing suspense account any monies received from the Chargor or on account of the Chargor's liability under this Deed.

7. Deferral of Guarantors' rights

Until all amounts which may be or become payable by the Borrower, any other member of the Group and/or the Chargor under or in connection with the Loan Documents have been irrevocably paid in full and unless the Lender otherwise directs, the Chargor shall not exercise any rights which it may have by reason of performance by it of its obligations under the Loan Documents or by reason of any amount being payable, or liability arising, under this Deed:

- (a) to be indemnified by the Borrower, any other member of the Group or the Chargor;
- (b) to claim any contribution from any other guarantor of the Borrower's, another Group member's or the Chargor's obligations under the Loan Documents;
- (c) to take the benefit (in whole or in part and whether by way of subrogation or otherwise) of any rights of the Lender under the Loan Documents or of any other guarantee or security taken pursuant to, or in connection with, the Loan Documents by the Lender;

-
- (d) to bring legal or other proceedings for an order requiring any member of the Group to make any payment, or perform any obligation, in respect of which the Chargor has given a guarantee, undertaking or indemnity under clause 2.1 (*Guarantee and indemnity*);
 - (e) to exercise any right of set-off against any member of the Group; and/or
 - (f) to claim or prove as a creditor of any member of the Group in competition with the Lender.

If the Chargor receives any benefit, payment or distribution in relation to such rights it shall hold that benefit, payment or distribution to the extent necessary to enable all amounts which may be or become payable to the Lender by the any member of the Group under or in connection with the Loan Documents to be repaid in full on trust for the Lender and shall promptly pay or transfer the same to the Lender.

8. Additional security

This guarantee is in addition to, and is not in any way prejudiced by, any other guarantee or security at the date of this guarantee or subsequently held by the Lender.

SCHEDULE 2: DETAILS OF SECURITY ASSETS

Part 1: Security Accounts

Security Accounts

<u>Account Holder</u>	<u>Account Number</u>	<u>Account Bank</u>	<u>Account bank details and sort code (if appropriate)</u>
Active Power Solutions Limited	10009981	The Royal Bank of Scotland plc	GBP Sort code: 60-00-04 SWIFT: NWBKGB2L IBAN: GB58NWBK60000410009981
Active Power Solutions Limited	5500013034642	The Royal Bank of Scotland plc	EURO SWIFT: NWBKGB2L IBAN: GB79NWBK60720013034642

Part 2: Relevant Contracts

None as at the date of this Deed

Part 3: Insurances

None as at the date of this Deed

SCHEDULE 3: FORM OF NOTICE TO AND ACKNOWLEDGEMENT FROM ACCOUNT BANK

To: [*Name and address of Account Bank*]

Dated: [—] 20[—]

Dear Sirs

Re: Account Holder: [—] (the “**Chargor**”)
Security Account Nos: [—] (the “**Security Account[s]**”)
Account Branch: [—]

9. We give notice that, by a debenture dated [—] 200[—] (the “**Debenture**”), we have charged to [—] (the “**Lender**”) all our present and future right, title and interest in and to the Security Accounts (as defined in this letter), all monies from time to time standing to the credit of the Security Accounts and all additions to or renewals or replacements thereof (in whatever currency) (together the “**Charged Accounts**”) and to all interest from time to time accrued or accruing on the Charged Accounts, any investment made out of any such monies or account and all rights to repayment of any of the foregoing by you.
10. We advise you that, under the terms of the Debenture, we are not entitled to withdraw any monies from the Security Accounts without first having obtained the written consent of the Lender.
11. We irrevocably authorise and instruct you from time to time:
- (a) unless the Lender so authorises you in writing, not to permit withdrawals from the Security Accounts;
 - (b) to hold all monies from time to time standing to the credit of the Charged Accounts to the order of the Lender;
 - (c) to pay all or any part of the monies standing to the credit of the Charged Accounts to the Lender (or as it may direct) promptly following receipt of written instructions from the Lender to that effect; and
 - (d) to disclose to the Lender such information relating to us and the Charged Accounts as the Lender may from time to time request you to provide.
12. We agree that you are not bound to enquire whether the right of the Lender to withdraw any monies from any Charged Account has arisen or be concerned with (A) the propriety or regularity of the exercise of that right or (B) notice to the contrary or (C) to be responsible for the application of any monies received by the Lender.
13. This notice may only be revoked or amended with the prior written consent of the Lender.
14. Please confirm by completing the enclosed copy of this notice and returning it to the Lender (with a copy to us) that you agree to the above and that:
- (a) you accept the authorisations and instructions contained in this notice and you undertake to comply with this notice;
 - (b) you have not, at the date this notice is returned to the Lender, received notice of any assignment or charge of or claim to the monies standing to the credit of any Charged Account or the grant of any security or other interest over those monies or any Charged Account in favour of any third party and you will notify the Lender promptly if you should do so in the future; and

(c) you do not at the date of this notice and will not in the future exercise any right to combine accounts or any rights of set-off or lien or any similar rights in relation to the monies standing to the credit of the Charged Accounts.

15. This notice, and any acknowledgement in connection with it, and any non-contractual obligations arising out of or in connection with any of them, shall be governed by English law.

Yours faithfully

for and on behalf of
[NAME OF CHARGOR]

Countersigned by

for and on behalf of
[NAME OF LENDER]

[*On copy*]

To: [—]
as Lender
[ADDRESS]

Copy to: [NAME OF THE CHARGOR]

We acknowledge receipt of the above notice. We confirm and agree:

- (a) that the matters referred to in it do not conflict with the terms which apply to any Charged Account; and
- (b) the matters set out in clause 6 of the above notice.

for and on behalf of
[Name of Account Bank]

Dated: [—] 200[—]

**SCHEDULE 4: FORM OF NOTICE TO AND ACKNOWLEDGEMENT BY PARTY TO
RELEVANT CONTRACT**

To: *[Insert name and address of relevant party]*

Dated: [—] 20[—]

Dear Sirs

Re: *[describe Relevant Contract]* dated [—] 200[—] between (1) you and [—] and (2)[—] (the “Chargor”)

1. We give notice that, by a debenture dated [—] 200[—] (the “**Debenture**”), we have assigned to [—] (the “**Lender**”) all our present and future right, title and interest in and to *[insert details of Relevant Contract]* (together with any other agreement supplementing or amending the same, the “**Agreement**”) including all rights and remedies in connection with the Agreement and all proceeds and claims arising from the Agreement.
2. We irrevocably authorise and instruct you from time to time:
 - (a) to disclose to the Lender at our expense (without any reference to or further authority from us and without any enquiry by you as to the justification for such disclosure), such information relating to the Agreement as the Lender may from time to time reasonably request;
 - (b) to hold all sums from time to time due and payable by you to us under the Agreement to the order of the Lender;
 - (c) to pay or release all or any part of the sums from time to time due and payable by you to us under the Agreement only in accordance with the written instructions given to you by the Lender from time to time;
 - (d) to comply with any written notice or instructions in any way relating to, or purporting to relate to, the Debenture or the Agreement or the debts represented thereby which you receive at any time from the Lender without any reference to or further authority from us and without any enquiry by you as to the justification for or validity of such notice or instruction; and
 - (e) to send copies of all notices and other information given or received under the Agreement to the Lender.
3. We are not permitted to receive from you, otherwise than through the Lender, any amount in respect of or on account of the sums payable to us from time to time under the Agreement or to agree any amendment or supplement to, or waive any obligation under, the Agreement without the prior written consent of the Lender.
4. This notice may only be revoked or amended with the prior written consent of the Lender.
5. Please confirm by completing the enclosed copy of this notice and returning it to the Lender (with a copy to us) that you agree to the above and that:
 - (a) you accept the instructions and authorisations contained in this notice and you undertake to comply with this notice;
 - (b) you have not, at the date this notice is returned to the Lender, received notice of the assignment or charge, the grant of any security or the existence of any other interest of any third party in or to the Agreement or any proceeds of it and you will notify the Lender promptly if you should do so in future;

-
- (c) you will not permit any sums to be paid to us or any other person (other than the Lender) under or pursuant to the Agreement without the prior written consent of the Lender; and
 - (d) you will not exercise any right to terminate the Agreement or take any action to amend or supplement the Agreement without the prior written consent of the Lender.
6. This notice, and any acknowledgement in connection with it, and any non-contractual obligations arising out of or in connection with any of them, shall be governed by English law.

Yours faithfully

for and on behalf of
[NAME OF CHARGOR]

[On copy]

To: [—]
as Lender
[ADDRESS]

Copy to: [NAME OF CHARGOR]

Dear Sirs

We acknowledge receipt of the above notice and consent and agree to its terms. We confirm and agree to the matters set out in clause 5 in the above notice.

for and on behalf of
[Name of relevant party]

Dated: [—] 200[—]

SCHEDULE 5: FORM OF NOTICE TO AND ACKNOWLEDGEMENT BY INSURERS

To: *[Insert name and address of insurer]*

Dated: [—] 20[—]

Dear Sirs

[Describe insurance policies] dated [—] 200[—] between (1) you and (2) [—] (the “**Chargor**”)

1. We give notice that, by a debenture dated [—] 200[—] (the “**Debenture**”), we have assigned to [—] (the “**Lender**”) all our present and future right, title and interest in and to the Policies (together with any other agreement supplementing or amending the same, the “**Policies**”) including all rights and remedies in connection with the Policies and all proceeds and claims arising from the Policies.
2. We irrevocably authorise and instruct you from time to time:
 - (a) to disclose to the Lender at our expense without any reference to or further authority from us (and without any enquiry by you as to the justification for such disclosure), such information relating to the Policies as the Lender may from time to time reasonably request;
 - (b) to hold all sums from time to time due and payable by you to us under the Policies to the order of the Lender;
 - (c) to pay or release all or any part of the sums from time to time due and payable by you to us under the Policies only in accordance with the written instructions given to you by the Lender from time to time;
 - (d) to comply with any written notice or instructions in any way relating to, or purporting to relate to, the Debenture, the sums payable to us from time to time under the Policies or the debts represented by them which you may receive from the Lender (without any reference to or further authority from us and without any enquiry by you as to the justification for or validity of such notice or instruction); and
 - (e) to send copies of all notices and other information given or received under the Policies to the Lender.
3. We irrevocably instruct you, with effect from the date of this notice, to note on the relevant Policies the Lender’s interest as loss payee and as first priority assignee of the Policies and the rights, remedies, proceeds and claims referred to above.
4. We are not permitted to receive from you, otherwise than through the Lender, any amount in respect of or on account of the sums payable to us from time to time under the Policies or to agree any amendment or supplement to, or waive any obligation under, the Policies without the prior written consent of the Lender.
5. This notice may only be revoked or amended with the prior written consent of the Lender.
6. Please confirm by completing the enclosed copy of this notice and returning it to the Lender (with a copy to us) that you agree to the above and that:
 - (a) you accept the instructions and authorisations contained in this notice and you undertake to comply with this notice;

-
- (b) you have not, at the date this notice is returned to the Lender, received notice of the assignment or charge, the grant of any security or the existence of any other interest of any third party in or to the Policies or any proceeds of them or any breach of the terms of any Policy and you will notify the Lender promptly if you should do so in future;
 - (c) you will not permit any sums to be paid to us or any other person under or pursuant to the Policies without the prior written consent of the Lender; and
 - (d) you will not exercise any right to terminate, cancel, vary or waive the Policies or take any action to amend or supplement the Policies without the prior written consent of the Lender.
7. This notice, and any acknowledgement in connection with it, and any non-contractual obligations arising out of or in connection with any of them, shall be governed by English law.

Yours faithfully

for and on behalf of
[NAME OF CHARGOR]

[On copy]

To: [—]
as Lender
[ADDRESS]

Copy to: [NAME OF CHARGOR]

Dear Sirs

We acknowledge receipt of the above notice and consent and agree to its terms. We confirm and agree to the matters set out in clause 6 in the above notice.

for and on behalf of
[Name of relevant insurer]

Dated: [—] 200[—]

EXECUTION PAGE

THE CHARGOR

Executed as a deed, but not delivered until the first date specified on)
page 1, by **ACTIVE POWER SOLUTIONS LIMITED** acting by:)
)
)

Director /s/ John Penver

Witness signature /s/ Sumie Kunishima

Witness name: Sumie Kunishima

Witness address: Sagami Bldg 2F

2-7-6 Iwamoto-cho, chi yoda-ku

Tokyo, Japan 101-0032

Address: Unit 4.1
Lauriston Business Park
Pitchill
Evesham
WR11 8SN
United Kingdom

Facsimile No: +44 (0) 1387 870 806

Attention: John Penver

THE LENDER

Signed Krista Hall by for and on behalf of **SILICON VALLEY**)
BANK)
) Signature

/s/ Krista Hall

Address: 3003 Tasman Drive
Santa Clara
California 95054
United States of America

Facsimile No: +1 (408) 654 1099

Attention: Krista Hall

EXECUTION PAGE

THE CHARGOR

Executed as a deed, but not delivered until the first date specified on page 1, by ACTIVE POWER SOLUTIONS LIMITED acting by:)
)
)
)

Director /s/ James A. Clishem
James A. Clishem
Director

Witness signature /s/ John K Penver

Witness name: John K. Penver

Witness address: 3701 Humble Cove
Austin, TX 78730, USA

Address: C/o Taylor Wessing LLP
5 New Street Square
London EC4A 3TW

Facsimile No: [i]

Attention: [i]

THE LENDER

Signed by _____ for and on behalf of SILICON VALLEY BANK)
)
) Signature _____

Address: 3003 Tasman Drive
Santa Clara
California 95054
United States of America

Facsimile No: [+1 (408) 654 1099]

Attention: [i]

CERTIFICATIONS

I, James A. Clishem, certify that:

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

Date: October 26, 2010

/s/ James A. Clishem

James A. Clishem
President and Chief Executive Officer
(Principal Executive Officer)

CERTIFICATIONS

I, John K. Penver, certify that:

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

Date: October 26, 2010

/s/ John K. Penver

John K. Penver
Vice President of Finance, Chief Financial
Officer and Secretary
(Principal Financial and Accounting Officer)

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

In connection with the Quarterly Report on Form 10-Q of Active Power, Inc. (the "Company") for the period ending September 30, 2010, 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, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

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

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

/s/ James A. Clishem

James A. Clishem
President and Chief Executive Officer
October 26, 2010

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

In connection with the Quarterly Report on Form 10-Q of Active Power, Inc. (the "Company") for the period ending September 30, 2010 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, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

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

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

/s/ John K. Penver

John K. Penver
Vice President of Finance, Chief Financial
Officer and Secretary
October 26, 2010