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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2001

or

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

Commission file number 001-15957

Capstone Turbine Corporation

(Exact name of Registrant as specified in its charter)

Delaware	**95-4180883**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

21211 Nordhoff Street, Chatsworth, California 91311

(Address of principal executive offices) (Zip code)

818-734-5300

(Registrant's telephone number, including area code)

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

None

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

Common Stock, par value $.001 per share

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 the filing requirements for the past 90 days. Yes ☑ No ☐

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

The aggregate market value of the shares of common stock held by non-affiliates of the registrant as of March 11, 2002 was $295.2 million based upon the composite closing price of the registrant's common stock on the Nasdaq National Market System on that date.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 77,401,149 shares of common stock, $.001 par value, were outstanding as of March 11, 2002.

DOCUMENTS INCORPORATED BY REFERENCE

Part III: Proxy Statement for Annual Meeting of Stockholders to be held May 30, 2002.

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CAPSTONE TURBINE CORPORATION

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PART I

Item 1. *Business.*

Overview

We develop, design, assemble and sell Capstone MicroTurbines for worldwide applications in the markets for on-site power production, also known as distributed power generation, and hybrid electric vehicles that combine the primary source battery with an auxiliary power source, such as a microturbine, to enhance performance. We are the first company to offer a proven, commercially available power source using microturbine technology. Our 30-kilowatt and 60-kilowatt products are state-of-the-art systems designed to produce electricity for commercial and small industrial users. Our microturbines combine patented air-bearing technology, advanced combustion technology and sophisticated power electronics to form efficient and reliable electricity and heat production systems. Also, our advanced technology allows our microturbines to operate by remote control. Our 30-kilowatt product can use a broad range of gaseous and liquid fuels in an environmentally friendly manner. We intend to develop corresponding configurations for our 60-kilowatt family of products.

We are a leading worldwide developer and supplier of microturbine technology. As of December 31, 2001, we shipped 2,035 commercial units, of which 212 were shipped during 1998 to 1999, 790 during 2000 and 1,033 during 2001. Of the units we shipped, we are tracking approximately 1,600 units, a combination of installed units, and those we believe are in the sales and commissioning cycle. Further, we believe that about 300 units are currently inactive in distributors' inventories. This has occurred for two primary reasons. First, these distributors purchased larger quantities of products to take advantage of volume discounts and second, some product sales to end-users have not occurred as anticipated because product integration designs and implementations are still under development by the distributors. Finally, we believe about 100 units are in inventory at a company that has stated its intention to divest of its distributed generation operations.

We are currently managing our business such that we generally ship product as it is ordered. Therefore, we do not have any significant backlog. This is different than a year ago, when the Company had programs that required new business partners to place orders in volume. However, as the business develops, backlog may again become meaningful.

We believe stationary applications for our microturbines, both independent of or connected to the electric utility grid, are extremely broad. The primary stationary markets that we are targeting include:

- *resource recovery* — using natural gas or other gasses that are otherwise burned or released directly into the atmosphere to produce power;

- *micro-cogeneration/combined heat and power* — using both electricity and heat, for example, for space heating, air conditioning and chilling water, to maximize use of available energy;

- *power quality and reliability, including back-up and standby power/peak shaving* — meeting power quality and reliability supply requirements for users with particularly low tolerances for power source interruption and providing a reliable back-up power supply for increasingly electricity-dependent enterprises and self-generation during hours when electricity prices spike; and

- *developing regions and other stationary power applications* — providing power in areas with limited access to transmission and distribution lines.

We also have applied our technology to hybrid electric vehicles such as buses, industrial use and other vehicles. Capstone MicroTurbine subassemblies are currently used in buses operating in Christchurch, New Zealand and U.S. cities such as Los Angeles, Atlanta, Chattanooga and Tempe.

Since our microturbine systems and subassemblies can be used as power sources within larger energy "solutions" for our customers, we envision our distributors and end-users developing more applications over time. Our marketing strategy includes partnering with major companies with strong connections to local markets and, when appropriate, to sell directly to the end-user.

Our Products

Capstone MicroTurbines are compact, environmentally friendly generators of electricity and heat. They operate on the same principle as a jet engine but can use a variety of commercially available fuels, such as natural gas, diesel, kerosene and propane, as well as previously unusable or underutilized fuels. For example, our 30-kilowatt product can operate on low British Thermal Unit ("BTU") gas, which is gas with low energy content, and can also operate on gas with a high amount of sulfur, known in the industry as sour gas. The small size and relatively lightweight modular design of our microturbines allows for easy transportation.

Our microturbines incorporate four major design features:

- advanced combustion technology;
- patented air-bearing technology;
- air cooling; and
- digital power electronics.

The air-bearing system allows our microturbine's single moving assembly to produce power without the need for typical petroleum-based lubrication. Air-bearings use a high-pressure field of air rather than petroleum lubricants. This improves reliability and reduces maintenance, such as oil changes. Air cooling eliminates maintenance required with conventional liquid cooling systems. The digital power controller ("DPC") manages critical functions and monitors operations of the microturbine. For instance, the DPC controls the microturbine's speed, temperature and fuel flow and communicates with external computers and modems. All control functions are performed digitally, as opposed to using analog electronics. The DPC optimizes performance, resulting in lower emissions, higher reliability and highest possible efficiency over a variable power range.

Our Model 330 and the Capstone 60-kilowatt units are approximately the size of a large refrigerator. Our Model 330 generates approximately 30 kilowatts of electric power, which is enough to power a typical convenience store, and approximately 300,000 kilojoules per hour of heat, enough energy to heat 20 gallons of water per minute with a 20-degree Fahrenheit temperature rise. We have the ability to vary and modify our microturbines to accommodate a variety of applications and needs.

Our strategy is to develop products that can operate:

- connected to the electric utility grid;
- on a stand-alone basis;
- multi-pack up to 100 units; or
- in dual mode, where the microturbine operates connected to the grid or, when the grid is unavailable, the microturbine automatically disconnects itself from the grid and operates on a stand-alone basis.

In September 2000, we shipped the first commercial unit of our 60-kilowatt family of microturbine systems.

Our family of products is currently available in the following configurations:

Product Configurations

Fuel:	Model 330		Capstone 60	
	Grid Connect	Stand-Alone	Grid Connect	Stand-Alone
low pressure natural gas	X	X	X	X
high pressure natural gas	X	X	X	X
low BTU gas	X	X		
sour gas	X	X		
gaseous propane	X	X		
compressed natural gas	X	X		
diesel	X	X		
kerosene	X	X		

We offer various accessories for our products including rotary gas compressors with digital controls, dual mode controllers that allow automatic transition between grid connect and stand-alone modes, batteries with digital controls for stand-alone or dual-mode operations, power servers, protocol converters for internet access, packaging options, and miscellaneous parts such as frames, exhaust ducting and installation hardware, if required. We also sell microturbine components and subassemblies.

Detailed MicroTurbine Description

The Model 330 Capstone MicroTurbine is designed to be a reliable, compact, low emissions, and low maintenance power generation system, which generates approximately 30 kilowatts of electric power as a stand-alone power source or grid connected. Our Capstone 60 family generates approximately 60 kilowatts of electric power. As an alternative power source, our microturbine may replace or efficiently supplement existing sources of electric power.

The Capstone MicroTurbine consists of a turbogenerator and DPC combined with ancillary systems such as a fuel system. The turbogenerator includes a mechanical combustor system and a single moving assembly rotating on our patented air-bearings at up to 96,000 revolutions per minute. The combustor system operates on a variety of fuels and at full power achieves nitrogen oxides (“NOx”) emissions levels in the exhaust of less than nine parts per million per volume with natural gas and less than 35 parts per million per volume when operating with diesel. The emissions from the turbogenerator combustion system are up to 20 times lower than emissions standard for a reciprocating diesel fuel generator set. As a result of our patented air-bearings, microturbines do not require lubrication. In addition, the microturbines do not utilize liquid cooling, keeping maintenance costs throughout their estimated 40,000-hour life extremely low.

The DPC is a state-of-the-art, air cooled, insulated gate bipolar transistor, commonly known as IGBT, based inverter with advanced digital signal processor based microelectronics. The advantages of digital electronics over analog electronics include accuracy, flexibility, and repeatability. In addition, we are taking advantage of the example set by the computer industry: digital data processing results in higher reliability with lower cost. The DPC controls and manages the microturbine using proprietary software and advanced algorithms. The DPC:

- starts the turbogenerator and manages its load;
- manages the speed, fuel flow, and exhaust temperature of the microturbine;
- converts the variable frequency, up to a maximum of 1,600 Hertz, and variable voltage power produced by the generator into a usable output of either 50/60 Hertz AC or optionally DC; and
- provides digital communications to externally maintain and control the equipment.

In addition, the DPC's application software provides an advantage to end-users by allowing them to remotely operate and manage the microturbine. Unlike the technology of other power sources that require manual monitoring and maintenance, the microturbine allows end-users to remotely and efficiently monitor performance, fuel input, power generation and time of operation using our proprietary communications software, which can interface with standard personal computers using our application software. This remote capability provides end-users with power generation flexibility and cost savings.

The Model 330 was initially designed to operate connected to an electric utility grid and uses a high pressure, natural gas fuel source. We can easily vary and modify the basic microturbine to accommodate a variety of applications and needs. We have operated with different fuels including a variety of carbon-based fuels such as propane, sour gas, kerosene and diesel. The combustor system remains the same for all fuels, except for the fuel injectors, which currently vary between liquid and gaseous fuels. The Capstone MicroTurbine's multi-fuel capability provides significant competitive advantages with respect to the markets in which we may operate. We offer other accessories including rotary gas compressors with digital controls, dual mode controllers that allow automatic transition between grid connect and stand-alone modes, batteries with digital controls for stand-alone or dual mode operations, packaging options, and miscellaneous parts such as frames and exhaust ducting and installation hardware where required.

Typical Operation of a MicroTurbine

Air is drawn into the air inlet by the compressor impeller. The compressor impeller increases the pressure of the air and ejects it into the recuperator. The recuperator is a heat exchanger that heats the air as it passes through it to approximately 1,000 degrees Fahrenheit. Preheating the air substantially lessens the amount of fuel needed, thus increasing the efficiency of the unit. The preheated air leaves the recuperator and enters the combustion chamber where it is mixed with the fuel and burned. The fuel is controlled and delivered to the combustion chamber for ignition and combustion by injectors and the combustor system. The mixture of combusted gas enters the turbine where it is then expanded. As the mixture expands, it causes the turbine to rotate. The turbine is directly coupled to the compressor and generator shaft, and as the turbine rotates, the compressor and generator rotate at a speed of up to 96,000 revolutions per minute, and generate electricity. The combusted gas mixture leaves the turbine at a temperature of up to approximately 1,200 degrees Fahrenheit and flows through the recuperator where it heats the cooler air brought into the combustor through the impeller. As the combusted gas mixture passes through the recuperator, the exhaust cools to a temperature of approximately 600 degrees Fahrenheit and is discharged through the exhaust pipe.

There is only one moving assembly in the entire turbogenerator, which consists of the rotating generator shaft, the compressor impeller, and the turbine rotor. This rotating component is supported by a combination of radial air bearings and one double acting axial air bearing. Air bearings avoid the need for oil lubrication resulting in low maintenance requirements and high reliability. The entire system is air-cooled, which avoids liquid cooling, thereby resulting in low maintenance requirements.

Our 30-kilowatt and 60-kilowatt grid-connect and stand-alone microturbine power systems meet the Underwriters' Laboratories certification for the UL2200 stationary engine generator standards and the UL1741 utility interactive requirements. We also have achieved ISO 9001 certification.

The California Energy Commission certified our 30- and 60- kilowatt microturbine power systems as the first, and so far the only, products that comply with the requirements of its "Rule 21" grid interconnection standard. The certification is significant in that it has the potential to streamline the process for connecting distributed generation systems to the grid in California, avoiding both costly external equipment procurement requirements and extensive site-by-site and utility-by-utility analysis.

Applications

Stationary Power Applications

Worldwide stationary power generation applications vary from huge central stationary generating facilities, above 1,000 megawatts, down to back-up uses below 10 kilowatts. Historically, power generation in

most developed countries such as the United States has been part of a regulated system. A number of developments related primarily to the deregulation of the industry as well as significant technology advances have broadened the range of power supply choices to customers. We believe our microturbines will be used in a variety of innovative electric power applications requiring less than 2 megawatts and more immediately in those requiring less than 300 kilowatts. Capstone has identified several markets with characteristics that we believe would value our inherently flexible, distributed electricity generating system. Stationary power applications for our microturbines include:

- resource recovery;
- micro-cogeneration/combined heat and power;
- power quality and reliability including back-up and standby power/ peak shaving; and
- developing regions and other stationary power applications.

Each of these markets may adopt our products at different rates depending upon several factors. We believe the resource recovery market generally and the combined heat and power market in Japan have properties that are conducive to the relatively rapid acceptance of our microturbines. However, the combined heat and power market in North America as well as the back-up and standby power and peak shaving markets will take longer to penetrate due to changing competitive conditions and the deregulating electric utility environment.

Resource Recovery

On a worldwide basis, there are thousands of locations where the production of fossil fuels and other extraction and production processes creates fuel byproducts, which traditionally have been released or burned into the atmosphere. Our Model 330 microturbine can burn these waste gases with minimal emissions thereby in some cases avoiding the imposition of penalties incurred for pollution, while simultaneously producing electricity for use at the site, or in the surrounding community. Our Model 330 has demonstrated effectiveness in this application and outperforms conventional combustion engines in a number of circumstances, including when the gas contains a high amount of sulfur. We intend to test our 60-kilowatt unit to confirm its functionality under the severe conditions involved in resource recovery operations. We have sold a substantial portion of our systems into the resource recovery market to be used at oil and gas exploration and production sites. We have also sold our systems to be used to burn gases released from landfills and waste water treatment facilities. These gases are considered renewable resources.

Micro-Cogeneration/ Combined Heat and Power

Micro-cogeneration, or combined heat and power, is a potentially extensive market that seeks to use both the heat energy and electric energy produced in the generation process. Using the heat and electricity created from a single combustion process increases the efficiency of the system from approximately 30% to 70% or more. The increased operating efficiency often reduces overall emissions and, through displacement of other separate systems, can reduce variable production costs. The most prominent uses of heat energy include space heating and air conditioning, heating and cooling water, as well as drying and other applications.

There are substantial existing markets for combined heat and power applications in Western Europe, Japan, and other parts of Asia, in addition to an emerging market in North America. Many governments have encouraged more efficient use of the power generation process to reduce pollution and the cost of locally produced goods. Japan, which has some of the highest electric power costs in the world, has been particularly active in exploring innovative ways to improve the efficiency of generating electricity. To access this market, we have entered into agreements with distributors, which have engineered combined heat and power packages that utilize the hot exhaust air of the microturbine for heating water.

We believe that Capstone MicroTurbines provide an economic solution in markets similar to Japan for delivering clean power when and where it is needed without requiring a large capital investment. Capstone MicroTurbines and/or subassemblies incorporated into a more comprehensive energy package should have the

potential to penetrate these large and growing markets. In particular, we believe our microturbine's ability to accept a wide range of fuel options may enhance our market position and accelerate acceptance in these locations.

Power Quality and Reliability, including Back-up and Standby Power/ Peak Shaving

Due to the potentially catastrophic consequences of even momentary system failure, certain power users, such as high technology and information systems companies, require particularly high levels of reliability in their power service. Our microturbines can follow levels of demand and have low emissions, which we believe permits them to be configured in multiple unit arrays and used in combination to provide a highly reliable electricity generating system. We believe that customers with particularly low tolerances for power service interruptions, such as high technology and information systems companies, represent a growing potential market for our microturbine products.

With the trends of continuing deregulation in the electric utility industry and increased reliance on sensitive digital electronics in day-to-day life, industrialized societies are increasingly demanding high quality, high reliability power. End customers with greater freedom of choice are investigating alternative power sources to protect their business operations and equipment from costly interruptions. Along with deregulation has come the initiation of competition in electricity generation and substantially increased electricity price volatility. We believe an increasing number of power marketers, energy service providers and end-users will use alternative power sources to protect against temporary price spikes by "peak shaving" or self-generating when the price charged by the local utility company gets too high. These load management applications give the user a unilateral opportunity to reduce energy costs.

Our 60-kilowatt microturbine, which we expect to be the primary product in these markets, provides users great flexibility. The Capstone MicroTurbine system architecture allows any user to determine its interface with the local electric grid with minimal disruption. In applications where emissions, weight or vibration are important considerations, the microturbine also has a competitive advantage due to its low emissions and flexibility in siting. In addition, microturbines can be managed and monitored remotely, thereby reducing on-site maintenance costs.

Utilities also can take advantage of Capstone MicroTurbines to avoid costly transmission and distribution system expansion or upgrades in uncertain growth or "weak" areas in the electric utility grid. These companies can place our microturbines where the electrical power is needed. The microturbines can supply power in conjunction with the power provided by the utility's standard generation and transmission equipment. In the alternative, the utility can use the microturbines to provide power during times when demand for power is at its highest, potentially reducing the need for expensive expansions to the central power plant. Rural electric cooperatives and electric utilities may use our microturbines as a stand-alone system to provide temporary or back-up power for specific applications or to provide primary power for remote needs.

Developing Regions and Other Stationary Power Applications

Many people in less developed countries do not have access to electric power. The ability of our microturbines to use a location's fuel of choice, for example kerosene, diesel or propane, will allow countries to use their available fuel source infrastructure more efficiently. We also have designed our microturbine to be a competitive, reliable primary power source alternative compared to diesel generators and other technologies that currently provide power to remote areas or areas with unreliable central generation. This is due to our microturbines' "load following" characteristic, meaning that our microturbines are able to match power output to the served facility's need for power. In addition, while emissions have not been a large market issue in these developing regions, we believe any increases in environmental concerns or stricter emissions requirements would benefit us in the long run. Furthermore, remote commercial and industrial applications, including offshore oil and gas platform power, pipeline cathodic protection, and resort and rural electrification, can use our microturbine effectively.

Hybrid Electric Vehicle Power Market

We are actively pursuing the hybrid electric bus and industrial and other passenger and commercial electric vehicle markets for our microturbines and microturbine subassemblies. Hybrid electric vehicular applications of our microturbine are competitive due to low emissions and low cost per mile of operation.

We believe that the hybrid electric vehicle market segment represents a significant opportunity and will expand as governments and consumers demand cost-efficient, reliable and environmentally friendly mobile electric power, particularly in urban areas. Transit authorities have already demonstrated hybrid electric buses as a viable alternative to pure electric buses and to diesel buses, which emit relatively high levels of emissions.

Instead of working purely on a battery or other energy storage device, hybrid electric vehicles combine the primary source battery with an auxiliary power source, such as a Capstone MicroTurbine, to enhance performance. The hybrid electric vehicles use electricity from the battery and the Capstone MicroTurbine recharges the battery on an as-needed basis while in operation. These vehicles have many of the positive attributes of pure electric vehicles but provide the added benefits of longer operating periods and longer ranges than pure electric vehicles using current technology.

Our microturbines have been used for over three years in vehicle applications. Our system has been designed into four different manufacturers' general production hybrid electric vehicle platforms, which were put into service in the United States beginning in 1997. The Capstone MicroTurbine has logged more than 300,000 miles of operation in various municipal fleets, providing a cost-efficient, low emission alternative to higher cost, pure electric vehicles and higher emissions reciprocating engines. The two significant design advantages of the microturbine as compared to the internal combustion engine are very low emissions and very low maintenance.

Hybrid electric vehicles using the microturbine can recharge their batteries using power from the electric utility grid at night when demand for electricity is lowest, and use power generated by the microturbine during the day when demand for grid power is highest. Electric utilities can therefore benefit from the implementation of Capstone MicroTurbine-equipped hybrid electric vehicles as a means of balancing intra-day demand for electricity.

MicroTurbine Benefits

Multi-Fuel Capability

The Capstone MicroTurbine design provides flexibility for use with a variety of possible fuels, including both gaseous and liquid fuels. This multi-fuel capability increases the number of applications and geographic locations in which our microturbines may be used. The Model 330 is currently capable of being configured for low pressure natural gas, high pressure natural gas, low British thermal unit gas like methane, high sulfur content (sour) gas, gaseous propane and compressed natural gas, as well as liquid fuels such as diesel and kerosene. Our 60-kilowatt product currently uses low pressure and high-pressure natural gas, and we are developing corresponding additional fuel configurations for the 60-kilowatt model.

Cost Competitive

We believe our microturbines have the potential to be cost competitive in their target markets. In the exploration and production markets, environmental penalties incurred for flaring or venting gas can be avoided by using our microturbines. Our low maintenance microturbines can burn wellhead gas directly off the casing head, avoiding any intermediary sulfur scrubbing devices, while competing devices require extra maintenance and additional intermediary devices to do the same. In the landfill gas digestion market, the microturbine can burn low BTU and sour gas while requiring minimal maintenance relative to competing technologies, like reciprocating engines. In the coal seam gas market, our microturbines require substantially less maintenance than reciprocating engines. The ability of the microturbine to operate on a stand-alone basis allows for less capital expenditures compared to the electric utility grid, which requires up-front capital expenditures for additional distribution and transmission lines. In combined heat and power applications, the microturbine's efficiency is approximately 60-70% compared to approximately 30% efficiency when used only to generate

electricity in typical technology. In the hybrid electric vehicle market, the microturbine results in lower cost per mile, lower emissions, and load balancing of the grid for the utility.

Because the applications for our microturbines are extremely broad and the number of features which can influence capital cost is also large, estimates of energy generation costs per kilowatt hour vary substantially depending on assumptions. When used in resource recovery applications, our microturbine operates with gas not otherwise useable as fuel. In some cases, consuming this gas avoids environmental penalties. Assuming the units are grouped in operating groups of four and run approximately 90% of the year, we estimate the generation cost at slightly less than $0.031 per kilowatt-hour. In combined heat and power applications where gas costs are approximately $6.00 per million BTUs, we estimate the generation cost at approximately $0.081 per kilowatt-hour. The generation costs are highly sensitive to the price of the fuel. Other applications including standby and peak shaving depend greatly on the specific set of circumstances confronting a potential end-user. Additionally, we believe that our 60-kilowatt units will exhibit better operating characteristics and lower electrical generation costs than our 30-kilowatt units.

Environmentally Friendly

In stationary power generation configurations, our digital power controlled combustion system produces less than nine parts per million per volume of emissions of NOx and unburned hydrocarbons at full power when burning natural gas or propane, and less than 25 parts per million per volume when using diesel fuel. We believe that these emission levels are less than the emissions of any fossil fuel combustor without catalytic combustion or other emissions reduction equipment, resulting in a high quality exhaust. Due to our patented air-bearing technology, our microturbines require no petroleum-based lubricants, avoiding potential ground contamination caused by petroleum-based lubricants used by conventional reciprocating engines, turbines and other similar technologies. Also, because our system is air cooled, we avoid the use of toxic liquid coolants, such as glycol.

Availability and Reliability

Our microturbines can provide both high availability and reliability when compared to other power generation alternatives. We designed the microturbine for a target availability of 98%. Our microturbines have often achieved this availability target when using high-pressure natural gas, and we are working to achieve this availability target across all of our units and for other fuel sources.

Minimal Maintenance

Our patented air-bearing system, DPC and air-cooled design can potentially reduce the maintenance cost of our microturbines. The air bearings eliminate the need for lubrication, avoiding the need to change oil and individually lubricate ball bearings or other similar devices. The DPC's ability to continuously and remotely monitor our microturbine performance avoids regularly scheduled diagnostic maintenance costs. The air-cooled design eliminates all of the maintenance related to liquid cooling systems utilized with conventional power electronics technology and generator cooling. Currently, the only scheduled maintenance for both the Model 330 and C60 is periodic cleaning or changing of the intake air filter and fuel filters every 8,000 hours of operation and thermocouple, igniter and fuel injector replacement every 16,000 hours of operation.

Remote Monitoring and Operating

The DPC allows users to efficiently monitor our microturbines' performance, fuel input, power generation and time of operation in the field from off-site locations by telephonic hook-up. In addition, the operator can remotely turn the microturbine on and off, control the fuel flow and vary the power output.

Flexible Configuration

Our Model 330 microturbines can be customized to serve a wide variety of operating requirements. They can be connected to the electric utility grid or operate on a stand-alone or dual mode basis. They can use a variety of fuel sources and can be readily integrated into combined heating and power applications. The

microturbine can be sold either as a ready-to-use unit, or in component and subassembly form for repackaging to the ultimate end-user. The microturbine can be operated as a single unit, or several units can be installed together and operated in parallel as one unit. We expect to develop our 60-kilowatt family of microturbines to be available for use in nearly all of these configurations.

Scalable Power System

Our microturbines are designed to allow multiple units to run together to meet each customer's specific needs. This feature enables users to meet more precisely their growing demand requirements and thereby manage their capital costs more efficiently.

Relative Ease of Transportation and Minimal Site Requirements

Our microturbines are easy to transport and relocate. Their small size allows great flexibility in siting. Our stationary systems in enclosures are approximately six feet tall and weigh between 900 and 1,700 pounds, depending upon model and optional equipment. Our microturbines require a fuel source hook-up, a hook-up for the power generated, and proper venting or utilization of exhaust. Larger multi-pack microturbine configurations may require concrete pads to support the additional weight, but the hook-ups are similar.

Protection Relay Functionality

Our microturbines have protective relay functions built into the DPC such that in grid-connect or dual mode, the microturbine will not send power out over the electric utility grid if the utility is not supplying voltage over its grid. This protection relay functionality minimizes the potential damage to the local electric grid, which is one of electric utilities' major concerns regarding the interconnection of distributed generation technologies. Our protective relay functionality was recognized by the state of New York in approving our microturbines to be connected to New York network grids.

Sales, Marketing and Distribution

We are focused on selling microturbines in the worldwide stationary and hybrid electric vehicular markets. We anticipate that our microturbines will be used in a variety of electric power applications requiring less than 2 megawatts. Specific early applications include combined heat and power, resource recovery, remote and onsite power generation and hybrid electric vehicles. Focusing on these target markets should help us build sales volume and reduce our unit production costs. The list price of our base Model 330 is $29,000, or approximately $967/ kilowatt, and $49,000 for the Capstone 60, or approximately $817/ kilowatt.

We believe the most effective way to penetrate our target markets is through business-to-business distribution strategies and, when appropriate, direct distribution. Distributors can incorporate subassemblies and components into uniquely designed packages for distribution, such as in Japan where our distributors incorporate our systems into combined heat and power applications. Elsewhere, distribution agreements are tailored to the particular strengths of partners in various local country markets. In some target markets, we will distribute our uniquely designed product solutions to major corporations or government entities, which will use the products directly.

Our approach for distribution within the hybrid electric vehicles market has been to identify early adopters who can demonstrate the feasibility of the microturbine technology. Our microturbine systems are currently in production platforms used by four different manufacturers for hybrid electric vehicles. We initially developed sales relationships with smaller bus companies, and having demonstrated the performance of our technology, we are now establishing relationships with larger regional bus companies.

Distribution Agreements

We continue to identify and enter into distribution arrangements with partners who we believe can provide value added service in our targeted markets. We also continue to cultivate agreements with interested and qualified third parties who will use our microturbine and/or subassemblies in their products and energy

solutions. We intend to become a supplier of critical components to the distributed energy solution industry as a whole.

North America

We continue to develop strategic distribution partners in our targeted distributed generation markets. A combination of market drivers including the continued national trend toward energy deregulation and stringent emissions monitoring and control are favorable to our technology. With increased focus on waste gases, we continue to sell into the exploration and production segment of the resource recovery market. Additionally, we are expanding our North American focus on combined heat and power applications. Low gas and high electricity prices make the combined heat and power applications more economical.

In 1999, we sold 152 units in the North American market, which generated approximately $4.8 million in revenue. In 2000, we sold 485 units and various parts in the North American market, which generated approximately $13.9 million in revenue. In 2001, we sold 642 units and various parts in the North American market, which generated approximately $23.9 million in revenue.

Asia

Our sales and marketing strategy in Asia has been to first enter the Japanese market by developing significant corporate distribution partnerships within Japan, which we expect will subsequently enable us to enter other selected markets along the Pacific Rim.

Our primary market focus in Japan is combined heat and power applications. Within Japan, there is great demand for economic energy solutions seeking to lower both the existing high cost of electricity and meet the greenhouse gas emissions guidelines of the Kyoto accords. Our local partners recognize the quickest and most practical way to accomplish this is through combined heat and power applications, which raise efficiencies from approximately 30% for pure electrical generation to approximately 60% to 70% or more. Each of our Japanese partners is seeking to design applications using our microturbines and/or subassemblies and components for their particular target combined heat and power market.

We are also exploring market opportunities in Southeast Asia, such as resource recovery applications.

In 1999, we sold 50 units in the Asian market, which generated approximately $1.6 million in revenue. In 2000, we sold 274 units and various parts in Asia, which generated approximately $8.3 million in revenue. In 2001, we sold 277 units and various parts in Asia, which generated approximately $8.3 million in revenue.

Europe

Capstone is developing a sales and service infrastructure in Europe focused on serving the local needs of customers in each country. We believe it is critical to find partners speaking the country language, and with the right local technical and commercial capabilities to assure that Capstone Microturbines are properly applied, installed and supported. Market focus is on combined heat and power applications (hotels, nursing homes, offices, greenhouses, laundry, recreation facilities), oil and gas production, and biogas (landfill and water treatment facilities).

In 1999, we sold nine units in Europe, which generated approximately $275,000 in revenue. In 2000, we sold 31 units and various parts in Europe, which generated approximately $977,000 in revenue. In 2001, we sold 58 units and various parts in Europe, which generated approximately $1.9 million in revenue.

South America and Africa

The primary market drivers in South America and Africa are increasing demand for reliable electricity and lack of fuel and power distribution infrastructure. The trend is locating mini power plants near the load centers and allowing the power supply to grow as the load increases to avoid large and untimely capital investments and minimizing stranded cost. Our microturbine's ability to operate on different fuels as a mini

plant for prime and base load applications is well suited for this type of capacity addition. We established a dedicated sales team in 2001 to further develop the markets in these regions.

In 2001, we sold 31 units and various parts in South America, which generated approximately $1.1 million in revenue, and 25 units and various parts in Africa, which generated approximately $0.7 million in revenue.

Customers

In 2001, the Company had sales to the South Coast Air Quality Management District in California of approximately $4.9 million and sales to the Los Angeles Department of Water and Power in California of approximately $3.8 million, which represented approximately 14% and 11%, respectively, of the Company's revenues for the year. No other customers represented 10% or more of the Company's revenues in 2001.

Competition

The market for our products is highly competitive and is changing rapidly with the interplay of a number of factors. Our microturbines compete with existing technologies such as the utility grid and reciprocating engines, and may also compete with emerging distributed generation technologies, including solar power, wind powered systems, fuel cells and other microturbines. As many of our distributed generation competitors are well-established firms, they derive advantages from production economies of scale, a worldwide presence and greater resources, which they can devote to product development or promotion.

Generally, power purchased from the electric utility grid is less costly than power produced by distributed generation technologies, such as fuel cells or microturbines. Utilities may also charge fees to attach to their power grid. However, we compete with the power grid in instances in which the costs of connecting to the grid from remote locations are high, reliability and power quality are of critical importance, or in situations where peak shaving could be economically advantageous due to highly variable electricity prices. Because the Capstone MicroTurbine can provide a reliable source of power and can operate on multiple fuel sources, we believe it offers a level of flexibility not currently offered by other current technologies such as reciprocating engines.

Our competitors producing reciprocating engines have products and markets that are well developed and technologies that have been proven for some time. A reciprocating engine is similar in design to internal combustion engines used in automobiles. Reciprocating engines are popular for back-up power applications but are not typically intended for primary use due to high levels of emissions, noise and maintenance. These technologies are currently produced by, among others, Caterpillar Inc., Interstate Companies and Kohler.

Our microturbine may also compete with other distributed generation technologies, including solar power and wind powered systems. Solar powered and wind powered systems produce no emissions. The main drawbacks to solar powered and wind powered systems are their dependence on weather conditions and their high capital costs.

Although the market for fuel cells is still developing, a number of companies are focused on the residential and vehicle fuel cell markets, including Plug Power, Avista Labs, H Power and Ballard Power Systems. Another developer of fuel cell technology, United Technologies Corporation, is focused on developing fuel cell solutions for large stationary power plants. Fuel cells have lower levels of NOx atmospheric emissions than our microturbines. We believe that none of these fuel cell technologies will compete directly with our microturbines in the short term. However, over the medium-to-long term, fuel cell technologies that compete directly with our products may be introduced.

We may also compete with several well-established companies at the initial commercial introduction stage or in the process of developing microturbines. We believe a number of major automotive and industrial companies have in-house microturbine development efforts, including Elliott Power Systems, Ingersoll-Rand, Toyota Motor Corporation, Mitsubishi Heavy Industries, Ltd. and Turbec. DTE Energy Co., Pratt & Whitney Canada Corp. and Turbo Genset Inc. formed a joint venture for developing a microturbine. We expect all of these companies to enter into commercial production of microturbines in the future.

We believe that our microturbine currently compares favorably to our competitors' products. For example, competing microturbines lack our Model 330 functionality in several important areas, including the ability to automatically switch from operating with the utility power grid to stand-alone operation, the ability to operate multiple units together in tandem when in stand-alone mode, the ability to match power output to the served facility's need for power, the ability to operate on gas with low energy content (less than 500 BTUs per cubic foot), and the ability to operate on sour gas. All of this functionality is currently available with the Model 330 and we expect it also to be available with our 60-kilowatt family of microturbines, except for the capability to operate on sour gas, about which we are uncertain. We anticipate that our product will, with higher production volume and higher kilowatt output products, become cost competitive. As competitors improve the functionality of their products, we expect competition to become more intense.

Sourcing and Manufacturing

Our microturbines are designed to achieve high volume, low-cost production objectives and offer significant manufacturing advantages through the use of commodity materials and conventional manufacturing processes. Our manufacturing designs use conventional technology, which has been proven in high volume automotive and turbocharger production for many years. The microturbines are designed for simple assembly and testing and to facilitate automated production techniques using less-skilled labor.

Our strategy of out-sourcing the manufacturing and assembly of our nonproprietary product components to a proven vendor base allows for more attractive pricing, quick ramp-up and the use of just-in-time inventory management techniques. While the current variability in our demand volumes and resulting imprecise demand forecasting impact our ability to leverage these capabilities, we believe that we can realize both purchase economies from existing vendors and economies of scale related to our product manufacturing costs as unit volume increases. We manufacture the air-bearings and combustion system components at our facility in Chatsworth, California. We also assemble and test the units at that location. We manufacture recuperator cores at our facility in Van Nuys, California. We have primary and secondary sources for other critical components.

Solar Turbines Incorporated, a wholly owned subsidiary of Caterpillar Inc., had been our sole supplier of recuperator cores. In 2000, we exercised an option to license Solar's technology, which allows us to manufacture cores ourselves. In June 2001, we started to manufacture recuperator cores. We continue to improve and develop the production process, however, we have sufficient inventory of recuperator cores to meet our needs for our projected sales volume in 2002.

Senior management has recognized the importance of quality control by appointing a vice president of quality deployment to oversee the implementation of a rigorous quality control program, which includes the use of outside consultants. One hundred percent of all systems go through assembly test procedures before a system is shipped. In addition, a sample of key subassemblies such as the DPC undergo up to 15 hours of burn-in. All engine subassemblies undergo independent testing to ensure perfect balance and operation. When a microturbine is completely assembled, it is tested in one of our two fully automated test cells.

Our recuperator facility is currently designed to produce about 5,000 cores per year and the assembly facility is currently designed to accommodate the production of approximately 10,000 units per year.

Research and Development

Our research and development ("R&D") activities have enabled us to become one of the first companies to develop a commercially available microturbine that operates in parallel with the grid. We are the first company to successfully demonstrate a commercially available microturbine that operates on a stand-alone basis. We believe that our more than ten years and over 300 man-years of R&D activities provide us with a significant advantage relative to our competitors. In fiscal years 1999, 2000 and 2001, we spent approximately $9.1, $11.3 and $10.7 million, respectively, on our R&D efforts. During 2000 and 2001, offsets to R&D expenses such as the award from the United States Department of Energy ("DOE") amounted to $0.1 million and $2.1 million, respectively.

We have successfully integrated turbo-engineering and control and power electronics. This is a direct result of the turbo-engineering R&D and the electronics R&D occurring in the same location. This has allowed us to immediately discover and solve integration issues in-house without relying on outsourced R&D. We believe that our continued in-house R&D, incorporating turbo-engineering and control with power electronics, will provide us with a competitive advantage relative to competitors that outsource R&D of components that are critical to a viable microturbine.

We intend to broaden our product line by developing additional microturbine products. In 2000, we shipped the first commercial model of our 60-kilowatt family of products. We shipped a total of 8 units of our 60-kilowatt products in 2000. In 2001, we shipped 238 units of our 60-kilowatt products. We are currently developing additional models of our 60-kilowatt microturbine system for expected commercial shipments in the next several calendar quarters. We intend to develop a family of microturbines with power output up to approximately 200 kilowatts. We expect to leverage our scaleable design architecture by developing microturbines and DPCs to provide a superior performance-price ratio while simultaneously improving our profitability.

We also intend to continue our R&D efforts to enhance our current products by increasing performance and efficiency, and adding features and functionality to our microturbines. R&D activities have also focused on development of related products and applications, including gas compressors that enhance the microturbines' multi-fuel capability and integration with energy storage devices like battery packs for stand-alone applications.

In 2000, the DOE awarded us $10 million under a Cooperative Agreement to develop an Advanced Microturbine System. The $10 million award, to be distributed over a five-year period, is the maximum amount available under the DOE's Advanced Microturbine Systems Program. The program is estimated to cost $23.0 million over the five years, which would require the Company to provide approximately $13.0 million of our own R&D expenditures. We intend to leverage, in part, the technology we develop using this award in the development of our 200 kilowatt microturbines, subject to any rights held pursuant to the agreement by the DOE with respect to the technology. As of December 31, 2001, the Company's remaining commitment to spend its own R&D expenditures under this award is approximately $12 million.

In 2001, the Company was awarded a $3 million grant from DOE for the research, development and testing of packaged cooling, heating and power systems for buildings. The contract is estimated to cost $5.5 million over a three-year period, which would require the Company to provide approximately $2.5 million of its own R&D expenditures. As of December 31, 2001, the $2.5 million remains to be spent.

Additionally, we are reviewing projects that will incorporate our microturbine technology as part of a hybrid energy source solution combining our microturbine with a traditional fuel cell. As part of this effort, in December 2000, we shipped our initial microturbine to FuelCell Energy as part of this strategic program. In 2001, Fuel Cell Energy executed a successful test program of a power plant, integrating fuel cell technology with our 30-kilowatt microturbine.

Intellectual Property Rights and Patents

We rely on a combination of patent, trade secret, copyright and trademark law, and nondisclosure agreements to establish and protect our intellectual property rights in our products. As of December 31, 2001, we had 46 issued United States patents and 16 international patents and several U.S. and international patent applications on file primarily covering our air-bearing systems, combustor systems and digital control systems. The protection of our intellectual property rights in these components is critical to our technology. In particular, we believe that each of our patents and patents pending in these areas are key to our business.

We believe that a policy of actively protecting intellectual property is an important component of our strategy of being the technology leader in microturbine system technology and will provide us with a long-term competitive advantage. In addition, we implement tight security procedures at our plant and facilities and have confidentiality agreements with our vendors, employees and visitors to our facilities.

Organization and Employees

We were organized in 1988. On June 22, 2000, we reincorporated as a Delaware corporation.

At December 31, 2001, we employed 267 employees. No employees are covered by any collective bargaining arrangements. We believe that our relationships with our employees are good.

Business Risks

This document contains certain forward-looking statements (as such term is defined in Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Exchange Act of 1934, as amended (the "Exchange Act") pertaining to, among other things, Capstone's future results of operations, R&D activities, including the expansion of our 60-kilowatt unit and development of our 200 kilowatt unit, sales expectations, sources for parts, federal, state and local regulations, and general business, industry and economic conditions applicable to Capstone. These statements are based largely on Capstone's current expectations and are subject to a number of risks and uncertainties. Actual results could differ materially from these forward-looking statements. Factors that can cause actual results to differ materially include, but are not limited to, those discussed below. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The following factors should be considered in addition to the other information contained herein in evaluating Capstone and its business.

We have a limited operating history characterized by net losses, we anticipate continued losses through at least 2002 and we may never become profitable.

Since our inception in 1988, we have reported net losses for each year. Our net losses were $29.5 million in 1999, $31.4 million in 2000 and $46.9 million in 2001. We anticipate incurring additional net losses through at least 2002. Since inception through December 31, 2001, we have recorded cumulative losses of approximately $194.7 million. We have only been commercially producing Capstone MicroTurbines since December 1998 and have made only limited sales to date. Also, because we are in the early stages of selling our products, we have relatively few customers and limited repeat business. Even if we do achieve profitability, we may be unable to increase our sales and sustain or increase our profitability in the future.

A sustainable market for microturbines may never develop or may take longer to develop than we anticipate, which would adversely impact our revenues and profitability.

Our products represent an emerging market, and we do not know whether our targeted customers will accept our technology or will purchase our products in sufficient quantities to grow our business. If a sustainable market fails to develop or develops more slowly than we anticipate, we may be unable to recover the losses we have incurred to develop our products, we may be unable to meet our operational expenses and we may be unable to achieve profitability. The development of a sustainable market for our systems may be impacted by many factors including some which are out of our control. Examples are:

- the cost competitiveness of our microturbines;
- costs associated with the installation and commissioning of our microturbines;
- the future costs and availability of fuels used by our microturbines;
- consumer reluctance to try a new product;
- consumer perceptions of our microturbines' safety and quality;
- regulatory requirements; and
- the emergence of newer, more competitive technologies and products.

If we are unable to manufacture recuperator cores internally, our assembly and production of microturbines may suffer delays and interruptions.

Solar Turbines Incorporated had been our sole supplier of recuperator cores, which are heat exchangers that preheat incoming air before it enters the combustion chamber and are an essential component of our microturbines. Solar is a wholly owned subsidiary of Caterpillar Inc. At present, we are not aware of any other suppliers that could produce these cores to our specifications within our time requirements. In June 2001, we started to manufacture recuperator cores under contractual rights to use Solar's intellectual property. We cannot assure you that Solar will honor the license agreement, that a court would enforce it, or that we will be able to meet our obligations under it, or that we will be able to successfully implement this technology in developing a sustainable manufacturing process. If we had to develop and produce our own recuperator cores without using Solar's intellectual property, we estimate it could take up to three years to begin production.

We may not be able to control our warranty exposure and our warranty reserve may not be sufficient to meet our warranty expense, which could impair our financial condition.

We sell our products with warranties. However, these warranties vary from product to product with respect to the time period covered and the extent of the warranty protection. Malfunctions of our product could expose us to significant warranty expenses. Because we are in the early stages of production, we cannot be certain that we have adequately determined our warranty exposure. Moreover, as we develop new configurations for our microturbines or as our customers place existing configurations in commercial use for long periods of time, we expect to experience product malfunctions that cause our products to fall substantially below our 98% availability target level. While our microturbines have often achieved this availability target when using high-pressure natural gas, we are still working to achieve this availability target across all of our units and for all fuel sources. We recorded estimated warranty costs in cost of goods sold of $2.6 million or 39% of revenue for the year ended December 31, 1999, $4.6 million or 20% of revenue for the year ended December 31, 2000 and $2.4 million or 7% of revenue for the year ended December 31, 2001. While management believes that the provision for estimated product warranty expenses made at the time of sale is reasonable, there can be no assurance that the provision will be sufficient to cover our warranty expenses in the future. Although we attempt to reduce our risk of warranty claims through warranty disclaimers, we cannot assure you that our efforts will effectively limit our liability. Any significant incurrence of warranty expense in excess of estimates could have a material adverse effect on our operating results and financial position.

Our product quality may not meet customer expectations and can have adverse consequences to our costs incurred and market acceptance.

We continue to improve the quality of our products by setting quality targets and improvement initiatives. However, our product quality may still not meet customer expectations which can affect the market acceptance of our products and have adverse consequences to our costs incurred. Any significant quality issues with our products could have a material adverse effect on our results of operations and financial position.

Our ability to identify Authorized Service Providers ("ASPs") can significantly impact our success.

Our ability to identify and develop business relationships with ASPs who can provide quality, cost effective installations and service can significantly impact our success. We need to reduce total installed cost of our microturbines to enhance market opportunities. Our inability to improve our ASP's quality of installation and commissioning standards while reducing associated cost could affect the marketability of our products.

Termination of certain Supply and Distribution Agreements may require us to repurchase parts inventory.

We have certain Supply and Distribution Agreements and ASP agreements that upon termination under specified conditions require us to repurchase particular elements of their parts inventories. To date, these conditions have never arisen and we believe that the amounts of such inventories currently are not significant. It is possible, however, that in the future such conditions could occur that would require such repurchases. These repurchases could result in higher prices for the repurchased parts inventory than would otherwise be

required to secure such quantities or could result in excess quantities of some parts inventory. In addition, certain ASP agreements require us to provide service to the customers of the ASP upon termination of the ASP agreement under specified conditions, until such time that we can identify and transfer the obligation to a new ASP. Since we do not have control over the terms of such third party service agreements, we may be exposed to significant risks and expenses that we cannot adequately quantify. To date these conditions have never arisen, however any significant exposure from such third party service agreements in the future could have a material adverse effect on our results of operations and financial position.

Distributors' failure to purchase contracted purchase commitments can significantly impact our sales.

We have certain Supply and Distribution Agreements that require distributors to purchase certain minimum quantities of microturbines. Failure by the distributors to meet such purchase commitments allows us to renegotiate the terms of such agreements, including discounts, and/ or to terminate such agreements. Failure by our distributors to meet their purchase commitments under such agreements could impact our anticipated rates of adoption.

Our success depends in significant part upon the service of management and key employees.

Our success depends in significant part upon the service of our executive officers, senior management, and sales and technical personnel. We have undergone numerous personnel changes in all levels of the organization. The failure of management and other personnel to fully integrate into our operations and to execute our strategy, and our failure to retain such management and personnel, could have a material adverse effect on our business. Our success will be dependent on our continued ability to attract, retain and motivate highly skilled employees, who are in great demand. There can be no assurance that we can do so.

If we do not effectively implement our sales and marketing expansion program, our sales will not grow and our profitability will suffer.

We have increased our internal sales and marketing staff in order to enhance our sales efforts. We cannot assure you that the expense of such internal expansion will not exceed the net revenues generated, or that our sales and marketing team will successfully compete against the more extensive and well-funded sales and marketing operations of our current and future competitors. In addition, to grow our sales, we hired new management team members to provide more sales and marketing expertise. Since these management team members do not have a proven track record with us, we cannot assure you that they will be successful in overseeing their functional areas. Our inability to recruit, or our loss of, important sales and marketing personnel, or the inability of new sales personnel to effectively sell and market our microturbine system could materially adversely affect our business and results of operations.

World economic factors may change and negatively impact our growth and sales.

It is predicted that the slowdown in the U.S. economy will continue through at least a portion of 2002. As a consequence of any extended U.S. recession or worldwide slowdown, we may not be able to expand our customer base and sales, which would negatively impact our results. As a result of the economic uncertainty, and a desire by companies to tighten capital expenditures, we have seen reluctance on the part of potentially large customers to buy our products. The economic uncertainty, along with fluctuations in energy prices and political disruptions or higher interest rates could result in weaker than anticipated business growth and worldwide sales of our products.

World demand for power and the development of transmission and distributions systems can also impact demand for our products.

We may not be able to establish strategic marketing relationships, in which case our sales would not increase as expected.

We are in the early stages of developing our distribution network. In order to expand our customer base, we believe that we must enter into strategic marketing alliances or similar collaborative relationships, in which

we ally ourselves with companies that have particular expertise in or more extensive access to desirable markets. Providing volume price discounts and other allowances along with significant costs incurred in customizing our products may reduce the potential profitability of these relationships. We may not be able to identify appropriate distributors on a timely basis, and we cannot assure you that the distributors with which we partner will focus adequate resources on selling our products or will be successful in selling them. In addition, we cannot assure you that we will be able to negotiate collaborative relationships on favorable terms or at all. The lack of success of our collaborators in marketing our products may adversely affect our financial condition and results of operations.

We have limited experience in international sales and may not succeed in growing our international sales.

We have limited experience in international sales and will depend on our international marketing partners for these sales. Most of our marketing partnerships are recently created and, accordingly, may not achieve the results that we expect. If a dispute arises between us and any of our partners, we may not achieve our desired sales results and we may be delayed or completely fail to penetrate some international markets, and our revenue and operations could be materially adversely affected. Any inability to obtain foreign regulatory approvals or quality standard certifications on a timely basis could negatively impact our business and results of operations. Also, as we seek to expand into the international markets, customers may have difficulty or be unable to integrate our products into their existing systems. As a result, our products may require redesign. In addition, we may be subject to a variety of other risks associated with international business, including:

- delays in establishing international distribution channels;
- difficulties in collecting international accounts receivables;
- difficulties in complying with foreign regulatory and commercial requirements;
- increased costs associated with maintaining international marketing efforts;
- compliance with U.S. Department of Commerce export controls;
- increases in duty rates;
- the introduction of non-tariff trade barriers;
- fluctuations in currency exchange rates;
- political and economic instability; and
- difficulties in enforcement of intellectual property rights.

The 60-kilowatt Capstone MicroTurbine may not reach the level of sales that we anticipate or it may erode sales of our 30-kilowatt unit.

In 2000, we shipped the first commercial model of our 60-kilowatt family of products. We shipped a total of 8 units of our 60-kilowatt products in 2000. In 2001, we shipped 238 units of our 60-kilowatt products. We cannot guarantee that demand for our 60-kilowatt unit will not diminish over time. It is also possible that production of the 60-kilowatt unit could replace or diminish the sales of our 30-kilowatt unit. If so, the sales of our 30-kilowatt unit would be adversely affected.

We may be unable to fund our future operating requirements, which could force us to curtail our operations.

We are a capital-intensive company and may need additional financing to fund our operations. In 2000, our net cash used in operations was $23.8 million and our net cash used in investing activities totaled $26.9 million. In 2001, our net cash used in operations was $49.8 million and our net cash used in investing activities totaled $17.4 million. As of December 31, 2001, we had approximately $170.9 million in cash and cash equivalents on hand. Our future capital requirements will depend on many factors, including our ability to successfully market and sell our products. To the extent that the funds we now have on hand are insufficient to

fund our future operating requirements, we will need to raise additional funds, through further public or private equity or debt financings. These financings may not be available or, if available, may be on terms that are not favorable to us and could result in further dilution to our stockholders. Downturns in worldwide capital markets may also impede our ability to raise additional capital on favorable terms or at all. If adequate capital were not available to us, we would likely be required to significantly curtail or possibly even cease our operations.

We may not be able to effectively predict or react to rapid technological changes that could render our products obsolete.

The market for our products is characterized by rapidly changing technologies, extensive research and new product introductions. We believe that our future success will depend in large part upon our ability to enhance our existing products and to develop, introduce and market new products. As a result, we expect to continue to make a significant investment in product development. We have in the past experienced setbacks in the development of our products and our anticipated roll out of our products has accordingly been delayed. If we are unable to develop and introduce new products or enhancements to our existing products that satisfy customer needs and address technological changes in target markets in a timely manner, our products will become noncompetitive or obsolete.

We may not achieve production cost reductions necessary to competitively price our product, which would impair our sales.

We believe that we will need to reduce the unit production cost of our products over time to maintain our ability to offer competitively priced products. Our ability to achieve cost reductions will depend on our ability to develop low cost design enhancements, to obtain necessary tooling and favorable vendor contracts, as well as to increase sales volumes so we can achieve economies of scale. We cannot assure you that we will be able to achieve any production cost reductions.

Our suppliers and manufacturers may not supply us with a sufficient amount of components or components of adequate quality, and we may not be able to produce our product.

Although we generally attempt to use standard parts and components for our products, some of our components are currently available only from limited sources. Also, we cannot guarantee that any of the parts or components that we purchase will be of adequate quality or that the prices we pay for these parts or components will not increase. We may experience delays in production of our Capstone MicroTurbine if we fail to identify alternative vendors, or any parts supply is interrupted or reduced or there is a significant increase in production costs, each of which could materially adversely affect our business and operations. Our inability to meet volume commitments with suppliers could affect the availability or pricing of our parts and components.

Our products involve a lengthy sales cycle and we may not anticipate sales levels appropriately, which could impair our profitability.

The sale of our products typically involves a significant commitment of capital by customers, with the attendant delays frequently associated with large capital expenditures. We are targeting, in part, customers in the utility industry, which generally commit to a larger number of products when ordering and which have a lengthy process for approving capital expenditures. We have also targeted the hybrid electric vehicle market, which requires a significant amount of lead-time due to the implementation costs incurred. For these and other reasons, the sales cycle associated with our products is typically lengthy and subject to a number of significant risks over which we have little or no control. We expect to plan our production and inventory levels based on internal forecasts of customer demand, which is highly unpredictable and can fluctuate substantially. If sales in any period fall significantly below anticipated levels, our financial condition and results of operations could suffer. If demand in any period increases well above anticipated levels, we may have difficulties in responding, incur greater costs to respond, or be unable to fulfill the demand in sufficient time to retain the order. In addition, our operating expenses are based on anticipated sales levels, and a high percentage of our

expenses are generally fixed in the short term. As a result of these factors, a small fluctuation in timing of sales can cause operating results to vary from period to period.

We face potentially significant fluctuations in operating results, which could impact our stock price.

A number of factors could affect our operating results and thereby impact our stock price, including:

- the timing of the introduction or enhancement of products by us or our competitors;
- quality of installation and commissioning of our products;
- our reliance on a small number of customers;
- the size, timing, shipment and pricing of individual orders;
- market acceptance of new products;
- potential delays in production as a result of the commencement of our manufacturing of recuperator cores;
- customers delaying orders of our products because of the anticipated release of new products by us;
- changes in our operating expenses, the mix of products sold, or product pricing;
- the ability of our suppliers to deliver quality parts when we need them;
- development of our direct and indirect sales channels;
- change in management and loss of key personnel;
- political unrest or changes in the trade policies, tariffs or other regulations of countries in which we do business that could lower demand for our products; and
- changes in market prices for natural resources that could lower the desirability of our products.

Because we are in the early stages of selling our products, with relatively few customers, we expect our order flow to continue to be uneven from period to period. Because a significant portion of our expenses is fixed, a small variation in the timing of recognition of revenue can cause significant variations in operating results from quarter to quarter.

We may not be able to effectively manage our growth or improve our management information systems, which would impair our profitability.

If we are successful in executing our business plan, we will experience growth in our business that could place a significant strain on our management and other resources. Our ability to manage our growth will require us to continue to improve our operational, financial and management information systems, to implement new systems and to motivate and effectively manage our employees. We cannot assure you that our management will be able to effectively manage this growth.

We may not effectively expand our production capabilities, which would negatively impact our sales.

We anticipate growth in our business operations, which may require expansion of our internal and external production capabilities. We may experience delays or problems in our expected production expansion that could significantly impact our business. Several factors could delay or prevent our expected production expansion, including our:

- inability to purchase parts or components in adequate quantities or sufficient quality;
- failure to increase our assembly and test operations;
- failure to hire and train additional personnel;
- failure to develop and implement manufacturing processes and equipment;

- inability to find and train proper partner companies in other countries with whom we can build product distribution, marketing, or development relationships;

- inability to manufacture recuperator cores on schedule, in quantities or with the quality that we require; and

- inability to acquire new space for additional production capacity.

Potential intellectual property, shareholder or other litigation may adversely impact our business.

Because of the nature of our business, we may face litigation relating to intellectual property matters, labor matters, product liability and shareholder disputes. For example, In December 2001, a purported shareholder class action lawsuit was filed in the United States District Court for the Southern District of New York against us, two of our officers, and the underwriters of our initial public offering. The suit purports to be a class action filed on behalf of purchasers of our common stock during the period from June 28, 2000 to December 6, 2000. The complaint alleges that the underwriter defendants agreed to allocate stock in our initial public offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for our initial public offering was false and misleading in violation of the securities laws because it did not disclose these arrangements. We understand that over three hundred other issuers have been named as defendants in nearly identical lawsuits filed by some of the same plaintiffs' law firms. We intend to defend these actions vigorously. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. Any unfavorable outcome of litigation could have an adverse impact on our business, financial condition and results of operations.

Our intellectual property is one of our principal assets. A negative outcome in a litigation relating to our intellectual property could have a material adverse effect on our business and operating results. An adverse judgment could negatively impact the price of our common stock and our ability to obtain future financing on favorable terms or at all. Any litigation could be costly, divert management attention or result in increased costs of doing business.

Our competitors, who have significantly greater resources than we have, may be able to adapt more quickly to new or emerging technologies or to devote greater resources to the promotion and sale of their products, and we may be unable to compete effectively.

Our competitors include several well-established companies that have substantially greater resources than we have and worldwide presence. Ingersoll-Rand Company and Elliott Power Systems are domestically based competitors of Capstone that benefit from larger economies of scale and who have microturbines in various stages of development and commercialization. Ingersoll-Rand Company announced in December 2001 that it has begun taking commercial orders for its first line of commercially available microturbine units. In addition to these domestic microturbine competitors, Turbec, a joint venture in Europe of AB Volvo and ABB Ltd., develops, produces and sells microturbines. Turbec's first product, a combined heat and power microturbine, is now available. A number of other major automotive and industrial companies have in-house microturbine development efforts, including Ishikawajima-Harima Heavy Industries, Mitsubishi Heavy Industries, Ltd. and Turbo Genset Inc. We believe that all of these companies will eventually have products that will compete with our microturbines. Some of our competitors are currently developing and testing microturbines which they expect to produce greater amounts of power than Capstone MicroTurbines, ranging from 75 kilowatts up to 350 kilowatts, and which may have longer useful lives than Capstone MicroTurbines. Capstone MicroTurbines also compete with other existing technologies, including the electric utility grid, reciprocating engines, fuel cells and solar systems. Many of the competitors producing these technologies also have greater resources than we have. For instance, reciprocating engines are produced by, among others, Caterpillar Inc., Interstate Companies and Cummins Inc. We cannot assure you that the market for distributed power generation products will not ultimately be dominated by technologies other than ours.

Because of greater resources, some of our competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements, or to devote greater resources to the promotion

and sale of their products than we can. We believe that developing and maintaining a competitive advantage will require continued investment by us in product development, manufacturing capability and sales and marketing. We cannot assure you that we will have sufficient resources to make the necessary investments to do so. In addition, current and potential competitors have established or may in the future establish collaborative relationships among themselves or with third parties, including third parties with whom we have strategic relationships. Accordingly, new competitors or alliances may emerge and rapidly acquire significant market share.

We operate in a highly competitive market and may not be able to compete effectively due to factors affecting the market for our products.

The market for our products is highly competitive and is changing rapidly. We believe that the primary competitive factors affecting the market for our products include:

- operating efficiency;
- reliability;
- product quality and performance;
- life cycle costs;
- development of new products and features;
- quality and experience of sales, marketing and service organizations;
- availability and price of fuel;
- product price;
- emissions levels;
- name recognition; and
- quality of distribution channels.

Several of these factors are outside our control. We cannot assure you that we will be able to compete successfully in the future with respect to these or any other competitive factors.

In addition, competing technologies may get certain benefits, like governmental subsidies or promotion that we do not enjoy or do not benefit from to the same extent. This could enhance their abilities to fund research or penetrate markets.

Utility companies could place barriers to our entry into the marketplace and we may not be able to effectively sell our product.

Utility companies commonly charge fees to industrial customers for disconnecting from the grid, for using less electricity, or for having the capacity to use power from the grid for back-up purposes. These types of fees could increase the cost to our potential customers for using our systems and could make our systems less desirable, thereby harming our revenue and profitability potential.

We depend on our intellectual property to make our products competitive and if we are unable to protect our intellectual property, our business will suffer.

We rely on a combination of patent, trade secret, copyright and trademark law, and nondisclosure agreements to establish and protect our intellectual property rights in our products. At December 31, 2001, we possessed 46 United States patents and 16 international patents, and we had additional patents pending. In particular, we believe that our patents and patents pending for our air-bearing systems, DPC and our combustion systems are key to our business. We believe that, due to the rapid pace of technological innovation in turbine products, our ability to establish and maintain a position among the technology leaders in the industry depends on both our patents and other intellectual property and the skills of our development

personnel. We cannot assure you that any patent, trademark, copyright or license owned or held by us will not be invalidated, circumvented or challenged, that the rights granted thereunder will provide competitive advantages to us or that any of our future patent applications will be issued with the scope of the claims asserted by us, if at all. Further, we cannot assure you that third parties or competitors will not develop technologies that are similar or superior to our technology, including our air bearing technology, duplicate our technology or design around our patents. Also, another party may be able to reverse engineer our technology and discover our intellectual property and trade secrets. We may be subject to or may initiate proceedings in the U.S. Patent and Trademark Office, which can require significant financial and management resources. In addition, the laws of foreign countries in which our products are or may be developed, manufactured or sold may not protect our products and intellectual property rights to the same extent as the laws of the United States. Our inability to protect our intellectual property adequately could have a material adverse effect on our financial condition or results of operations.

If we are found to infringe upon the intellectual property rights of others, we may not be able to produce our products or may have to enter into costly license agreements.

Third parties may claim infringement by us with respect to past, current or future proprietary rights. In particular, General Electric, Honeywell, United Technologies and Solar Turbines Incorporated have patents in areas related to our business and core technologies. Any infringement claim, whether meritorious or not, could be time-consuming, result in costly litigation or arbitration and diversion of technical and management personnel or require us to develop non-infringing technology or to enter into royalty or licensing agreements. Royalty or licensing agreements, if required, may not be available on terms acceptable to us, or at all, and could significantly harm our business and operating results. Litigation may also be necessary in the future to enforce our patent or other intellectual property rights, to protect our trade secrets and to determine the validity and scope of proprietary rights of others. For example, in 1997, we were involved in a dispute with Honeywell (AlliedSignal) regarding various disputed intellectual property rights. We entered into a settlement agreement regarding these issues. These types of disputes could result in substantial costs and diversion of resources and could materially adversely affect our financial condition and results of operations.

We operate in a highly regulated business environment and changes in regulation could impose costs on us or make our products less economical.

Our products are subject to federal, state, local and foreign laws and regulations, governing, among other things, emissions to air as well as laws relating to occupational health and safety. Regulatory agencies may impose special requirements for implementation and operation of our products (*e.g.,* connection with the electric grid) or may significantly impact or even eliminate some of our target markets. We may incur material costs or liabilities in complying with government regulations. In addition, potentially significant expenditures could be required in order to comply with evolving environmental and health and safety laws, regulations and requirements that may be adopted or imposed in the future. Furthermore, our potential utility customers must comply with numerous laws and regulations. The deregulation of the utility industry may also create challenges for our marketing efforts. For example, as part of electric utility deregulation, federal, state and local governmental authorities may impose transitional charges or exit fees, which would make it less economical for some potential customers to switch to our products. Further, our ability to penetrate the Japanese market will depend on our receipt of approvals and changes to regulatory requirements surrounding power generation by Japan's Ministry of International Trade and Industry, or MITI. We can provide no assurances that we will be able to obtain these approvals and changes in a timely manner, or at all.

The market price of our common stock is highly volatile and may decline regardless of our operating performance.

The market price of our common stock is highly volatile. Factors that could cause fluctuation in our stock price may include, among other things:

- actual or anticipated variations in quarterly operating results;
- changes in financial estimates by securities analysts;
- conditions or trends in our industry;
- changes in the market valuations of other technology companies;
- the listing for trading of options on our common stock;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives;
- capital commitments;
- additions or departures of key personnel; and
- sales of common stock.

Many of these factors are beyond our control. These factors may cause the market price of our common stock to decline, regardless of our operating performance.

Item 2. ***Properties.***

Our principal corporate offices, administrative, sales and marketing, R&D and support facilities consist of approximately 98,000 square feet of office space, warehouse space and assembly and test space at 21211 Nordhoff Street in Chatsworth, California. Our lease for those premises expires in 2010. We also lease an approximately 79,000 square foot facility at 16640 Stagg Street in nearby Van Nuys, California as engineering test and manufacturing facility for our recuperator cores. This lease will expire in 2010. In 2001, we entered into a lease for an approximately 6,800 square feet of office space at 21700 Oxnard Street in Woodland Hills, California for the use of our subsidiary. In October 2001, the subsidiary vacated the office and moved to the Company's principal office. We are currently seeking a sub-lessee for this office. This lease expires in 2006. See Footnote 7, Commitments and Contingencies, in the Company's financial statements.

Item 3. ***Legal Proceedings.***

On February 11, 1998, we filed a complaint against a former employee alleging trade secret misappropriation, breach of contract and other related causes of action in the Superior Court for the County of Orange, California. The former employee filed a cross-complaint alleging wrongful termination, breach of contract, and other related causes of action. The relief requested in the cross complaint included declaratory relief as well as lost earnings and incidental, general, special, and punitive damages, but none of these amounts were specified in the cross-complaint. We settled our claims against the former employee, receiving a permanent injunction that prevents the former employee from disclosing or using any confidential information. With respect to the cross-complaint, we prevailed on summary judgment in February 1999. The former employee filed a notice of appeal and the parties filed briefs on the issue. On February 27, 2002, the California Courts of Appeals ruled in our favor and affirmed the trial court's grant of summary judgment.

In December 2001, a purported shareholder class action lawsuit was filed in the United States District Court for the Southern District of New York against the Company, two of its officers, and the underwriters of our initial public offering. The suit purports to be a class action filed on behalf of purchasers of our common stock during the period from June 28, 2000 to December 6, 2000. The complaint alleges that the underwriter defendants agreed to allocate stock in the Company's initial public offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for the Company's

initial public offering was false and misleading in violation of the securities laws because it did not disclose these arrangements. The Company understands that over three hundred other issuers have been named as defendants in nearly identical lawsuits filed by some of the same plaintiffs' law firms. We intend to defend these actions vigorously. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. Any unfavorable outcome of litigation could have an adverse impact on our business, financial condition and results of operations.

We are involved in various other legal proceedings, claims, and litigation arising in the ordinary course of business, the outcome of which, in the opinion of management, will not have a material effect on our financial position or results of operations.

Item 4. ***Submission of Matters to a Vote of Security Holders.***

We did not submit any matters to a vote of our stockholders during the fourth quarter of fiscal year 2001.

PART II

Item 5. ***Market for the Registrant's Common Equity and Related Stockholder Matters.***

Price Range of Common Stock

Our common stock has traded on the Nasdaq National Market under the symbol "CPST" since our initial public offering on June 29, 2000. The following table sets forth, for the periods indicated, the high and low sales prices per share of our common stock as reported on the Nasdaq National Market.

	High	Low
Fiscal Year 2000:		
Second Quarter (beginning June 29, 2000)	$51.750	$27.375
Third Quarter	98.500	37.500
Fourth Quarter	69.750	17.750
Fiscal Year 2001:		
First Quarter	47.375	21.688
Second Quarter	38.251	18.500
Third Quarter	23.530	4.450
Fourth Quarter	6.550	3.200

As of March 11, 2002, the last reported sale price of our common stock on the Nasdaq National Market was $3.99 per share. As of March 11, 2002, there were 1,037 stockholders of record of our common stock. This does not include the number of persons whose stock is in nominee or "street name" accounts through brokers.

Dividend Policy

We currently intend to retain any earnings for use in our business and, therefore, we do not anticipate paying any cash dividends in the foreseeable future. We have never declared or paid any cash dividends on our capital stock. In the future, the decision to pay any cash dividends will depend upon our results of operations, financial condition and capital expenditure plans, as well as such other factors as our Board of Directors, in its sole discretion, may consider relevant.

Recent Sales of Unregistered Securities

During the three fiscal years ended December 31, 1999, 2000 and 2001, we issued and sold the following unregistered securities, all of which were deemed to be exempt from registration under the Securities Act in

reliance upon Section 4(2) of the Securities Act or Regulation D promulgated thereunder as transactions by an issuer not involving any public offering:

- On May 31, 1999, we issued 11,129,246 shares of Series F preferred stock for $2.00 per share to accredited investors in connection with a private financing. We received proceeds, net of origination costs, of approximately $21.8 million.

- On February 24, 2000, we issued 35,683,979 shares of series G preferred stock for $4.00 per share to accredited investors in connection with a private financing. Capstone received proceeds, net of origination costs, of approximately $131.1 million. Of the shares of series G preferred stock issued, 1,250,000 shares were issued to an existing stockholder for no cash consideration and 58,979 shares were issued to holders of promissory notes for accrued interest.

- As a result of Capstone's initial public offering, on July 5, 2000 we issued a total of 51,312,037 shares of our common stock upon the automatic conversion of all shares of Capstone's preferred stock. As a result of a three-for-five reverse stock split on May 26, 2000, series A, B, C, D, E, F and G preferred stock were convertible at a factor of .60, .70, .77, .90, .95, .60 and .60, respectively into shares of common stock.

Use of Proceeds from Registered Securities

On July 5, 2000, we completed the initial public offering of our common stock. This offering was managed by Goldman, Sachs & Co., Merrill Lynch, Pierce Fenner & Smith Incorporated and Morgan Stanley & Co. Incorporated. The shares of common stock sold in the offering were registered under the Securities Act on a Registration Statement on Form S-1/ A (No. 333-33024). The Securities and Exchange Commission declared the Registration Statement effective on June 28, 2000.

In our initial public offering, we sold an aggregate of 10,454,545 shares our common stock, for a gross aggregate offering price of $167.3 million. We incurred underwriting commissions of approximately $11.7 million and other expenses of approximately $2.0 million resulting in net proceeds of approximately $153.6 million. Since our initial public offering, we have used from the general corporate funds, which includes proceeds from a previous offering of the Series G preferred stock, approximately $24.9 million to purchase tooling and manufacturing equipment, $11 million to repurchase marketing rights and $64.5 million to fund operating activities, including sales and marketing and R&D. As of December 31, 2001, remaining net proceeds from the offering were primarily held in cash equivalents. With the exception of marketing rights acquired from Fletcher Challenge Limited and payments of compensation in the ordinary course of business to officers and directors, none of the net proceeds of the offering were paid, directly or indirectly, to any director or officer of Capstone or any of their associates, or to persons owning ten percent or more of any class of our equity securities, or any affiliates.

Item 6. ***Selected Financial Data.***

The selected financial data shown below for, and as of the end of, each of the years in the five-year period ended December 31, 2001 have been derived from the audited financial statements of Capstone. The historical results are not necessarily indicative of the operating results to be expected in the future. The selected financial data should be read in conjunction with "Business Risks", "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes

included elsewhere in this Form 10-K filing for the statement of operations for the years ended December 31, 1999, 2000 and 2001 and for the balance sheet data at December 31, 2000 and 2001.

	Year Ended December 31,				
	1997	1998	1999	2000	2001
	Amounts in thousands, except per share data.				
Statement of Operations:					
Total revenues	$ 1,623	$ 84	$ 6,694	$ 23,163	$ 35,956
Cost of goods sold	8,147	5,335	15,629	27,815	39,602
Gross loss	(6,524)	(5,251)	(8,935)	(4,652)	(3,646)
Operating costs and expenses:					
Research and development	13,281	19,019	9,151	11,319	10,658
Selling, general and administrative	10,946	10,257	11,191	24,067	40,780
Loss from operations(a)	(30,751)	(34,527)	(29,277)	(40,038)	(55,084)
Net loss	$(30,553)	$(33,073)	$(29,530)	$(31,424)	$(46,859)
Net loss per share of common stock — basic and diluted	$ (18.82)	$ (17.76)	$ (24.53)	$ (12.82)	$ (0.61)

(a) Loss before interest income, interest expense and other income (expense)

	As of December 31,				
	1997	1998	1999	2000	2001
Balance Sheet Data:					
Cash and cash equivalents	$ 44,563	$ 4,943	$ 6,858	$236,947	$170,868
Working capital	41,431	6,919	6,294	238,128	189,162
Total assets	56,989	25,770	36,927	302,018	254,254
Capital lease obligations	1,885	4,449	5,899	5,496	3,833
Long-term debt	—	—	—	—	—
Redeemable preferred stock	99,720	101,624	156,469	—	—
Stockholders' (deficiency)/equity	(56,057)	(91,151)	(144,225)	279,382	237,454
Total liabilities and stockholders' equity	$ 56,989	$ 25,770	$ 36,927	$302,018	$254,254

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

The following discussion should be read in conjunction with the financial statements and related notes included in Item 8 of this Form 10-K. When used in the following discussion, the words "believes", "anticipates", "intends", "expects" and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those projected. These risks include those identified under "Business Risks" in Item 1 of this Form 10-K. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent liabilities. On an on-going basis, we evaluate our estimates, including those related to intangible assets, fixed assets, bad debts, inventories, warranty obligations, income taxes, product returns, contingencies and litigation. We based our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which

form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of the consolidated financial statements.

- We review long-lived assets, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Our intangible assets consist of a license granted to the Company to use a former supplier's intellectual property and marketing rights repurchased by the Company from a former shareholder. Long-lived assets are being depreciated or amortized over their useful lives. Future write-downs may be required if the value of these assets becomes impaired or depreciation and amortization may be accelerated if estimated useful lives are shortened.

- We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate or if other conditions arose, resulting in an impairment of their ability or intention to make payments, additional allowances may be required.

- Our Revenues consist of revenue from sales of products and parts, net of discounts. We recognize revenue upon shipment of the goods to the customer. There are no rights of return privileges on product sales. Therefore, we do not establish a reserve for future returns.

- Our inventories are valued at lower of cost or market. We routinely evaluate the composition of our inventory and identify slow-moving, excess, obsolete or otherwise impaired inventories. Inventories identified as impaired are evaluated to determine if reserves are required. Included in this assessment is a review for obsolescence as a result of engineering changes in our product. Future product enhancement and development may render certain inventories obsolete, resulting in additional write-downs of inventory.

- We provide for the estimated cost of warranties at the time revenue from sales is recognized. While we engage in extensive quality programs and processes, our warranty obligation is affected by failure rates and service costs in correcting failures. Should actual failure rates or service costs differ from our estimates, revisions to the warranty liability would be required.

- We have a history of unprofitable operations. These losses generated a sizable federal and state net operating loss ("NOL") carryforward. GAAP require that we record a valuation allowance against the deferred tax asset associated with this NOL if it is "more likely than not" that we will not be able to utilize it to offset future taxes. Due to the uncertainty surrounding the timing of realizing the benefits of our favorable tax attributes in future income tax returns, we have not recognized any of our deferred tax assets. We currently provide for income taxes only to the extent that we expect to pay cash taxes, primarily state taxes. It is possible, however, that we could be profitable in the future at levels which cause management to determine that it is more likely than not that we will realize all or a portion of the NOL carryforward. Upon reaching such conclusion, we would immediately record the estimated net realizable value of the deferred tax asset at that time. Such adjustment would increase income in the period such determination was made.

- We account for contingencies in accordance with SFAS 5, "Accounting for Contingencies". SFAS 5 requires that we record an estimated loss from a loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Accounting for contingencies such as legal matters requires us to use our judgment. We also have certain Supply and Distribution Agreements and ASP agreements that upon termination under specified conditions require us to repurchase particular elements of the their parts inventories. To date, these conditions have never arisen and we believe that the amounts of such inventories currently are not significant. It is possible, however, that in the future such conditions could

occur that would require such repurchases. These repurchases could result in higher prices for the repurchased inventory than would otherwise be required to secure such quantities or could result in excess quantities of some inventory. In addition, certain ASP agreements require us to provide service to the customers of the ASP upon termination of the ASP agreement under specified conditions, until such time that we can identify and transfer the obligation to a new ASP. Since we do not have control over the terms of such third party service agreements, we may be exposed to significant risks and expenses that we cannot adequately quantify. Any significant exposure from such third party service agreements could have a material adverse effect on our results of operations and financial position. Any unfavorable outcome of litigation or other contingencies could have an adverse impact on our financial condition and results of operations.

Overview

We develop, manufacture and market microturbine technology for use in stationary, combined heat and power generation, resource recovery, hybrid electric vehicle and other power and heat applications in the markets for distributed power generation. Our microturbines provide power at the site of consumption and to hybrid electric vehicles that combine a primary source battery with an auxiliary power source, such as a microturbine, to enhance performance. We believe the simple and flexible design of our microturbines will enable our distributors and end-users to develop an increasingly broad range of applications to fit their particular power needs. We expect our microturbines to provide the commercial power generation industry with clean, multifunctional, and scalable distributed power sources.

We began commercial sales of our units in 1998, targeting the emerging distributed generation industry that is being driven by fundamental changes in power requirements. We are currently focusing on growth of our sales and marketing efforts, development of new products, acquisition of intellectual property rights and manufacturing facility expansion. We are currently managing our business such that we generally ship product as it is ordered. Therefore, we do not have any significant backlog. This is different than a year ago, when the Company had programs that required new business partners to place orders in volume. However, as the business develops, backlog may again become meaningful. We intend to achieve long-run profitability through production efficiencies and economies of scale. Specifically, in 2000, we consolidated our administrative and production operations into one building and we acquired intellectual property from a former supplier which will provide us the ability to manufacture recuperator cores previously purchased from this supplier. In 2001, we started to manufacture recuperator cores at our new facility. We continue working to develop new, higher profit-margin products.

We sell complete microturbine units, subassemblies and components. The microturbines are sold primarily through our distributors. ASPs provide installation and service. Successful implementation of the microturbine relies on the quality of the microturbine, the ability of the distributors to sell into appropriate applications, and the ASPs providing quality installations and support. As this is a new technology, we are encountering quality and reliability issues along this chain. We are actively working to address these issues. As we gain additional experience from more types of installations, we will have more information available for use in further improving the quality of our products and processes.

Our microturbines can be fueled by various sources including natural gas, propane, sour gas, kerosene and diesel. We will continue investing significant resources to develop new products and enhancements, including enhancements that enable greater kilowatt power production, additional fuel capabilities and additional distributed power generation solutions such as co-generation applications.

We have certain Supply and Distribution Agreements that require distributors to purchase certain minimum quantities of microturbines. Failure by the distributors to meet such purchase commitments allows us to renegotiate the terms of such agreements, including discounts, and/or to terminate such agreements. For example, in January of 2001, we entered into a Supply and Distribution Agreement with Advantica Technologies Ltd. (“Advantica”). In return for certain limited exclusivity rights and discounts, Advantica committed to purchase up to 250 units over a two-year period. Advantica fell significantly short of its 100 units commitment in the first year of the agreement. We believe Advantica will not meet its 150 units commitment

for the second year of the agreement. Failure by our distributors to meet their purchase commitments under such agreements could impact our anticipated rates of adoption.

Since inception through December 31, 2001, we generated cumulative operating losses of approximately $194.7 million and we expect to continue to sustain operating losses through at least fiscal year 2002. Our sales cycles vary by application and geographic region, and in many cases require long lead times between identifying customer needs and providing commercially available solutions. As a result of anticipated increases in our operating expenses resulting from our expansion and the difficulty in forecasting revenue levels, we expect our quarterly performance to fluctuate. We are also a young company with respect to sales growth, and therefore period-to-period comparisons between years may not necessarily be meaningful.

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Revenues. Revenues in 2001 increased $12.8 million to $36 million, compared to $23.2 million for 2000. The increase in revenues is attributable to greater sales to a larger customer base, which has resulted from expanding our sales and marketing efforts. During 2001, we shipped 795 units of our 30-kilowatt products, an increase of 13 units over the 782 units we shipped in 2000. During 2001, we shipped 238 units of our 60-kilowatt products, an increase of 230 units over the 8 units we shipped in 2000. In terms of megawatts, sales grew to 38 megawatts in 2001, a 59% growth over megawatts sold in 2000.

Our sales in 2001 were highly influenced by sales to a few new major customers, South Coast Air Quality Management District and the Los Angeles Department of Water and Power. Sales to these two customers totaled approximately $8.7 million, which accounted for 24% of total revenues for the year. By contrast, in 2000, sales to two customers totaled approximately $7.4 million that represented approximately 32% of the Company's revenues for the year. Throughout the year, results were significantly impacted by these discrete sales, which were still project-based sales from which similar future orders may not arise. Sales in the first half of 2001 benefited from the energy shortages in California that abated during the year.

Gross Loss. Cost of goods sold includes direct material costs, production overhead, inventory adjustments and provision for estimated products warranty expenses. Our gross loss decreased $1.1 million, or 23%, to $3.6 million in 2001 from a gross loss of $4.7 million for 2000. Gross loss as a percentage of revenue declined as more 60-kilowatt units with higher margin were sold in 2001, warranty costs declined on a per unit basis and production overhead costs were allocated over larger volumes of production. Inventory charges increased in 2001 as a result of reserves for items such as slow-moving and excess and obsolete inventories caused by engineering changes in our products. Production overhead also increased in 2001 primarily due to the overhead related to our new recuperator core facility. The provision for estimated products warranty expenses decreased $2.2 million to $2.4 million in 2001 from $4.6 million for 2000. Warranty costs on a per unit basis continued to decline based on our actual warranty cost experience. We estimate the warranty expenses based upon historical and projected product failure rates, estimated costs of parts and labor to repair or replace a unit and the number of units covered under the warranty period.

We had gross losses in 1999, 2000 and 2001. We expect this trend to continue until such time that we can sell a sufficient number of units to achieve a break-even margin. We have focused our efforts on transitioning the Company to a market-focused sales operation. We have realigned our sales organization in an effort to better support the needs of both the end-users and our sales channel partners. Part of the support we are working to provide addresses the end-user's total installed costs. Total installed costs fall into two broad categories — product costs and installation/commissioning costs. We have undertaken several initiatives to help reduce the installation and commissioning costs of our products. In order to improve quality and reliability of our products, we are addressing the problems associated with the quality of the installation and commissioning of our products by our ASPs or customers.

R&D Expenses. R&D expenses include compensation, the engineering department overhead allocations for administration and facilities and material costs associated with development. R&D expenses were for expanding the functionality of our 60-kilowatt family of products and for next generation products. R&D expenses in 2001 decreased $0.6 million, or 5%, to $10.7 million, compared to $11.3 million for 2000. R&D expenses are reported net of a $2.1 million benefit in 2001 and a $0.1 million benefit in 2000 from cost sharing

programs such as the DOE Advanced Microturbine Program. We believe our investments in R&D are critical to our future and we intend to continue to invest in this area and to seek additional funding relationships.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses include compensation and related expenses in support of our general corporate functions, which include human resources, finance and accounting, information systems and legal services. Selling, general, and administrative expenses in 2001 increased $16.7 million, or 69%, to $40.8 million, compared to $24.1 million for 2000. The primary cause of the increase was 48 new employees and general overhead associated with our growth. We expanded our selling and marketing efforts through increases in staff headcount and related overhead expenses, and we anticipate this trend to continue as we enter into new markets and develop new sales and marketing programs. Of the increase, $2.9 million was attributable to pre-production costs in 2001 associated with the Company's core manufacturing facility, $1.3 million increase in marketing rights amortization expense relating to the repurchase of marketing rights from Fletcher Challenge Limited and $389,000 increase in non-cash, stock-based compensation expense. Marketing rights amortization expense will continue through 2005, as the expense is being amortized over the original term of the contract. Stock-based compensation expense of $2.2 million will continue to be amortized through 2004, as the expense is based on the vesting period of the underlying instruments. In addition, legal expenses increased to support our patent pursuit efforts.

Interest Income. Interest income decreased $0.9 million to $8.7 million in 2001, compared to $9.6 million for 2000. The decrease is primarily attributable to the lower cash balances and lower interest rates in 2001. We expect decreasing cash balances from our use of funds will continue to diminish our interest income.

Income Tax Provision. At December 31, 2001, we had federal and state net operating loss carryforwards of approximately $180 million and $158 million, respectively, which may be utilized to reduce future taxable income, subject to limitations. Under the Tax Reform Act of 1996, the amounts of and benefit from net operating losses are subject to an annual limitation due to ownership change limitations. We have provided a valuation allowance for 100% of our net deferred tax asset of $89.6 million at December 31, 2001, due to the uncertainty surrounding the timing of realizing the benefits of favorable tax attributes in future income tax returns.

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

Revenues. Revenues in 2000 increased $16.5 million to $23.2 million, compared to $6.7 million for 1999. The increase in revenues was attributable to greater sales to a larger customer base, which has resulted from expanding our marketing efforts. Revenues for 2000 and 1999 were derived almost entirely from unit sales of our 30-kilowatt products. These units were used for various commercial applications and operated using different fuel types. During 2000, we shipped 790 units, an increase of 579 units over the 211 units we shipped in 1999.

Gross Loss. Cost of goods sold includes direct material costs, production overhead, inventory adjustments and provision for estimated products warranty expenses. Our gross loss decreased $4.2 million, or 47%, to $4.7 million in 2000 from a gross loss of $8.9 million for 1999. Gross loss as a percentage of revenue declined as production overhead costs were allocated over larger volumes of production. Costs for replacement parts and systems are charged against our warranty reserve, which is accrued through charges to cost of goods sold. The warranty reserve charge increased $2.0 million to $4.6 million in 2000 from $2.6 million for 1999 due to an increase in unit shipments. Warranty costs on a per unit basis continued to decline based on our actual warranty loss experience.

R&D Expenses. R&D expenses include compensation, the engineering department overhead allocations for administration and facilities, and material costs associated with development. R&D expenses were for expanding the functionality of our 30-kilowatt family of products and development of the 60-kilowatt family of products and for next generation products. R&D expenses in 2000 increased $2.2 million, or 24%, to $11.3 million, compared to $9.1 million for 1999.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses include compensation and related expenses in support of our general corporate functions, which include human resources, finance and accounting, information systems and legal services. Selling, general, and administrative expenses in 2000 increased $12.9 million, or 115%, to $24.1 million, compared to $11.2 million for 1999. The primary cause of the increase was 63 new employees and general overhead associated with our growth. $1.4 million of the increase was attributable to non-cash, stock-based compensation expense and $3.9 million to marketing rights amortization expense relating to the repurchase of marketing rights from Fletcher Challenge Limited. Stock-based compensation expense will continue at least through 2004, as the expense is based on the vesting period of the underlying instruments. Marketing rights amortization expense will continue through 2005, as the expense is being amortized over the original term of the contract.

Interest Income. Interest income increased $9.1 million to $9.6 million in 2000, compared to $452,000 for 1999. The increase is primarily attributable to the higher average investment balances due to the funds received from our Series G preferred stock issuance in February 2000, our initial public offering in July 2000 and our secondary public offering in November 2000.

Income Tax Provision. At December 31, 2000, we had federal and state net operating loss carryforwards of approximately $135.9 million and $114.1 million, respectively, which may be utilized to reduce future taxable income, subject to limitations. Under the Tax Reform Act of 1996, the amounts of and benefit from net operating losses are subject to an annual limitation due to the ownership change limitations. We have provided a valuation allowance for 100% of our net deferred tax asset of $63.5 million at December 31, 2000, due to the uncertainty surrounding the timing of realizing the benefits of its favorable tax attributes in future income tax returns.

Quarterly Results of Operations

The following table presents unaudited quarterly financial information for the eight quarters ended December 31, 2001. This information was prepared in accordance with generally accepted accounting principles, and, in the opinion of management, contains all adjustments necessary for a fair presentation of such quarterly information when read in conjunction with the financial statements included elsewhere herein. Our operating results for any prior quarters may not necessarily indicate the results for any future periods.

	2000				2001			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	Amounts in thousands, except per share data							
Total revenues	$ 3,746	$ 6,086	$ 6,197	$ 7,134	$ 8,906	$ 13,559	$ 3,346	$ 10,145
Cost of goods sold	5,124	8,256	7,278	7,157	8,583	12,982	5,468	12,569
Gross (loss) profit	(1,378)	(2,170)	(1,081)	(23)	323	577	(2,122)	(2,424)
Operating costs and expenses:								
R&D	2,441	3,022	2,953	2,903	2,770	2,889	2,512	2,487
Selling, general and administrative	4,384	5,677	7,203	6,803	9,844	10,893	9,210	10,833
Loss from operations	(8,203)	(10,869)	(11,237)	(9,729)	(12,291)	(13,205)	(13,844)	(15,744)
Net loss	(7,811)	(9,175)	(8,081)	(6,357)	(9,469)	(10,263)	(12,485)	(14,642)
Preferred stock dividends and Accretion	(139,932)	(419,930)	—	—	—	—	—	—
Net loss attributable to common stockholders	$(147,743)	$(429,105)	$ (8,081)	$(6,357)	$ (9,469)	$(10,263)	$(12,485)	$(14,642)
Net loss per common share	$ (36.49)	$ (14.32)	$ (0.11)	$ (0.08)	$ (0.12)	$ (0.13)	$ (0.16)	$ (0.19)

Liquidity and Capital Resources

Our cash requirements depend on many factors, including our product development activities, our production expansion and our commercialization efforts. We expect to devote substantial capital resources to

continue the development of our sales and marketing programs and to expand our R&D activities. We believe that our current cash balance of $170.9 million is sufficient to fund operations at least through 2002.

Accounts receivable increased to $8 million as of December 31, 2001 compared to $3.7 million as of December 31, 2000. The increase in accounts receivable was primarily attributable to an increase in sales in the fourth quarter 2001 to $10.1 million from $7.1 million for the same period in 2000 and increased aging for certain customers. We are addressing collection issues and we believe that our reserves for doubtful accounts are adequate.

Inventory increased to $22 million as of December 31, 2001 compared to $14 million as of December 31, 2000. Inventory is reported net of obsolescence reserves of $3.2 million and $1.5 million as of December 31, 2001 and 2000, respectively. The increase of $1.7 million in reserve was related to inventory rendered obsolete in part by product improvements. The increase in inventory was attributable to an inventory build-up due to slower-than-anticipated sales in the third quarter of 2001, partially reduced by sales in the fourth quarter of 2001. Inventory at December 31, 2001 included $6.3 million of finished goods, ready for shipment.

Our net cash used in operating activities increased to $49.8 million in 2001, compared to $23.8 million in 2000. Our net cash used in operating activities in 2001 was primarily from the net loss, adjusted on a cash basis, of $28.4 million and changes in working capital of $21.4 million. Our net cash used in operating activities in 2000 was primarily from the net loss, adjusted on a cash basis, of $17.4 million and changes in working capital of $6.4 million. Net cash used in investing activities was $17.4 million in 2001 compared to $26.9 million for 2000. Investing activities in 2001 primarily consisted of equipment purchases, intangible asset purchase and leasehold improvements associated with our recuperator core manufacturing facility. During the year ending December 31, 2002, the Company anticipates spending approximately $8 million to $10 million for capital expenditures principally to support our production, which will be funded from existing cash balances.

Our net cash provided by financing activities was $1.0 million in 2001, compared to $280.8 million for 2000. We have financed our operations and investing activities primarily through private and public equity issuances. The primary source of our cash balance as of December 31, 2001 was provided by financing activities during 2000 from the issuance of common stock in our initial public offering with net proceeds of $153.6 million and the issuance of common stock in our secondary offering with net proceeds of $19.6 million.

We have invested our cash in an institutional fund that invests in high quality short-term money market instruments to provide liquidity for operations and for capital preservation. In addition, we use capital lease commitments to sell and leaseback various fixed assets. As of December 31, 2001, we had $3.8 million outstanding primarily under various capital leases with Transamerica.

Contractual Obligations and Commercial Commitments

At December 31, 2001, the Company's commitments under non-cancelable operating and capital leases were as follows:

Year Ending December 31,	Operating Leases	Capital Leases
2002	$ 1,505,000	$1,732,000
2003	1,553,000	1,821,000
2004	1,599,000	946,000
2005	1,639,000	—
2006	1,506,000	—
Thereafter	5,584,000	—
Total minimum lease payments	$ 13,386,000	4,499,000
Less amount representing interest		666,000
Net present value		3,833,000
Less current portion		1,308,000
Long-term portion		$2,525,000

In 2000, the United States Department of Energy ("DOE") awarded us $10 million under a Cooperative Agreement to develop an Advanced Microturbine System. The $10 million award, to be distributed over a five-year period, is the maximum amount available under the Department of Energy's Advanced Microturbine Systems Program. The program is estimated to cost $23.0 million over the five years, which would require the Company to provide approximately $13.0 million of our own R&D expenditures. As of December 31, 2001, the Company's remaining commitment to spend its own R&D expenditures under this award is approximately $12 million. In 2001, the Company was awarded a $3 million grant from DOE for the research, development and testing of packaged cooling, heating and power systems for buildings. The contract is estimated to cost $5.5 million over a three-year period, which would require the Company to provide approximately $2.5 million of its own R&D expenditures. As of December 31, 2001, the $2.5 million remains to be spent.

Item 7A. ***Quantitative and Qualitative Disclosure About Market Risk.***

We do not currently use derivative financial instruments for speculative purposes that expose us to market risk. Information required by this item is included in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Note 2 of Notes to Financial Statements.

Foreign Currency

We currently develop products in the United States and market our products predominantly in North America, Europe and Asia. As a result, factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets could affect our financial results. As all of our sales and supplies are currently made in U.S. dollars, we do not utilize foreign exchange contracts to reduce our exposure to foreign currency fluctuations. We have employees in Sweden and Canada. Payroll and related benefits and other office expenses are paid in the country's local currency. In the future, as our customers, employees and vendor bases expand, we anticipate entering into more transactions that are denominated in foreign currencies.

Interest

We have no long-term debt outstanding, except for capital leases, and do not use any derivative instruments. We have invested our cash in an institutional fund that invests in high quality short-term money market instruments.

Inflation

We do not believe that inflation has had a material effect on our financial position or results of operations during the past three years. However, we cannot predict the future effects of inflation, including interest rate fluctuations and market fluctuations.

Impact of Recently Issued Accounting Standards

Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, is effective for all fiscal years beginning after June 15, 2000. SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. Under SFAS 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. The Company adopted SFAS 133 effective January 1, 2001. The adoption of SFAS 133 did not have a significant impact on the financial position, results of operations, or cash flows of the Company.

During July 2001, SFAS No. 142, "Goodwill and Other Intangible Assets" was issued by the Financial Accounting Standards Board. SFAS 142 applies to all acquired intangible assets whether acquired singly, as part of a group, or in a business combination. SFAS 142 specifies that goodwill and indefinite lived intangible assets will no longer be amortized but instead will be subject to periodic impairment testing. Intangible assets with a determinable useful life will continue to be amortized over that period. The Company is required to implement SFAS 142 on January 1, 2002 and it has not determined the impact, if any, that this statement will have on its consolidated financial position or results of operations.

In August 2001, SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", was issued by the Financial Accounting Standards Board. SFAS 144 addresses the financial accounting and reporting issues for the impairment or disposal of long-lived assets. This statement supersedes SFAS 121 but retains the fundamental provisions for (a) recognition/ measurement of impairment of long-lived assets to be held and used and (b) measurement of long-lived assets to be disposed of by sales. It is effective for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The Company is currently evaluating the provisions of SFAS 144 and it has not determined the impact, if any, that this statement will have on its consolidated financial position or results of operations.

Item 8. ***Financial Statements and Supplementary Data.***

CAPSTONE TURBINE CORPORATION

INDEX TO FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders

Capstone Turbine Corporation:

We have audited the accompanying consolidated balance sheets of Capstone Turbine Corporation (the "Company") as of December 31, 2000 and 2001, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Capstone Turbine Corporation as of December 31, 2000 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

/s/ DELOITTE & TOUCHE LLP

Los Angeles, California

March 28, 2002

CAPSTONE TURBINE CORPORATION

CONSOLIDATED BALANCE SHEETS

	December 31,	
	2000	2001
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 236,947,000	$ 170,868,000
Accounts receivable, net of allowance for doubtful accounts of $85,000 in 2000 and $163,000 in 2001.	3,664,000	8,016,000
Inventory	14,123,000	21,973,000
Prepaid expenses and other current assets	1,689,000	1,422,000
Total current assets	256,423,000	202,279,000
Equipment and Leasehold Improvements:		
Machinery, equipment, and furniture	13,664,000	22,895,000
Leasehold improvements	3,055,000	9,235,000
Molds and tooling	1,331,000	4,534,000
	18,050,000	36,664,000
Less accumulated depreciation and amortization	6,434,000	9,362,000
Total equipment and leasehold improvements	11,616,000	27,302,000
Deposits on Fixed Assets	6,649,000	2,550,000
Other Assets	302,000	242,000
Intangible Assets, Net	27,028,000	21,881,000
Total	$ 302,018,000	$ 254,254,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 4,728,000	$ 3,490,000
Accrued salaries and wages	1,135,000	1,440,000
Other accrued liabilities	1,282,000	1,263,000
Accrued warranty reserve	5,589,000	4,145,000
Deferred revenue	4,064,000	1,471,000
Current portion of capital lease obligations	1,497,000	1,308,000
Total current liabilities	18,295,000	13,117,000
Long-Term Portion of Capital Lease Obligations	3,999,000	2,525,000
Other Long-Term Liabilities	342,000	1,158,000
Commitments and Contingencies	—	—
Stockholders' Equity:		
Common stock, $.001 par value; 415,000,000 shares authorized; 75,771,303 and 77,207,383 shares issued and outstanding at December 31, 2000 and 2001	76,000	77,000
Additional paid-in capital	516,738,000	521,668,000
Accumulated deficit	(237,432,000)	(284,291,000)
Total stockholders' equity	279,382,000	237,454,000
Total	$ 302,018,000	$ 254,254,000

See accompanying notes to consolidated financial statements

CAPSTONE TURBINE CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,		
	1999	2000	2001
Revenues	$ 6,694,000	$ 23,163,000	$ 35,956,000
Cost of Goods Sold	15,629,000	27,815,000	39,602,000
Gross Loss	(8,935,000)	(4,652,000)	(3,646,000)
Operating Costs and Expenses:			
R&D	9,151,000	11,319,000	10,658,000
Selling, general, and administrative	11,191,000	24,067,000	40,780,000
Total operating costs and expenses	20,342,000	35,386,000	51,438,000
Interest Income	452,000	9,589,000	8,690,000
Interest Expense	(721,000)	(915,000)	(585,000)
Other Income (Expense), net	17,000	(59,000)	121,000
Loss Before Income Taxes	(29,529,000)	(31,423,000)	(46,858,000)
Provision for Income Taxes	1,000	1,000	1,000
Net Loss	(29,530,000)	(31,424,000)	(46,859,000)
Preferred Stock Dividends and Accretion	(26,700,000)	(559,862,000)	—
Net Loss Attributable to Common Stockholders	$(56,230,000)	$(591,286,000)	$(46,859,000)
Net Loss Per Share of Common Stock — Basic and Diluted	$ (24.53)	$ (12.82)	$ (0.61)
Weighted Average Common Shares Outstanding	2,292,242	46,107,074	76,694,670

See accompanying notes to consolidated financial statements

CAPSTONE TURBINE CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' (DEFICIENCY) EQUITY

	Common Stock		Additional		
	Shares Outstanding	Amount	Paid-in Capital	Accumulated Deficit	Total
Balance, January 1, 1999	2,171,265	$ 2,000	$ —	$ (91,153,000)	$ (91,151,000)
Common stock warrants granted			2,969,000		2,969,000
Stock-based compensation			135,000		135,000
Exercise of stock options and warrants	206,561		53,000		53,000
Accretion of preferred stock			(3,157,000)	(21,637,000)	(24,794,000)
Dividends accrued for Series A preferred stock				(363,000)	(363,000)
Dividends accrued for Series B preferred stock				(174,000)	(174,000)
Dividends accrued for Series C preferred stock				(368,000)	(368,000)
Dividends accrued for Series D preferred stock				(255,000)	(255,000)
Dividends accrued for Series E preferred stock				(747,000)	(747,000)
Net loss				(29,530,000)	(29,530,000)
Balance, December 31, 1999	2,377,826	2,000	—	(144,227,000)	(144,225,000)
Common stock warrants granted			8,132,000		8,132,000
Stock-based compensation			1,744,000		1,744,000
Exercise of stock options, warrants and employee stock purchases	10,912,609	12,000	3,653,000		3,665,000
Repurchase of preferred stock			2,209,000	454,000	2,663,000
Accretion of preferred stock			(13,883,000)	(457,593,000)	(471,476,000)
Dividends accrued for Series A preferred stock				(196,000)	(196,000)
Dividends accrued for Series B preferred stock				(94,000)	(94,000)
Dividends accrued for Series C preferred stock				(198,000)	(198,000)
Dividends accrued for Series D preferred stock				(137,000)	(137,000)
Dividends accrued for Series E preferred stock				(403,000)	(403,000)
Beneficial conversion feature for Series G preferred stock				(89,567,000)	(89,567,000)
Dividends waived on preferred stock			440,000	6,309,000	6,749,000
Conversion of preferred stock	51,312,037	51,000	341,296,000	479,644,000	820,991,000
Issuance of common stock	11,168,831	11,000	173,147,000		173,158,000
Net loss				(31,424,000)	(31,424,000)
Balance, December 31, 2000	75,771,303	76,000	516,738,000	(237,432,000)	279,382,000
Stock-based compensation			2,535,000		2,535,000
Exercise of stock options and employee stock purchases	1,436,080	1,000	2,505,000		2,506,000
Stock issuance costs			(110,000)		(110,000)
Net loss				(46,859,000)	(46,859,000)
Balance, December 31, 2001	77,207,383	$77,000	$521,668,000	$(284,291,000)	$ 237,454,000

See accompanying notes to consolidated financial statements

CAPSTONE TURBINE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	1999	2000	2001
Cash Flows from Operating Activities:			
Net loss	$(29,530,000)	$ (31,424,000)	$ (46,859,000)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	2,356,000	7,126,000	10,560,000
Provision for inventory reserve	1,120,000	407,000	2,900,000
Provision for warranty expenses	2,643,000	4,569,000	2,391,000
Loss on disposal of fixed assets	239,000	95,000	90,000
Non-employee stock compensation	80,000	60,000	396,000
Employee stock compensation	131,000	1,744,000	2,139,000
Changes in operating assets and liabilities:			
Accounts receivable	(2,329,000)	(1,239,000)	(4,301,000)
Inventory	(1,220,000)	(5,727,000)	(10,750,000)
Prepaid expenses and other assets	(1,328,000)	648,000	236,000
Accounts payable	497,000	2,999,000	(1,238,000)
Accrued salaries and wages	157,000	458,000	531,000
Other accrued liabilities	(1,617,000)	(716,000)	578,000
Accrued warranty reserve	(348,000)	(2,148,000)	(3,835,000)
Deferred revenue	4,696,000	(632,000)	(2,592,000)
Net cash used in operating activities	(24,453,000)	(23,780,000)	(49,754,000)
Cash Flows from Investing Activities:			
Acquisition of and deposits on equipment and leasehold improvements	(2,527,000)	(10,041,000)	(16,818,000)
Proceeds from sale of equipment	2,338,000	1,221,000	1,000
Intangible assets	(5,000,000)	(18,106,000)	(557,000)
Net cash used in investing activities	(5,189,000)	(26,926,000)	(17,374,000)
Cash Flows from Financing Activities:			
Repayment of capital lease obligations	(1,119,000)	(1,608,000)	(1,347,000)
Exercise of stock options, warrants and employee stock purchases	53,000	4,375,000	2,506,000
Net proceeds from issuance of Series F preferred stock	21,789,000	—	—
Proceeds from promissory notes associated with Series G preferred stock	10,834,000	—	—
Net proceeds from issuance of Series G preferred stock	—	120,362,000	—
Stock issuance costs	—	—	(110,000)
Repurchase of preferred stock	—	(15,492,000)	—
Net proceeds from issuance of common stock	—	173,158,000	—
Net cash provided by financing activities	31,557,000	280,795,000	1,049,000
Net Increase (Decrease) in Cash and Cash Equivalents	1,915,000	230,089,000	(66,079,000)
Cash and Cash Equivalents, Beginning of Year	4,943,000	6,858,000	236,947,000
Cash and Cash Equivalents, End of Year	$ 6,858,000	$236,947,000	$170,868,000
Supplemental Disclosures of Cash Flow Information			
Cash paid during the year for:			
Interest	$ 630,000	$ 770,000	$ 584,000
Income taxes	$ 1,000	$ 1,000	$ 1,000

See accompanying notes to consolidated financial statements

CAPSTONE TURBINE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of the Company

Capstone Turbine Corporation (the "Company") develops, manufactures, and markets microturbine generator sets for use in stationary, vehicular, and other electrical distributed generation applications. The Company was organized in 1988 and has been commercially producing its microturbine generators since 1998.

The Company has incurred significant operating losses since its inception. Management anticipates incurring additional losses until the Company can produce sufficient revenues to cover costs. To date, the Company has funded its activities primarily through private and public equity offerings.

2. Summary of Significant Accounting Policies

Principles of Consolidation — The consolidated financial statements include the accounts of the parent company and Capstone California Corporation, its wholly owned subsidiary, after elimination of inter-company transactions.

Cash Equivalents — The Company considers only those investments that are highly liquid, readily convertible to cash and mature within three months from the date of purchase as cash equivalents.

Depreciation and Amortization — Depreciation and amortization are provided for using the straight-line method over the estimated useful lives of the related assets, ranging from three to ten years. Leasehold improvements are amortized over the period of the lease or the estimated useful lives of the assets, whichever is shorter. Intangible assets are amortized over their estimated useful lives using the straight-line method. Amortization of assets under capital leases and intangible assets are included with depreciation and amortization expense. Depreciation and amortization expense was $2,356,000, $7,126,000 and $10,560,000 for the years ended December 31, 1999, 2000 and 2001, respectively.

Long-Lived Assets — The Company reviews the recoverability of long-lived assets whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. If the expected future cash flows from the use of such assets (undiscounted and without interest charges) are less than the carrying value, the Company's policy is to record a write-down, which is determined based on the difference between the carrying value of the assets and their estimated fair value.

Product Revenues — The Company's policy is to recognize product revenue upon shipment of the product to the customer. There are no rights of return privileges on product sales. Therefore, we do not establish a reserve for future returns.

Warranty Policy — Estimated future warranty obligations are provided for by charges to operations in the period in which the related revenue is recognized. The warranty reserve is based upon historical and projected product and parts failure rates, estimated costs to repair or replace a unit or part and the number of units or parts covered under the warranty period.

Deferred Revenue — Deferred revenue consists of customer deposits. Deferred revenue will be recognized upon shipment of the product to the customer. The Company has the right to retain all or part of the deposits under certain conditions.

Income Taxes — Deferred income tax assets and liabilities are computed for differences between the financial statement and income tax bases of assets and liabilities. Such deferred income tax asset and liability computations are based on enacted tax laws and rates applicable to periods in which the differences are expected to reverse. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amounts expected to be realized.

Accounting for Stock-Based Compensation — Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation" requires expanded disclosures of stock-based compensation arrangements with employees and encourages (but does not require) compensation cost to be measured

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

based on the fair value of the equity instrument awarded. Under SFAS 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models even though such models were developed to estimate the fair value of freely tradable and fully transferable options, without vesting restrictions, which significantly differ from the Company's stock option awards. Companies are permitted, however, to continue to apply Accounting Principle Board Opinion ("APB Opinion") No. 25, "Accounting for Stock Issued to Employees," which recognizes compensation cost based on the intrinsic value of the equity instrument awarded. The Company has elected to continue to apply APB Opinion No. 25 in its employee stock-based compensation arrangements (see Note 6). Expense for common stock options granted to non-employees is recorded based upon the fair value of the equity instrument awarded calculated through the use of an option-pricing model as required by SFAS 123 and Emerging Issues Task Force No. 96-18.

Contingencies — We account for contingencies in accordance with SFAS No. 5, "Accounting for Contingencies". SFAS 5 requires that we record an estimated loss from a loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

Risk Concentrations — Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents and accounts receivable. The Company places its cash equivalents with high credit quality institutions. The Company performs ongoing credit evaluations of its customers and maintains an allowance for potential credit losses.

The Company had sales to a single customer of $1,858,000 that represented approximately 28% of the Company's revenues for the year ended December 31, 1999. The Company had accounts receivable from two customers of approximately $613,000 and $277,000, respectively, that represented approximately 25% and 11%, respectively of total accounts receivable at December 31, 1999.

The Company had sales to two customers of $5,069,000 and $2,374,000 that represented approximately 22% and 10%, respectively, of the Company's revenues for the year ended December 31, 2000. The Company had accounts receivable from two customers of approximately $809,000 and $715,000 that represented approximately 22% and 20%, respectively, of total accounts receivable at December 31, 2000.

The Company had sales to two customers of $4,889,000 and $3,803,000 that represented approximately 14% and 11%, respectively, of the Company's revenues for the year ended December 31, 2001. The Company had accounts receivable from a single customer of approximately $1,852,000 that represented approximately 23% of total accounts receivable at December 31, 2001.

Estimates and Assumptions — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Net Loss Per Common Share — Basic loss per common share is computed using the weighted-average number of common shares outstanding for the period. The weighted-average number of common shares outstanding, was 2,292,242, 46,107,074 and 76,694,670 in 1999, 2000 and 2001, respectively. The impact of common stock options, outstanding preferred stock, warrants for preferred stock, and warrants for common stock have not been included for purposes of the computation of diluted earnings per share as their inclusion would have had an antidilutive effect on the per-share amounts for the periods presented; therefore, diluted loss per share is equal to basic loss per share. All outstanding common stock options and warrants of 14,303,142, 5,666,097 and 6,612,741 in 1999, 2000 and 2001, respectively, were not included in the calculation of net loss per common share.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Supplemental Cash Flow Information — During 1999, the Company granted 12,000 common stock options to a consultant. The fair value of these options was determined to be $37,000. The expense was recognized over the vesting period.

During 1999 and 2000, the Company financed machinery purchases of $2,467,000 and $1,290,000, respectively, through capital lease obligations.

During 1999 and 2000, the Company issued approximately $76,000 and $60,000, respectively, of preferred stock for services rendered by several vendors. The expense was recorded at the fair value of services received.

During 2001, the Company recognized compensation expense of $396,000 representing the fair value of 14,750 common stock options held by former employees who became consultants of the Company. In addition, the Company recognized stock-based compensation of $548,000 based upon the intrinsic value of the accelerated vesting of options held by the then Chief Financial Officer.

Segment Reporting — The Company is considered to be a single operating segment in conformity with SFAS No. 131, *"Disclosures about Segments of an Enterprise and Related Information."* The business activities of said operating segment are the development, manufacture and sale of turbine generator sets. Following is the geographic revenue information:

	Years Ended December 31,		
	1999	2000	2001
North America	$4,811,000	$13,913,000	$23,935,000
Asia	1,608,000	8,273,000	8,321,000
Europe	275,000	977,000	1,902,000
South America	—	—	1,058,000
Africa	—	—	740,000
Total Revenues	$6,694,000	$23,163,000	$35,956,000

All long-lived assets of the Company are located in the United States of America.

Reclassifications — Certain prior year balances have been reclassified to conform with the current year presentation.

New Accounting Pronouncements — SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. The Company adopted SFAS 133 effective January 1, 2001. The adoption of SFAS 133 did not have a significant impact on the consolidated financial position or results of operations.

During July 2001, SFAS No. 142, "Goodwill and Other Intangible Assets" was issued by the Financial Accounting Standards Board. SFAS 142 applies to all acquired intangible assets whether acquired singly, as part of a group, or in a business combination. SFAS 142 specifies that goodwill and indefinite lived intangible assets will no longer be amortized but instead will be subject to periodic impairment testing. Intangible assets with a determinable useful life will continue to be amortized over that period. The Company is required to implement SFAS 142 on January 1, 2002 and it has not determined the impact, if any, that this statement will have on its consolidated financial position or results of operations.

In August 2001, SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", was issued by the Financial Accounting Standards Board. SFAS 144 addresses the financial accounting and reporting issues for the impairment or disposal of long-lived assets. This statement supersedes SFAS 121 but retains the fundamental provisions for (a) recognition/measurement of impairment of long-lived assets to be

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

held and used and (b) measurement of long-lived assets to be disposed of by sales. It is effective for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The Company is currently evaluating the provisions of SFAS 144 and it has not determined the impact, if any, that this statement will have on its consolidated financial position or results of operations.

3. Inventories

Inventories are stated at the lower of standard cost (which approximates actual cost on the first-in, first-out method) or market. The amounts below are net of $1,546,000 and $3,205,000 of reserves for excess and obsolete inventories at December 31, 2000 and 2001, respectively.

	December 31,	
	2000	2001
Raw materials	$10,133,000	$13,466,000
Work in process	3,354,000	2,220,000
Finished goods	636,000	6,287,000
	$14,123,000	$21,973,000

4. Income Taxes

Significant components of the Company's deferred income tax assets (liabilities) and related valuation allowances at December 31, 2000 and 2001 are as follows:

	2000	2001
Current deferred income tax assets:		
Inventory	$ 662,000	$ 3,031,000
Warranty reserve	2,384,000	1,776,000
Deferred revenue	977,000	655,000
Other	763,000	968,000
Current deferred income tax liabilities:		
State taxes	(4,838,000)	(6,978,000)
Net current deferred income tax liabilities	(52,000)	(548,000)
Long-term deferred income tax assets:		
Net operating loss ("NOL") carryforwards	56,274,000	75,287,000
Tax credit carryforwards	8,093,000	9,594,000
Other income tax assets	—	5,786,000
Long-term deferred income tax liabilities:		
Depreciation and amortization	(793,000)	(498,000)
Net long-term deferred income tax assets	63,574,000	90,169,000
Valuation allowance	(63,522,000)	(89,621,000)
Total deferred income tax assets	$ —	$ —

Due to the uncertainty surrounding the timing of realizing the benefits of our favorable tax attributes in future income tax returns, the Company has placed a valuation allowance against its otherwise recognizable deferred income tax assets.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company's net operating loss and tax credit carryforwards for federal and state income tax purposes at December 31, 2001 are as follows:

		Expiration Period
Federal NOL	$180,221,000	2009 to 2021
State NOL	158,499,000	2002 to 2011
Federal tax credit carryforwards	5,498,000	2009 to 2016
State tax credit carryforwards	4,094,000	2009 to 2016

The net operating losses and federal and state tax credits can be carried forward to offset future taxable income, if any. Utilization of the net operating losses and tax credits are subject to an annual limitation of approximately $57.6 million due to the ownership change limitations provided by the Internal Revenue Code of 1986 and similar state provisions.

Tax benefits arising from the disposition of certain shares issued upon exercise of stock options within two years of the date of grant or within one year of the date of exercise by the option holder ("Disqualifying Dispositions") provide the Company with a tax deduction equal to the difference between the exercise price and the fair market value of the stock on the date of exercise. Approximately $21.5 million of the Company's federal and state net operating loss carryforwards as of December 31, 2001 were generated by disqualifying dispositions of stock options and exercises of nonqualified stock options. Upon realization, if any, tax benefits of $8.6 million associated with these stock options will be excluded from the provision (benefit) for income taxes and credited directly to additional paid-in-capital.

A reconciliation of income tax benefit to the federal statutory rate follows:

	Years Ended December 31,		
	1999	2000	2001
Federal income tax at the statutory rate	$(10,040,000)	$(10,680,000)	$(15,932,000)
State taxes, net of federal effect	(2,610,000)	(2,800,000)	(4,142,000)
Other	190,000	992,000	420,000
Valuation allowance	12,460,000	12,488,000	19,654,000
	$ —	$ —	$ —

5. Stockholders' Equity

On May 26, 2000 a three-for-five reverse split of the Company's outstanding common stock became effective. All share and per share amounts in the accompanying financial statements have been retroactively restated to reflect this stock split.

In 1999, the Company granted 8,692,230 common stock warrants at a weighted average exercise price of $0.36. 8,396,624 warrants at an exercise price of $0.33 were issued to Series F preferred stock stockholders. The fair value on the date of grant was approximately $2,645,000, which was recorded as additional paid-in capital. 90,000 common stock warrants at an exercise price of $0.50 were granted to two stockholders relating to the Series G financing. The fair value on the date of grant was approximately $263,000, which was recorded as additional paid-in capital. 40,606 common stock warrants at an exercise price of $5.00 were granted to a lessor. The fair value on the date of grant was approximately $61,000, which was recorded as a prepaid asset and additional paid-in capital (see Note 9). The prepaid asset was amortized as rent expense over twelve months. The Company also granted 165,000 warrants at an exercise price of $0.50 to two stockholders relating to the Series G financing. The fair value of $483,000 was recorded as a liability at December 31, 1999. Upon

issuance in January 2000 the fair value was recorded as additional paid-in capital. The fair values of the common stock warrants were determined using the Black-Scholes model.

In 1999, the Company received $10,834,000 in exchange for promissory notes associated with the Series G preferred stock from various stockholders. These notes represent promissory notes to the respective stockholders and bear interest from the deposit date until stock issuance at 5.54%. Interest expense associated with these notes was $90,000 and $145,000 for the years ended December 31, 1999 and 2000, respectively, all of which was payable on the stock issuance date.

On February 24, 2000, the Company closed the Series G preferred stock issuance for $4.00 per share in a private placement. Proceeds, net of origination fees, to the Company approximated $131.1 million, of which $10.8 million was received in 1999. 35,683,979 shares of Series G were issued, which included 1,250,000 shares issued to an existing stockholder for no cash consideration (see Note 9) and 58,979 shares issued to holders of promissory notes for accrued interest. The Series G preferred stock was issued with a beneficial conversion feature as the fair value of the common stock into which the preferred stock was convertible exceeded the carrying value. The beneficial conversion feature was determined to be approximately $89.6 million. This amount was accounted for as a charge to accumulated deficit and an in-substance dividend to the preferred stockholders in February 2000 and accordingly increased the loss applicable to common stockholders. The Company issued 739,577 common stock warrants at a per share exercise price of $0.67 to an investment banker for services rendered in conjunction with the Series G preferred stock offering. The fair value of these warrants of $7.6 million was recorded as origination fees at the time of the Series G issuance.

As part of a stock repurchase and settlement agreement entered into by the Company in May 2000, the Company reacquired 2,319,129 shares of Series E preferred stock for $6.68 per share, which was less than the carrying value on the reacquisition date. The excess carrying value over the reacquisition price of $2.2 million was recorded as additional paid-in capital and included as a component of net loss attributable to common stockholders during the fiscal year ended December 31, 2000.

On June 28, 2000, the Company entered into an agreement to sell approximately 10.5 million shares of common stock at an offering price of $16.00 per share through an initial public stock offering. All of the shares issued in the public offering were sold by the Company. The gross proceeds from the initial public offering were $167.3 million and the Company incurred $13.7 million in costs in connection with the offering.

Prior to the public offering, the Company had several series of preferred stock outstanding. It therefore accreted the difference between the redemption value of each series of preferred stock and the net proceeds received in each preferred stock offering under the effective interest method from the respective stock issuance date of each series to the respective redemption date. The accretion was recorded as a component of net loss attributable to common stockholders. The Company also recorded the accrual of preferred stock dividends under the effective interest method.

As a result of the Company's public offering, the total remaining fair value accretion with respect to its preferred stock of $471.5 million was recorded as a component of net loss attributable to common stockholders during the fiscal year ended December 31, 2000. All outstanding shares of the Company's preferred stock converted into approximately 51.3 million shares of common stock as a result of the public offering. Of the $821.0 million carrying value of the preferred stock, $479.6 million was recorded as an increase to accumulated deficit and $341.3 million was recorded as an increase to additional paid-in capital, amounts equal to previously recorded accretion charges.

The Company accrued $1.0 million in preferred stock dividends, which were recorded as a component of net loss attributable to common stockholders during the fiscal year ended December 31, 2000. $6.7 million in accrued preferred stock dividends were waived as a result of the automatic conversion of preferred stock into common stock and were also reversed, which resulted in an increase to accumulated deficit of $6.3 million and

an increase to additional paid-in capital of $440,000, amounts equal to previously recorded dividend accrual charges.

On November 16, 2000, the Company entered into an agreement to sell approximately 5.0 million shares of common stock at an offering price of $30.00 per share through a secondary public stock offering. Of the 5.0 million shares sold, the Company sold 714,286 shares and existing shareholders sold 4,285,714 shares. The gross proceeds to the Company from the secondary public stock offering were $21.4 million and the Company incurred approximately $1.8 million in costs in connection with the offering.

During the fiscal year ended December 31, 2000, 9,962,509 shares of common stock were issued from the exercise of common and preferred stock warrants. As of December 31, 2000, there were no warrants outstanding for the Company's stock.

The Company issued 478 and 222 shares of common stock to employees in consideration for services performed in 2000 and 2001, respectively.

6. Stock Options and Employee Stock Purchase Plan

In June 2000, the Company adopted the 2000 Equity Incentive Plan, as a successor plan to the 1993 Incentive Stock Plan. The 2000 Plan provides for awards of up to 3,300,000 shares of common stock, plus 493,709 shares previously authorized and remaining available under the 1993 Plan.

In June 2000, the Company adopted the 2000 Employee Stock Purchase Plan (the "Purchase Plan"), which provides for the granting of Purchase Rights to purchase common stock to regular full and part-time employees or officers of the Company and its subsidiaries. Under the Purchase Plan, shares of common stock will be issued upon exercise of the Purchase Rights. Under the Purchase Plan, an aggregate of 900,000 shares may be issued pursuant to the exercise of Purchase Rights. The maximum amount that an employee can contribute during a Purchase Right Period is $25,000 or 15% of the employee's regular compensation. Under the Purchase Plan, the exercise price of a Purchase Right will be the lesser of 85% of the fair market value of such shares on the first day of the Purchase Right Period or the last day of the Purchase Right Period. For this purpose, the fair market value of the stock is its closing price as reported on the Nasdaq Stock Market on the day in question. In conjunction with its Employee Stock Purchase Plan, the Company issued 57,294 and 77,966 shares of common stock in 2000 and 2001, respectively.

During 1999 and 2000, the Company issued common stock options at less than the fair value of its common stock. Accordingly, the Company recorded employee stock-based compensation expense based on the vesting of these grants of $131,000, $1,744,000 and $2,139,000 for the years ended December 31, 1999, 2000 and 2001, respectively. Included in $2,139,000 in 2001 was $548,000 related to the accelerated vesting of stock options granted to the Company's former Chief Financial Officer (see Note 9). Stock-based compensation expense for the year ended December 31, 1999 was included in cost of goods sold, R&D and selling, general, and administrative expenses in the amounts of $2,000, $24,000 and $105,000, respectively. Stock-based compensation expense for year ended December 31, 2000 was included in cost of goods sold, R&D, and selling, general, and administrative expenses in the amounts of $64,000, $305,000, and $1,375,000, respectively. Stock-based compensation expense for year ended December 31, 2001 was included in cost of goods sold, R&D, and selling, general, and administrative expenses in the amounts of $61,000, $314,000 and $1,764,000, respectively. As of December 31, 2001, the Company had $2.2 million in deferred stock compensation related to stock options, which will be recognized as stock-based compensation expense through 2004.

During 2001, the Company issued 800,000 non-qualified common stock options outside of the 2000 Equity Incentive Plan at exercise price equal to the fair value of its common stock. Accordingly, no stock-based compensation was recorded for the grant. The options were issued as part of the compensation package of the Company's new Chief Operating Officer.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Information relating to all outstanding stock options is as follows:

	Shares	Weighted-Average Exercise Price
Outstanding at December 31, 1998	2,658,876	$ 0.98
Granted	2,952,720	0.37
Exercised	(133,348)	0.30
Canceled	(387,911)	1.02
Outstanding at December 31, 1999	5,090,337	0.63
Granted	1,515,600	8.39
Exercised	(892,328)	0.51
Canceled	(47,512)	3.41
Outstanding at December 31, 2000	5,666,097	2.61
Granted	3,170,550	13.45
Exercised	(1,357,893)	1.30
Canceled	(866,013)	11.54
Outstanding at December 31, 2001	6,612,741	$ 6.91

Options exercisable at December 31, 1999, 2000 and 2001 were 1,612,594, 1,984,874 and 2,161,201 with weighted average exercise prices of $0.74, $0.79 and $1.89, respectively.

Additional information regarding options outstanding at December 31, 2001, is as follows:

	Options Outstanding			Options Exercisable	
Exercise Price	Number of Shares Outstanding at December 31, 2001	Weighted Average Remaining Contractual Life (in Years)	Weighted Average Exercise Price	Exercisable at December 31, 2001	Weighted Average Exercise Price
Up to $1.00	2,892,738	6.9	$ 0.57	1,820,019	$ 0.66
$1.01 to $10.00	2,385,453	8.8	$ 4.48	256,497	$ 4.45
$10.01 to $20.00	225,900	9.0	$16.97	53,050	$15.55
Greater than $20.00	1,108,650	9.3	$26.64	31,635	$28.59
	6,612,741	8.0	$ 6.91	2,161,201	$ 1.89

As of December 31, 2001, 1,975,750 shares were available for future grant.

If the Company recognized employee stock option-related compensation expense in accordance with SFAS No. 123 and used the minimum value method for 1999 and the Black-Scholes method for 2000 and 2001 for determining the fair value of options granted, the net loss attributable to common stockholders and net loss per share — basic and diluted would have been $56,739,000 and $24.75, respectively, for the year ended December 31, 1999, $594,940,000 and $12.90, respectively, for the year ended December 31, 2000 and $51,311,000 and $0.67, respectively, for the year ended December 31, 2001.

In computing the impact of SFAS No. 123, the weighted-average fair value of $0.45, $9.12 and $15.37 for 1999, 2000 and 2001 stock option grants, respectively, was estimated at the dates of grant using the following assumptions for 1999, 2000 and 2001: risk-free interest rate of approximately 5.4%, 6.2% and 4.6%, respectively, and no assumed dividend yield. The weighted average expected life of the options was 4 years for each of the years 1999, 2000 and 2001. The volatility used for 2000 and 2001 was 95% and 140%, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

For purposes of determining the SFAS No. 123 pro forma compensation expense, the weighted-average fair value of the options is amortized over the vesting period.

7. Commitments and Contingencies

At December 31, 2000 and 2001, respectively, the Company had equipment under capital leases with a cost of $8,208,000 and $6,618,000 and accumulated amortization of $3,440,000 and $3,625,000, respectively. The lease terms range from three to five years. The deferred gain on sale-leaseback capital lease obligations was $109,000 and $55,000 as of December 31, 2000 and 2001, respectively, which is being recognized as an offset to amortization expense over the useful life of the asset. The related assets collateralize the capital lease obligations.

The Company leases offices, manufacturing and warehouse spaces under various non-cancelable operating leases. The lease agreements provide for rent escalation over the lease term. Rent expense is recognized on a straight-line basis over the period of the lease. Rent expense amounted to approximately $954,000, $1,191,000 and $1,878,000 for the years ended December 31, 1999, 2000 and 2001, respectively. Deferred rent included in Other Long-term Liabilities amounted to $342,000 and $497,000 as of December 31, 2000 and 2001, respectively. The Company also recorded a loss in 2001 pertaining to its lease of an office space previously occupied by its wholly owned subsidiary in the amount of $526,000, which is included in Other Long-Term Liabilities.

At December 31, 2001, the Company's commitments under non-cancelable operating and capital leases were as follows:

Year Ending December 31,	Operating Leases	Capital Leases
2002	$ 1,505,000	$1,732,000
2003	1,553,000	1,821,000
2004	1,599,000	946,000
2005	1,639,000	—
2006	1,506,000	—
Thereafter	5,584,000	—
Total minimum lease payments	$ 13,386,000	4,499,000
Less amount representing interest		666,000
Net present value		3,833,000
Less current portion		1,308,000
Long-term portion		$2,525,000

In August 2000, the Company entered into a Transition Agreement and Amended and Restated License Agreement with a supplier, requiring a total of $9.1 million in payments based on various milestones through April 2001. All payments have been made as of December 31, 2001. Under the terms of the Agreements, the Company acquired fixed assets and manufacturing technology, which provided the Company with the ability to manufacture components previously purchased from the supplier. The Agreements require the Company to pay a per-unit royalty fee over a seventeen-year period. As of December 31, 2001, there was no royalty due under the terms of the agreement. As a result of these agreements, the Company and supplier mutually

terminated any obligations under their prior agreements. The total consideration of $9,100,000 was allocated as follows:

Fixed assets	$3,665,000
Intangible	3,663,000
Inventory	658,000
Expense	1,114,000
	$9,100,000

The fixed assets acquired are being depreciated over their useful lives, ranging from three to ten years. The intangible asset represents the license granted to the Company to use the former supplier's intellectual property for the design and manufacture of licensed product for use in microturbines. The intangible asset is being amortized over a period of ten years. Accumulated amortization of the intangible asset amounted to $78,000 and $448,000 as of December 31, 2000 and 2001, respectively.

As of December 31, 2000 and 2001, deposits on fixed assets amounted to $6,649,000 and $2,550,000, respectively. These deposits, made in the normal course of business, will be capitalized as fixed assets upon receipt of the assets.

In 2000, the United States Department of Energy ("DOE") awarded us $10 million under a Cooperative Agreement to develop an Advanced Microturbine System. The $10 million award is to be distributed over a five-year period. The program is estimated to cost $23 million over the five years, which would require the Company to provide approximately $13 million of its own R&D expenditures. As of December 31, 2001, the Company's remaining commitment to spend its own R&D expenditures under this award is approximately $12 million. In 2001, the Company was awarded a $3 million grant from DOE for the research, development and testing of packaged cooling, heating and power systems for buildings. The contract is estimated to cost $5.5 million over a three-year period, which would require the Company to provide approximately $2.5 million of its own R&D expenditures. As of December 31, 2001, the $2.5 million remains to be spent. The Company accounts for grant distributions as offset to R&D expenses. During 2000 and 2001, offsets to R&D expenses such as the DOE award amounted to $0.1 million and $2.1 million, respectively.

On February 11, 1998, the Company filed a complaint against a former employee, alleging trade secret misappropriation, breach of contract and other related causes of action in the Superior Court for the County of Orange, California. The former employee filed a cross-complaint alleging wrongful termination, breach of contract, and other related causes of action. The relief requested in the cross complaint included declaratory relief as well as lost earnings and incidental, general, special, and punitive damages, but none of these amounts were specified in the cross-complaint. We settled our claims against the former employee, receiving a permanent injunction that prevents that former employee from disclosing or using any confidential information. With respect to the cross-complaint, we prevailed on summary judgment in February 1999. The former employee filed a notice of appeal and the parties filed briefs on the issue. On February 27, 2002, the California Courts of Appeals ruled in favor of the Company and affirmed the trial court's grant of summary judgment.

In December 2001, a purported shareholder class action lawsuit was filed in the United States District Court for the Southern District of New York against the Company, two of its officers, and the underwriters of our initial public offering. The suit purports to be a class action filed on behalf of purchasers of our common stock during the period from June 28, 2000 to December 6, 2000. The complaint alleges that the underwriter defendants agreed to allocate stock in the Company's initial public offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the prospectus for the Company's initial public offering was false and misleading in violation of the securities laws because it did not disclose these arrangements. The Company understands that over three hundred other issuers have been named as

defendants in nearly identical lawsuits filed by some of the same plaintiffs' law firms. We intend to defend these actions vigorously. However, due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation. Any unfavorable outcome of litigation could have an adverse impact on our business, financial condition and results of operations.

We are involved in various other legal proceedings, claims, and litigation arising in the ordinary course of business, the outcome of which, in the opinion of management, will not have a material effect on our financial position or results of operations.

The Company has certain Supply and Distribution Agreements and Authorized Service Provider ("ASP") agreements that upon termination under specified conditions require the Company to repurchase particular elements of their parts inventories. To date, these conditions have never arisen and management believes the amounts of such parts inventories are currently not significant. It is possible, however, that in the future such conditions could occur that would require such repurchases. These repurchases could result in higher prices for the repurchased parts inventory than would otherwise be required to secure such quantities or could result in excess quantities of some inventory. In addition, certain ASP agreements require the Company to provide service to the customers of the ASP upon termination of the ASP agreement, under specified conditions, until such time that the Company can identify and transfer the obligation to a new ASP. Since we do not have control over the terms of such third party service agreements, we may be exposed to significant risks and expenses that we cannot adequately quantify. To date these conditions have never arisen, however any significant exposure from such third party service agreements in the future could have a material adverse effect on our results of operations and financial position.

8. Employee Benefit Plans

The Company maintains a defined contribution 401(k) profit-sharing plan in which all employees are eligible to participate. Employees may contribute up to 15 percent of their eligible compensation. Employees are fully vested in their contributions to the plan. The plan also provides for both Company matching and discretionary contributions, which are to be determined by the Board of Directors. No Company contributions have been made to the plan since its inception.

The Company has a deferred compensation plan providing eligible executives with the opportunity to participate in an unfunded, deferred compensation program. Under the program, participants may defer base compensation and bonuses and earn interest on their deferred amounts. The program is not qualified under Section 401 of the Internal Revenue Code. The total of participant deferrals and earnings thereon was $135,000 at December 31, 2001. The participant deferrals earn interest at prime interest rate set by Wells Fargo Bank plus 1% per year. The interest expense related to this plan was $1,000 in 2001. The total amount of deferrals and interest is included in Other Long-Term Liabilities.

9. Related Party Transactions

In 1999 and 2000, the Company entered into non-exclusive marketing agreements with various distributors. These agreements included product purchase and equity investment commitments in Series G preferred stock on behalf of the distributors. Sales to these distributors were $1.0 million and $2.0 million in 1999 and 2000, respectively, and deferred revenue amounted to approximately $4.2 million and $2.3 million as of December 31, 1999 and 2000, respectively. Promissory notes related to Series G preferred stock from these distributors amounted to $6.2 million as of December 31, 1999. As of December 31, 2001, none of these distributors owned more than 5% of the Company's common stock.

In 1999, the Company reacquired contractual marketing rights for certain territories from a former shareholder. As part of the agreement, the Company paid $5.0 million in 1999 and $4.0 million in January 2000. In February 2000, the Company issued 1,250,000 shares of Series G preferred stock with a fair value of

CAPSTONE TURBINE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

$8.3 million as part of the consideration paid to reacquire the marketing rights. Because the stock issuance was part of the consideration, it was recorded at its fair value in accordance with SFAS 123. In addition, the agreement for the repurchase of the marketing rights provided for the acceleration of future royalty payments in the event of an initial public offering. In July 2000, the Company paid $11.0 million in royalty payments, consisting of $204,000 in a previously recorded royalty liability and $10.8 million in an accelerated royalty liability. The Company recorded an intangible asset for the repurchase of marketing rights in the total amount of $28.0 million. Accumulated amortization amounted to $4.0 million and $9.4 million, as of December 31, 2000 and 2001, respectively. The marketing rights are being amortized over the original agreement period of 6 years and the Company recorded $104,000, $3.9 million and $5.3 million of amortization expense in selling, general, and administrative expenses for the fiscal years ended December 31, 1999, 2000 and 2001, respectively.

During 1999, the Company granted a lessor 40,606 common stock warrants. The fair value on the date of grant was approximately $61,000, which was recorded as additional paid-in capital.

During 2000, the Company loaned an aggregate of $300,000 to two of its then senior vice presidents. The current and non-current portions of the notes are included in Accounts Receivable and Other Assets, respectively. The loans were secured by deeds of trusts and bore interest at 6.80%. In 2001, $150,000 was collected on the two notes. The Company waived the accrued interest on the two notes. As of December 31, 2001, $150,000 of the principal amounts of the loans was outstanding, which was subsequently collected in January 2002.

In December 2001, the Company entered into a Separation and Consulting Agreement with its then Chief Financial Officer. The agreement provides, among other items, an acceleration of vesting of his then unvested common stock options and consulting fees through June 30, 2002. The Company recognized stock-based compensation of $548,000 in 2001 based upon the intrinsic value of the unvested options that became vested.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.***

Capstone had no changes in independent auditors during the fiscal years ended December 31, 2000 and 2001.

PART III

Item 10. ***Directors and Executive Officers of the Registrant.***

The information required by this Item 10 is incorporated by reference from Capstone's definitive proxy statement for its 2001 annual meeting of stockholders, scheduled to be held on May 30, 2002.

Item 11. ***Executive Compensation.***

The information required by this Item 11 is incorporated by reference from Capstone's definitive proxy statement for its 2001 annual meeting of stockholders, scheduled to be held on May 30, 2002.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management.***

The information required by this Item 12 is incorporated by reference from Capstone's definitive proxy statement for its 2001 annual meeting of stockholders, scheduled to be held on May 30, 2002.

Item 13. ***Certain Relationships and Related Transactions.***

The information required by this Item 13 is incorporated by reference from Capstone's definitive proxy statement for its 2001 annual meeting of stockholders, scheduled to be held on May 30, 2002.

PART IV

Item 14. ***Exhibits, Financial Statement Schedules, and Reports on Form 8-K.***

1. *Index to Financial Statements.*

2. *Financial Statement Schedule.*

3. *Index to Exhibits.*

The following exhibits are filed with, or incorporated by reference into, this Annual Report on Form 10-K:

Exhibit Number	Description
3.1(2)	Second Amended and Restated Certificate of Incorporation of Capstone Turbine.
3.2(2)	Amended and Restated Bylaws of Capstone Turbine.
4.1(2)	Specimen stock certificate.
9.1(2)	Investor Rights Agreement.
9.2(2)	Amendment No. 1 to Investors Rights Agreement.
9.3(3)	Amendment No. 2 to Investors Rights Agreement.
9.4(3)	Amendment No. 3 to Investors Rights Agreement.
10.1(2)	Lease between Capstone Turbine and Northpark Industrial — Leahy Division LLC, dated December 1, 1999, for leased premises at 21211 Nordhoff Street, Chatsworth, California.
10.2(2)	1993 Incentive Stock Option Plan.
10.3(2)	Employee Stock Purchase Plan.
10.4(2)	2000 Equity Incentive Plan.
10.5(4)	Transition Agreement, dated August 2, 2000, by and between Capstone Turbine and Solar Turbines Incorporated.
10.6(4)	Amended and Restated License Agreement, dated August 2, 2000, by and between Solar Turbines Incorporated and Capstone Turbine.
10.7(1)	Lease between Capstone Turbine and AMB Property, L.P., dated September 25, 2000, for leased premises at 16640 Stagg Street, Van Nuys, California.
10.8(1)	Lease between Capstone Turbine and AH Warner Center Properties, Limited Liability Company, dated February 16, 2001, for leased premises at 21700 Oxnard Street, Woodland Hills, California.
10.9(5)	Deferred Compensation Plan of Capstone Turbine
21.1(1)	List of Subsidiaries of Registrant.
23.1(1)	Consent of Deloitte & Touche LLP.
24.1(1)	Power of Attorney (included in the signature page of this Form 10-K).

(1) Filed herewith.

(2) Incorporated by reference to Capstone Turbine's Registration Statement on Form S-1 (File No. 333-33024).

(3) Incorporated by reference to Capstone Turbine's Registration Statement on Form S-1 (File No. 333-48524).

(4) Incorporated by reference to Capstone Turbine's Current Report on Form 8-K filed on October 16, 2000.

(5) Incorporated by reference to Capstone Turbine's Registration Statement on Form S-8 (File No. 333-66390)

(b) *Reports on Form 8-K.*

None

SIGNATURES

Pursuant to the requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 29th day of March, 2002.

CAPSTONE TURBINE CORPORATION

By: /s/ KAREN CLARK

Karen Clark
Senior Vice President,
Chief Financial Officer

KNOW ALL MEN BY THESE PRESENTS, that we, the undersigned officers and directors of Capstone Turbine Corporation, hereby severally constitute Ake Almgren and Karen Clark, and each of them singly, our true and lawful attorneys with full power to them, and each of them singly, to sign for us and in our names in the capacities indicated below, the Form 10-K filed herewith and any and all amendments to said Form 10-K, and generally to do all such things in our names and in our capacities as officers and directors to enable Capstone Turbine Corporation to comply with the provisions of the Securities Exchange Act of 1934, and all requirements of the Securities and Exchange Commission, hereby ratifying and confirming our signatures as they may be signed by our said attorneys, or any of them, to said Form 10-K and any and all amendments thereto.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on the 29th day of March, 2002 by the following persons on behalf of the Registrant and in the capacities indicated.

Signature	Title
/s/ DR. AKE ALMGREN Dr. Ake Almgren	Chief Executive Officer and Director (Principal Executive Officer)
/s/ KAREN CLARK Karen Clark	Chief Financial Officer (Principal Financial and Accounting Officer)
/s/ RICHARD AUBE Richard Aube	Director
/s/ JOHN JAGGERS John Jaggers	Director
/s/ JEAN-RENE MARCOUX Jean-Rene Marcoux	Director
/s/ JOHN G. MCDONALD John G. McDonald	Director
/s/ ERIC YOUNG Eric Young	Director

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders

Capstone Turbine Corporation:

We have audited the financial statements of Capstone Turbine Corporation as of December 31, 2000 and 2001, and for each of the three years in the period ended December 31, 2001, and have issued our report thereon dated March 28, 2002; included elsewhere in this Annual Report on Form 10-K. Our audits also included the financial statement schedule of Capstone Turbine Corporation listed in Item 14. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP

Los Angeles, California

March 28, 2002

SCHEDULE II

CAPSTONE TURBINE CORPORATION

VALUATION AND QUALIFYING ACCOUNTS

Three-Year Period Ended December 31, 2001

	Balance at Beginning of Year	Additions Charged to Operations	Deductions from Reserve	Balance at End of Year
Allowance for doubtful accounts year ended:				
December 31, 1999	$ 3,000	$ 50,000	$ 3,000	$ 50,000
December 31, 2000	50,000	35,000	—	85,000
December 31, 2001	85,000	160,000	82,000	163,000
Reserve for excess and obsolete inventories year ended:				
December 31, 1999	2,537,000	1,120,000	414,000	3,243,000
December 31, 2000	3,243,000	407,000	2,104,000	1,546,000
December 31, 2001	1,546,000	2,900,000	1,241,000	3,205,000
Warranty reserve year ended:				
December 31, 1999	873,000	2,643,000	348,000	3,168,000
December 31, 2000	3,168,000	4,569,000	2,148,000	5,589,000
December 31, 2001	5,589,000	2,391,000	3,835,000	4,145,000

EXHIBIT INDEX

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(5) Incorporated by reference to Capstone Turbine's Registration Statement on Form S-8 (File No. 333-66390)

Exhibit 10.7

INDUSTRIAL LEASE

by and between

AMB PROPERTY, L.P.
"LANDLORD"

and

CAPSTONE TURBINE CORPORATION
"TENANT"

Dated: September 25, 2000

TABLE OF CONTENTS

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TABLE OF CONTENTS

AMB PROPERTY CORPORATION
INDUSTRIAL LEASE

1. BASIC PROVISIONS ("Basic Provisions").

1.1 Parties: This Lease ("Lease") dated September 25, 2000, is made by and between AMB Property, L.P., a Delaware limited partnership, ("Landlord") and Capstone Turbine Corporation, a Delaware corporation, ("Tenant") (collectively, the "Parties" or individually, a "Party").

1.2 Premises The premises ("Premises") consist of:

[ ] Approximately square feet of space as depicted on Exhibit A. This space is a part of the building ("Building") which is also identified on Exhibit A.

or

[X] All of the building ("Building") identified on Exhibit A, consisting of approximately 78,711 square feet and commonly known as 16640 Stagg Street, Van Nuys, California.

If the Premises are all of the Building, there shall, for purposes of this

Lease, be no distinction between the words "Premises" or "Building."

1.3 Term: 10 years and 2 months ("Term") commencing October 1, 2000 ("Commencement Date") and ending December 31, 2010 ("Expiration Date").

1.4 Base Rent: $44,078.00 per month ("Base Rent"). $51,495.00 is payable on execution of this Lease for the period December 2000.

1.5 Tenant's Share of Operating Expenses ("Tenant's Share"):

(a) Building Operating Expenses 100%

1.6 Tenant's Estimated Monthly Rent Payment: Following is the estimated monthly Rent payment to Landlord pursuant to the provisions of this Lease. This estimate is made at the inception of the Lease and is subject to adjustment pursuant to the provisions of this Lease:

(a)	Base Rent (Paragraph 4.1)	$44,078.00
(b)	Operating Expenses (Paragraph 4.2, excluding Real Property Taxes, Landlord Insurance, and HVAC)	$ 3,000.00
(c)	Landlord Insurance (Paragraph 8.3)	$ 415.00
(d)	Real Property Taxes (Paragraph 10)	$ 4,002.00
(e)	HVAC maintenance (Paragraph 4.2)	$ -0-
	Estimated Monthly Payment	$51,495.00

1.7 Security Deposit: $44,078.00 ("Security Deposit").

1.8 Permitted Use ("Permitted Use"): Office, assembly, product testing (outside and inside), warehouse and distribution of micro-turbines, recuperators and related parts and for other general office, assembly, warehouse and distribution purposes provided they do not involve Hazardous Substances, as defined in this Lease and for no other purpose.

1.9 Guarantor: None

1.10 Addenda: Attached hereto are the following Addenda, all of which constitute a part of this Lease:

(a) Addenda: Rent Adjustment
(b) Addenda: Option to Extend
(c) Addenda: Addendum
(d) Addenda: Tenant Improvement Addendum

1.11 Exhibits: Attached hereto are the following Exhibits, all of which constitute a part of this Lease:

Exhibit A: Description of Premises.
Exhibit B: Commencement Date Certificate.
Exhibit C: Estoppel Certificate
Exhibit D: Hazardous Substances Questionnaire

1.12 Address for Rent Payments: All amounts payable by Tenant to Landlord shall, until further notice from Landlord, be paid to AMB Property Corporation at the following address:

AMB Property, L.P.
P.O. Box 840507
Dallas, TX 75284-0507

2. PREMISES AND COMMON AREAS.

2.1 Letting. Landlord hereby leases to Tenant and Tenant hereby leases from Landlord the Premises upon all of the terms, covenants, and conditions, set

forth in this Lease. Any statement of square footage set forth in this Lease or that may have been used in calculating Base Rent and/or Operating Expenses is an approximation which Landlord and Tenant agree is reasonable, and the Base Rent and Tenant's Share based thereon is not subject to revision whether or not the actual square footage is more or less.

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2.2 Condition of Premises. Landlord shall deliver the Premises to Tenant clean and free of debris on the Commencement Date. Landlord represents and warrants to Tenant that the roof shall be water-tight and the plumbing, lighting, ceiling, interior and exterior walls, electrical, air conditioning, fire-sprinklers, heating, ventilating and other mechanical systems and equipment and fixtures in the Premises, and the loading doors shall be in good operating condition on the Commencement Date. Without limitation to Landlord's obligations as set forth in Paragraph 7.2, in the event that Tenant gives notice to Landlord within 6 months following the Commencement Date of any defect or malfunction in or repair reasonably needed to any of the aforementioned items or systems, as long as not caused by Tenant, then it shall be the obligation of Landlord to promptly, at Landlord's sole cost and expense, perform such work.

3. TERM.

3.1 Term. The Commencement Date, Expiration Date, and Term of this Lease are as specified in Paragraph 1.3.

3.2 Delay in Possession. If for any reason Landlord cannot deliver possession of the Premises to Tenant by the Commencement Date, except as provided below, Landlord shall not be subject to any liability therefor, nor shall such failure affect the validity of this Lease or the obligations of Tenant hereunder. In such case, Tenant shall not, except as otherwise provided herein, be obligated to pay Rent or perform any other obligation of Tenant under the terms of this Lease until Landlord delivers possession of the Premises to Tenant. The term of the Lease shall commence on the earlier of (a) the date Tenant takes possession of the Premises or (b) 10 days following notice to Tenant that Landlord is prepared to tender possession of the Premises to Tenant. If possession of the Premises is not delivered to Tenant within 60 days after the Commencement Date and such delay is not due to Tenant's acts, failure to act, or omissions, Tenant shall have the option to either (i) by notice in writing to Landlord within 10 days after the end of said 60-day period cancel this Lease and the parties shall be discharged from all obligations hereunder; or (ii) elect not to cancel this Lease, in which case Tenant shall receive rent abatement, to be applied to the rent coming due when the term of the Lease commences, equal to one day for each day following such sixtieth (60th) day that Landlord fails to deliver the Premises to Tenant If such written notice of Tenant's cancellation under (i) above is not received by Landlord within said 10-day period, Tenant's right to cancel this Lease shall terminate and Tenant shall be deemed to have elected option (ii) above.

3.3 Commencement Date Certificate. At the request of Landlord, Tenant shall execute and deliver to Landlord a completed certificate ("Commencement Date Certificate") in the form attached hereto as Exhibit B.

4. RENT.

4.1 Base Rent. Tenant shall pay to Landlord Base Rent and other monetary obligations of Tenant to Landlord under the terms of this Lease (such other monetary obligations are herein referred to as "Additional Rent") in lawful money of the United States, without offset or deduction, in advance on or before the first day of each month. Base Rent and Additional Rent for any period during the term hereof which is for less than one full month shall be prorated based upon the actual number of days of the month involved. Payment of Base Rent and Additional Rent shall be made to Landlord at its address stated herein or to such other persons or at such other addresses as Landlord may from time to time designate in writing to Tenant. Base Rent and Additional Rent are collectively referred to as "Rent." All monetary obligations of Tenant to Landlord under the terms of this Lease are deemed to be Rent.

4.2 Operating Expenses. Tenant shall pay to Landlord on the first day of each month during the term hereof, in addition to the Base Rent, Tenant's Share of all Operating Expenses in accordance with the following provisions:

(a) "Operating Expenses" are all reasonable costs incurred by Landlord relating to the ownership and operation of the Premises including, but not limited to, the following:

(i) The operation, repair, maintenance, and replacement in neat, clean, good order, and condition of the areas of the Premises Landlord is obligated to maintain under this Lease.

(ii) Property management.

(iii) Reserves set aside for maintenance, repair, and replacement of the Building.

(iv) Real Property Taxes.

(v) Premiums for the insurance policies maintained by Landlord under Paragraph 8 hereof.

(vi) Environmental monitoring and insurance programs, but only in the event that such monitoring is required by the acts or omissions of Tenant or its agents.

(vii) Monthly amortization of capital improvements to the Building. The monthly amortization of any given capital improvement shall be the sum of the (a) quotient obtained by dividing the cost of the capital improvement by Landlord's estimate of the number of months of useful life of such improvement plus (b) an amount equal to the cost of the capital improvement times 1/12 of the lesser of 12% or the maximum annual interest rate permitted by law.

(viii) Maintenance of the Building including, but not limited to, painting, caulking, and repair and replacement of Building components, including, but not limited to, roof, elevators, and fire detection and sprinkler systems.

(ix) Maintenance, repair and replacement of the heating, ventilating, and air conditioning systems ("HVAC").

(b) Tenant's Share of Operating Expenses shall be 100%.

(c) Tenant shall pay monthly in advance, on the same day that the Base Rent is due, Tenant's Share of estimated Operating Expenses and HVAC maintenance costs in the amount set forth in Paragraph 1.6. Landlord shall deliver to Tenant within 90 days after the expiration of each calendar year a reasonably detailed statement showing Tenant's Share of the actual Operating Expenses incurred during the preceding year. If Tenant's estimated payments under this Paragraph 4(c) during the preceding year exceed Tenant's Share as indicated on said statement, Tenant shall be credited the amount of such overpayment against Tenant's Share of Operating Expenses next becoming due, or, if such amount is owing at the end of Lease term, such amount shall be paid within 30 days following the end of the Lease term. If Tenant's estimated payments under this Paragraph 4.2(c) during said preceding year were less than Tenant's Share as indicated on said statement, Tenant shall pay to Landlord the amount of the deficiency within 30 days after delivery by Landlord to Tenant of said statement. At any time Landlord may, in the exercise of its reasonable judgment, adjust the amount of the estimated Tenant's Share of Operating Expenses and HVAC maintenance costs to reflect Landlord's estimate of such expenses for the year.

5. SECURITY DEPOSIT. Tenant shall deposit with Landlord upon Tenant's execution hereof the Security Deposit set forth in Paragraph 1.7 as security for Tenant's faithful performance of Tenant's obligations under this Lease. If Tenant fails to pay Base Rent or Additional Rent or otherwise defaults under this Lease (as defined in paragraph 13.1), landlord may use the security deposit for the payment of any amount due Landlord or to reimburse or compensate Landlord for any liability, cost, expense, loss, or damage (including attorneys' fees) which Landlord may suffer or incur by reason thereof. Tenant shall on demand pay Landlord the amount so used or applied so as to restore the Security Deposit to the amount set forth in Paragraph 1.7. Landlord shall not be required to keep all or any part of the Security Deposit separate from its general accounts. Landlord shall, at the expiration or earlier termination of the term hereof and after Tenant has vacated the Premises, return to Tenant that portion of the Security Deposit not used or applied by Landlord. No part of the Security Deposit shall be considered to be held in trust, to bear interest, or to be prepayment for any monies to be paid by Tenant under this Lease.

6. USE.

6.1 Permitted Use. Tenant shall use and occupy the Premises only for the Permitted Use set forth in Paragraph 1.8. Tenant shall not commit any nuisance, permit the emission of any objectionable noise or odor, suffer any waste, make any use of the Premises which is

contrary to any law or ordinance, or which will invalidate or increase the premiums for any of Landlord's insurance. Tenant shall not service, maintain, or repair vehicles on the Premises. Tenant shall not store foods, pallets, drums, or any other materials outside the Premises. Notwithstanding the foregoing,

Tenant shall be permitted, provided such use is not in violation of any law or ordinance and such use is screened from view by screening reasonably acceptable to Landlord, to use the exterior areas of the Premises for the purposes of product testing and uses related to such product testing.

6.2 Hazardous Substances.

(a) Reportable Uses Require Consent. The term, "Hazardous Substance," as used in this Lease, shall mean any product, substance, chemical, material, or waste whose presence, nature, quantity, and/or intensity of existence, use, manufacture, disposal, transportation, spill, release, or effect, either by itself or in combination with other materials expected to be on the Premises, is either: (i) potentially injurious to the public health, safety or welfare, the environment, or the Premises; (ii) regulated or monitored by any governmental authority; or (iii) a basis for potential liability of Landlord to any governmental agency or third party under any applicable statute or common law theory. Hazardous Substance shall include, but not be limited to, hydrocarbons, petroleum, gasoline, crude oil, or any products or by-products thereof. Tenant shall not engage in any activity in or about the Premises which constitutes a Reportable Use (as hereinafter defined) of Hazardous Substances without the express prior written consent of Landlord and compliance in a timely manner (at Tenant's sole cost and expense) with all Applicable Requirements (as defined in Paragraph 6.3). "Reportable Use" shall mean (i) the installation or use of any above or below ground storage tank, (ii) the generation, possession, storage, use, transportation, or disposal of a Hazardous Substance that requires a permit from, or with respect to which a report, notice, registration, or business plan is required to be filed with, any governmental authority, and (iii) the presence in, on, or about the Premises of a Hazardous Substance with respect to which any Applicable Requirements require that a notice be given to persons entering or occupying the Premises or neighboring properties. Notwithstanding the foregoing, Tenant may, without Landlord's prior consent, but upon notice to Landlord and in compliance with all Applicable Requirements, use any ordinary and customary materials reasonably required to be used by Tenant in the normal course of the Permitted Use, so long as such use is not a Reportable Use and does not expose the Premises or neighboring properties to any meaningful risk of contamination or damage, or expose Landlord to any liability therefor. In addition, Landlord may (but without any obligation to do so) condition its consent to any Reportable Use of any Hazardous Substance by Tenant upon Tenant's giving Landlord such additional assurances as Landlord, in its reasonable discretion, deems necessary to protect itself, the public, the Premises, and the environment against damage, contamination, injury, and/or liability therefor, including but not limited to the installation (and, at Landlord's option, removal on or before Lease expiration or earlier termination) of reasonably necessary protective modifications to the Premises (such as concrete encasements) and/or the deposit of an additional Security Deposit.

(b) Duty to Inform Landlord. If Tenant knows, or has reasonable cause to believe, that a Hazardous Substance is located in, under, or about the Premises or the Building, Tenant shall immediately give Landlord written notice thereof, together with a copy of any statement, report, notice, registration, application, permit, business plan, license, claim, action, or proceeding given to, or received from, any governmental authority or private party concerning the presence, spill, release, discharge of, or exposure to such Hazardous Substance. Tenant shall not cause or permit any Hazardous Substance to be spilled or released in, on, under, or about the Premises (including, without limitation, through the plumbing or sanitary sewer system).

(c) Indemnification. Tenant shall indemnify, protect, defend, and hold Landlord, Landlord's affiliates, Lenders, and the officers, directors, shareholders, partners, employees, managers, independent contractors, attorneys, and agents of the foregoing ("Landlord Entities") and the Premises harmless from and against any and all damages, liabilities, judgments, costs, claims, liens, expenses, penalties, loss of permits, and attorneys' and consultants' fees arising out of or involving any Hazardous Substance on or brought onto the Premises by or for Tenant or by any of Tenant's employees, agents, contractors, servants, visitors, suppliers, or invitees (such employees, agents, contractors, servants, visitors, suppliers, and invitees as herein collectively referred to as "Tenant Entities"). Tenant's obligations under this Paragraph 6.2(c) shall include, but not be limited to, the effects of any contamination or injury to person, property, or the environment created or suffered by Tenant, and the cost of investigation (including consultants' and attorneys' fees and testing), removal, remediation,

restoration and/or abatement thereof, or of any contamination therein involved. Tenant's obligations under this Paragraph 6.2(c) shall survive the Expiration Date or earlier termination of this Lease.

6.3 Tenant's Compliance with Requirements. Tenant shall, at Tenant's sole cost and expense, fully, diligently, and in a timely manner comply with all "Applicable Requirements," which term is used in this Lease to mean all laws,

rules, regulations, ordinances, directives, covenants, easements, and restrictions of record, permits, the requirements of any applicable fire insurance underwriter or rating bureau, and the reasonable recommendations of Landlord's engineers and/or consultants, relating in any manner to the Premises (including but not limited to matters pertaining to (a) industrial hygiene, (b) environmental conditions on, in, under, or about the Premises, including soil and groundwater conditions, and (c) the use, generation, manufacture, production, installation, maintenance, removal, transportation, storage, spill, or release of any Hazardous Substance), now in effect or which may hereafter come into effect. Tenant shall, within 5 days after receipt of Landlord's written request, provide Landlord with copies of all documents and information evidencing Tenant's compliance with any Applicable Requirements, and shall immediately upon receipt notify Landlord in writing (with copies of any documents involved) of any claim, notice, citation, warning, complaint, or report pertaining to or involving failure by Tenant or the Premises to comply with any Applicable Requirements.

6.4 Inspection; Compliance with Law. In addition to Landlord's environmental monitoring and insurance program, the cost of which is included in Operating Expenses as provided in Paragraph 4, Landlord and the holders of any mortgages, deeds of trust, or ground leases on the Premises ("Lenders") shall have the right to enter the Premises at any time in the case of an emergency, and otherwise at reasonable times, for the purpose of inspecting the condition of the Premises and for verifying compliance by Tenant with this Lease and all Applicable Requirements. Landlord shall be entitled to employ experts and/or consultants in connection therewith to advise Landlord with respect to Tenant's installation, operation, use, monitoring, maintenance, or removal of any Hazardous Substance on or from the Premises. The cost and expenses of any such inspections shall be paid by the party requesting same unless a violation of Applicable Requirements exists or is imminent, or the inspection is requested or ordered by a governmental authority. Tenant shall upon request reimburse Landlord or Landlord's Lender, as the case may be, for the costs and expenses of such inspections.

7. MAINTENANCE, REPAIRS, TRADE FIXTURES AND ALTERATIONS.

7.1 Tenant's Obligations. Subject to the provisions of Paragraph 2.6 (Condition of the Premises, Paragraph 7.2 (Landlord's Obligations), Paragraph 9 (Damage or Destruction), and Paragraph 14 (Condemnation), Tenant shall, at Tenant's sole cost and expense and at all times, keep the Premises and every part thereof in good order, condition, and repair (whether or not such portion of the Premises requiring repair, or the means of repairing the same, are reasonable or readily accessible to Tenant and whether or not the need for such repairs occurs as a result of Tenant's use, any prior use, the elements, or the age of such portion of the Premises) including, without limiting the generality of the foregoing, all equipment or facilities specifically serving the Premises, such as plumbing, heating, ventilating, electrical, lighting facilities, boilers, fired or unfired pressure vessels, fire hose connectors if within the Premises, fixtures, interior walls, interior surfaces of exterior walls, ceilings, floors, windows, doors, plate glass, and skylights, but excluding any items which are the responsibility of Landlord pursuant to Paragraph 7.2 below. Tenant's obligations shall include restorations, replacements, or renewals when necessary to keep the Premises and all improvements thereon or a part thereof in good order, condition, and state of repair.

7.2 Landlord's Obligations. Subject to the provisions of Paragraph 6 (Use), Paragraph 7.1 (Tenant's Obligations), Paragraph 9 (Damage or Destruction), and Paragraph 14 (Condemnation), Landlord, at its expense and not subject to the reimbursement requirements of Paragraph 4.2, shall keep in good order, condition, and repair the roof structure, foundations and exterior walls of the Building. Landlord, subject to reimbursement pursuant to Paragraph 4.2, shall keep in good order, condition, and repair the air conditioning systems servicing the Premises, Building roof membrane, and Common Areas.

7.3 Alterations. Tenant shall not make nor cause to be made any alterations or installations in, on, under, or about the Premises without the prior written consent of Landlord which will not be unreasonably withheld or delayed.

7.4 Surrender/Restoration. Tenant shall surrender the Premises by the end of the last day of the Lease term or any earlier termination date, clean and free of debris and in good operating order, condition, and state of repair, ordinary wear and tear excepted. Without limiting

the generality of the above, Tenant shall remove all Alterations designated by Landlord in Landlord's sole discretion, personal property, trade fixtures, and floor bolts, patch all floors, and cause all lights to be in good operating condition. Notwithstanding the foregoing, Tenant by written notice to Landlord may require, prior to the installation of any Alterations, that Landlord elect

whether such Alterations must be removed at the end of the Lease term or whether Tenant shall have the option of removing such Alterations at the end of the Lease term, and Landlord shall make such election within 20 days following Landlord's receipt such written notice.

8. INSURANCE; INDEMNITY.

8.1 Payment of Premiums. The cost of the premiums for the insurance policies maintained by Landlord under this Paragraph 8 shall be an Operating Expense reimbursable pursuant to Paragraph 4.2 hereof. Premiums for policy periods commencing prior to, or extending beyond, the term of this Lease shall be prorated to coincide with the corresponding Commencement Date and Expiration Date.

8.2 Tenant's Insurance.

(a) At its sole cost and expense, Tenant shall maintain in full force and effect during the Term of the Lease the following insurance coverages insuring against claims which may arise from or in connection with the Tenant's operation and use of the Premises.

(i) Commercial General Liability insurance with minimum limits of $1,000,000 per occurrence and $3,000,000 general aggregate for bodily injury, personal injury, and property damage. If required by Landlord, liquor liability coverage will be included. Such insurance shall be endorsed to include Landlord and Landlord Entities as additional insureds, shall be primary and noncontributory with any Landlord insurance, and shall provide severability of interests between or among insureds.

(ii) Workers' Compensation insurance with statutory limits and Employers Liability with a $1,000,000 per accident limit for bodily injury or disease.

(iii) Automobile Liability insurance covering all owned, nonowned, and hired vehicles with a $1,000,000 per accident limit for bodily injury and property damage.

(iv) Property insurance against "all risks" at least as broad as the current ISO Special Form policy, including earthquake and flood, for loss to any tenant improvements or betterments, floor and wall coverings, and business personal property (except for earthquake and flood coverage) on a full insurable replacement cost basis with no coinsurance clause, and Business Income insurance covering at least six months of loss of income and continuing expense.

(b) Tenant shall deliver to AMB certificates of all insurance reflecting evidence of required coverages prior to initial occupancy, and annually thereafter.

(c) If, in the opinion of Landlord's insurance advisor, the amount or scope of such coverage is deemed inadequate at any time during the Term, Tenant shall increase such coverage to such reasonable amounts or scope as Landlord's advisor deems adequate and which are customary for premises of the size and location of the Premises.

(d) All insurance required under Paragraph 8.2 (i) shall be issued by insurers licensed to do business in the state in which the Premises are located and which are rated A:VII or better by Best's Key Rating Guide and (ii) shall be endorsed to provide at least 30-days prior notification of cancellation or material change in coverage to said additional insureds.

8.3 Landlord's Insurance. Landlord shall maintain "all risks" coverage as broad as the current ISO Special Form policy, including earthquake and flood, covering Building and such other insurance in such amounts and covering such other liability or hazards as deemed appropriate by Landlord. The amount and scope of coverage of Landlord's insurance shall be determined by Landlord from time to time in its sole discretion and shall be subject to such reasonable deductible amounts as Landlord may elect. Except as to the "all risks" coverage for the Building, Landlord shall have the right to reduce or terminate any insurance or coverage.

8.4 Waiver of Subrogation. To the extent permitted by law and with permission of their insurance carriers, Landlord and Tenant each waive any right to recover against the other on account of any and all claims Landlord or Tenant may have against the other with respect to property insurance actually carried, or required to be carried hereunder, to the extent of the proceeds realized from such insurance coverage.

8.5 Indemnity. Tenant shall protect, defend, indemnify, and hold Landlord and Landlord Entities harmless from and against any and all loss, claims, liability, or costs (including court costs and attorneys' fees) incurred by reason of:

(a) any damage to any property (including but not limited to

property of any Landlord Entity) or death, bodily, or personal injury to any person occurring in or about the

Premises, the Building, or the Industrial Center to the extent that such injury or damage shall be caused by or arise from any actual or alleged act, neglect, fault, or omission by or of Tenant, its agents, servants, employees, invitees, contractors, suppliers, subtenants, or visitors;

(b) the conduct or management of any work or anything whatsoever done by the Tenant on or about the Premises or from transactions of the Tenant concerning the Premises;

(c) Tenant's failure to comply with any and all governmental laws, ordinances, and regulations applicable to the condition or use of the Premises or its occupancy; or

(d) any breach or default on the part of Tenant in the performance of any covenant or agreement to be performed pursuant to this Lease.

The provisions of this Paragraph 8.5 shall, with respect to any claims or liability accruing prior to such termination, survive the Expiration Date or earlier termination of this Lease.

8.6 Exemption of Landlord from Liability. Except to the extent caused by the gross negligence or willful misconduct of Landlord, Landlord shall not be liable for and Tenant waives any claims against Landlord for injury or damage to the person or the property of Tenant, Tenant Entities, or any other person in or about the Premises, Building, or Industrial Center from any cause whatsoever, including, but not limited to, damage or injury which is caused by or results from (a) fire, steam, electricity, gas, water, or rain, or from the breakage, leakage, seepage, back up of sewers or drains, obstruction, or other defects of pipes, fire sprinklers, wires, appliances, plumbing, air conditioning, or lighting fixtures or (b) from the condition of the Premises, other portions of the Building, or Industrial Center. Landlord shall not be liable for any damages arising from any act or neglect of any other tenant of Landlord nor from the failure by Landlord to enforce the provisions of any other lease of which Landlord is the landlord. Except with respect to Landlord's gross negligence or willful misconduct, Landlord shall not be liable for injury to Tenant's business, for any loss of income or profit therefrom, or any indirect, consequential, or punitive damages.

9. DAMAGE OR DESTRUCTION.

9.1 Termination Right. Tenant shall give Landlord immediate written notice of any damage to the Premises. Subject to the provisions of Paragraph 9.2, if the Premises or the Building shall be damaged to such an extent that there is substantial interference for a period exceeding 90 consecutive days with the conduct by Tenant of its business at the Premises, Tenant, at any time prior to commencement of repair of the Premises and following 10 days written notice to Landlord, may terminate this Lease effective 30 days after delivery of such notice to Landlord. Such termination shall not excuse the performance by Tenant of those covenants which under the terms hereof survive termination. Rent shall be abated in proportion to the degree of interference during the period that there is such substantial interference with the conduct of Tenant's business at the Premises. Abatement of rent and Tenant's right of termination pursuant to this provision shall be Tenant's sole remedy for Tenant's loss of beneficial use of the Premises due to the failure of Landlord to keep in good order, condition, and repair the foundations and exterior walls of the Building, Building roof, utility systems outside the Building, the Common Areas, and HVAC.

9.2 Damage Caused by Tenant. Tenant's termination rights under Paragraph 9.1 shall not apply if the damage to the Premises or Building is the result of any act or omission of Tenant or of any of Tenant's, agents, employees, customers, invitees, or contractors ("Tenant Acts"). Any damage resulting from a Tenant Act shall be promptly repaired by Tenant. Landlord at its option may at tenant's expense repair any damage caused by tenant acts. Tenant shall continue to pay all rent and other sums due hereunder and shall be liable to Landlord for all damages that Landlord may sustain resulting from a Tenant Act. This section shall not apply to any damage covered by Landlord's insurance pursuant to Section 8.3.

10. REAL PROPERTY TAXES.

10.1 Payment of Real Property Taxes. Landlord shall pay the Real Property Taxes due and payable during the term of this Lease and, except as otherwise provided in Paragraph 10.3, such payments shall be a Common Area Operating Expense reimbursable pursuant to Paragraph 4.2. Notwithstanding the foregoing, there shall be excluded from Real Property Taxes: (i) all excess profits taxes, franchise taxes, gift taxes, capital stock taxes, inheritance and

succession taxes, estate taxes, federal and state income taxes, and other taxes to the extent applicable to Landlord's general or net income (as opposed to rents, receipts, or income attributable to operations at the project), and (ii) any items included as operating expenses.

10.2 Real Property Tax Definition. As used herein, the term "Real Property Taxes" is any form of tax or assessment, general, special, ordinary, or extraordinary, imposed or levied upon (a) the Industrial Center or Building, (b) any interest of Landlord in the Industrial Center or

Building, (c) Landlord's right to rent or other income from the Industrial Center or Building, and/or (d) Landlord's business of leasing the Premises. Real Property Taxes include (a) any licenses fee, commercial rental tax, excise tax, improvement bond or bonds, levy, or tax; (b) any tax or charge which replaces or is in addition to any of such above-described "Real Property Taxes," and (c) any fees, expenses, or costs (including attorneys' fees, expert fees, and the like) incurred by Landlord in protesting or contesting any assessments levied or any tax rate. Real Property Taxes for tax years commencing prior to, or extending beyond, the term of this Lease shall be prorated to coincide with the corresponding Commencement Date and Expiration Date.

10.3 Additional Improvements. Operating Expenses shall not include Real Property Taxes attributable to improvements placed upon the Building by Landlord unless requested by Tenant. Tenant shall, however, pay to Landlord at the time Operating Expenses are payable under Paragraph 4.2, the entirety of any increase in Real Property Taxes if assessed by reason of improvements placed upon the Premises by Tenant or at Tenant's request.

10.4 Joint Assessment. If the Building is not separately assessed, Real Property Taxes allocated to the Building shall be an equitable proportion of the Real Property Taxes for all of the land and improvements included within the tax parcel assessed.

10.5 Tenant's Property Taxes. Tenant shall pay prior to delinquency all taxes assessed against and levied upon Tenant's improvements, fixtures, furnishings, equipment, and all personal property of Tenant contained in the Premises.

11. UTILITIES. Tenant shall pay directly for all utilities and services supplied to the Premises, including but not limited to electricity, telephone, security, gas, and cleaning of the Premises, together with any taxes thereon.

12. ASSIGNMENT AND SUBLETTING

12.1 Landlord's Consent Required.

(a) Tenant shall not assign, transfer, mortgage, or otherwise transfer or encumber (collectively, "assign") or sublet all or any part of Tenant's interest in this Lease or in the Premises without Landlord's prior written consent, which consent shall not be unreasonably withheld. Relevant criteria in determining reasonability of consent include, but are not limited to, credit history of a proposed assignee or sublessee, references from prior landlords, any change or intensification of use of the Premises or the Common Areas, and any limitations imposed by the Internal Revenue Code and the Regulations promulgated thereunder relating to Real Estate Investment Trusts. Assignment or sublet shall not release Tenant from its obligations hereunder. Tenant shall not (i) sublet, assign, or enter into other arrangements in which the amounts to be paid by the sublessee or assignee thereunder would be based, in whole or in part, on the income or profits derived by the business activities of the sublessee or assignee; (ii) sublet the Premises or assign this Lease to any person or entity in which Landlord owns an interest, directly or indirectly (by applying constructive ownership rules set forth in Section 856(d)(5) of the Internal Revenue Code (the "Code"); or (iii) sublet the Premises or assign this Lease in any other manner which could cause any portion of the amounts received by Landlord pursuant to this Lease or any sublease to fail to qualify as "rents from real property" within the meaning of Section 856(d) of the Code, or which could cause any other income received by Landlord to fail to qualify as income described in Section 856(c)(2) of the Code. The requirements of this Section 12.1 shall apply to any further subleasing by any subtenant. Notwithstanding the foregoing, in the event of any assignment or subletting to which Landlord consents, Landlord shall receive fifty percent (50%), in the event of a sublease, of any rent received by Tenant above the rent then being paid by Tenant to Landlord less: (i) rent obligations paid by Tenant hereunder during any period when the Premises were vacant following the marketing of the Premises for such sublease; (ii) the costs of any tenant improvements made or allowance given to the subtenant for tenant improvements; (iii) any free rent or other economic concessions given the subtenant; and (iv) any commissions or marketing expense paid by Tenant for such sublease. In addition, Landlord shall receive fifty percent (50%), in the event of an assignment, of any profit derived by Tenant from such assignment less any commissions or marketing expense paid by

Tenant for such assignment. In the event of any assignment or subletting, Tenant shall pay to Landlord or its authorized managing agent (as directed by Landlord) a fee of $750.00 to cover Landlord's costs of review, negotiation, preparation or execution of any documentation regarding such assignment or subletting. Notwithstanding the foregoing, Tenant may sublease up to 50% of the Premises, pursuant to this Section, and Landlord shall not receive any portion of the profit derived from such sublease. Landlord shall approve or disapprove a proposed sublease of up to 50% of the Premises within ten (10) days following receipt of Tenant's written request.

(b) A change in the control of Tenant shall constitute an assignment requiring Landlord's consent. The transfer, on a cumulative basis, of 25% or more of the voting or management control of Tenant shall constitute a change in control for this purpose, provided that changes resulting from the sale of stock through a recognized stock exchange shall not constitute a change of control hereunder.

12.2 Non-Transfers. The term "Affiliate" shall mean any entity which is controlled by controls, or is under common control with, Tenant or which merges with, is acquired by, or acquires all of Tenant's assets or stock. "Control," as used in this Paragraph 12.2, shall mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person or entity, whether through the ownership of voting securities, by contract or otherwise. Notwithstanding anything to the contrary contained in this Paragraph 12, an assignment or subletting of all or a portion of the Premises to an "Affiliate" of Tenant shall not be deemed a Transfer under this Paragraph 12, provided that Tenant notifies Landlord of any such assignment or sublease and promptly supplies Landlord with any documents or information reasonably required by Landlord regarding such assignment or sublease or such Affiliate, and further provided that such assignment or sublease is not a subterfuge by Tenant to avoid its obligations and Tenant remains liable under this Lease.

13. DEFAULT; REMEDIES.

13.1 Default. The occurrence of any one of the following events shall constitute an event of default on the part of Tenant ("Default"):

(a) The abandonment of the Premises by Tenant;

(b) Failure to pay any installment of Base Rent, Additional Rent, or any other monies due and payable hereunder, said failure continuing for a period of 5 days after Tenant receives notices that such payment was not received when due, which notice shall be in lieu of and not in addition to any notice required by statute;

(c) A general assignment by Tenant or any guarantor for the benefit of creditors;

(d) The filing of a voluntary petition of bankruptcy by Tenant or any guarantor; the filing of a voluntary petition for an arrangement; the filing of a petition, voluntary or involuntary, for reorganization; or the filing of an involuntary petition by Tenant's creditors or guarantors;

(e) Receivership, attachment, of other judicial seizure of the Premises or all or substantially all of Tenant's assets on the Premises;

(f) Failure of Tenant to maintain insurance as required by Paragraph 8.2;

(g) Any breach by Tenant of its covenants under Paragraph 6.2;

(h) Failure in the performance of any of Tenant's covenants, agreements, or obligations hereunder (except those failures specified as events of Default in other Paragraphs of this Paragraph 13.1 which shall be governed by such other Paragraphs), which failure continues for 20 days after written notice thereof from Landlord to Tenant; provided that, if Tenant has exercised reasonable diligence to cure such failure and such failure cannot be cured within such 20-day period despite reasonable diligence, tenant shall not be in default under this subparagraph unless Tenant fails thereafter diligently and continuously to prosecute the cure to completion;

13.2 Remedies. In the event of any Default by Tenant, Landlord shall have any or all of the following remedies:

(a) Termination. In the event of any Default by Tenant, then in addition to any other remedies available to Landlord at law or in equity and under this Lease, Landlord shall have the immediate option to terminate this Lease and all rights of Tenant hereunder by giving written notice of such

intention to terminate. In the event that Landlord shall elect to so terminate this Lease then Landlord may recover from Tenant:

(1) the worth at the time of award of any unpaid Rent and any other sums due and payable which have been earned at the time of such termination; plus

(2) the worth at the time of award of the amount by which the unpaid Rent and any other sums due and payable which would have been earned after termination until the time of award exceeds the amount of such rental loss Tenant proves could have been reasonably avoided; plus

(3) the worth at the time of award of the amount by which the unpaid Rent and any other sums due and payable for the balance of the term of this Lease after the time of award exceeds the amount of such rental loss that Tenant proves could be reasonably avoided; plus

(4) any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which in the ordinary course would be likely to result therefrom, including, without limitation, any costs or expenses incurred by Landlord (i) in retaking possession of the Premises; (ii) in maintaining, repairing, preserving, restoring, replacing, cleaning, the Premises or any portion thereof, including such acts for reletting to a new lessee or lessees; (iii) for leasing commissions; or (iv) for any other costs necessary or appropriate to relet the Premises; plus

(5) such reasonable attorneys' fees incurred by Landlord as a result of a Default, and costs in the event suit is filed by Landlord to enforce such remedy; and plus

(6) at Landlord's election, such other amounts in addition to or in lieu of the foregoing as may be permitted from time to time by applicable law. As used in subparagraphs (1) and (2) above, the "worth at the time of award" is computed by allowing interest at an annual rate equal to twelve percent (12%) per annum or the maximum rate permitted by law, whichever is less. As used in subparagraph (3) above, the "worth at the time of award" is computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award, plus one percent (1 %). Tenant waives redemption or relief from forfeiture under California Code of Civil Procedure Sections 1174 and 1179, or under any other present or future law, in the event Tenant is evicted or Landlord takes possession of the Premises by reason of any Default of Tenant hereunder.

(b) Continuation of Lease. In the event of any Default by Tenant, then in addition to any other remedies available to Landlord at law or in equity and under this Lease, Landlord shall have the remedy described in California Civil Code Section 1951.4 (Landlord may continue this Lease in effect after Tenant's Default and abandonment and recover Rent as it becomes due, provided tenant has the right to sublet or assign, subject only to reasonable limitations).

(c) Re-entry. In the event of any Default by Tenant, Landlord shall also have the right, with or without terminating this Lease, in compliance with applicable law, to re-enter the Premises and remove all persons and property from the Premises; such property may be removed and stored in a public warehouse or elsewhere at the cost of and for the account of Tenant.

(d) Reletting. In the event of the abandonment of the Premises by Tenant or in the event that Landlord shall elect to re-enter or shall take possession of the Premises pursuant to legal proceeding or pursuant to any notice provided by law, then if Landlord does not elect to terminate this Lease as provided in Paragraph a, Landlord may from time to time, without terminating this Lease, relet the Premises or any part thereof for such term or terms and at such rental or rentals and upon such other terms and conditions as Landlord in its sole discretion may deem advisable with the right to make alterations and repairs to the Premises. In the event that Landlord shall elect to so relet, then rentals received by Landlord from such reletting shall be applied in the following order: (1) to reasonable attorneys' fees incurred by Landlord as a result of a Default and costs in the event suit is filed by Landlord to enforce such remedies; (2) to the payment of any indebtedness other than Rent due hereunder from Tenant to Landlord; (3) to the payment of any costs of such reletting; (4) to the payment of the costs of any alterations and repairs to the Premises; (5) to the payment of Rent due and unpaid hereunder; and (6) the residue, if any, shall be held by landlord and applied in payment of future Rent and other sums payable by Tenant hereunder as the same may become due and payable hereunder. Should that portion of such rentals received from such reletting during any month, which is applied to the payment of Rent hereunder, be less than the Rent payable during the month by Tenant hereunder, then Tenant shall pay such deficiency to Landlord. Such deficiency shall be calculated and

paid monthly. Tenant shall also pay to Landlord, as soon as ascertained, any costs and expenses incurred by Landlord in such reletting or in making such alterations and repairs not covered by the rentals received from such reletting.

(e) Termination. No re-entry or taking of possession of the Premises by Landlord pursuant to this Addendum shall be construed as an election to terminate this Lease unless a written notice of such intention is given to Tenant or unless the termination thereof is decreed by a court of competent jurisdiction. Notwithstanding any reletting without termination by Landlord because of any Default by Tenant, Landlord may at any time after such reletting elect to terminate this Lease for any such Default.

(f) Cumulative Remedies. The remedies herein provided are not exclusive and Landlord shall have any and all other remedies provided herein or by law or in equity.

(g) No Surrender. No act or conduct of Landlord, whether consisting of the acceptance of the keys to the premises, or otherwise, shall be deemed to be or constitute an acceptance of the surrender of the premises by tenant prior to the expiration of the term, and such acceptance by Landlord of surrender by tenant shall only flow from and must be evidenced by a written acknowledgment of acceptance of surrender signed by landlord. The surrender of this lease by tenant, voluntarily or otherwise, shall not work a merger unless Landlord elects in writing that

such merger take place, but shall operate as an assignment to Landlord of any and all, existing subleases, or Landlord may, at its option, elect in writing to treat such surrender as a merger terminating Tenant's estate under this Lease, and thereupon Landlord may terminate any or all such subleases by notifying the sublessee of its election so to do within five (5) days after such surrender.

(h) Notice Provisions. Tenant agrees that any notice given by Landlord pursuant to Paragraph 13.1 of the Lease shall satisfy the requirements for notice under California Code of Civil Procedure Section 1161, and Landlord shall not be required to give any additional notice in order to be entitled to commence an unlawful detainer proceeding. Should Landlord prepare any notice to Tenant for failure to pay rent, additional rent or perform any other obligation under the Lease, Tenant shall pay to Landlord, without any further notice from Landlord, the additional sum of $75.00 which the parties hereby agree represents a fair and reasonable estimate of the costs Landlord will incur by reason of preparing such notice.

13.3 Late Charges. Tenant hereby acknowledges that late payment by Tenant to Landlord of Rent and other sums due hereunder will cause Landlord to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges. Accordingly, if any installment of Rent or other sum due from Tenant shall not be received by Landlord or Landlord's designee within 4 days after such amount shall be due, then, without any requirement for notice to Tenant, Tenant shall pay to Landlord a late charge equal to 5% of such overdue amount. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Landlord will incur by reason of late payment by Tenant. Acceptance of such late charge by Landlord shall in no event constitute a waiver of Tenant's Default with respect to such overdue amount, nor prevent Landlord from exercising any of the other rights and remedies granted hereunder. In addition, should Landlord be unable to negotiate any payment made by Tenant on the first attempt by Landlord and without any notice to Tenant, Tenant shall pay to Landlord a fee of $50.00 per item which the parties hereby agree represents a fair and reasonable estimate of the costs Landlord will incur by reason of Landlord's inability to negotiate such item(s). Notwithstanding the foregoing or anything to the contrary, Tenant shall not be obligated to pay a late charge until each time after the fourth time during the term or extended term of that Tenant fails to pay any amount due under this Lease within 4 days after said amount shall be due.

14. CONDEMNATION. If the Premises or any portion thereof are taken under the power of eminent domain or sold under the threat of exercise of said power (all of which are herein called "condemnation"), this Lease shall terminate as to the part so taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than 10% of the floor area of the Premises, or more than 25% of the portion of the Common Areas designated for Tenant's, parking, is taken by condemnation, Tenant may, at Tenant's option, to be exercised in writing within 10 days after Landlord shall have given Tenant written notice of such taking (or in the absence of such notice, within 10 days after the condemning authority shall have taken possession), terminate this Lease as of the date the condemning authority takes such possession. If Tenant does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the Base Rent shall be reduced in the same proportion as the

rentable floor area of the Premises taken bears to the total rentable floor area of the premises. No reduction of Base Rent shall occur if the condemnation does not apply to any portion of the Premises. Any award for the taking of all or any part of the Premises under the power of eminent domain or any payment made under threat of the exercise of such power shall be the property of Landlord; provided, however, that Tenant shall be entitled to any compensation, separately awarded to Tenant, for Tenant's relocation expenses and/or loss of Tenant's trade fixtures. In the event that this Lease is not terminated by reason of such condemnation, Landlord shall to the extent of its net severance damages in the condemnation matter, repair any damage to the Premises caused by such condemnation authority. Tenant shall be responsible for the payment of any amount in excess of such net severance damages required to complete such repair.

15. ESTOPPEL CERTIFICATE AND FINANCIAL STATEMENTS.

15.1 Estoppel Certificate. Each party (herein referred to as "Responding Party") shall within 10 days after written notice from the other Party (the "Requesting Party") execute, acknowledge, and deliver to the Requesting Party, to the extent it can truthfully do so, an estoppel certificate in the form attached hereto as Exhibit C, plus such additional information, confirmation, and statements as be reasonably requested by the Requesting Party. Should Tenant fail to deliver an executed and acknowledged estoppel certificate to Landlord as prescribed herein, Tenant hereby authorizes Landlord to act as Tenant's attorney-in-fact in executing such

estoppel certificate or, at Landlord's option, Tenant shall pay a fee of $100.00 per day ("Estoppel Delay Fee") for each day after the 10 days' written notice in which Tenant fails to comply with this requirement.

15.2 Financial Statement. If Landlord desires to finance, refinance, or sell the Building, Industrial Center, or any part thereof, Tenant shall deliver to any potential lender or purchaser designated by Landlord such financial statements of Tenant as may be reasonably required by such lender or purchaser, including but not limited to Tenant's financial statements for the past 3 years. All such financial statements shall be received by Landlord and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

16. ADDITIONAL COVENANTS AND PROVISIONS.

16.1 Severability. The invalidity of any provision of this Lease, as determined by a court of competent jurisdiction, shall not affect the validity of any other provision hereof.

16.2 Interest on Past-Due Obligations. Any monetary payment due Landlord hereunder not received by Landlord within 10 days following the date on which it was due shall bear interest from the date due at 12% per annum, but not exceeding the maximum rate allowed by law in addition to the late charge provided for in Paragraph 13.3.

16.3 Time of Essence. Time is of the essence with respect to the performance of all obligations to be performed or observed by the Parties under this Lease.

16.4 Landlord Liability. Tenant, its successors, and assigns shall not assert nor seek to enforce any claim for breach of this Lease against any of Landlord's assets other than Landlord's interest in the Industrial Center. Tenant agrees to look solely to such interest for the satisfaction of any liability or claim against Landlord under this Lease. In no event whatsoever shall Landlord (which term shall include, without limitation, any general or limited partner, trustees, beneficiaries, officers, directors, or stockholders of Landlord) ever be personally liable for any such liability.

16.5 No Prior or Other Agreements. This Lease contains all agreements between the Parties with respect to any matter mentioned herein, and supersedes all prior or contemporaneous oral or written agreements or understandings.

16.6 Notice Requirements. All notices required or permitted by this Lease shall be in writing and may be delivered in person (by hand, messenger, or courier service) or may be sent by regular, certified, or registered mail or U.S. Postal Service Express Mail, with postage prepaid, or by facsimile transmission during normal business hours, and shall be deemed sufficiently given if served in a manner specified in this Paragraph 16.6. The addresses noted adjacent to a Party's signature on this Lease shall be that Party's address for delivery or mailing of notice purposes. Either Party may by written notice to the other specify a different address for notice purposes, except that upon Tenant's taking possessing of the Premises, the Premises shall constitute Tenant's address for the purpose of mailing or delivering notices to Tenant. A copy of all notices required or permitted to be given to Landlord hereunder shall be concurrently transmitted to such party or parties at such addresses as

Landlord may from time to time hereafter designate by written notice to Tenant.

16.7 Date of Notice. Any notice sent by registered or certified mail, return receipt requested, shall be deemed given on the date of delivery shown on the receipt card, or if no delivery date is shown, the postmark thereon. If sent by regular mail, the notice shall be deemed given 48 hours after the same is addressed as required herein and mailed with postage prepaid. Notices delivered by United States Express Mail or an overnight courier that guarantees next day delivery shall be deemed given 24 hours after delivery of the same to the United States Postal Service or courier. If any notice is transmitted by facsimile transmission or similar means, the same shall be deemed served or delivered upon telephone or facsimile confirmation of receipt of the transmission thereof, provided a copy is also delivered via hand or overnight delivery or certified mail. If notice is received on a Saturday, Sunday, or legal holiday, it shall be deemed received on the next business day.

16.8 Waivers. No waiver by Landlord of a Default by Tenant shall be deemed a waiver of any other town, covenant, or condition hereof, or of any subsequent Default by Tenant of the same or any other term, covenant, or condition hereof.

16.9 Holdover. Tenant has no right to retain possession of the Premises or any part thereof beyond the expiration or earlier termination of this Lease. If Tenant holds over with the consent of Landlord: (a) the Base Rent payable shall be increased to 150% of the Base Rent applicable during the month immediately preceding such expiration or earlier termination; (b) Tenant's right to possession shall terminate on 30 days notice from Landlord; and (c) all other terms and conditions of this Lease shall continue to apply. Nothing contained herein shall be

construed as a consent by Landlord to any holding over by Tenant. Tenant shall indemnify, defend, and hold Landlord harmless from and against any and all claims, demands, actions, losses, damages, obligations, costs, and expenses, including, without limitation, attorneys' fees incurred or suffered by Landlord by reason of Tenant's failure to surrender the Premises on the expiration or earlier termination of this Lease in accordance with the provisions of this Lease.

16.10 Cumulative Remedies. No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies in law or in equity.

16.11 Binding Effect: Choice of Law. This Lease shall be binding upon the Parties, their personal representatives, successors, and assigns, and be governed by the laws of the State in which the Premises are located. Any litigation between the Parties hereto concerning this Lease shall be initiated in the county in which the Premises are located.

16.12 Landlord. The covenants and obligations contained in this Lease on the part of Landlord are binding on Landlord, its successors, and assigns only during their respective period of ownership of an interest in the Building. In the event of any transfer or transfers of such title to the Building, Landlord (and, in the case of any subsequent transfers or conveyances, the then grantor) shall be concurrently freed and relieved from and after the date of such transfer or conveyance, without any further instrument or agreement, of all liability with respect to the performance of any covenants or obligations on the part of Landlord contained in this Lease thereafter to be performed.

16.13 Attorneys' Fees and Other Costs. If any Party brings an action or proceeding to enforce the terms hereof or declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding shall be entitled to reasonable attorneys' fees. The term "Prevailing Party" shall include, without limitation, a Party who substantially obtains or defeats the relief sought. Landlord shall be entitled to attorneys' fees, costs, and expenses incurred in the preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting breach. Tenant shall reimburse Landlord on demand for all reasonable legal, engineering, and other professional services expenses incurred by Landlord in connection with all requests by Tenant or any lender of Tenant for consent, waiver or approval of any kind.

16.14 Landlord's Access; Showing Premises; Repairs. Landlord and Landlord's agents shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times upon reasonable notice for the purpose of showing the same to prospective purchasers, lenders, or tenants, and making such alterations, repairs, improvements, or additions to the Premises or to the Building, as Landlord may reasonably deem necessary. Landlord may at any time place on or about the Premises or Building any ordinary "For Sale" signs, and Landlord may at any time during the last 180 days of the term

hereof place on or about the Premises any ordinary "For Lease" signs. All such activities of Landlord shall be without abatement of rent or liability to Tenant.

16.15 Signs. Tenant shall not place any signs at or upon the exterior of the Premises or the Building, except that Tenant may, with Landlord's prior written consent, install (but not on the roof) such signs as are reasonably required to advertise Tenant's own business so long as such signs are in a location designated by Landlord and comply with sign ordinances and the signage criteria established for the Industrial Center by Landlord.

16.16 Termination; Merger. Unless specifically stated otherwise in writing by Landlord, the voluntary or other surrender of this Lease by Tenant, the mutual termination or cancellation hereof, or a termination hereof by Landlord for Default by Tenant, shall automatically terminate any sublease or lesser estate in the Premises; provided, however, Landlord shall, in the event of any such surrender, termination, or cancellation, have the option to continue any one or all of any existing subtenancies. Landlord's failure within 10 days following any such event to make a written election to the contrary by written notice to the holder of any such lesser interest shall constitute Landlord's election to have such event constitute the termination of such interest.

16.17 Quiet Possession. Upon payment by Tenant of the Base Rent and Additional Rent for the Premises and the performance of all of the covenants, conditions, and provisions on Tenant's part to be observed and performed under this Lease, Tenant shall have quiet possession of the Premises for the entire term hereof, subject to all of the provisions of this Lease.

16.18 Subordination; Attornment; Non-Disturbance.

(a) Subordination. This Lease shall be subject and subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or mortgage (collectively, "Mortgage") now or hereafter placed by Landlord upon the real property of which the Premises are a part, to

any and all advances made on the security thereof, and to all renewals, modifications, consolidations, replacements, and extensions thereof. Tenant agrees that any person holding any Mortgage shall have no duty, liability, or obligation to perform any of the obligations of Landlord under this Lease. In the event of Landlord's default with respect to any such obligation, Tenant will give any Lender, whose name and address have previously been furnished in writing to Tenant, notice of a default by Landlord. Tenant may not exercise any remedies for default by Landlord unless and until Landlord and the Lender shall have received written notice of such default and a reasonable time (not less than 90 days) shall thereafter have elapsed without the default having been cured. If any Lender shall elect to have this Lease superior to the lien of its Mortgage and shall give written notice thereof to Tenant, this Lease shall be deemed prior to such Mortgage. The provisions of a Mortgage relating to the disposition of condemnation and insurance proceeds shall prevail over any contrary provisions contained in this Lease.

(b) Attornment. Subject to the nondisturbance provisions of subparagraph (c) of this Paragraph 16.18, Tenant agrees to attorn to a Lender or any other party who acquires ownership of the Premises by reason of a foreclosure of a Mortgage. In the event of such foreclosure, such new owner shall not: (i) be liable for any act or omission of any prior landlord or with respect to events occurring prior to acquisition of ownership, (ii) be subject to any offsets or defenses which Tenant might have against any prior Landlord, or (iii) be liable for security deposits or be bound by prepayment of more than one month's rent.

(c) Non-Disturbance. With respect to a Mortgage entered into by Landlord after the execution of this Lease, Tenant's subordination of this Lease shall be subject to receiving assurance (a "nondisturbance agreement") from the Mortgage holder that Tenant's possession and this Lease will not be disturbed so long as Tenant is not in default and attorns to the record owner of the Premises.

(d) Self-Executing. The agreements contained in this Paragraph 16.18 shall be effective without the execution of any further documents; provided, however, that upon written request from Landlord or a Lender in connection with a sale, financing, or refinancing of Premises, Tenant and Landlord shall execute such further writings as may be reasonably required to separately document any such subordination or nonsubordination, attornment, and/or nondisturbance agreement, as is provided for herein. Landlord is hereby irrevocably vested with full power to subordinate this Lease to a Mortgage.

16.19 Rules and Regulations. Tenant agrees that it will abide by, and to cause its employees, suppliers, shippers, customers, tenants, contractors, and

invitees to abide by, all reasonable rules and regulations ("Rules and Regulations") which Landlord may make from time to time for the management, safety, care, and cleanliness of the Industrial Center, the parking and unloading of vehicles, and the preservation of good order, as well as for the convenience of other occupants or tenants of the Building and the Industrial Center and their invitees. Landlord shall not be responsible to Tenant for the noncompliance with said Rules and Regulations by other tenants of the Industrial Center.

16.20 Security Measures. Tenant acknowledges that the rental payable to Landlord hereunder does not include the cost of guard service or other security measures. Landlord has no obligations to provide same. Except for the gross negligence or intentional acts of Landlord and its agents, Tenant assumes all responsibility for the protection of the Premises, Tenant, its agents, and invitees and their property from the acts of third parties.

16.21 Reservations. Landlord reserves the right to grant such easements that Landlord deems necessary and to cause the recordation of parcel maps, so long as such easements and maps do not unreasonably interfere with the use of the Premises by Tenant. Tenant agrees to sign any documents reasonably requested by Landlord to effectuate any such easements or maps.

16.22 Conflict. Any conflict between the printed provisions of this Lease and the typewritten or handwritten provisions shall be controlled by the typewritten or handwritten provisions.

16.23 Offer. Preparation of this lease by either Landlord or Tenant or Landlord's agent or Tenant's agent and submission of same to Tenant or Landlord shall not be deemed an offer to lease. This Lease is not intended to be binding until executed and delivered by all Parties hereto.

16.24 Amendments. This Lease may be modified only in writing, signed by the parties in interest at the time of the modification.

16.25 Multiple Parties. Except as otherwise expressly provided herein, if more than one person or entity is named herein as Tenant, the obligations of such persons shall be the joint and several responsibility of all persons or entities named herein as such Tenant.

16.26 Authority. Each person signing on behalf of Landlord or Tenant warrants and represents that she or he is authorized to execute and deliver this Lease and to make it a binding obligation of Landlord or Tenant.

[SIGNATURES ON FOLLOWING PAGE]

The parties hereto have executed this Lease at the place and on the dates specified below their respective signatures.

LANDLORD:	*TENANT:*
AMB PROPERTY, L.P.	*CAPSTONE TURBINE CORPORATION*
a Delaware limited partnership	*A Delaware corporation*
By: AMB Property Corporation,	
a Maryland corporation	
	By: /s/ J. WATTS 9/26/00
By: /s/ MARTIN J. COYNE	*Its: CFO*
	N/A
Martin J. Coyne, Vice President	*By: ----------*
	Telephone: (818) 734-5552
Telephone: (415) 394-9000	*Facsimile: (818) 734-5352*
Facsimile: (415) 394-9001	*Executed at: Manhattan Beach, CA*
Executed at: San Francisco, CA	*Executed at: 90266*
on: 10/11/2000	*ADDRESS ----------*

ADDRESS	ADDRESS
505 Montgomery Street	----------
San Francisco, CA 94111	----------
	Tax ID: ----------

GLOSSARY

The following terms in the Lease are defined in the paragraphs opposite the terms.

TERM DEFINED IN PARAGRAPH

Assignment	12
Base Rent	1.4
Basic Provisions	1
Building	1.2
Building Operating Expenses	4.2
Commencement Date	1.3
Commencement Date Certificate	3.3
Condemnation	14
Default	13.1
Expiration Date	1.3
HVAC	4.2(a)(x)
Hazardous Substance	6.2
Indemnity	8.5
Landlord	1.1
Landlord Entities	6.2(c)
Lease	1.1
Mortgage	16.18
Operating Expenses	4.2
Party/Parties	1.1
Permitted Use	1.8
Premises	1.2
Real Property Taxes	10.2
Rent	4.1
Reportable Use	6.2
Requesting Party	15
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Rules and Regulations	16.19
Security Deposit	1.7,5
Taxes	10.2
Tenant	1.1
Tenant Acts	9.2
Tenant's Entity	6.2(c)
Tenant's Share	1.5
Term	1.3
Use	6.1

AMB PROPERTY, L.P.,
A DELAWARE LIMITED PARTNERSHIP
INDUSTRIAL LEASE
RENT ADJUSTMENT ADDENDUM

This Rent Adjustment Addendum is a part of the Lease dated September 251, 2000, by and between AMB PROPERTY, L.P. ("Landlord") and Capstone Turbine Corporation ("Tenant") for the premises commonly known as 16664 Stagg Street, Van Nuys, California.

Monthly Base Rent for the each of the periods designated in this Addendum ("Adjustment Periods") shall be the amount calculated in accordance with the alternative selected below ("Rent Adjustment Alternative"), but in no event shall the monthly Base Rent for an Adjustment Period be less than the highest monthly rent payable during the term preceding the Adjustment Period.

1. ADJUSTMENT PERIODS:

October 1, 2000 to March 31, 2003 ("Period One")
April 1, 2003 to September 30, 2005 ("Period Two")
October 1, 2005 to March 31, 2008 ("Period Three")
April 1, 2008 to September 30, 2010 ("Period Four")
October 1, 2010 to November 30, 2010 ("Period Five")

2. RENT ADJUSTMENT ALTERNATIVES

[X] Fixed rent adjustment ("Fixed Rent Adjustment")
$44,078.00 shall be the monthly Base Rent for Period One.
$47,384.00 shall be the monthly Base Rent for Period Two.
$50,938.00 shall be the monthly Base Rent for Period Three.
$54;758.00 shall be the monthly Base Rent for Period Four.
$58,865.00 shall be the monthly Base Rent for Period Five.

[ ] Cost of living adjustment ("CPI Adjustment")

Monthly Base Rent shall be calculated using the following CPI index ("Index"):

[ ] Urban Wage Earners and Clerical Workers
[ ] All Urban Consumers
[ ] _____

The Comparison Month is:
[ ] the first month of the term of this Lease; or
[ ] _____

[ ] Market rent ("Market Rent Adjustment")

3. CALCULATION OF RENT ADJUSTMENT

LANDLORD:
AMB PROPERTY, L.P.
A DELAWARE LIMITED-PARTNERSHIP
By: AMB Property Corporation,
a Maryland corporation, its
general partner

By: /s/ MARTIN COYNE

Martin Coyne, Vice President

TENANT:
CAPSTONE TURBINE CORPORATION
A DELAWARE CORPORATION

/s/ J. WATTS

By: J. Watts
Its: CFO

By: [ILLEGIBLE]
Its: [ILLEGIBLE]

AMB PROPERTY, L.P.,
A DELAWARE LIMITED PARTNERSHIP
INDUSTRIAL LEASE

OPTION TO EXTEND

This Option to Extend is a part of the Lease dated September 25, 2000, by and between AMB PROPERTY, L.P. ("Landlord") and Capstone Turbine Corporation ("Tenant") for the premises commonly known as 16640 Stagg Street, Van Nuys,

California.

1. OPTION TO EXTEND. Landlord hereby grants to Tenant the option to extend the term of this Lease for the following periods ("Option Periods") commencing when the prior term expires:

December 1, 2010 to November 30, 2015 ("Period One")

December 1, 2015 to November 30, 2020 ("Period Two")

2. EXERCISE DATES. For purposes of Paragraph 4 of this Addendum,

a. the Earliest Exercise Date is 12 months prior to the date that the Option Period would commence, and

b. the Last Exercise Date is 4 months prior to the date that the Option Period would commence.

3. MONTHLY BASE RENT. The monthly Base Rent for each month of an Option Period shall be the amount calculated in accordance with the alternative selected below ("Rent Adjustment Alternative"), but in no event shall the monthly Base Rent for an Option Period be less than the highest monthly Base Rent payable during the term immediately preceding the Option Period.

[X] Fixed rent adjustment ("Fixed Rent Adjustment")
7.5% increase at the 1st and 31st month of each option period.

[ ] Cost of living adjustment ("CPI Adjustment")
Monthly Base Rent shall be calculated using the following CPI index ("Index"):

[ ] Urban Wage Earners and Clerical Workers

[ ] All Urban Consumers

[ ] _____

The Comparison Month is:

[ ] the first month of the term of this Lease; or

[ ] _____

[ ] Market rent ("Market Rent Adjustment")

4. CONDITIONS TO EXERCISE OF OPTION. Tenant's right to extend is conditioned upon and subject to each of the following:

a. In order to exercise an option to extend, Tenant must give written notice of such election to Landlord and Landlord must receive the same by the Last Exercise Date but not prior to the Earliest Exercise Date. If proper notification of the exercise of an option is not given and/or received, such option shall automatically expire. Options (if there are more than one) may only be exercised consecutively. Failure to exercise an option terminates that option and all subsequent options. Tenant acknowledges that because of the importance to Landlord of knowing no later than the Last Exercise Date whether or not Tenant will exercise the option, the failure of Tenant to notify Landlord by the Last Exercise Date will conclusively be presumed an election by Tenant not to exercise the option.

b. Tenant shall have no right to exercise an option (i) if Tenant is in Default or (ii) in the event that Landlord has given to Tenant three or more notices of separate Defaults during the 12-month period immediately preceding the exercise of the option, whether or not the Defaults are cured. The period of time within which an option may be exercised shall not be extended or enlarged by reason of Tenant's inability to exercise an option because of the provisions of this paragraph.

c. All of the terms and conditions of this Lease, except where specifically modified by this Addendum, shall apply.

d. The options are personal to the Tenant, cannot be assigned or exercised by anyone other than the Tenant, and only while the Tenant is in full possession of the Premises and without the intention of thereafter assigning or subletting.

LANDLORD: *TENANT:*

AMB PROPERTY, L.P.
a Delaware limited partnership
By: AMB Property Corporation,
a Maryland corporation

BY
Martin Coyne, Vice President

/s/ MARTIN COYNE

Capstone Turbine Corporation
a California corporation

By: J. Watts
Its: CFO 9/26/00

By: /s/ J. WATTS

Its: CFO

AMB PROPERTY, L.P.,
A DELAWARE LIMITED PARTNERSHIP
INDUSTRIAL LEASE

ADDENDUM

This Addendum to Industrial Lease ("Addendum") is made and entered into as of the 25th day of September, 2000, by and between AMB Property, L.P., a Delaware limited partnership ("Landlord"), and Capstone Turbine Corporation, a Delaware corporation ("Tenant"), with reference to that certain Industrial Lease dated as of September 25th, 2000, by and between Landlord and Tenant ("Lease"). The promises, covenants, agreements and declarations made and set forth herein are intended to and shall have the same force and effect as if set forth at length in the body of the Lease. To the extent that the provisions of this Addendum are inconsistent with the terms and conditions of the Lease, the terms of this Addendum shall prevail and control for all purposes. Unless otherwise defined below, all terms used in this Addendum and defined in the Lease shall have the same meaning as is ascribed to such terms in the Lease.

1. Delivery of Premises. Subject to Landlord performing the improvements set forth on Attachment 2 and delivering the Premises pursuant to Section 2.6 of the Lease, Tenant acknowledges that it has inspected and accepts the Premises in their present "as-is" condition as suitable for the purpose for which the Premises are leased. The taking of possession by Tenant shall be conclusive to establish that the Premises are in good and satisfactory condition when possession is taken, except as expressly set forth in this Lease. Tenant further acknowledges that no representations or promises were made by Landlord or any agent of Landlord to repair, alter, remodel or improve the Premises, except as expressly set forth in this Lease.

2. Signage. Provided Tenant is not in default hereunder, Tenant shall have the right to install (i) a monument sign, and (ii) exterior sign identification of the Premises, at Tenant's sole cost and expense (collectively, "Tenant's Signage"). Tenant's Signage shall be subject to Landlord's approval as to size, design, location, graphics, materials, colors and similar specifications and shall be consistent with the exterior design, materials and appearance of the Industrial Center and the Industrial Center's signage program and shall be further subject to and comply with all applicable local governmental laws, rules, regulations, codes and other approvals. Landlord has the right, but not the obligation, to oversee the installation of Tenant's Signage. The cost to operate, if any, Tenant's Signage shall be paid for by Tenant, and Tenant shall be separately metered for such expense (the cost of separately metering any utility usage shall also be paid for by Tenant). Upon the expiration of the Lease Term, or other earlier termination of this Lease, Tenant shall be responsible for any and all costs associated with the removal of Tenant's Signage, including, but not limited to, the cost to repair and restore the Premises to its original condition, normal wear and tear excepted.

3. Rental Abatement. Landlord shall grant to Tenant base rental abatement for the first 2 months of the Lease Term.

4. DWP Interconnect. Landlord shall allow Tenant the right to interconnect with the DWP grid, subject to DWP final approval. There shall be no cost or expense to Landlord.

5. Environmental Indemnification. Landlord shall indemnify, protect, defend, and hold Tenant, Tenant's affiliates, and the officers, directors, shareholders, partners, employees, managers, independent contractors, attorneys, and agents of the foregoing ("Tenant Entities") and the Premises, harmless from and against any and all damages, liabilities, judgments, costs, claims, liens, expenses, penalties, loss of permits, and attorneys' and consultants' fees arising out of or involving any Hazardous Substance that exists at or beneath the Premises or that migrate to, beneath or from the Premises, unless directly caused by Tenant or its agents. Landlord's obligations under this Paragraph 4 shall include, but not be limited to, the effects of any contamination or injury to persons, property, or the environment and the cost of investigation

(including consultants' and attorneys' fees and testing), removal, remediation, restoration and/or abatement thereof, or of any contamination therein involved. Landlord's obligations under this Paragraph 4 shall survive the Expiration Date or earlier termination of this Lease directly caused by Tenant.

6. Early Possession. Tenant shall be given early possession of the premises (subject to all terms and conditions of the Lease with the exception of Rent) upon full execution of Lease documents.

7. Roof Maintenance. Roof maintenance following the Commencement Date shall be the responsibility of Tenant, subject to an annual maintenance cost cap of $1,500.00. All costs in excess of $1,500 shall be paid by Landlord except that Tenant shall bear the entire cost of any roof repair attributable to a negligent or intentional act or omission of Tenant's Entities.

8. Tenant Improvements. Tenant shall have the right to construct canopies over the east parking lot/yard portion of the Premises, subject to Landlord's reasonable approval. Such canopies shall be removed at the end of the Lease Term.

9. Subordination - Non-Disturbance from Existing Lender. Prior to the Commencement Date, Landlord shall provide Tenant with a commercially reasonable subordination and non-disturbance agreement from any existing lender to whose interest, Tenant's interest in this Lease is subordinate.

IN WITNESS WHEREOF, the parties hereto have executed this Addendum as of the date first written above.

LANDLORD:

AMB PROPERTY, L.P.,
a Delaware limited partnership

By: AMB Property Corporation,
a Maryland corporation, its general partner

By: /s/ MARTIN J. COYNE
Martin J. Coyne, Vice President

TENANT:

CAPSTONE TURBINE CORPORATION,
a Delaware corporation

By: /S/ J. WATTS 9/26/00

Its: CFO

ATTACHMENT 1

PARKING DIAGRAM

[PARKING DIAGRAM]

Bldg 7
78, 711 SF
16640 Stagg St.

Attachment 2

LANDLORD'S WORK

As part of Landlord's Work, Landlord will:

1. *Carpet (in a mutually agreeable color/grade) the entire office space.*

2. *Once the cul-de-sac is completed, Landlord shall install a wrought iron fence with gate similar to the existing entrance to the property (or a mutually acceptable substitute).*

3. *Repair, clean, and seal the warehouse floor.*

4. *Assist in the installation of a 4" high pressure gas line; any repair work necessitated by the installation shall be Landlord's sole cost and expense.*

5. *Install traffic rated drain across the northeastern ground level door.*

6. *Landlord warrants that the parking lot shall drain properly with no unreasonable puddling.*

7. *Term shall not commence until Landlord's work as described in Item 3 above, as well connection to permanent electrical power is completed.*

AMB PROPERTY, L.P.,
DELAWARE LIMITED PARTNERSHIP
INDUSTRIAL LEASE

TENANT IMPROVEMENT ADDENDUM

This Tenant Improvement Addendum is a part of the Lease dated September 25, 2000, by and between AMB PROPERTY, L.P. "(Landlord") and Capstone Turbine Corporation, a Delaware corporation ("Tenant") for the premises commonly known as 16640 Stagg Street, Van Nuys, California.

Tenant may construct at its sole cost and expense the improvements ("Alterations") described on Exhibit 1 attached hereto. Prior to commencement of construction, Tenant shall obtain and deliver to Landlord any building permit required by applicable law and a copy of the executed construction contract(s). Tenant shall reimburse Landlord within 10 days after the rendition of a bill for all of Landlord's actual out-of-pocket costs incurred in connection with the Alterations, including, without limitation, all management, engineering, outside consulting, and construction fees incurred by or on behalf of Landlord for the review and approval of Tenant's plans and specifications and for the monitoring of construction of the Alterations. Tenant shall require its contractor to maintain insurance in the amounts and in the forms described in Exhibit 2. The Alterations shall be constructed by licensed contractors approved by Landlord and in accordance with rules, such as hours of construction, imposed by Landlord. The Alterations shall be completed lien free, in accordance with the plans and specifications described in Exhibit 1, in a good, workmanlike, and prompt manner, with new materials of first-class quality and comply with all applicable local, state, and federal regulations. The competed Alterations shall be the property of Landlord and shall, subject to the provisions of the next sentence, be surrendered with the Premises upon the expiration or sooner termination of this Lease.

Prior to commencing construction of the Improvements, Tenant shall obtain from its contractors and deliver to Landlord a commercially reasonable waiver and release of any and all claims against Landlord and liens against the Premises to which such contractor might at any time be entitled and to provide such payment and performance bonds as Landlord may require. The delivery of the waiver and release of claims and liens and such bonds shall be a condition precedent to Tenant's ability to begin its construction work at the Premises.

Tenant shall pay when due all claims for labor or materials furnished or alleged to have been furnished to or for Tenant at or for use on the Premises. Tenant shall give Landlord not less than 10 days' notice prior to the commencement of any work in, on, or about the Premises, and Landlord shall have the right to post notices of non-responsibility in or on the Premises as provided by law.

Tenant agrees to indemnify, protect, and defend Landlord and hold Landlord harmless against any loss, liability, or damage resulting from construction of the Alterations.

EXHIBITS

Exhibit 1: Description of Alterations and plans and specifications

Exhibit 2: Insurance requirements

EXHIBIT A

DESCRIPTION OF PREMISES

[DESCRIPTION OF PREMISES]

Bldg 7
78, 711 SF
16640 Stagg St.

COMMENCEMENT DATE MEMORANDUM

LANDLORD:	AMB PROPERTY, L.P.
TENANT:	Capstone Turbine Corporation
LEASE DATE:	September 25, 2000
PREMISES:	16640 Stagg Street Van Nuys, CA

Tenant hereby accepts the Premises as being in the condition required under the Lease.

The Commencement Date of the Lease is October 1, 2000.

The Expiration Date of the Lease is September 30, 2005.

LANDLORD:
AMB PROPERTY, L.P.,

a Delaware limited partnership

By: AMB Property Corporation,
a Maryland corporation,
its general partner

By: Martin J. Coyne
Its: Vice President

Telephone: (415) 394-9000

Facsimile: 415 394-6257

ADDRESS:

505 Montgomery Street

San Francisco, CA 94111

TENANT:
CAPSTONE TURBINE CORPORATION,

a Delaware corporation

By:

Its:

Title:

Telephone: ( )

Facsimile: ( )

ADDRESS:

Tax ID:

EXHIBIT B

EXHIBIT "D"

TENANT MOVE-IN AND LEASE RENEWAL ENVIRONMENTAL QUESTIONNAIRE

FOR
COMMERCIAL AND INDUSTRIAL PROPERTIES

Property Name: *Airport Business Park*
Property Address: *16640 Stagg Street, Van Nuys, CA*

Addendum to the Lease Dated September 25, 2000
Between
CAPSTONE TURBINE CORPORATION
a Delaware corporation
("Tenant")
and
AMB PROPERTY, L.P.
("Landlord")

Instructions: The following questionnaire is to be completed by the Tenant Representative with knowledge of the planned/existing operations for the specified building/location. A copy of the completed form must be attached to all new leases and renewals, and forwarded to the Owner's Risk Management Department.

1.0 PLANNED USE/OPERATIONS

1-1. Describe planned use (new Lease) or existing operations (lease renewal), and include brief description of manufacturing processes employed.

THE MANUFACTURING PROCESSES INCLUDE: METAL FORMING, WELDING, MECHANICAL ASSEMBLY AND PRODUCT PERFORMANCE TESTING.

2.0 HAZARDOUS MATERIALS

2-1. Are hazardous materials used or stored? If so, continue with the next question. If not, go to Section 3.0.

YES

2-2. Are any of the following materials handled on the property? (A material is handled if it is used, generated, processed, produced, packaged, treated, stored, emitted, discharged, or disposed.) If so, complete this section. If this section is not applicable, skip this section and go on to Section 5.0.

[ ] Explosives	*[X] Fuels*	*[X] Oils*
[ ] Solvents	*[ ] Oxidizers*	*[X] Organics/Inorganics*
[ ] Acids	*[ ] Bases*	*[ ] Pesticides*
[X] Gases	*[ ] PCBs*	*[ ] Radioactive Materials*

[ ] Other (please specify)

2-3. For the following groups of chemicals, please check the type(s), use(s), and quantity of each chemical used or stored on the site. Attach either a chemical inventory or list the chemicals in each category.

*Solvents*_____ *Gases* _____ **SEE ATTACHMENT "A"**

*Type:*_____ *Type:*_____

*Use:*_____ *Use:*_____

*Quantity:*_____ *Quantity:*_____

*Inorganic*_____ *Acids*_____

Type: *Type:*
- ---------- ----------

Use: *Use:*
- ---------- ----------

Quantity: *Quantity:*
- ---------- ----------

Fuels *Explosives*
- ---------- ----------

Type:
- ----------

Use:
- ----------

Quantity:
- ----------

Type:

Use:

Quantity:

Oils
- ----------

Type:
- ----------

Use:
- ----------

Quantity:
- ----------

Bases

Type:

Use:

Quantity:

Oxidizers
- ----------

Type:
- ----------

Use:
- ----------

Quantity:
- ----------

Pesticides

Type:

Use:

Quantity:

Organic
- ----------

Type:
- ----------

Use:
- ----------

Quantity:
- ----------

Radioactive Materials

Type:

Use:

Quantity:

Other
- ----------

Type:
- ----------

Use:
- ----------

Quantity:
- ----------

2-4. List and quantify the materials identified above. SEE ATTACHMENT "A"

MATERIAL	*PHYSICAL STATE*	*CONTAINER SIZE*	*NUMBER OF CONTAINERS*

- ---

==========

2-5. Describe the storage area location(s) for these materials.

3.0 HAZARDOUS WASTES

3-1. Are hazardous wastes generated? If so, continue with the next question. If not, skip this section and go to section 4.0.

YES

3-2. Are any of the following wastes generated, handled, or disposed of (where applicable) on the property?

[ ]	Hazardous wastes	[X]	Industrial Wastewater
[X]	Waste oils	[ ]	PCBs
[X]	Air emissions	[ ]	Sludges
[ ]	Other (please specify)		

3-3. Identify and describe those wastes generated, handled or disposed of (disposition). Specify any wastes known to be regulated under the Resource Conservation and Recovery Act (RCRA) as "listed characteristic or statutory" wastes. Include total amounts generated monthly. Please include name, location, and permit number (e.g. EPA ID No.) for transporter and disposal facility, if applicable. Attach separate pages as necessary.

EPA ID # CAL 000131155

1) WASTE OILS FROM METAL WORKING WATER SOLUBLE

2) INDUSTRIAL WASTEWATER FROM WELDING OPERATIONS

3) AIR EMISSION FROM WELDING AND PRODUCT TESTING.

3-4. List and quantify the materials identified in Question 3-2 of this section.

<Table>
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WASTE GENERATED	SOURCE	APPROXIMATE MONTHLY QUANTITY	WASTE CHARACTERIZATION	DISPOSITION
<S>	<C>	<C>	<C>	<C>
INDUSTRIAL WASTEWATER	WELDING	60,000 GAL PER MO	BAY AREA WASTEWATER BEING ANALYZED	COULD BE CONDITIONALLY AUTHORIZED FOR NPORS
WASTE OILS WATER SOLUBLE	MACHINES METAL WORK	55 GAL PER MO	HAZ WASTE LIQUID NON-FLAM RCRA	STORE FOR HAZ WASTE PICK-UP AND DISPOSAL

</Table>

3-5. Are pollution controls or monitoring employed in the process to prevent or minimize the release of wastes into the environment? If so, please describe.

NO

4.0 USTS/ASTS

4-1. Are underground storage tanks (USTs), aboveground storage tanks (ASTs), or associated pipelines present on site (lease renewals) or required for planned operations (new tenants)? If not, continue with section 5.0. If yes, please describe capacity, contents, age, design and construction of USTs or ASTs.

YES
ONE AST 300 GALLON WITH SECONDARY CONTAINMENT, ONE YEAR OLD

4-2. Is the UST/AST registered and permitted with the appropriate regulatory agencies? Please provide a copy of the required permits.

NOT PROCURED - TO BE DETERMINED

4-3. Indicate if any of the following leak prevention measures have been provided for the USTs/ASTs and their associated piping. Additionally,

please indicate the number of tanks that are provided with the indicated measure. Please provide copies of written test results and monitoring documentation.

NOT YET DESIGNED OR PROCURED

____ Integrity testing *____ Inventory reconciliation*

____ Leak detection system *____ Overfill spill protection*

____ Secondary containment *_____ Other (please describe)*

____ Cathodic protection

4-4. If this Questionnaire is being completed for a lease renewal, and if any of the USTs/ASTs have leaked, please state the substance released, the media(s) impacted (e.g., soil, water, asphalt, etc.), the actions taken, and all remedial responses to the incident.

N/A

4-5. If this Questionnaire is being completed for a lease renewal, have USTs/AST's been removed from the property? If so, please provide any official closure letters or reports and supporting documentation (e.g., analytical test results, remediation report results, etc.)

N/A

4-6. For Lease renewals, are there any above or below ground pipelines on site used to transfer chemicals or wastes? For new tenants, are installations of this type required for the planned operations? If so, please describe.

To be determined.

4-7. If present or planned, have the chemical transfer pipelines been inspected or tested for leaks? If so, please indicate the results and provide a copy of the inspection or test results.

Not present – not planned.

5.0 ASBESTOS CONTAINING BUILDING MATERIALS

5-1. Please be advised that this property participates in an Asbestos Operations and Maintenance Program, and that an asbestos survey may have been performed at the Property. If provided, please review the information that identifies the locations of known asbestos containing material or presumed asbestos containing material. All personnel and appropriate subcontractors should be notified of the presence of these materials, and informed not to disturb these materials. Any activity that involves the disturbance or removal of these materials must be done by an appropriately trained individual/contractor.

6.0 REGULATORY

6-1. For lease Renewals, are there any past, current, or pending regulatory actions by federal, state, or local environmental agencies alleging noncompliance with regulations? If so, please describe.

Unknown

6-2. For lease renewals, are there any past, current, or pending lawsuits or administrative proceedings for alleged environmental damages involving the property, you, or any owner or tenant of the property? If so, please describe.

Yes – previous tenants/current owner have remediation in process for trichloroethylene. Should be complete in 4 months.

6-3. Does the operation have or require a National Pollutant Discharge Elimination System (NPDES) or equivalent permit? If so, please provide a copy of this permit.

No

6-4. For Lease renewals, have there been any complaints from the surrounding community regarding facility operations? If so, please describe. Have there been any worker complaints or regulatory investigations regarding hazardous material exposure at the facility? If so, please describe status

and any corrective actions taken.

Unknown

6-5. Has a Hazardous Materials Business Plan been developed for the site? If so, please provide a copy.

No

CERTIFICATION

I am familiar with the real property described in this questionnaire. By signing below, I represent and warrant that the answers to the above questions are complete and accurate to the best of my knowledge. I also understand that the Owner will rely on the completeness and accuracy of my answers in assessing any environmental liability risks associated with the property.

Signature: /s/ J WATTS
Name: J Watts
Title: CFO
Date: 10-9-00
Telephone: 818-734-5552

ATTACHMENT "A"
TENANT MOVE-IN AND LEASE RENEWAL ENVIRONMENTAL QUESTIONNAIRE
FOR
COMMERCIAL AND INDUSTRIAL PROPERTIES

Property Name: Airport Business Park
Property Address: 16640 Stagg Street, Van Nuys, CA

Addendum to the Lease Dated September 25, 2000

CAPSTONE TURBINE CORPORATION
A Delaware corporation
("Tenant")
and
AMB Property, L.P.
("Landlord")

Ref: EXHIBIT "D", Section 2-3 & 2-4

CHEMICAL/SUBSTANCE INVENTORY

<Table>
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CATEGORY	MATERIAL SUBSTANCE NAME	PHYSICAL STATE	CONTAINER SIZE	QTY	USE
<S>	<C>	<C>	<C>	<C>	<C>
Oils	Compressor Oil	liquid	1 gallon	2	lubricant for equipment
	Hydraulic jack oil	liquid	1 gallon	2	hydraulic fluid - equip
	LPS Tapmatic cutting fluid	liquid	16 oz	4	metalworking lubricant
	LPS LST Penetrant oil	liquid	11 oz	2	penetrating oil
	Rapid Tap cutting oil	liquid	4 oz	4	metal cutting oil
	Saf-T-Eze anti-seize	liquid	8 oz	4	thread anti-seize
	White multipurpose grease	liquid	14 oz	4	lubricant
	Molly Graph multipurpose	liquid	14 oz	4	lubricant
Gases	Air - compressed	gas	"A" cylinder	2	calibration
	Mixture: CO in air	gas	"A" cylinder	1	calibration
	Mixture: CO2 in air	gas	"A" cylinder	1	calibration
	Mixture: NO in air	gas	"A" cylinder		calibration
	Mixture: propane in air/ non-flammable	gas	"A" cylinder	1	calibration
	Carbon Dioxide	gas	"A" cylinder	2	calibration
	Nitrogen	gas	"A" cylinder	2	calibration
	Methane	gas	"A" cylinder	1	calibration

	Acetylene	gas	"A" cylinder	1	calibration
	Argon	gas	400 ltr	1	calibration/welding
	Hydrogen	gas	400 ltr	1	welding
	Hydrogen/Helium mix	gas	"A" cylinder	1	calibration
	Propane	gas	498 gallons	1	fuel – product testing
Oxidizers	Oxygen	gas	"A" cylinder	2	calibration
Organics & Inorganics	Isopropyl Alcohol	liquid	1 gallon	4	cleaning–hand wipe
	Acetone	liquid	1 gallon	4	cleaning–hand wipe
	Methyl Ethyl Keytone	liquid	1 gallon	1	thinning
Fuels	Diesel #2	liquid	300 gallons	1	fuel – product testing
	Gasoline	liquid	5 gallons	2	fuel – product testing
	Kerosene	liquid	5 gallons	4	fuel – product testing

</Table>

EXHIBIT 10.8

OFFICE LEASE

WARNER CENTER

AH WARNER CENTER PROPERTIES,
LIMITED LIABILITY COMPANY
a Delaware limited liability company

as Landlord,

and

CAPSTONE TURBINE CORPORATION,
a Delaware corporation

as Tenant.

WARNER CENTER PLAZA

SUMMARY OF BASIC LEASE INFORMATION

The undersigned hereby agree to the following terms of this Summary of Basic Lease Information (the "SUMMARY"). This Summary is hereby incorporated into and made a part of the attached Office Lease (the "OFFICE LEASE") which pertains to the "Project," as that term is defined in the Office Lease, commonly known as "Warner Center Plaza" located in Woodland Hills, California. This Summary and the Office Lease are collectively referred to herein as the "Lease". Each reference in the Office Lease to any term of this Summary shall have the meaning set forth in this Summary for such term. In the event of a conflict between the terms of this Summary and the Office Lease, the terms of the Office Lease shall prevail. Any capitalized terms used herein and not otherwise defined herein shall have the meanings set forth in the Office Lease.

TERMS OF LEASE (References are to the Office Lease)	*DESCRIPTION*
1. Date:	*February 16, 2001.*
2. Landlord:	*AH WARNER CENTER PROPERTIES, LIMITED LIABILITY COMPANY, a Delaware limited liability company.*
3. Tenant:	*CAPSTONE TURBINE CORPORATION, a Delaware corporation.*
4. Premises (Article 1).	
4.1 Building Address:	*21700 Oxnard Street, Woodland Hills, California 91367.*
4.2 Premises:	*Approximately 6,846 rentable (6,005 usable) square feet of space located on the 16th floor of the Building, as further set forth in Exhibit A to the Office Lease.*
5. Lease Term (Article 2).	
5.1 Length of Term:	*Five (5) years.*
5.2 Lease Commencement Date:	*April 1, 2001.*
5.3 Lease Expiration Date:	*March 31, 2006.*

6. Base Rent (Article 3):

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Month of Lease Term	Annual Base Rent	Monthly Installment of Base Rent	Monthly Rental Rate per Rentable Square Foot
<S>	<C>	<C>	<C>
1-12	$217,702.80	$18,141.90	$2.65
13-24	$224,274.96	$18,689.58	$2.73
25-36	$230,847.12	$19,237.26	$2.81
37-48	$238,240.80	$19,853.40	$2.90
49-60	$244,812.96	$20,401.08	$2.98

</TABLE>

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7. Additional Rent (Article 3).	
7.1 Base Year:	The calendar year of 2001.
7.2 Tenant's Share:	Approximately 1.52%.
7.3 Tenant's Common Area Share:	Approximately 1.03%.
8. Security Deposit (Article 4):	$18,142.00.
9. Parking Pass Ratio (Article 18):	Twenty (20) unreserved parking passes.
10. Address of Tenant (Section 19.5):	21211 Nordoff Street Chatsworth, California 91311 Attention: Jeffrey Watts (Prior to Lease Commencement Date) and 21700 0xnard Street, Suite 1650 Woodland Hills, California 91367 Attention: Office Manager (After Lease Commencement Date)
11. Broker(s) (Article 14):	CB Richard Ellis, Inc., Colliers Seeley International, Inc

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EXHIBITS

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OFFICE LEASE

This Office Lease, which includes the preceding Summary of Basic Lease Information (the "SUMMARY") attached hereto and incorporated herein by this

reference (the Office Lease and Summary are collectively referred to herein as the "LEASE"), dated as of the date set forth in Section 1 of the Summary is made by and between AH WARNER CENTER PROPERTIES, LIMITED LIABILITY COMPANY, a Delaware limited liability company ("LANDLORD"), and CAPSTONE TURBINE CORPORATION, a Delaware corporation ("TENANT").

ARTICLE 1

PREMISES, BUILDING, PROJECT, AND COMMON AREAS

1.1 The Premises. Upon and subject to the terms, covenants and conditions hereinafter set forth in this Lease, Landlord hereby leases to Tenant and Tenant hereby leases from Landlord the premises set forth in Section 4.2 of the Summary (the "PREMISES"). The outline of the Premises is set forth in Exhibit A attached hereto.

1.2 The Building and The Project. The Premises are a part of the building set forth in Section 4.1 of the Summary (the "BUILDING"). The Building is part of an office project known as WARNER CENTER PLAZA. The term "PROJECT," as used in this Lease, shall mean (i) the Building and the "Common Areas", as that term is defined in Section 1.3 below, (ii) the land (which is improved with landscaping, parking facilities and other improvements as shown on Exhibit B attached hereto) upon which the Building and the Common Areas are located, and (iii) at Landlord's discretion, any additional real property, areas, land, buildings or other improvements added thereto pursuant to the terms of Section 1.4 of this Lease.

1.3 Common Areas. Tenant shall have the non-exclusive right to use in common with other tenants in the Project, and subject to the rules and regulations referred to in Article 5 of this Lease, those portions of the Project which are provided, from time to time, for use in common by Landlord, Tenant and any other tenants of the Project (such areas, together with such other portions of the Project designated by Landlord, in its discretion, including certain areas designated for the exclusive use of certain tenants, or to be shared by Landlord and certain tenants, are collectively referred to herein as the "COMMON AREAS"). The Common Areas shall consist of the "Project Common Areas" and the "Building Common Areas". The term "PROJECT COMMON AREAS", as used in this Lease, shall mean the portion of the Project designated as such by Landlord, and may include, without limitation, any fixtures, systems, signs, facilities, parking areas, gardens, parks or other landscaping contained, maintained or used in connection with the Project, and may include any city sidewalks adjacent to the Project, pedestrian walkway system, whether above or below-grade, park or other facilities open to the general public and roadways, sidewalks, walkways, parkways, driveways and landscape areas appurtenant to the Project. The location of the Project Common Areas as of the date of this Lease is shown on Exhibit B attached hereto. The term "BUILDING COMMON AREAS", as used in this Lease, shall mean the portions of the Common Areas located within the Building designated as such by Landlord, and may include, without limitation, the common entrances, lobbies, atrium areas, restrooms, elevators, stairways and accessways, loading docks, ramps, drives, platforms, passageways,

serviceways, common pipes, conduits, wires, equipment, loading and unloading areas, parking facilities and trash areas servicing the Building. The manner in which the Common Areas are maintained and operated shall be at the sole discretion of Landlord, provided that, notwithstanding the foregoing, Landlord shall maintain the Common Areas in a manner consistent with other class "A" properties in the area.

1.4 Landlord's Use and Operation of the Building, Project, and Common Areas. Landlord reserves the right from time to time without notice to Tenant (i) to close temporarily any of the Common Areas; (ii) to make changes to the Common Areas, including, without limitation, changes in the location, size, shape and number of street entrances, driveways, ramps, entrances, exits, passages, stairways and other ingress and egress, direction of traffic, landscaped areas, loading and unloading areas, and walkways; (iii) to expand the Building; (iv) to add additional buildings and improvements to the Common Areas; (v) to designate land outside the Project to be part of the Project, and in connection with the improvement of such land to add additional buildings and common areas to the Project and/or to delete land and improvements from the Project; (vi) to use the Common Areas while engaged in making additional improvements, repairs or alterations to the Project or to any adjacent land, or any portion thereof; and (vii) to do and perform such other acts and make such

other changes in, to or with respect to the Project, Common Areas and Building or the expansion thereof as Landlord may deem to be appropriate; provided, however, in connection with Landlord's exercise of its rights under this Section 1.4, Landlord shall use commercially reasonable efforts to minimize interference with Tenant's business operations..

ARTICLE 2

LEASE TERM

2.1 Initial Term. The terms and provisions of this Lease shall be effective as of the date of this Lease. Landlord shall deliver the Premises to Tenant in its current "as is" condition, upon the date of full execution and delivery of this Lease (the "DELIVERY DATE"). The term of this Lease (the "LEASE TERM") shall be as set forth in Section 5.1 of the Summary, shall commence on the date set forth in Section 5.2 of the Summary (the "LEASE COMMENCEMENT DATE"), and shall terminate on the date set forth in Section 5.3 of the Summary (the "LEASE EXPIRATION DATE") unless this Lease is sooner terminated as hereinafter provided. Tenant shall have the right to commence business from the Premises during the period from the Delivery Date to the Lease Commencement Date (the "BENEFICIAL OCCUPANCY PERIOD"), provided that (A) Tenant shall give Landlord prior notice of any such occupancy of the Premises, (B) a certificate of occupancy (or its equivalent) shall have been issued by the appropriate governmental authorities for the Premises, and (C) all of the terms and conditions of this Lease shall apply, including Tenant's obligations to pay parking fees pursuant to Article 28 below, during the Beneficial Occupancy Period, except that Tenant's obligation to pay Base Rent and any Direct Expenses shall not apply during the Beneficial Occupancy Period. For purposes of this Lease, the term "LEASE YEAR" shall mean each consecutive twelve (12) month period during the Lease Term; provided, however, that the first Lease Year shall commence on the Lease Commencement Date and end on the last day of the eleventh calendar month thereafter and the second and each succeeding Lease Year shall commence on the first day of the next calendar month; and further provided that the last Lease Year shall end on the Lease Expiration Date. At

any time during the Lease Term, Landlord may deliver to Tenant a notice in the form as set forth in Exhibit D, attached hereto, which Tenant shall execute and return to Landlord within five (5) days of receipt thereof.

2.2 Option Term. Landlord hereby grants to the original Tenant named in this Lease (the "ORIGINAL TENANT"), one (1) option to extend the Lease Term for a period of five (5) years (the "OPTION TERM"), which option shall be exercisable only by written notice ("OPTION NOTICE") delivered by Tenant to Landlord as provided in Section 2.2.2 below, provided that, as of the date of delivery of such notice and, at Landlord's option, as of the last day of the initial Lease Term, Tenant is not in default under this Lease after expiration of applicable cure periods. The right contained in this Section 2.2 shall be personal to the Original Tenant and may only be exercised by the Original Tenant or an Affiliated Assignee (and not any other assignee, sublessee or other transferee of the Original Tenant's interest in this Lease) if the Original Tenant or such Affiliated Assignee occupies the entire Premises as of the date of the Option Notice.

2.2.1 Option Rent. The Rent payable by Tenant during the Option Term (the "OPTION RENT") shall be equal to the then prevailing fair market rent for the Premises as of the commencement date of the Option Term. The then prevailing fair market rent shall be the rental rate, including all escalations, at which renewal tenants, as of the commencement of the Option Term, are entering into leases for non-sublease, non-encumbered space comparable in size, location and quality to the Premises for a term of approximately the Option Term, which comparable space is located in comparable buildings in Warner Center, taking into consideration the following concessions: (a) rental abatement concessions, if any, being granted such tenants in connection with such comparable space and (b) tenant improvements or allowances provided or to be provided for such comparable space, taking into account, and deducting the value of, the existing improvements in the Premises, with such value to be based upon the age, quality and layout of the improvements and the extent to which the same could be utilized by Tenant based upon the fact that the precise tenant improvements existing in the Premises are specifically suitable to Tenant.

2.2.2 Exercise of Option. The option contained in this Section 2.2 shall be exercised by Tenant, if at all, only in the following manner: (i) Tenant shall deliver written notice ("INTEREST NOTICE") to Landlord on or before the date which is twelve (12) months prior to the expiration of the initial Lease Term, stating that Tenant is interested in exercising its option; (ii) Landlord, after receipt of Tenant's notice, shall deliver notice (the "OPTION RENT NOTICE") to Tenant not less than ten (10) months prior to the expiration of the initial Lease Term, setting forth the Option Rent; and (iii) if Tenant wishes to exercise such option, Tenant shall, on or before the earlier of (A) the date occurring nine (9) months prior to the expiration of the initial Lease Term, and (B) the date occurring thirty (30) days after Tenant's receipt of the Option Rent Notice, exercise the option by delivering the Option Notice to Landlord. Failure of Tenant to deliver the Interest Notice to Landlord on or before the date specified in (i) above or to deliver the Option Notice to Landlord on or before the date specified in (iii) above shall be deemed to constitute Tenant's failure to exercise its option to extend. If Tenant timely and properly exercises its option to extend, the Lease Term shall be extended for the Option Term upon all of the terms and conditions set forth in this Lease, except that the Rent shall be as indicated in the Option Rent Notice.

ARTICLE 3

RENT

3.1 Base Rent. Tenant shall pay, without prior notice or demand, to Landlord or Landlord's agent at the management office of the Project, or, at Landlord's option, at such other place as Landlord may from time to time designate in writing, in a check for currency which, at the time of payment, is legal tender for private or public debts in the United States of America, base rent ("BASE RENT") as set forth in Section 6 of the Summary, payable in equal monthly installments as set forth in Section 6 of the Summary in advance on or before the first day of each and every month during the Lease Term, without any setoff or deduction whatsoever. The Base Rent for the first full month of the Lease Term which occurs after the expiration of any free rent period shall be paid at the time of Tenant's execution of this Lease. If any Rent payment date (including the Lease Commencement Date) falls on a day of the month other than the first day of such month or if any payment of Rent is for a period which is shorter than one month, the Rent for any fractional month shall accrue on a daily basis for the period from the date such payment is due to the end of such calendar month or to the end of the Lease Term at a rate per day which is equal to 1/365 of the applicable annual Rent. All other payments or adjustments required to be made under the terms of this Lease that require proration on a time basis shall be prorated on the same basis.

3.2 Additional Rent. In addition to paying the Base Rent specified in Section 3.1 of this Lease, Tenant shall pay "Tenant's Share" of the annual "Building Direct Expenses," as those terms are defined in Sections 3.3.10 and 3.3.2 of this Lease, respectively, to the extent such Building Direct Expenses are in excess of Building Direct Expenses for the "Base Year," as that term is defined in Section 3.3.1 of this Lease. Such payments by Tenant, together with any and all other amounts payable by Tenant to Landlord pursuant to the terms of this Lease, are hereinafter collectively referred to as the "ADDITIONAL RENT", and the Base Rent and the Additional Rent are herein collectively referred to as "Rent." All amounts due under this Article 3 as Additional Rent shall be payable for the same periods and in the same manner as the Base Rent. Without limitation on other obligations of Tenant which survive the expiration of the Lease Term, the obligations of Tenant to pay the Additional Rent provided for in this Article 3 shall survive the expiration of the Lease Term.

3.3 Definitions of Key Terms Relating to Additional Rent. As used in this Article 3, the following terms shall have the meanings hereinafter set forth:

3.3.1 "BASE YEAR" shall be as set forth in Section 7.1 of the Summary.

3.3.2 "BUILDING DIRECT EXPENSES" shall mean "Building

Operating Expenses" and "Building Tax Expenses", as those terms are defined in Sections 3.3.3 and 3.3.4, below, respectively.

3.3.3 "BUILDING OPERATING EXPENSES" shall mean the portion of "Operating Expenses," as that term is defined in Section 3.3.7 below, allocated to the tenants of the Building pursuant to the terms of Section 3.4.1 below.

3.3.4 "BUILDING TAX EXPENSES" shall mean that portion of "Tax Expenses", as that term is defined in Section 3.3.9 below, allocated to the tenants of the Building pursuant to the terms of Section 3.4.1 below.

3.3.5 "EXPENSE YEAR" shall mean each calendar year in which any portion of the Lease Term falls, through and including the calendar year in which the Lease Term expires, provided that Landlord, upon notice to Tenant, may change the Expense Year from time to time to any other twelve (12) consecutive month period, and, in the event of any such change, Tenant's Share of Building Direct Expenses shall be equitably adjusted for any Expense Year involved in any such change.

3.3.6 "DIRECT EXPENSES" shall mean "Operating Expenses" and "Tax Expenses".

3.3.7 "OPERATING EXPENSES" shall mean all expenses, costs and amounts of every kind and nature which Landlord pays during any Expense Year because of or in connection with the ownership, management, maintenance, repair, replacement, restoration or operation of the Project, or any portion thereof. Without limiting the generality of the foregoing, Operating Expenses shall specifically include any and all of the following: (i) the cost of supplying all utilities, the cost of operating, maintaining, repairing, renovating, complying with conservation measures in connection with, and managing the utility systems, mechanical systems, sanitary and storm drainage systems, and elevator systems, and the cost of supplies and equipment and maintenance and service contracts in connection therewith; (ii) the cost of licenses, certificates, permits and inspections and the cost of contesting the validity or applicability of any governmental enactments which may affect Operating Expenses, and the costs incurred in connection with the implementation and operation of a transportation system management program or a municipal, private or public shuttle service or parking program; (iii) the cost of all insurance carried by Landlord in connection with the Project, or any portion thereof; (iv) the cost of landscaping, relamping, and all supplies, tools, equipment and materials used in the operation, repair and maintenance of the Project, or any portion thereof; (v) the cost of parking area repair, restoration, and maintenance including, but not limited to, resurfacing, repainting, restriping, and cleaning; (vi) fees, charges and other costs, including consulting fees, legal fees and accounting fees, of all contractors and consultants engaged by Landlord or reasonably incurred by Landlord in connection with the management, operation, maintenance and repair of the Project, or any portion thereof including the fair market rental value of any office space utilized for such purpose and a management fee in the amount of fifteen percent (15%) of all other Direct Expenses; (vii) payments under any equipment rental agreements; (viii) wages, salaries and other compensation and benefits of all persons engaged in the operation, maintenance or security of the Project, or any portion thereof, including employer's Social Security taxes, unemployment taxes or insurance, and any other taxes which may be levied on such wages, salaries, compensation and benefits; provided, that if any employees of Landlord provide services for more than one project of Landlord, then a prorated portion of such employees' wages, benefits and taxes shall be included in Operating Expenses based on the portion of their working time devoted to the Project, or any portion thereof; (ix) payments, fees or charges under any easement, license, operating agreement, declaration, restrictive covenant, or instrument pertaining to the sharing of costs by the Project, or any portion thereof; (x) operation, repair, maintenance and replacement of all "Systems and Equipment," as that term is defined in

Section 3.3.8 of this Lease, and components thereof; (xi) the cost of janitorial

services, alarm and security service, window cleaning, trash removal, replacement of wall and floor coverings, ceiling tiles and fixtures in lobbies, corridors, restrooms and other common or public areas or facilities, maintenance and replacement of curbs and walkways, repair to roofs and re-roofing; (xii) amortization (including interest on the unamortized cost at a rate reasonably determined by Landlord) of the cost of acquiring or the rental expense of personal property used in the maintenance, operation and repair of the Project, or any portion thereof; (xiii) the cost of capital improvements or other costs incurred in connection with the Project (A) which are intended to effect economies in the operation or maintenance of the Project, or any portion thereof, or (B) that are required under any governmental law or regulation; provided, however, that any capital expenditure shall be amortized over its useful life as Landlord shall reasonably determine, and the unamortized cost of the same shall bear interest at a rate reasonably determined by Landlord; and (xiv) costs, fees, charges or assessments imposed by any federal, state or local government for fire and police protection, trash removal, community services, or other services which do not constitute "Tax Expenses" as that term is defined in Section 3.3.9, below. If Landlord is not furnishing any particular work or service (the cost of which, if performed by Landlord, would be included i n Operating Expenses) to a tenant who has undertaken to perform such work or service in lieu of the performance thereof by Landlord, Operating Expenses shall be deemed to be increased by an amount equal to the additional Operating Expenses which would reasonably have been incurred during such period by Landlord if it had at its own expense furnished such work or service to such tenant. If the Building is not at least ninety-five percent (95%) occupied during all or a portion of any Expense Year (including the Base Year), Landlord shall make an appropriate adjustment to the variable components of Operating Expenses for such year employing sound accounting and management principles, to determine the amount of Operating Expenses that would have been paid had the Building been ninety-five percent (95%) occupied; and the amount so determined shall be deemed to have been the amount of Operating Expenses for such year. Notwithstanding the foregoing, for purposes of this Lease, Operating Expenses shall not, except as otherwise set forth in this Section 3.3, include (A) depreciation, interest and amortization on mortgages, or ground lease payments, if any; (B) legal fees incurred in negotiating and enforcing tenant leases; (C) real estate brokers' leasing commissions; (D) initial improvements or alterations to tenant spaces; (E) the cost of providing any service directly to and paid directly by any tenant; (F) any costs expressly excluded from Operating Expenses elsewhere in this Lease; (G) costs of any items to the extent Landlord receives reimbursement from insurance proceeds or from a third party (such proceeds to be credited to Operating Expenses in the year in which received, except that any deductible amount under any insurance policy shall be included within Operating Expenses); (H) Tax Expenses; (I) costs of capital improvements, except those set forth in this Section 3.3 or those includable in Operating Expenses pursuant to an application by Landlord of sound real estate management principles; (J) marketing costs, including leasing commissions, attorneys' fees in connection with the negotiation and preparation of letters, deal memos, letters of intent, leases, subleases and/or assignments, space planning costs, and other costs and expenses incurred in connection with lease, sublease and/or assignment negotiations and transactions with present or prospective tenants or other occupants of the Building, including attorneys' fees and other costs and expenditures incurred in connection with disputes with present or prospective tenants or other occupants of the Building; (K) expenses in connection with services or other benefits which are not offered to Tenant or for which Tenant is charged for directly but which are provided to

another tenant or occupant of the Building without charge; (L) the cost of any items for which Landlord is reimbursed by insurance proceeds, condemnation awards, a tenant of the Building, or otherwise to the extent so reimbursed; (M) bad debt expenses and interest, principal, points and fees on debts (except in connection with the financing of items which may be included in Operating Expenses); and (N) costs of correcting defects in or inadequacy of the initial design or construction of the Building. Notwithstanding anything to the contrary set forth in this Article 3, when calculating Direct Expenses for the Base Year, Operating Expenses shall exclude (i) market-wide labor-rate increases due to extraordinary circumstances, including, but not limited to, boycotts and strikes, (ii) utility rate increases due to extraordinary circumstances including, but not limited to, conservation surcharges, boycotts, embargoes or other shortages, and (iii) amortization and other costs of capital improvement,

restoration, and replacement relating to any portion of the Project (including the amortization expenses of any such costs incurred in prior years) ; provided, however, that if Landlord does not carry earthquake insurance for the Project during any part of the Base Year but subsequently obtains earthquake insurance for the Project during the Lease Term, then from and after the date upon which Landlord obtains such earthquake insurance and continuing throughout the period during which Landlord maintains such insurance, Operating Expenses for the Base Year shall be deemed to be increased by the amount of the premium Landlord reasonably estimates it would have incurred had Landlord maintained such insurance for the same period of time during the Base Year as such insurance was maintained by Landlord during such subsequent calendar year.

3.3.8 "SYSTEMS AND EQUIPMENT" shall mean any plant, machinery, transformers, duct work, conduit, pipe, bus duct, cable, wires, and other equipment, facilities, and systems designed to supply-heat, ventilation, air conditioning and humidity or any other services or utilities, or comprising or serving as any component or portion of the electrical, gas, steam, plumbing, sprinkler, communications, alarm, security, or fire/life safety systems or equipment, or any other mechanical, electrical, electronic, computer or other systems or equipment which serve the Project in whole or in part.

3.3.9 "TAX EXPENSES" shall mean all federal, state, county, or local governmental or municipal taxes, fees, charges or other impositions of every kind and nature, whether general, special, ordinary or extraordinary, (including, without limitation, real estate taxes, general and special assessments, transit taxes, leasehold taxes or taxes based upon the receipt of rent, including gross receipts or sales taxes applicable to the receipt of rent, unless required to be paid by Tenant, personal property taxes imposed upon the fixtures, machinery, equipment, apparatus, systems and equipment, appurtenances, furniture and other personal property used in connection with the Project, or any portion thereof), which shall be paid during any Expense Year (without regard to any different fiscal year used by such governmental or municipal authority) because of or in connection with the ownership, leasing and operation of the Project, or any portion thereof.

3.3.9.1 Tax Expenses shall include, without limitation:

(i) Any tax on the rent, right to rent or other income from the Project, or any portion thereof, or as against the business of leasing the Project, or any portion thereof;

(ii) Any assessment, tax, fee, levy or charge in addition to, or in substitution, partially or totally, of any assessment, tax, fee, levy or charge previously included within the definition of real property tax, it being acknowledged by Tenant and Landlord that Proposition 13 was adopted by the voters of the State of California in the June 1978 election ("PROPOSITION 13") and that assessments, taxes, fees, levies and charges may be imposed by governmental agencies for such services as fire protection, street, sidewalk and road maintenance, refuse removal and for other governmental services formerly provided without charge to property owners or occupants, and, in further recognition of the decrease in the level and quality of governmental services and amenities as a result of Proposition 13, Tax Expenses shall also include any governmental or private assessments or the Project's contribution towards a governmental or private cost-sharing agreement for the purpose of augmenting or improving the quality of services and amenities normally provided by governmental agencies. It is the intention of Tenant and Landlord that all such new and increased assessments, taxes, fees, levies, and charges and all similar assessments, taxes, fees, levies and charges be included within the definition of Tax Expenses for the purposes of this Lease;

(iii) Any assessment, tax, fee, levy, or charge allocable to or measured by the area of the Premises or the Rent payable hereunder, including, without limitation, any gross income tax with respect to the receipt of such rent, or upon or with respect to the possession, leasing, operating, management, maintenance, alteration, repair, use or occupancy by Tenant of the Premises, or any portion

thereof; and

(iv) Any assessment, tax, fee, levy or charge, upon this transaction or any document to which Tenant is a party, creating or transferring an interest or an estate in the Premises.

3.3.9.2 With respect to any assessment that may be levied against, upon, or in connection with the Project, or any portion thereof, and may be evidenced by improvement or other bonds, or may be paid in annual installments, there shall be included within the definition of Tax Expenses with respect to any tax fiscal year only the amount currently payable on such bonds, including interest, for such tax fiscal year, or the current annual installment for such tax fiscal year.

3.3.9.3 If the method of taxation of real estate prevailing at the time of execution hereof shall be, or has been, altered so as to cause the whole or any part of the taxes now, hereafter or heretofore levied, assessed or imposed on real estate to be levied, assessed or imposed upon the owner or owners of the Project, wholly or partially, as a capital levy or otherwise, or on or measured by the rents received therefrom, then such new or altered taxes attributable to the Project, or any portion thereof, shall be included within the term "Tax Expenses" except that the same shall not include any enhancement of said tax attributable to other income.

3.3.9.4 In no event shall Tax Expenses for any Expense Year be less than Tax Expenses for the Base Year.

3.3.9.5 If Tax Expenses for any period during the Lease Term or any extension thereof are increased after payment thereof for any reason, including, without limitation, error or reassessment by applicable governmental or municipal authorities, Tenant shall pay Landlord upon demand Tenant's Share of any such increased Tax Expenses included by Landlord as Building Tax Expenses pursuant to the terms of this Lease.

3.3.9.6 Any expenses incurred in attempting to protest, reduce or minimize Tax Expenses shall be included in Tax Expenses in the Expense Year such expenses are paid. Tax refunds shall be deducted from Tax Expenses in the Expense Year they are received.

3.3.9.7 Notwithstanding anything to the contrary contained in this Section 3.3.9 (except as set forth in Sections 3.3.9.1 and 3.3.9.3, above), there shall be excluded from Tax Expenses (i) all excess profits taxes, franchise taxes, gift taxes, capital stock taxes, inheritance and succession taxes, estate taxes, federal and state income taxes, and other taxes to the extent applicable to Landlord's general or net income (as opposed to rents, receipts or income attributable to operations at the Project), (ii) any items included as Operating Expenses, and (iii) any items paid by Tenant under Article 9 of this Lease.

3.3.9.8 Notwithstanding anything to the contrary set forth in this Article 3, when calculating Direct Expenses for the Base Year, such Direct Expenses shall not include any increase in Tax Expenses attributable to special assessments, charges, costs, or fees, or due to modifications or changes in governmental laws or regulations, including, but not limited to, the institution of a split tax roll.

3.3.10 "TENANT'S SHARE" shall mean the percentage calculated by dividing the number of rentable square feet of the Premises by the total number of rentable square feet in the Building. In the event either the rentable square feet of the Premises and/or the total rentable square feet of the Building is changed, Tenant's Share shall be appropriately adjusted, and, as to the Expense Year in which such change occurs, Tenant's Share for such Expense Year shall be determined on the basis of the number of days during such Expense Year that each such Tenant's Share was in effect.

3.3.11 Landlord shall, at Landlord's option, have the right to segregate Direct Expenses into two (2) separate categories, one (1) such category to be applicable only to Direct Expenses incurred for the Building

and the other category applicable to Direct Expenses incurred for the Project Common Areas. If Landlord so segregates Direct Expenses into two (2) categories, two (2) Tenant's Shares shall apply, one (1) such Tenant's Share shall be calculated by dividing the number of rentable square feet of the Premises by the total number of rentable square feet in the Building ("TENANT'S BUILDING SHARE"), subject to adjustment as provided in Section 3.3.10 above, and the other Tenant's Share to be calculated by dividing the number of rentable square feet of the Premises by the total number of rentable square feet (subject to adjustment as provided in Section 1.2 of all buildings in the Project ("TENANT'S COMMON AREA SHARE"). Consequently, if Landlord elects to so segregate Direct Expenses info two (2) categories, any reference in this Lease to "TENANT'S SHARE OF BUILDING DIRECT EXPENSES" shall mean and refer to both Tenant's Building Share of Direct Expenses and Tenant's Common Area Share of Direct Expenses. No Operating Expenses or Taxes may be charged in a duplicative

manner or as both Tenant's Building Share of Direct Expenses and Tenant's Common Area Share of Direct Expenses.

3.4 Allocation of Direct Expenses.

3.4.1 Method of Allocation. The parties acknowledge that the Building is a part of a multi-building project and that the costs and expenses incurred in connection with the Project (i.e., the Direct Expenses) should be shared between the tenants of the Building and the tenants of the other buildings in the Project. Accordingly, as set forth in Section 3.3 above, Direct Expenses (which consists of Operating Expenses and Tax Expenses) are determined annually for the Project as a whole, and a portion of the Direct Expenses, which portion shall be determined by Landlord on an equitable basis, shall be allocated to the tenants of the Building (as opposed to the tenants of any other buildings in the Project) and such portion shall be the Building Direct Expenses for purposes of this Lease. Such portion of Direct Expenses allocated to the tenants of the Building shall include all Direct Expenses attributable solely to the Building and an equitable portion of the Direct Expenses attributable to the Project as a whole.

3.4.2 Cost Pools. Landlord shall have the right, from time to time, to equitably allocate some or all of the Direct Expenses for the Project among different portions or occupants of the Project (the "COST POOLS"), in Landlord's discretion. Such Cost Pools may include, but shall not be limited to, the office space tenants of a building of the Project or of the Project, and the retail space tenants of a building of the Project or of the Project. The Direct Expenses within each such Cost Pool shall be allocated and charged to the tenants within such Cost Pool in a reasonable, non-discriminatory and equitable manner.

3.5 Calculation and Payment of Additional Rent. For every Expense Year ending or commencing within the Lease Term, Tenant shall pay to Landlord, in the manner set forth in Section 3.5.1, below, and as Additional Rent an amount equal to Tenant's Share of Building Direct Expenses for such Expense Year in excess of the Building Direct Expenses for the Base Year.

3.5.1 Statement of Actual Building Direct Expenses and Payment by Tenant. Landlord shall endeavor to give to Tenant on or before the first day of April following the end of each Expense Year, a statement (the "STATEMENT") which shall state the Building Direct Expenses incurred or accrued for such preceding Expense Year, and which shall indicate the amount of Tenant's Share of such Building Direct Expenses in excess of the Building Direct Expenses for the Base Year. Upon receipt of the Statement for each Expense Year commencing or ending during the Lease Term, Tenant shall pay, with its next installment of Base Rent due, the full amount of Tenant's Share of Building Direct Expenses for such Expense Year in excess of the Building Direct Expenses for the Base Year, less the amounts, if any, paid during such Expense Year as "Estimated Additional Rent," as that term is defined in Section 3.5.2, below. The failure of Landlord to timely furnish the Statement for any Expense Year shall not prejudice Landlord or Tenant from enforcing its rights under this Article 3. Even though the Lease Term has expired and Tenant has vacated the Premises, when the final determination is made of Tenant's Share of Building Direct Expenses for the Expense Year in which this Lease terminates, Tenant shall pay to Landlord any underpaid amounts described herein or Landlord shall

pay to Tenant any overpaid amounts, as applicable, within thirty (30) days following delivery of the

Statement. The provisions of this Section 3.5.1 shall survive the expiration or earlier termination of the Lease Term.

3.5.2 Statement of Estimated Building Direct Expenses. In addition, Landlord shall endeavor to give Tenant a yearly expense estimate statement (the "ESTIMATE STATEMENT") which shall set forth Landlord's reasonable estimate (the "ESTIMATE") of what the total amount of Building Direct Expenses for the then-current Expense Year shall be and the estimated amount of Tenant's Share of Building Direct Expenses for the then-current Expense Year in excess of the Building Direct Expenses for the Base Year (the "ESTIMATED ADDITIONAL RENT"). The failure of Landlord to timely furnish the Estimate Statement for any Expense Year shall not preclude Landlord from enforcing its rights to collect any Estimated Additional Rent under this Article 3. Thereafter, Tenant shall pay, with its next installment of Base Rent due, a fraction of the Estimated Additional Rent for the then-current Expense Year (reduced by any amounts paid pursuant to the last sentence of this Section 3.5.2). Such fraction shall have as its numerator the number of months which have elapsed in such current Expense Year, including the month of such payment, and twelve (12) as its denominator. Until a new Estimate Statement is furnished (which Landlord shall have the right to deliver to Tenant at any time), Tenant shall pay monthly, with the monthly Base Rent installments, an amount equal to one-twelfth (1/12) of the total Estimated Additional Rent set forth in the previous Estimate Statement delivered by Landlord to Tenant.

3.6 Landlord's Books and Records. Within ninety (90) days after receipt of a Statement by Tenant ("REVIEW PERIOD"), if Tenant disputes the amount of Additional Rent set forth in the Statement, Tenant's employees or an accountant designated by Tenant and not paid on a contingency fee basis (collectively, "TENANT REPRESENTATIVE"), may, after reasonable notice to Landlord and during normal business hours, inspect and photocopy Landlord's records at Landlord's offices, provided that Tenant is not then in default after expiration of any applicable cure period, and provided, further, that Tenant and the Tenant Representative shall, and each of them shall use their commercially reasonable efforts to cause their respective employees to, maintain all information contained in Landlord's records in strict confidence. If after such inspection, Tenant notifies Landlord in writing ("AUDIT NOTICE") that Tenant still disputes such Additional Rent a certification as to the proper amount shall be made, at 'Tenant's expense, by an independent certified public accountant (which accountant is a member of a nationally recognized accounting firm and is not compensated on a contingency fee basis) selected by Landlord and approved by Tenant. The designated accountant shall review the Landlord records and calculations, each parties' contentions and this Lease. Landlord shall cooperate in good faith with Tenant and the designated accountant to show Tenant and the designated accountant the information upon which the certification is to be based; provided that if such certification by the designated accountant proves that the Direct Expenses set forth in the Statement were overstated by more than five percent (5%), then the cost of the designated accountant and the cost of such certification shall be paid for by Landlord. Promptly following the parties receipt of such certification, the parties shall make such appropriate payments or reimbursements, as the case may be, to each other, as are determined to be owing pursuant to such certification, together with interest at the Interest Rate from the date due until paid, in the case of payments by Tenant to Landlord, or from the date paid until reimbursed, in the case of reimbursements by Landlord to Tenant. The payment by Tenant of any amounts pursuant to this Article 3 shall not preclude Tenant from questioning the correctness of any Statement delivered by Landlord, provided that

the failure of Tenant to deliver the Audit Notice prior to the expiration of the Review Period shall be conclusively deemed Tenant's approval of the applicable Statement.

ARTICLE 4

SECURITY DEPOSIT

Concurrent with Tenant's execution of this Lease, Tenant shall deposit with Landlord a security deposit (the "SECURITY DEPOSIT") in the amount set forth in Section 8 of the Summary. The Security Deposit shall be held by Landlord as security for the faithful performance by Tenant of all the terms, covenants, and conditions of this Lease to be kept and performed by Tenant during the Lease Term. The Security Deposit shall not be mortgaged, assigned or encumbered in any manner whatsoever by Tenant without the prior written consent of Landlord. If Tenant defaults with respect to any provisions of this Lease, including, but not limited to, the provisions relating to the payment of Rent, Landlord may, but shall not be required to, use, apply or retain all or any part of the Security Deposit for the payment of any Rent or any other sum in default, or for the payment of any amount that Landlord may spend or become obligated to spend by reason of Tenant's default, or to compensate Landlord for any other loss or damage that Landlord may suffer by reason of Tenant's default. If any portion of the Security Deposit is so used or applied, Tenant shall, within five (5) days after written demand therefor, deposit cash with Landlord in an amount sufficient to restore the Security Deposit to its original amount, and Tenant's failure to do so shall be a default under this Lease. Tenant acknowledges that Landlord has the right to transfer or mortgage its interest in the Building or Project and in this Lease and Tenant agrees that in the event of any such transfer or mortgage, Landlord shall have the right to transfer or assign the Security Deposit to the transferee or mortgagee. Upon such transfer or assignment of the Security Deposit, Landlord shall thereby be released by Tenant from all liability or obligation for the return of such Security Deposit and Tenant shall look solely to such transferee or mortgagee for the return of the Security Deposit. If Tenant shall fully and faithfully perform every provision of this Lease to be performed by it, the Security Deposit, or any balance thereof, shall be returned to Tenant, or, at Landlord's option, to the last assignee of Tenant's interest hereunder, within thirty (30) days following the expiration of the Lease Term. Tenant shall not be entitled to any interest on the Security Deposit. Tenant hereby waives the provisions of Section 1950.7 of the California Civil Code, and all other provisions of law, now or hereafter enforced, which provide that Landlord may claim from a security deposit only those sums reasonably necessary to remedy defaults in the payment of rent, to repair damage caused by Tenant or to clean the Premises, it being agreed that Landlord may, in addition, claim those sums reasonably necessary to compensate Landlord for any other loss or damage, foreseeable or unforeseeable, caused by the acts or omissions of Tenant or any officer, employee, agent, contractor or invitee of Tenant.

ARTICLE 5

USE OF PREMISES

5.1 Permitted Use. Tenant shall use the Premises solely for general office purposes and related uses consistent with the character of the Project as a first-class office building project, and Tenant shall not use or permit the Premises to be used for any other purpose

or purposes whatsoever without the prior written consent of Landlord, which Landlord may withhold in its sole discretion.

5.2 Prohibited Uses. Tenant further covenants and agrees that Tenant shall not use, or suffer or permit any person or persons to use, the Premises, the Common Areas (including, without limitation, the Project's parking facility) or any part thereof for any use or purpose contrary to the provisions of Exhibit E attached hereto ("RULES AND REGULATIONS"), or in violation of the laws of the United States of America, the State of California, or the ordinances, regulations or requirements of the local municipal or county governing body or other lawful authorities having jurisdiction over the Project) including, without limitation, any such laws, ordinances, regulations or requirements relating to "Hazardous Material", as that term is defined in Section 19.29 below. Tenant shall comply with all recorded covenants, conditions, and restrictions now or hereafter affecting the Project.

5.3 Labor Harmony. Tenant shall not use (and upon notice from

Landlord shall cease using) contractors, services, workmen, labor, materials or equipment that, in Landlord's reasonable judgment, would disturb labor harmony with the workforce or trades engaged in performing other work, labor or services in or about the Project.

ARTICLE 6

REPAIRS, ADDITIONS AND ALTERATIONS

6.1 Repairs. Tenant shall, at Tenant's own expense, keep the Premises, including all improvements, fixtures and furnishings therein, in good order, repair and condition at all times during the Lease Term. In addition, Tenant shall, at Tenant's own expense, but under the supervision and subject to the prior approval of Landlord, and within any reasonable period of time specified by Landlord, promptly and adequately repair all damage to the Premises and replace or repair all damaged, broken, or worn fixtures and appurtenances; provided however, that, at Landlord's option, or if Tenant fails to make such repairs, Landlord may, but need not, make such repairs and replacements, and Tenant shall pay Landlord the cost thereof, including a percentage of the cost thereof (to be uniformly established for the Building and/or the Project) sufficient to reimburse Landlord for all overhead, general conditions, fees and other costs or expenses arising from Landlord's involvement with such repairs and replacements forthwith upon being billed for same. Landlord may, but shall not be required to, enter the Premises at all reasonable times to make such repairs, alterations, improvements or additions to the Premises or to the Project or to any equipment located in the Project as Landlord shall desire or deem necessary or as Landlord may be required to do by governmental or quasi-governmental authority or court order or decree. Tenant hereby waives and releases its right to make repairs at Landlord's expense under Sections 1941 and 1942 of the California Civil Code or under any similar law, statute, or ordinance now or hereafter in effect.

6.2 Landlord's Consent to Alterations Tenant may, not make any improvements, alterations, additions or changes to the Premises (collectively, the "ALTERATIONS") without first procuring the prior written consent of Landlord to such Alterations, which consent shall be requested by Tenant not less than thirty (30) days prior to the commencement thereof, and which consent shall not be unreasonably withheld by Landlord. Notwithstanding the

foregoing, Tenant may make strictly cosmetic changes to the finish work in the Premises, without Landlord's consent, provided that the aggregate cost of any such changes does not exceed $15,000.00 in any twelve (12) month period, and such changes do not require any structural or other substantial modifications to the Premises, do not require any changes to, or adversely affect, the Systems and Equipment, and do not affect the exterior appearance of the Building. Tenant shall give Landlord at least thirty (30) days prior notice of such cosmetic changes, which notice shall be accompanied by reasonably adequate evidence that such changes meet the criteria contained in this Section 6.2. The construction of the initial improvements to the Premises shall be governed by the terms of the Tenant Work Letter and not the terms of this Article 6.

6.3 Manner of Construction. Landlord may impose, as a condition of its consent to any and all Alterations or repairs of the Premises or about the Premises, such requirements as Landlord in its sole discretion may deem desirable, including, but not limited to, the requirement that upon Landlord's request given concurrently with Landlord's consent to such Alteration, Tenant shall, at Tenant's expense, remove such Alterations upon the expiration or any early termination of the Lease Term, and/or the requirement that Tenant utilize for such purposes only contractors, materials, mechanics and materialmen selected by Landlord. In any event, a contractor of Landlord's selection shall perform all mechanical, electrical, plumbing, lifesafety, sprinkler and structural work, and such work shall be performed at Tenant's cost. Tenant shall construct such Alterations and perform such repairs in conformance with any and all applicable federal, state, county or municipal laws, rules and regulations and pursuant to a valid building permit, all in conformance with Landlord's construction rules and regulations. All work with respect to any Alterations must be done in a good and workmanlike manner and diligently prosecuted to completion to the end that the Premises shall at all times be a complete unit

except during the period of work. In performing the work of any such Alterations, Tenant shall have the work performed in such manner so as not to obstruct access to the Project or any portion thereof by any other tenant of the Project, and so as not to obstruct the business of Landlord or other tenants in the Project, or interfere with the labor force working in the Project. In addition to Tenant's obligations under Section 19.18 of this Lease, upon completion of any Alterations, Tenant agrees to cause a Notice of Completion to be recorded in the office of the Recorder of the County of Los Angeles in accordance with Section 3093 of the Civil Code of the State of California or any successor statute, and Tenant shall deliver to the Project management office a reproducible, full-sized copy of the "as built" drawings (1 /8 inch = 1 foot scale) of the Alterations.

6.4 Payment for Improvements. In the event Tenant orders any Alterations or repair work directly from Landlord, the charges for such work shall be deemed Additional Rent under this Lease, due and payable prior to the commencement of such work. If payment is made directly to contractors, Tenant shall comply with Landlord's requirements for final lien releases and waivers in connection with Tenant's payment for work to such contractors: Whether or not Tenant orders any work directly from Landlord, Tenant shall pay to Landlord a percentage of the cost of such work (such percentage, which shall vary depending upon whether or not Tenant orders the work directly from Landlord, to be established on a uniform basis for the Building and/or Project, but shall in no event exceed five percent (5%) of the cost of such work) sufficient to compensate Landlord for all overhead, general conditions, fees and other costs and expenses arising from Landlord's involvement with such work.

6.5 Construction Insurance. In addition to the requirements of Article 7 of this Lease, in the event that Tenant makes any Alterations, prior to the commencement of such Alterations, Tenant shall provide Landlord with evidence that Tenant carries "Builder's All Risk" insurance in an amount approved by Landlord covering the construction of such Alterations, and such other insurance as Landlord may require, it being understood and agreed that all of such Alterations shall be insured by Tenant pursuant to Article 7 of this Lease immediately upon completion thereof. In addition, Landlord may, in its discretion, require Tenant to obtain a lien and completion bond or some alternate form of security satisfactory to Landlord in an amount sufficient to ensure the lien-free completion of such Alterations and naming Landlord as a co-obligee Notwithstanding the foregoing, if the cost of such Alterations is $15,000 or less and the net worth of the Tenant as of the date Tenant requests Landlord's consent to such Alterations is not less than that of Tenant as of the date of this Lease calculated under generally accepted accounting principles, no lien and completion bond shall be required.

6.6 Landlord's Property. All Alterations, improvements, fixtures and/or equipment which may be installed or placed in or about the Premises, and all signs installed in, on or about the Premises, from time to time, shall be at the sole cost of Tenant and shall be and become the property of Landlord. Furthermore, if Landlord, as a condition to Landlord's consent to any Alteration, requires that Tenant remove any Alteration upon the expiration or early termination of the Lease Term, Landlord may, by written notice to Tenant prior to the end of the Lease Term, or given following any earlier termination of this Lease, require Tenant, at Tenant's expense, to remove such Alterations and to repair any damage to the Premises and Building caused by such removal. If Tenant fails to complete such removal and/or to repair any damage caused by the removal of any Alterations, Landlord may do so and may charge the cost thereof to Tenant.

ARTICLE 7

INSURANCE

7.1 Indemnification and Waiver. To the extent not prohibited by law, Landlord, its members, their partners and all of their respective officers, agents (including, without limitation, Transwestern Commercial Services), servants, employees, and independent contractors (collectively, "LANDLORD PARTIES") shall not be liable for, and are hereby released from any responsibility for, any damage either to person or property or resulting from the loss of use thereof, which damage is sustained by Tenant or by other persons

claiming through Tenant. Tenant shall indemnify, defend, protect, and hold harmless the Landlord Parties from any and all loss, cost, damage, expense and liability (including without limitation court costs and reasonable attorneys' fees) incurred in connection with or arising from any cause in, on or about the Premises, provided that Tenant shall not be required to indemnify and hold Landlord harmless from any loss, cost, liability, damage or expense, including, but not limited to, penalties, fines, attorneys' fees or costs (collectively, "CLAIMS"), to any person, property or entity resulting from the negligence or willful misconduct of Landlord or its agents, contractors, employees or licensees, in connection with Landlord's activities in the Building (except for damage to the Tenant Improvements and Tenant's personal property, fixtures, furniture and equipment in the Premises, to the extent Tenant is required to obtain the requisite insurance coverage pursuant to this Lease) or the Project, and Landlord hereby so indemnifies and holds Tenant harmless from

any such Claims; provided further that because Landlord is required to maintain insurance on the Building and Tenant compensates Landlord for such insurance as part of Tenant's Share of Direct Expenses and because of the existence of waivers of subrogation set forth in Section 7.5 of this Lease, and to minimize multiplicity of actions, Landlord hereby defends, indemnifies and holds Tenant harmless from any Claims to any property outside of the Premises, including damage to the Building and Landlord's property, even if resulting from the negligent acts, omissions, or willful misconduct of Tenant or those of its agents, contractors, servants, employees or licensees. Similarly, since Tenant must carry insurance pursuant to this Article 7 to cover its personal property within the Premises and the Tenant Improvements, and because of the waiver of subrogation set forth in Section 7.5 and to minimize duplicity of action, Tenant hereby defends, indemnifies and holds Landlord harmless from any Claim to any property within the Premises, even if resulting from the negligent acts, omissions or willful misconduct of Landlord or those of its agents, contractors, employees or licensees. The provisions of this Section 7.1 shall survive the expiration or sooner termination of this Lease with respect to any claims or liability arising in connection with any event occurring prior to such expiration or termination.

7.2 Tenant's Compliance with Landlord's Fire and Casualty Insurance. Tenant shall, at Tenant's expense, comply with all insurance company requirements pertaining to the use of the Premises. If Tenant's conduct or use of the Premises causes any increase in the premium for such insurance policies then Tenant shall reimburse Landlord for any such increase within ten (10) days after receipt of notice of such increase. Tenant, at Tenant's expense, shall comply with all rules, orders, regulations or requirements of the American Insurance Association (formerly the National Board of Fire Underwriters) and with any similar body.

7.3 Tenant's Insurance. Tenant shall maintain the following coverages in the following amounts.

7.3.1 Commercial General Liability Insurance on an occurrence basis covering the insured against claims of bodily injury, personal injury and property damage arising out of Tenant's operations, assumed liabilities or use of the Premises, including the following divisions of insurance: Premises and Operations, Independent Contractors and Blanket Contractual Liability. Such insurance shall cover the insuring provisions of this Lease and the performance by Tenant of the indemnity agreements set forth in Section 7.1 of this Lease, for limits of liability not less than:

Bodily Injury and Property Damage Liability	*$3,000,000 each occurrence* *$3,000,000 annual aggregate*
Personal Injury Liability	*$3,000,000 each occurrence* *$3,000,000 annual aggregate* *0% Insured's participation*

7.3.2 Property Insurance covering (i) all office furniture, trade fixtures, office equipment, merchandise and all other items of Tenant's property on the Premises installed by, for, or at the expense of Tenant, (ii) the Tenant Improvements, and (iii) all other

improvements, alterations and additions to the Premises. Such insurance shall be written on an "all risks" of physical loss or damage basis, for the full replacement cost value new without deduction for depreciation of the covered items and in amounts that meet any co-insurance clauses of the policies of insurance and shall include a vandalism and malicious mischief endorsement, sprinkler leakage coverage and earthquake sprinkler leakage coverage.

7.3.3 Loss-of-income and extra-expense insurance in such amounts as will reimburse Tenant for direct or indirect loss of earnings attributable to all perils commonly insured against by prudent tenants or attributable to prevention of access to the Premises or to the Building as a result of such perils.

7.4 Form of Policies. The minimum limits of policies of insurance required of Tenant under this Lease shall in no event limit the liability of Tenant under this Lease. All insurance shall (i) be issued by an insurance company having a rating of not less than A-X in Best's Insurance Guide or which is otherwise acceptable to Landlord and licensed to do business in the State of California; and (ii) provide that said insurance shall not be canceled or coverage changed unless thirty (30) days' prior written notice shall have been given to Landlord and any mortgagee of Landlord. In addition, the insurance described in Section 7.3.1 shall (a) name Landlord, and any other party specified by Landlord, as an additional insured; (b) specifically cover the liability assumed by Tenant under this Lease including, but not limited to, Tenant's obligations under Section 7.1 of this Lease; and (c) be primary insurance as to all claims thereunder and provide that any insurance carried by Landlord is excess and is non-contributing with any insurance requirement of Tenant. Tenant shall deliver all policies or certificates thereof to Landlord on or before the Delivery Date and at least thirty (30) days before the expiration dates thereof. In the event Tenant shall fail to procure such insurance, or to deliver such policies or certificate, Landlord may, at its option, (i) deny Tenant the right to occupy the Premises until such time as Tenant delivers such policies or certificate (which denial shall have no effect upon the Lease Commencement Date), or (ii) following three (3) days prior notice to Tenant, procure such policies for the account of Tenant, and the cost thereof shall be paid to Landlord within five (5) days after delivery to Tenant of bills therefor.

7.5 Subrogation. Tenant agrees to have its insurer(s) issuing the insurance described in Sections 7.3.2 and 7.3.3 above, to waive any rights of subrogation that such companies may have against Landlord. Tenant hereby waives any right that Tenant may have against Landlord as a result of any loss or damage to the extent such loss or damage is insurable under such policies.

7.6 Additional Insurance Obligations. Tenant shall carry and maintain during the entire Lease Term, at Tenant's sole cost and expense, increased amounts of the insurance required to be carried by Tenant pursuant to this Article 7, and such other reasonable types of insurance coverage and in such reasonable amounts covering the Premises and Tenant's operations therein, as may be reasonably requested by Landlord.

ARTICLE 8

DAMAGE AND DESTRUCTION

8.1 Repair of Damage to Premises by Landlord. Tenant shall promptly notify Landlord of any damage to the Premises resulting from fire or any other casualty. Within sixty (60) days after the date Landlord learns of the necessity for repairs as a result of damage, Landlord shall notify Tenant ("DAMAGE REPAIR ESTIMATE") of Landlord's estimated assessment of the period of time in which the repairs will be completed, which assessment shall be based upon the opinion of a contractor reasonably selected by Landlord and experienced in comparable repairs of high-rise office buildings. If the Premises or any Common Areas serving or providing access to the Premises shall be damaged by

fire or other casualty, Landlord shall promptly and diligently, subject to reasonable delays for insurance adjustment or other matters beyond Landlord's reasonable control, and subject to all other terms of this Article 8, restore the base, shell and core of the Building and such Common Areas. Such restoration shall be to substantially the same condition of the base, shell, and core of the Building and the Common Areas prior to the casualty, except for modifications required by zoning and building codes and other laws or by the holder of a mortgage on the Building or Project or any other modifications to the Common Areas deemed desirable by Landlord, provided that access to the Premises and any common restrooms serving the Premises shall not be materially impaired. Upon the occurrence of any damage to the Premises, Tenant shall assign to Landlord (or to any party designated by Landlord) all insurance proceeds payable to Tenant under Tenant's insurance required under Section 7.3.2 of this Lease, and Landlord shall repair any injury or damage to the Tenant Improvements installed in the Premises and shall return such Tenant Improvements to their original condition; provided that if the cost of such repair by Landlord exceeds the amount of insurance proceeds received by Landlord from Tenant's insurance carrier, as assigned by Tenant, the cost of such repairs shall be paid by Tenant to Landlord prior to Landlord's repair of the damage. In connection with such repairs and replacements, Tenant shall, prior to the commencement of construction, submit to Landlord, for Landlord's review and approval, all plans, specifications and working drawings relating thereto, and Landlord shall select the contractors to perform such improvement work. Such submittal of plans and construction of improvements shall be performed in substantial compliance with the terms of the Tenant Work Letter as though such construction of improvements were the initial construction of the Tenant Improvements. Landlord shall not be liable for any inconvenience or annoyance to Tenant or its visitors, or injury to Tenant's business resulting in any way from such damage or the repair thereof; provided however, that if such fire or other casualty shall have damaged the Premises, and if such damage is not the result of the negligence or willful misconduct of Tenant or Tenant's employees, contractors, licensees, or invitees, Landlord shall allow Tenant a proportionate abatement of Rent during the time and to the extent the Premises are unfit for occupancy for the purposes permitted under this Lease, and not occupied by Tenant as a result thereof.

8.2 Landlord's Option to Repair: Notwithstanding the terms of Section 8.1 of this Lease, Landlord may elect not to rebuild and/or restore the Premises, Building and/or Project, and instead terminate this Lease, by notifying Tenant in writing of such termination within sixty (60) days after Landlord learns of the necessity for repairs as the result of damage, such notice to include a termination date giving Tenant ninety (90) days to vacate the Premises, but Landlord may so elect only if the Building or Project shall be damaged by fire or other

casualty or cause, whether or not the Premises are affected, and one or more of the following conditions is present: (i) in Landlord's reasonable judgment, repairs cannot reasonably be completed within one hundred twenty (120) days after the date Landlord learns of the necessity for repairs as the result of damage (when such repairs are made without the payment of overtime or other premiums); (ii) the holder of any mortgage on the Building or Project or ground lessor with respect to the Building or Project shall require that the insurance proceeds or any portion thereof be used to retire the mortgage debt, or shall terminate the ground lease, as the case may be; or (iii) the damage is not fully covered, except for deductible amounts, by Landlord's insurance policies. However, if Landlord does not elect to terminate this Lease pursuant to Landlord's termination right as provided above, and the Damage Repair Estimate indicates that repairs cannot be completed within one hundred eighty (180) days after being commenced, Tenant may elect, not later than thirty (30) days after Tenant's receipt of the Damage Repair Estimate, to terminate this Lease by written notice to Landlord effective as of the date specified in Tenant's notice.

8.3 Waiver of Statutory Provisions. The provisions of this Lease, including this Article 8, constitute an express agreement between Landlord and Tenant with respect to any and all damage to, or destruction of, all or any part of the Premises, the Building or the Project, and any statute or regulation of the State of California, including, without limitation, Sections 1932(2) and 1933(4) of the California Civil Code, with respect to any rights or obligations concerning damage or destruction in the absence of an express agreement between

the parties, and any other statute or regulation, now or hereafter in effect, shall have no application to this Lease or any damage or destruction to all or any part of the Premises, the Building or the Project.

8.4 Damage Near End of Term. In the event that the Premises, the Building, or the Project is destroyed or damaged to any substantial extent during the last twenty-four (24) months of the Lease Term, then notwithstanding anything contained in this Article 8, Landlord shall have the option to terminate this Lease by giving written notice to Tenant of the exercise of such option within sixty (60) days after Landlord learns of the necessity for repairs as the result of such damage or destruction, in which event this Lease shall cease and terminate as of the date of such notice, Tenant shall pay the Base Rent and Additional Rent, properly apportioned up to such date of damage, and both parties hereto shall thereafter be freed and discharged of all further obligations hereunder, except as provided for in provisions of this Lease which by their terms survive the expiration or earlier termination of the Lease Term.

ARTICLE 9

PERSONAL PROPERTY AND OTHER TAX

Tenant shall reimburse Landlord upon demand for any and all taxes required to be paid by Landlord (except to the extent included in Tax Expenses by Landlord), excluding state, local and federal personal or corporate income taxes measured by the net income of Landlord from all sources and estate and inheritance taxes, whether or not now customary or within the contemplation of the parties hereto, when: (i) such taxes are measured by or reasonably attributable to the cost or value of Tenant's equipment, furniture, fixtures and other personal property located in the Premises, or by the cost or value of any leasehold improvements made in

or to the Premises by or for Tenant, to the extent the cost or value of such leasehold improvements exceeds the cost or value of a building standard build-out as determined by Landlord regardless of whether title to such improvements shall be vested in Tenant or Landlord; (ii) such taxes are assessed upon or with respect to the possession, leasing, operation, management, maintenance, alteration, repair, use or occupancy by Tenant of the Premises or any portion of the Project, including the Project's parking facility; (iii) such taxes are assessed upon this transaction or any document to which Tenant is a party creating or transferring an interest or an estate in the Premises; or (iv) such taxes or assessments are levied or assessed upon the Project or any part thereof or upon Landlord by any governmental authority or entity, and relate to the construction, operation, management, use, alteration or repair of mass transit improvements.

ARTICLE 10

SERVICES AND UTILITIES

10.1 Standard Tenant Services. Landlord shall provide the following services on all days (unless otherwise stated below) during the Lease Term.

10.1.1 Subject to all governmental rules, regulations and guidelines applicable thereto, Landlord shall provide heating ventilation and air conditioning when necessary for normal comfort for normal office use in the Premises, from Monday through Friday, during the period from 8:00 A.M. to 6:00 P.M. and on Saturday during the period from 9:00 A.M. to 1:00 P.M., except for the date of observation of New Year's Day, Independence Day, Labor Day, Memorial Day, Thanksgiving Day, Christmas Day and, at Landlord's discretion, other locally or nationally recognized holidays (collectively, the "Holidays").

10.1.2 Landlord shall provide adequate electrical wiring, power and facilities for connection to Tenant's lighting fixtures and incidental uses, provided that (i) the monthly connected electrical load of the incidental use equipment does not exceed an average of two (2.0) watts per usable square foot of the Premises, and (ii) the monthly connected electrical load of Tenant's lighting fixtures does not exceed an average of one and one-half (1 1/2) watt per usable square foot of the Premises. Tenant shall bear the initial cost of

lamps, starters and ballasts for lighting fixtures within the Premises. Tenant shall also bear the cost of replacement of non-standard lamps, starters and ballasts for lighting fixtures within the Premises; however, the cost of replacement of Building-standard lamps, starters and ballasts for lighting fixtures within the Premises shall be included in Operating Expenses.

10.1.3 Landlord shall provide city water from the regular Building outlets for drinking, lavatory and toilet purposes.

10.1.4 Landlord shall provide janitorial services Monday through Friday except the date of observation of the Holidays, in and about the Premises.

10.1.5 Landlord shall provide nonexclusive automatic passenger elevator service.

10.1.6 Landlord shall provide nonexclusive freight elevator service subject to scheduling by Landlord.

10.2 Overstandard Tenant Use. Tenant shall not, without Landlord's prior written consent, use heat-generating machines, machines other than normal office machines, or equipment or lighting other than Building standard lights in the Premises, which may affect the temperature otherwise maintained by the air conditioning system or increase the water normally furnished for the Premises by Landlord pursuant to the terms of Section 10.1 of this Lease. If such consent is given, Landlord shall have the right to install supplementary air conditioning units or other facilities in the Premises, including supplementary or additional metering devices, and the cost thereof, including the cost of installation, operation and maintenance, increased wear and tear on existing equipment and other similar charges, together with an administrative fee, shall be paid by Tenant to Landlord upon billing by Landlord. If Tenant uses water or electricity in excess of that supplied by Landlord pursuant to Section 10.1 of this Lease, and in excess of that typically used by office tenants of the Building, Tenant shall pay to Landlord, upon billing, the cost of such excess consumption, the cost of the installation, operation, and maintenance of equipment which is installed in order to supply such excess consumption, and the cost of the increased wear and tear on existing equipment caused by such excess consumption; and Landlord may install devices to separately meter any increased use and in such event Tenant shall pay the increased cost directly to Landlord, on demand, including the cost of such additional metering devices. If Tenant desires to use heat, ventilation or air conditioning during hours other than those for which Landlord is obligated to supply such utilities pursuant to the terms of Section 10.1 of this Lease, Tenant shall give Landlord such prior notice, if any, as Landlord shall from time to time establish as appropriate, of Tenant's desired use in order to supply such utilities, and Landlord shall supply such utilities to Tenant at such commercially reasonable hourly cost to Tenant as Landlord shall from time to time establish. Amounts payable by Tenant to Landlord for such use of additional utilities shall be deemed Additional Rent hereunder and shall be billed on a monthly basis. Landlord may increase the hours or days during which air conditioning, heating and ventilation are provided to the Premises and the Building to accommodate the usage by tenants occupying two-thirds or more of the rentable square feet of the Building or Project.

10.3 Interruption of Use. Tenant agrees that Landlord shall not be liable for damages, by abatement of Rent or otherwise, for failure to furnish or delay in furnishing any service (including telephone and telecommunication services), or for any diminution in the quality or quantity thereof, when such failure or delay or diminution is occasioned, in whole or in part, by repairs, replacements, or improvements, by any strike, lockout or other labor trouble, by inability to secure electricity, gas, water, or other fuel at the Building or Project after reasonable effort to do so, by any accident or casualty whatsoever, by act or default of Tenant or other parties, or by any other cause beyond Landlord's reasonable control; and such failures or delays or diminution shall never be deemed to constitute an eviction or disturbance of Tenant's use and possession of the Premises or relieve Tenant from paying Rent or performing any of its obligations under this Lease. Furthermore, Landlord shall not be liable under any circumstances for a loss of, or injury to, property or for injury to, or interference with, Tenant's business, including, without

limitation, loss of profits, however occurring, through or in connection with or incidental to a failure to furnish any of the services or utilities as set forth in this Article 10. If any governmental entity promulgates or revises any statute, ordinance, building code, fire code

or other code or imposes mandatory or voluntary controls or guidelines on Landlord or the Project or any portion thereof, relating to the use or conservation of energy, water, gas, light or electricity or the reduction of automobile or other emissions or the provision of any other utility or service provided with respect to this Lease or if Landlord is required to make alterations to the Project or any portion thereof in order to comply with such mandatory or voluntary controls or guidelines, then Landlord may, in its sole discretion, comply with such mandatory or voluntary controls or guidelines or make such alterations to the Project related thereto without creating any liability of Landlord to Tenant under this Lease, provided that the Premises are not thereby rendered untenantable, and further provided that Landlord will not voluntarily reduce the level of services provided to the Premises unless Landlord is motivated to do so by anticipated costs savings and efficiencies of operation consistent with the first class character of the Project. Such compliance and the making of such permitted alterations shall in no event entitle Tenant to any damages, relieve Tenant of the obligation to pay the full Rent reserved hereunder or constitute or be construed as a constructive or other eviction of Tenant. In addition, the cost of such compliance and alterations shall be included in Operating Expenses.

10.4 Additional Services. Landlord shall also have the exclusive right, but not the obligation, to provide any additional services which may be required by Tenant, including, without limitation, locksmithing, lamp replacement, additional janitorial service, and additional repairs and maintenance, provided that Tenant shall pay to Landlord upon billing, the sum of all costs to Landlord of such additional services plus an administration fee at a rate equal to the fee Landlord is generally charging tenants of the Project for such services. Charges for any service for which Tenant is required to pay from time to time hereunder shall be deemed Additional Rent hereunder and shall be billed on a monthly basis. Notwithstanding anything to the contrary set forth in this Lease, if Tenant fails to make payment for any such services within ten (10) days of receipt of bills therefor, Landlord may discontinue any or all of such services and such discontinuance shall not be deemed to constitute an eviction or disturbance of Tenant's use and possession of the Premises or relieve Tenant from paying Rent or performing any of its other obligations under this Lease.

ARTICLE 11

ASSIGNMENT AND SUBLETTING

11.1 Transfers. Tenant shall not, without the prior written consent of Landlord, assign, mortgage, pledge, hypothecate, encumber, or permit any lien to attach to, or otherwise transfer, this Lease or any interest hereunder, permit any assignment, or other transfer of this Lease or any interest hereunder by operation of law, sublet the Premises or any part thereof, or permit the use of the Premises by any persons other than Tenant and its employees (all of the foregoing are hereinafter sometimes referred to collectively as "TRANSFERS" and any entity to whom any Transfer is made or sought to be made is hereinafter sometimes referred to as a "TRANSFEREE"). If Tenant desires Landlord's consent to any Transfer, Tenant shall notify Landlord in writing, which notice (the "TRANSFER NOTICE") shall include (i) the proposed effective date of the Transfer, which shall not be less than thirty (30) days nor more than one hundred eighty (180) days after the date of delivery of the Transfer Notice, (ii) a description of the portion of the Premises to be transferred (the "SUBJECT SPACE"), (iii) all of the terms of the proposed Transfer and the consideration therefor, including calculation of the "Transfer

Premium", as that term is defined in Section 11.3 below, in connection with such Transfer, the name and address of the proposed Transferee, and a copy of all

existing executed and/or proposed documentation pertaining to the proposed Transfer, including all existing operative documents to be executed to evidence such Transfer or the agreements incidental or related to such Transfer, and (iv) current financial statements of the proposed Transferee (including, without limitation, federal income tax returns for the two (2) most recent years) certified by an officer, partner or owner thereof, and any other information required by Landlord, which will enable Landlord to determine the financial responsibility, character, and reputation of the proposed Transferee, nature of such Transferee's business and proposed use of the Subject Space, and such other information as Landlord may reasonably require. Any Transfer made without Landlord's prior written consent shall, at Landlord's option, be null, void and of no effect, and shall, at Landlord's option, constitute a default by Tenant. Whether or not Landlord consents to any proposed Transfer, Tenant shall pay Landlord's review and processing fees, as well as any reasonable legal fees incurred by Landlord, within thirty (30) days after written request by Landlord, which fees shall not exceed, in the aggregate, Two Thousand Dollars ($2,000.00) per proposed Transfer.

11.2 Landlord's Consent. Landlord shall not unreasonably withhold its consent to any proposed Transfer of the Subject Space to the Transferee on the terms specified in the Transfer Notice. Without limitation as to other reasonable grounds for withholding consent, the parties hereby agree that it shall be reasonable under this Lease and under any applicable law for Landlord to withhold consent to any proposed Transfer where one or more of the following apply:

11.2.1 The Transferee is of a character or reputation or engaged in a business which is not consistent with the quality of the Building or the Project,;

11.2.2 The Transferee intends to use the Subject Space for purposes which are not permitted under this Lease;

11.2.3 The Transferee is either a governmental agency or instrumentality thereof;

11.2.4 The Transfer will result in more than a reasonable and safe number of occupants per floor within the Subject Space;

11.2.5 The Transferee is not a party of reasonable financial worth and/or financial stability in light of the responsibilities involved under the Lease on the date consent is requested;

11.2.6 The proposed Transfer would cause a violation of another lease for space in the Project, or would give an occupant of the Project a right to cancel its lease; or

11.2.7 Either the proposed Transferee, or any person of entity which directly or indirectly, controls, is controlled by, or is under common control with, the proposed Transferee is negotiating with Landlord to lease space in the Project.

If Landlord consents to any Transfer pursuant to the terms of this Section 11.2 (and does not exercise any recapture rights Landlord may have under Section 11.4 of this Lease), Tenant may within six (6) months after Landlord's consent, but not later than the expiration of said six-month period, enter into such Transfer of the Premises or portion thereof, upon substantially the same terms and conditions as are set forth in the Transfer Notice furnished by Tenant to Landlord pursuant to Section 11.1 of this Lease, provided that if there are any changes in the terms and conditions from those specified in the Transfer Notice (i) such that Landlord would initially have been entitled to refuse its consent to such Transfer under this Section 11.2, or (ii) which would cause the proposed Transfer to be more favorable to the Transferee than the terms set forth in Tenant's original Transfer Notice, Tenant shall again submit the Transfer to Landlord for its approval and other action under this Article 11 (including Landlord's right of recapture, if any, under Section 11.4 of this Lease). Notwithstanding any contrary provision of this Lease, if Tenant or any proposed Transferee claims that Landlord has unreasonably withheld or delayed its consent to a proposed Transfer or otherwise has breached its obligations

under this Article 11, Tenant's and such Transferee's sole remedy shall be to seek a declaratory judgment and/or injunctive relief, and Tenant, on behalf of itself and, to the extent permitted by law, such proposed Transferee, waives all other remedies against Landlord, including without limitation, the right to seek monetary damages or to terminate this Lease.

11.3 Transfer Premium.

11.3.1 Definition of Transfer Premium. If Landlord consents to a Transfer, as a condition thereto which the parties hereby agree is reasonable, Tenant shall pay to Landlord fifty percent (50%) of any "Transfer Premium," as that term is defined in this Section 11.3, received by Tenant from such Transferee. "TRANSFER PREMIUM" shall mean all rent, additional rent or other consideration payable by such Transferee in connection with the Transfer in excess of the Rent and Additional Rent payable by Tenant under this Lease during the term of the Transfer on a per rentable square foot basis if less than all of the Premises is transferred, after deducting the reasonable expenses incurred by Tenant for (i) any changes, alterations and improvements to the Premises in connection with the Transfer, and (ii) any brokerage commissions in connection with the Transfer (collectively, the "TRANSFER COSTS"). "Transfer Premium" shall also include, but not be limited to, key money, bonus money or other cash consideration paid by Transferee to Tenant in connection with such Transfer, and any payment in excess of fair market value for services rendered by Tenant to Transferee or for assets, fixtures, inventory, equipment, or furniture transferred by Tenant to Transferee in connection with such Transfer. If part of the Transfer Premium shall be payable by the Transferee other than in cash, Landlord's share of such non-cash consideration shall be in such form as is reasonably satisfactory to Landlord.

11.3.2 Payment of Transfer Premium. The determination of the amount of Landlord's applicable share of the Transfer Premium shall be made on an annual basis in accordance with the terms of this Section 11.3.2, but an estimate of the amount of Landlord's applicable share of the Transfer Premium shall be made each month and one-twelfth of such estimated amount shall be paid to Landlord promptly, but in no event later than the next date for payment of Base Rent hereunder, subject to an annual reconciliation on each anniversary date of the Transfer. If the payments to Landlord under this Section 11.3.2 during the twelve (12) months preceding each annual reconciliation exceed the amount of Landlord's applicable share of

Transfer Premium determined on an annual basis, then Landlord shall credit the overpayment against Tenant's future obligations under this Section 11.3.2 or if the overpayment occurs during the last year of the Transfer in question, refund the excess to Tenant. If Tenant has underpaid Landlord's applicable share of the Transfer Premium, as determined by such annual reconciliation, Tenant shall pay the amount of such deficiency to Landlord promptly, but in no event later than the next date for payment of Base Rent hereunder. For purposes of calculating the Transfer Premium on an annual basis, Tenant's Transfer Costs shall be deemed to be offset against the first rent, additional rent or other consideration payable by the Transferee, until such Transfer Costs are exhausted.

11.3.3 Calculations of Rent. In the calculation of the Rent (as it relates to the Transfer Premium calculated under Section 11.3.1 of this Lease), the Rent paid during each annual period for the Subject Space by Tenant shall be computed after adjusting such rent to the actual effective rent to be paid, taking into consideration any and all leasehold concessions granted in connection therewith, including, but not limited to, any rent credit and tenant improvement allowance. For purposes of calculating any such effective rent all such concessions shall be amortized on a straight-line basis over the relevant term.

11.4 Landlord's Option as to Subject Space. Notwithstanding anything to the contrary contained in this Article 11, Landlord shall have the option, by giving written notice to Tenant within thirty (30) days after receipt of any Transfer Notice, to recapture the Subject Space. Such recapture notice shall cancel and terminate this Lease with respect to the Subject Space as of the date stated in the Transfer Notice as the effective date of the proposed Transfer until the last day of the term of the Transfer as set forth in the Transfer Notice. In the event of a recapture by Landlord, if this Lease shall be

canceled with respect to less than the entire Premises, the Rent reserved herein shall be prorated on the basis of the number of rentable square feet retained by Tenant in proportion to the number of rentable square feet contained in the Premises, and this Lease as so amended shall continue thereafter in full force and effect, and upon request of either party, the parties shall execute written confirmation of the same. If Landlord declines, or fails to elect in a timely manner to recapture the Subject Space under this Section 11.4, then, provided Landlord has consented to the proposed Transfer, Tenant shall be entitled to proceed to transfer the Subject Space to the proposed Transferee, subject to provisions of this Article 11.

11.5 Effect of Transfer. If Landlord consents to a Transfer, (i) the terms and conditions of this Lease shall in no way be deemed to have been waived or modified, (ii) such consent shall not be deemed consent to any further Transfer by either Tenant or a Transferee, (iii) Tenant shall deliver to Landlord, promptly after execution, an original executed copy of all documentation pertaining to the Transfer in form reasonably acceptable to Landlord, (iv) Tenant shall furnish upon Landlord's request a complete statement, certified by an independent certified public accountant, or Tenant's chief financial officer, setting forth in detail the computation of any Transfer Premium Tenant has derived and shall derive from such Transfer, and (v) no Transfer relating to this Lease or agreement entered into with respect thereto, whether with or without Landlord's consent, shall relieve Tenant or any guarantor of the Lease from liability under this Lease. Landlord or its authorized representatives shall have the right at all reasonable times to audit the books, records and papers of Tenant relating to any Transfer, and shall have the right to make copies thereof. If the Transfer Premium with respect to any Transfer shall be

found understated, Tenant shall, within thirty (30) days after demand, pay the deficiency and Landlord's costs of such audit, and if understated by more than ten percent (10%), Tenant shall pay to Landlord a late charge and interest in connection with such understated amount at rates as set forth in Section 19.28 of this Lease.

11.6 Additional Transfers. For purposes of this Lease, the term "Transfer" shall also include (i) if Tenant is a partnership, the withdrawal or change, voluntary, involuntary or by operation of law, of fifty percent (50%) or more of the partners, or transfer of FIFTY percent (50%) or more of partnership interests, within a twelve (12)-month period, or the dissolution of the partnership without immediate reconstitution thereof, and (ii) if Tenant is a closely held corporation (i.e., whose stock is not publicly held and not traded through an exchange or over the counter), (A) the dissolution, merger, consolidation or other reorganization of Tenant or (B) the sale or other transfer of more than an aggregate of fifty percent (50%) of the voting shares of Tenant (other than to immediate family members by reason of gift or death), within a twelve (12)-month period, or (C) the sale, mortgage, hypothecation or pledge of more than an aggregate of fifty percent (50%) of the value of the unencumbered assets of Tenant within a twelve (12)month period.

11.7 Non-Transfers. Notwithstanding anything to the contrary contained in this Article 11, an assignment or subletting of all or a portion of the Premises to an affiliate of Tenant (an entity which is controlled by, controls, or is under common control with, Tenant), shall not be deemed a Transfer under this Article 11, provided that Tenant notifies Landlord of any such assignment or sublease and promptly supplies Landlord with any documents or information requested by Landlord regarding such assignment or sublease or such affiliate, and further provided that such assignment or sublease is not a subterfuge by Tenant to avoid its obligations under this Lease. An assignee of Tenant's entire interest in this Lease pursuant to the immediately preceding sentence may be referred to herein as an "AFFILIATED ASSIGNEE." "CONTROL," as used in this Section 11.7, shall mean the ownership, directly or indirectly, of greater than FIFTY percent (50%) of the voting securities of, or possession of the right to vote, in the ordinary direction of its affairs, of greater than fifty percent (50%) of the voting interest in, an entity.

ARTICLE 12

DEFAULTS; REMEDIES

12.1 Events of Default. The occurrence of any of the following shall constitute a default of this Lease by Tenant:

12.1.1 Any failure by Tenant to pay any Rent or any other charge required to be paid under this Lease, or any part thereof, when due; or

12.1.2 Any failure by Tenant to observe or perform any other provision, covenant or condition of this Lease to be observed or performed by Tenant where such failure continues for fifteen (15) days after written notice thereof from Landlord to Tenant; provided that (i) any such notice shall be in lieu of, and not in addition to, any notice required under California Code of Civil Procedure Section 1161 or any similar or successor law; (ii) if the

nature of such default is such that the same cannot reasonably be cured within a fifteen (15) day period, Tenant shall not be deemed to be in default if it diligently commences such cure within such period and thereafter diligently proceeds to rectify and cure said default, as soon as possible; and (iii) the cure period specified in this Section 12.1.2 shall not be applicable to Tenant's obligations under Sections 7.3 and 7.4 and Sections 19.1 and 19.11 of this Lease; i.e., Tenant's failure to comply with any provision, covenant or condition described in such Sections and/or articles within the time periods specified therein shall constitute a default under this Section 12.1.2; or

12.1.3 Abandonment of the Premises by Tenant; ("ABANDONMENT" is herein defined to include, but is not limited to, any absence by Tenant from the Premises for three (3) business days or longer while in default of any provision of this Lease.

12.2 Remedies Upon Default. Upon the occurrence of any event of default by Tenant, Landlord shall have, in addition to any other remedies available to Landlord at law or in equity, the option to pursue any one or more of the following remedies, each and all of which shall be cumulative and nonexclusive, without any notice or demand whatsoever.

12.2.1 Terminate this Lease, in which event Tenant shall immediately surrender the Premises to Landlord, and if Tenant fails to do so, Landlord may, without prejudice to any other remedy which it may have for possession or arrearages in rent, enter upon and take possession of the Premises and expel or remove Tenant and any other person who may be occupying the Premises or any part thereof, without being liable for prosecution or any claim or damages therefor; and Landlord may recover from Tenant the following:

(i) The worth at the time of award of any unpaid rent which had been earned at the time of such termination; plus

(ii) The worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus

(iii) The worth at the time of award of the amount by which the unpaid rent for the balance of the Lease Term after the time of award exceeds the amount of such rental loss that Tenant proves could have been reasonably avoided; plus

(iv) Any other amount necessary to compensate Landlord for all the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, specifically including but not limited to, brokerage commissions and advertising expenses incurred, expenses of remodeling the Premises or any portion thereof for a new tenant, whether for the same or a different use, and any special concessions made to obtain a new tenant; and

(v) At Landlord's election, such other amounts in addition to or in lieu of the foregoing as may be permitted from time to time by applicable law.

The term "rent" as used in this Section 12.2 shall be deemed to be and to mean all sums of every nature required to be paid by Tenant pursuant to the terms of this Lease, whether to Landlord or to others. As used in Paragraphs 12.2.1(i) and (ii), above, the "worth at the time of award" shall be computed by allowing interest at the rate set forth in Section 19.28 of this Lease, but in no case greater than the maximum amount of such interest permitted by law. As used in Paragraph 12.2.1 (iii) above, the "worth at the time of award" shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus one percent (1%).

12.2.2 Landlord shall have the remedy described in California Civil Code Section 1951.4 (lessor may continue lease in effect after lessee's breach and abandonment and recover rent as it becomes due, if lessee has the right to sublet or assign, subject only to reasonable limitations). Accordingly, if Landlord does not elect to terminate this Lease on account of any default by Tenant, Landlord may, from time to time, without terminating this Lease, enforce all of its rights and remedies under this Lease, including the right to recover all rent as it becomes due.

12.3 Sublessees of Tenant. Whether or not Landlord elects to terminate this Lease on account of any default by Tenant as set forth in this Article 12, Landlord shall have the right to terminate any and all subleases, licenses, concessions or other consensual arrangements for possession entered into by Tenant and affecting the Premises or may, in Landlord's sole discretion, succeed to Tenant's interest in such subleases, licenses, concessions or arrangements. In the event of Landlord's election to succeed to Tenant's interest in any such subleases, licenses, concessions or arrangements, Tenant shall, as of the date of notice by Landlord of such election, have no further right to or interest in the rent or other consideration receivable thereunder.

12.4 Form of Payment After Default. Following the occurrence of an, event of default by Tenant, Landlord shall have the right to require that any or all subsequent amounts paid by Tenant to Landlord hereunder, whether to cure the default in question or otherwise, be paid in the form of cash, money order, cashier's or certified check drawn on an institution acceptable to Landlord, or by other means approved by Landlord, notwithstanding any prior practice of accepting payments in any different form.

12.5 Efforts to Relet. For the purposes of this Article 12, Tenant's right to possession shall not be deemed to have been terminated by efforts of Landlord to relet the Premises, by its acts of maintenance or preservation with respect to the Premises, or by appointment of a receiver to protect Landlord's interests hereunder. The foregoing enumeration is not exhaustive, but merely illustrative of acts which may be performed by Landlord without terminating Tenant's right to possession.

ARTICLE 13

CONDEMNATION

13.1 Permanent Taking. If the whole or any part of the Premises, Building or Project shall be taken by power of eminent domain or condemned by any competent authority for any public or quasi-public use or purpose, or if any adjacent property or street shall be so taken

or condemned, or reconfigured or vacated by such authority in such manner as to require the use, reconstruction or remodeling of any part of the Premises, Building or Project, or if Landlord shall grant a deed or other instrument in lieu of such taking by eminent domain or condemnation, Landlord shall have the option to terminate this Lease upon ninety (90) days' notice, provided such notice is given no later than one hundred eighty (180) days after the date of such taking, condemnation, reconfiguration, vacation, deed or other instrument. If more than twenty-five percent (25%) of the rentable square feet of the Premises is taken, or if access to the Premises is substantially impaired, Tenant shall have the option to terminate this Lease upon ninety (90) days' notice, provided such notice is given no later than one hundred eighty (180)

days after the date of such taking. Landlord shall be entitled to the entire award or payment in connection therewith, except that Tenant shall have the right to file any separate claim available to Tenant for any taking of Tenant's personal property and fixtures belonging to Tenant and removable by Tenant upon expiration of the Lease Term pursuant to the terms of this Lease, and for moving expenses, so long as such claims do not diminish the award available to Landlord, its ground lessor with respect to the Building or Project or its mortgagee, and such claim is payable separately to Tenant. All Rent shall be apportioned as of the date of such termination, or the date of such taking, whichever shall first occur. If any part of the Premises shall be taken, and this Lease shall not be so terminated, the Rent shall be proportionately abated. Tenant hereby waives any and all rights it might otherwise have pursuant to Section 1265.130 of The California Code of Civil Procedure.

13.2 Temporary Taking. Notwithstanding anything to the contrary contained in this Article 13, in the event of a temporary taking of all or any portion of the Premises for a period of one hundred and eighty (180) days or less, then this Lease shall not terminate but the Base Rent and the Additional Rent shall be abated for the period of such taking in proportion to the ratio that the number of rentable square feet of the Premises taken bears to the total rentable square feet of the Premises. Landlord shall be entitled to receive the entire award made in connection with any such temporary taking.

ARTICLE 14

BROKERS

Landlord and Tenant hereby warrant to each other that they have had no dealings with any real estate broker or agent in connection with the negotiation of this Lease, excepting only the real estate brokers or agents specified in Section 11 of the Summary (the "BROKERS"), and that they know of no other real estate broker or agent who is entitled to a commission in connection with this lease. Each party agrees to indemnify and defend the other party against and hold the other party harmless from any and all claims, demands, losses, liabilities, lawsuits, judgments, costs and expenses (including without limitation reasonable attorneys' fees) with respect to any leasing commission or equivalent compensation alleged to be owing on account of any dealings with any real estate broker or agent, other than the Brokers, occurring by, through, or under the indemnifying party.

ARTICLE 15

LANDLORD'S LIABILITY

It is expressly understood and agreed that notwithstanding anything in this Lease to the contrary, and notwithstanding any applicable law to the contrary, the liability of Landlord and the Landlord Parties hereunder (including any successor landlord hereunder) and any recourse by Tenant against Landlord or the Landlord Parties shall be limited solely and exclusively to an amount which is equal to the lesser of (i) the interest of Landlord in and to the Building, or (ii) the equity interest Landlord would have in the Building if the Building were encumbered by third-party debt in an amount equal to eighty percent (80%) of the value of the Building (as such value is determined by Landlord), and neither Landlord, nor any of the Landlord Parties, shall have any personal liability therefor, and Tenant, on behalf of itself and all persons claiming by, through or under Tenant, hereby expressly waives and releases Landlord and the Landlord Parties from such personal liability.

ARTICLE 16

SUBSTITUTION OF OTHER PREMISES

16.1 New Premises. At any time after the date of this Lease, Landlord shall have the right to substitute for the premises then being leased or to be leased hereunder (the "EXISTING PREMISES") other premises within the Project (the "New Premises"), provided that the New Premises shall be of at least substantially the same size and shall either have substantially the same perimeter configuration or a perimeter configuration substantially usable for the purposes for which the Existing Premises were being used by Tenant or, if

possession of the Existing Premises had not yet been received by Tenant, then for the purposes for which the Existing Premises were to be used by Tenant.

16.2 Effectiveness Prior to Commencement of Construction of the Premises. If Tenant shall not have received possession of the Existing Premises and no construction has been commenced thereon, then, as of the date Landlord gives notice of a substitution, such substitution shall be effective, the New Premises shall be the Premises hereunder and the Existing Premises shall cease to be the Premises hereunder.

16.3 Effectiveness After Commencement of Construction of the Premises. If construction of the Premises shall have already begun or if Tenant shall have already received possession of the Existing Premises as of the date Landlord gives notice of the substitution, the following provisions of this Section 16.3 shall apply. In the case where Tenant already has possession of the Existing Premises, Tenant shall vacate and surrender the Existing Premises on or before the date (the "VACATION DATE") which occurs on the later of (i) the thirtieth (30th) day after the date that Landlord shall notify Tenant of Landlord's intent to make the substitution in question, or (ii) the fifteenth (15th) day after Landlord shall have substantially completed the work to be done by Landlord in the New Premises pursuant to this Section 16.3. Such substitution of the New Premises for the Existing Premises shall be effective as of the sooner of the Vacation Date or the date Tenant surrenders and vacates the Existing Premises. In the case where the Existing Premises are under construction, Tenant shall immediately surrender the

Existing Premises, the New Premises shall be the Premises for purposes of this Lease, and the Existing Premises shall cease to be the Premises for purposes of this Lease. In either case, (A) Landlord shall pay the actual and reasonable out-of-pocket expenses of Tenant's moving of its property, if any, from the Existing Premises to the New Premises, provided that Landlord may elect to either move Tenant's property or provide personnel to do so under Tenant's direction, (B) Landlord shall improve the New Premises so that they are substantially similar to the Existing Premises as of the time of the notice of substitution (and in the case of the Existing Premises being under construction, the remaining construction necessary to the completion of the New Premises shall be performed pursuant to the terms of the Tenant Work Letter), and (C) Landlord shall promptly reimburse Tenant for Tenant's actual and reasonable out-of-pocket costs relating to the relocation of any telephone or other communications equipment, if any, from the Existing Premises to the New Premises and relating to stationery reprinting costs necessary to reflect the address of the New Premises.

16.4 General Provisions. Tenant shall not be entitled to any compensation for any inconvenience or interference with Tenant's business, nor to any abatement or reduction in Rent, nor shall Tenant's obligations under this Lease be otherwise affected, as a result of the substitution, except as otherwise provided in this Article 16. Tenant agrees to cooperate with Landlord so as to facilitate the prompt completion by Landlord of its obligations under this Article 16. Without limiting the generality of the preceding sentence, Tenant agrees to promptly provide Landlord with such documentation, approvals, instructions, plans, specifications or other information as may be reasonably requested by Landlord in connection with this Article 16, and to promptly execute any operative documents to evidence Landlord's actions under this Article 16. Upon delivery of the New Premises to Tenant as set forth herein, Tenant shall execute, within five (5) days of delivery to Tenant by Landlord, an amendment amending all amounts, percentages and figures appearing or referred to in this Lease (including, without limitation, the amount of the Rent and any Security Deposit), to reflect the substitution of the New Premises for the Existing Premises.

ARTICLE 17

WARNER CENTER ASSOCIATION

It is understood that at the time of the execution of this Lease an association has been formed, the purpose of which is to identify and promote the best interest of the employers and employees of Warner Center. Tenant shall, throughout the Lease Term, at its sole cost and expense, cooperate with and

promote the programs of such association as they may from time to time exist so long as the policies of such association shall be non-discriminatory with respect to Tenant and with respect to any membership fee.

ARTICLE 18

TENANT PARKING

Tenant shall lease, commencing on the Lease Commencement Date, the number of parking passes set forth in Section 9 of the Summary, throughout the Lease Term, which parking passes shall pertain to that portion or structure of the Project parking facility designated for

Tenant's parking by Landlord. Tenant shall pay to Landlord or, at Landlord's option, "Landlord's Designee" (as that term is defined in this Article 18 below), for such automobile parking passes, on a monthly basis, the prevailing rate charged from time to time for parking passes in the parking facility or facilities. In addition, Tenant shall be responsible for any taxes imposed by any governmental authority in connection with the renting of such parking passes by Tenant or the use of the parking facility by Tenant. Tenant's continued right to use the parking passes is conditioned upon Tenant abiding by all Rules and Regulations which are prescribed from time to time for the orderly operation and use of the parking facility or facilities and upon Tenant's cooperation in seeing that Tenant's employees and visitors also comply with such Rules and Regulations. Landlord specifically reserves the right, at any time, to (i) change the size, configuration, design, layout and all other aspects of the parking facility or facilities, and/or (ii) perform repairs to the parking facility or facilities, and Tenant acknowledges and agrees that Landlord may, without incurring any liability to Tenant and without any abatement of Rent under this Lease, from time to time, close-off or restrict access to the parking facility or facilities for purposes of permitting or facilitating any such construction, alteration, improvements or repairs. Landlord may lease the parking areas, enter into a license agreement or otherwise delegate its responsibilities under this Article 18 to a parking operator ("LANDLORD'S DESIGNEE") in which case Landlord's Designee shall have all the rights attributed under this Article 18 to the Landlord. The parking passes leased by Tenant pursuant to this Article 18 are provided to Tenant solely for use by Tenant's own personnel and such passes may not be transferred, assigned, subleased or otherwise alienated by Tenant without Landlord's prior approval.

ARTICLE 19

MISCELLANEOUS PROVISIONS

19.1 Estoppel Certificates. Within ten (10) business days following a request in writing by Landlord, Tenant shall execute and deliver to Landlord an estoppel certificate, which, as submitted by Landlord, shall be substantially in the form of Exhibit F, attached hereto (or such other form as may be required by any prospective mortgagee or purchaser of the Project, or any portion thereof), indicating therein any exceptions thereto that may exist at that time, and shall also contain any other information reasonably requested by Landlord or Landlord's mortgagee or prospective mortgagee. Tenant shall execute and deliver whatever other instruments may be reasonably required for such purposes. Failure of Tenant to timely execute and deliver such estoppel certificate or other instruments shall constitute an acceptance of the Premises and an acknowledgment by Tenant that statements included in the estoppel certificate are true and correct, without exception.

19.2 Partial Invalidity. If any term, provision or condition contained in this Lease shall, to any extent, be invalid or unenforceable, the remainder of this Lease, or the application of such term, provision or condition to persons or circumstances other than those with respect to which it is invalid or unenforceable, shall not be affected thereby, and each and every other term, provision and condition of this Lease shall be valid and enforceable to the fullest extent possible permitted by law.

19.3 Time of Essence. Time is of the essence of this Lease and each of its provisions.

19.4 Captions. The captions of Articles and Sections are for convenience only and shall not be deemed to limit, construe, affect or alter the meaning of such Articles and Sections.

19.5 Notices. All notices, demands, statements, designations, approvals or other communications (collectively, "NOTICES") given or required to be given by either party to the other hereunder shall be in writing, shall be sent by United States certified or registered mail, postage prepaid, return receipt requested, or delivered personally (i) to Tenant at the appropriate address set forth in Section 10 of the Summary, or to such other place as Tenant may from time to time designate in a Notice to Landlord; or (ii) to Landlord at the following addresses, or to such other firm or to such other place as Landlord may from time to time designate in a Notice to Tenant:

21600 Oxnard Street
Suite 300
Woodland Hills, California 91367
Attn: Property Manager

With a copy to:

Allen, Matkins, Leck, Gamble & Mallory LLP
515 South Figueroa Street, 8th Floor
Los Angeles, California 90071
Attn: Anton N. Natsis, Esq.

Any Notice will be deemed given on the date it is mailed as provided in this Section 19.5 or upon the date personal delivery is made. If Tenant is notified of the identity and address of the holder of any deed of trust or ground or underlying lessor, Tenant shall give to such mortgagee or ground or underlying lessor written notice of any default by Landlord under the terms of this Lease by registered or certified mail, and such mortgagee or ground or underlying lessor shall be given a reasonable opportunity to cure such default prior to Tenant's exercising any remedy available to Tenant.

19.6 Nonwaiver. No waiver of any provision of this Lease shall be implied by any failure of Landlord to enforce any remedy on account of the violation of such provision and even if such violation shall continue or be repeated subsequently, any waiver by Landlord of any provision of this Lease may only be in writing. Additionally, no express waiver shall affect any provision other than the one specified in such waiver and then only for the time and in the manner specifically stated. No receipt of monies by Landlord from Tenant after the termination of this Lease shall in any way alter the length of the Lease Term or of Tenant's right of possession hereunder, or after the giving of any notice shall reinstate, continue or extend the Lease Term or affect any notice given Tenant prior to the receipt of such monies, it being agreed that after the service of notice or the commencement of a suit, or after final judgment for possession of the Premises, Landlord may receive and collect any Rent due, and the payment of said Rent shall not waive or affect said notice, suit or judgment.

19.7 Holding Over. If Tenant holds over after the expiration of the Lease Term hereof, with or without the express or implied consent of Landlord, such tenancy shall be from month-to-month only, and shall not constitute a renewal hereof or an extension for any further term, and in such case Base Rent shall be payable at a monthly rate equal to the product of (i) the Base Rent applicable during the last rental period of the Lease Term under this Lease, and (ii) a percentage equal to the sum of (A) 150% and (B) the percentage by which Base Rent was increased at the time of the last increase of Base Rent during the Lease Term. Such month-to-month tenancy shall be subject to every other applicable term, covenant and agreement contained herein. Nothing contained in this Section 19.7 shall be construed as consent by Landlord to any holding over by Tenant, and Landlord expressly reserves the right to require Tenant to surrender possession of the Premises to Landlord as provided in this Lease upon the expiration or other termination of this Lease. The provisions of this

Section 19.7 shall not be deemed to limit or constitute a waiver of any other rights or remedies of Landlord provided herein or at law. If Tenant fails to surrender the Premises upon the termination or expiration of this Lease, in addition to any other liabilities to Landlord accruing therefrom, Tenant shall protect, defend, indemnify and hold Landlord harmless from all loss, costs (including reasonable attorneys' fees) and liability resulting from such failure, including, without limiting the generality of the foregoing, any claims made by any succeeding tenant founded upon such failure to surrender and any lost profits to Landlord resulting therefrom.

19.8 Waiver of Default. No waiver by Landlord or Tenant of any violation or breach of any of the terms, provisions and covenants herein contained shall be deemed or construed to constitute a waiver of any other or later violation or breach of the same or any other of the terms, provisions, and covenants herein contained. Forbearance by Landlord in enforcement of one or more of the remedies herein provided upon an event of default shall not be deemed or construed to constitute a waiver of such default. The acceptance of any Rent hereunder by Landlord following the occurrence of any default, whether or not known to Landlord, shall not be deemed a waiver of any such default, except only a default in the payment of the Rent so accepted.

19.9 Binding Effect. Subject to all other provisions of this Lease, each of the provisions of this Lease shall extend to and shall, as the case may require, bird or inure to the benefit not only of Landlord and of Tenant, but also of their respective successors or assigns, provided this clause shall not permit any assignment by Tenant contrary to the provisions of Article 11 of this Lease.

19.10 Governing. Law. This Lease shall be construed and enforced in accordance with the laws of the State of California.

19.11 Subordination. This Lease shall be subject and subordinate to all present and future ground or underlying leases of the Building or Project and to the lien of any mortgage or trust deed, now or hereafter in force against the Building or Project, if any, and to all renewals, extensions, modifications, consolidations and replacements thereof, and to all advances made or hereafter to be made upon the security of such mortgages or trust deeds, unless the holders of such mortgages or trust deeds, or the lessors under such ground lease or underlying leases, require in writing that this Lease be superior thereto. Tenant covenants and agrees in the event any proceedings are brought for the foreclosure of any such mortgage or deed in lieu thereof, to

attorn, without any deductions or set-offs whatsoever, to the purchaser or any successors thereto upon any such foreclosure sale or deed in lieu thereof if so requested to do so by such purchaser, and to recognize such purchaser as the lessor under this Lease. Tenant shall, within five (5) days of request by Landlord, execute such further instruments or assurances as Landlord may reasonably deem necessary to evidence or confirm the subordination or superiority of this Lease to any such mortgages, trust deeds, ground leases or underlying leases. Tenant hereby irrevocably authorizes Landlord to execute and deliver in the name of Tenant any such instrument or instruments if Tenant fails to do so, provided that such authorization shall in no way relieve Tenant from the obligation of executing such instruments of subordination or superiority. Tenant waives the provisions of any current or future statute, rule or law which may give or purport to give Tenant any right or election to terminate or otherwise adversely affect this Lease and the obligations of the Tenant hereunder in the event of any foreclosure proceeding or sale. Within ten (10) days following a request in writing by Landlord, Tenant shall execute and deliver to Landlord a Subordination of Deed of Trust Agreement in the form of Exhibit G attached hereto and made a part hereof.

19.12 Waiver of Jury Trial; Attorneys' Fees. EACH PARTY HEREBY WAIVES ANY RIGHT TO A TRIAL BY JURY IN ANY ACTION TO ENFORCE THE SPECIFIC PERFORMANCE OF THIS LEASE, FOR DAMAGES FOR THE BREACH HEREOF, OR OTHERWISE FOR ENFORCEMENT OF ANY REMEDY HEREUNDER. If either party commences litigation against the other for the specific performance of this Lease, for damages for the breach hereof or otherwise for enforcement of any remedy hereunder, the prevailing party shall be entitled to recover from the other party such costs and reasonable attorneys' fees as may have been incurred, including any and all costs incurred in

enforcing, perfecting and executing such judgment.

19.13 Entry by Landlord. Landlord reserves the right at all reasonable times and upon reasonable notice to Tenant (except in the case of an emergency) to enter the Premises to (i) inspect them; (ii) show the Premises to prospective purchasers, mortgagees or tenants, or to the ground or underlying lessors; (iii) post notices of nonresponsibility; or (iv) alter, improve or repair the Premises or the Building if necessary to comply with current building codes or other applicable laws, or for structural alterations, repairs or improvements to the Building. Notwithstanding anything to the contrary contained in this Section 19.13, Landlord may enter the Premises at any time to (A) perform services required of Landlord; (B) take possession due to any breach of this Lease in the manner provided herein; and (C) perform any covenants of Tenant which Tenant fails to perform. Landlord may make any such entries without the abatement of Rent and may take such reasonable steps as required to accomplish the stated purposes. Tenant hereby waives any claims for damages or for any injuries or inconvenience to or interference with Tenant's business, lost profits, any loss of occupancy or quiet enjoyment of the Premises, and any other loss occasioned thereby. For each of the above purposes, Landlord shall at all times have a key with which to unlock all the doors in the Premises, excluding Tenant's vaults, safes and special security areas designated in advance by Tenant. In an emergency, Landlord shall have the right to use any means that Landlord may deem proper to open the doors in and to the Premises. Any entry into the Premises by Landlord in the manner herein before described shall not be deemed to be a forcible or unlawful entry into, or a detainer of, the Premises, or an actual or constructive eviction of Tenant from any portion of the Premises.

19.14 Authority. If Tenant is a corporation, partnership or limited liability company, each individual executing this Lease on behalf of said entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on behalf of said entity in accordance with: (i) if Tenant is a corporation, a duly adopted resolution of the Board of Directors of said corporation or in accordance with the by-laws of said corporation, (ii) if Tenant is a partnership, the terms of the partnership agreement, and (iii) if Tenant is a limited liability company, the terms of its operating agreement, and that this Lease is binding upon said entity in accordance with its terms. Concurrently with Tenant's execution of this Lease, Tenant shall provide to Landlord a copy of (a) if Tenant is a corporation, a resolution of the Board of Directors authorizing the execution of this Lease on behalf of such corporation, which copy of resolution shall be duly certified by the secretary or an assistant secretary of the corporation to be a true copy of a resolution duly adopted by the Board of Directors of said corporation and shall be in the form of Exhibit "H" or in some other form reasonably acceptable to Landlord, (b) if Tenant is a partnership, a copy of the provisions of the partnership agreement granting the requisite authority to each individual executing this Lease on behalf of said partnership, and (c) if Tenant is a limited liability company, a copy of the provisions of its operating agreement granting the requisite authority to each individual executing this Lease on behalf of said limited liability company. In the event Tenant fails to comply with the requirements set forth in this Section 19.14, then each individual executing this Lease shall be personally liable for all of Tenant's obligations in this Lease.

19.15 Surrender of Premises; Ownership and Removal of Trade Fixtures.

19.15.1 Surrender of Premises. No act or thing done by Landlord or any agent or employee of Landlord during the Lease Term shall be deemed to constitute an acceptance by Landlord of a surrender of the Premises unless such intent is specifically acknowledged in writing by Landlord. The delivery of keys to the Premises to Landlord or any agent or employee of Landlord shall not constitute a surrender of the Premises or effect a termination of this Lease, whether or not the keys are thereafter retained by Landlord, and notwithstanding such delivery Tenant shall be entitled to the return of such keys at any reasonable time upon request until this Lease shall have been properly terminated. The voluntary or other surrender of this Lease by Tenant, whether accepted by Landlord or not, or a mutual termination hereof, shall not work a merger, and at the option of Landlord shall operate as an assignment to Landlord of all subleases or subtenancies affecting the Premises.

19.15.2 Removal of Tenant Property by Tenant. Upon the expiration

of the Lease Term, or upon any earlier termination of this Lease, Tenant shall, subject to the provisions of this Section 19.15, quit and surrender possession of the Premises to Landlord in as good order and condition as when Tenant took possession and as thereafter improved by Landlord and/or Tenant, reasonable wear and tear and repairs which are specifically made the responsibility of Landlord hereunder excepted. Upon such expiration or termination, Tenant shall, without expense to Landlord, remove or cause to be removed from the Premises (i) all debris and rubbish, and such items of furniture, equipment, free-standing cabinet work, telephone and data cabling and other articles of personal property owned by Tenant or installed or placed by Tenant at its expense in the Premises, and any similar articles of any other persons claiming under Tenant, and (ii) those cables and wires in the Premises as Landlord may, in its sole

discretion, require to be removed. Tenant shall repair at its own expense all damage to the Premises and Building resulting from removal of the items described in this Section 19.15.2.

19.16 Entire Agreement. It is understood and acknowledged that there are no oral agreements between the parties hereto affecting this Lease and this Lease supersedes and cancels any and all previous negotiations, arrangements, brochures, agreements and understandings, if any, between the parties hereto or displayed by Landlord to Tenant with respect to the subject matter thereof, and none thereof shall be used to interpret or construe this Lease. This Lease, the exhibits and schedules attached hereto, and any side letter or separate agreement executed by Landlord and Tenant in connection with this Lease and dated of even date herewith, contain all of the terms, covenants, conditions, warranties and agreements of the parties relating in any manner to the rental, use and occupancy of the Premises and shall be considered to be the only agreement between the parties hereto and their representatives and agents. None of the terms, covenants, conditions or provisions of this Lease can be modified, deleted or added to except in writing signed by the parties hereto. All negotiations and oral agreements acceptable to both parties have been merged into and are included herein. There are no other representations or warranties between the parties, and all reliance with respect to representations is based totally upon the representations and agreements contained in this Lease.

19.17 Signs.

19.17.1 Full Floors. Subject to Landlord's prior written approval, in its sole discretion, and provided all signs are in keeping with the quality, design and style of the Building and Project, Tenant, for any portion of the Premises which comprises an entire floor of the Building, at its sole cost and expense, may install identification signage anywhere in such full floor portion of the Premises including in the elevator lobby of such full floor portion of the Premises, provided that such signs must not be visible from the exterior of the Building. Tenant shall be responsible, at Tenant's sole cost and expense, for maintenance and repair of any such signs. In addition, Tenant shall cause such signs to be removed from the Premises and shall repair all damage to the Premises and the Building resulting from such removal, at Tenant's sole cost and expense, prior to the expiration or earlier termination of this Lease.

19.17.2 Multi-Tenant Floors. If other tenants occupy space on the floor on which the Premises is located, Tenant's identifying signage shall be provided by Landlord, at Tenant's cost, and such signage shall be comparable to that used by Landlord for other similar floors in the Building and shall comply with Landlord's Building standard signage program.

19.17.3 Prohibited Signage and Other Items. Any signs, notices, logos, pictures, names or advertisements which are installed and that have not been separately approved by Landlord may be removed without notice by Landlord at the sole expense of Tenant. Tenant may not install any signs on the exterior or roof of the Project or the Common Areas. Any signs, window coverings, or blinds (even if the same are located behind the Landlord-approved window coverings for the Building), or other items visible from the exterior of the Premises or Building, shall be subject to the prior written approval of landlord, in its sole discretion.

19.18 Covenant Against Liens. Tenant has no authority or power to cause or permit any lien or encumbrance of any kind whatsoever, whether created by act

of Tenant,

operation of law or otherwise, to attach to or be placed upon the Project or Premises, and any and all liens and encumbrances created by Tenant shall attach to Tenant's interest only. Landlord shall have the right at all times to post and keep posted on the Premises any notice which it deems necessary for protection from such liens. Tenant covenants and agrees not to suffer or permit any lien of mechanics or materialmen or others to be placed against the Project, the Building or the Premises, or any portion thereof, with respect to work or services claimed to have been performed for or materials claimed to have been furnished to Tenant or the Premises, and, in case of any such lien attaching or notice of any lien, Tenant covenants and agrees to cause it to be immediately released and removed of record. Notwithstanding anything to the contrary set forth in this Lease, in the event that such lien is not released and removed on or before the date occurring five (S) days after notice of such lien is delivered by Landlord to Tenant, Landlord, at its sole option, may immediately take all action necessary to release and remove such lien, without any duty to investigate the validity thereof, and all sums, costs and expenses, including reasonable attorneys' fees and costs, incurred by Landlord in connection with such lien shall be deemed Additional Rent under this Lease and shall immediately be due and payable by Tenant.

19.19 Terms. The necessary grammatical changes required to make the provisions hereof apply either to corporations or partnerships or individuals, men or women, as the case may require, shall in all cases be assumed as though in each case fully expressed.

19.20 Prohibition Against Recording. Except as provided in Section 19.32 of this Lease, neither this Lease, nor any memorandum, affidavit or other writing with respect thereto, shall be recorded by Tenant or by anyone acting through, under or on behalf of Tenant, and the recording thereof in violation of this provision shall make this Lease null and void at Landlord's election.

19.21 Confidentiality. Tenant acknowledges that the content of this Lease and any related documents are confidential information. Tenant shall keep such confidential information strictly confidential and shall not disclose such confidential information to any person or entity other than Tenant's financial, legal, and space planning consultants.

19.22 Quiet Enjoyment. Landlord covenants that Tenant, on paying the Rent, charges for services and other payments herein reserved and on keeping, observing and performing all the other terms, covenants, conditions, provisions and agreements herein contained on the part of Tenant to be kept, observed and performed, shall, during the Lease Term, peaceably and quietly have, hold and enjoy the Premises subject to the terms, covenants, conditions, provisions and agreements hereof without interference by any persons lawfully claiming by or through Landlord. The foregoing covenant is in lieu of any other covenant express or implied.

19.23 Improvement of the Premises. Except as specifically set forth in this Lease and in the Tenant Work Letter attached hereto as Exhibit C, Landlord shall not be obligated to provide or pay for any improvement work or services related to the improvement of the Premises. Tenant also acknowledges that Landlord has made no representation or warranty regarding the condition of the Premises or the Project except as specifically set forth in this Lease and the Tenant Work Letter.

19.24 Force Majeure. Any prevention, delay or stoppage due to strikes, lockouts, labor disputes, acts of God, inability to obtain services, labor, or materials or reasonable substitutes therefor, governmental action(s) or inaction(s), civil commotions, fire or other casualty, and other causes beyond the reasonable control of the party obligated to perform, except with respect to the obligations imposed with regard to Rent and other charges to be paid by Tenant pursuant to this Lease (collectively, a "FORCE MAJEURE"), notwithstanding anything to the contrary contained in this Lease, shall excuse the performance

of such party for a period equal to any such prevention, delay or stoppage and, therefore, if this Lease specifies a time period for performance of an obligation of either party, that time period shall be extended by the period of any delay in such party's performance caused by a Force Majeure.

19.25 Verification of Rentable Square Feet of Premises, Building, and Project. The rentable square feet of the Premises, the Building, and the Project are subject to verification from time to time by Landlord's floor area consultant and such verification shall be made in accordance with the provisions of this Section 19.25. For purposes of this Lease, "rentable square feet" shall mean rentable area calculated pursuant to Standard Method for Measuring Floor Area in Office Buildings, ANSI Z65.1 - 1996 ("BOMA"), provided that the rentable square footage of the Building and the Project shall include all of (and the rentable square footage of the Premises therefore shall include a portion of) (i) the Building Common Areas, and (ii) an equitable portion of space of the Project dedicated to the service of the Project. Tenant's architect may consult with Landlord's floor area consultant regarding such verification as it pertains to the Premises; however, the determination of Landlord's floor area consultant shall be conclusive and binding upon the parties. In the event that Landlord's floor area consultant determines that the amounts thereof shall be different from those set forth in this Lease, all amounts, percentages and figures appearing or referred to in this Lease based upon such incorrect amount (including, without limitation, the amount of the "Rent" and any "Security Deposit," as those terms are defined in Article 3 and Article 4 of this Lease, respectively) shall be modified in accordance with such determination. If such determination is made, it will be confirmed in writing by Landlord to Tenant.

19.26 Transportation Management. Tenant shall fully comply with all present or future programs intended to manage parking, transportation or traffic in and around the Project or Building, and in connection therewith, Tenant shall take responsible action for the transportation planning and management of all employees located at the Premises by working directly with Landlord, any governmental transportation management organization or any other transportation-related committees or entities. Such programs may include, without limitation: (i) restrictions on the number of peak-hour vehicle trips generated by Tenant; (ii) increased vehicle occupancy; (iii) implementation of an in-house ridesharing program and an employee transportation coordinator; (iv) working with employees and any Project, Building or area-wide ridesharing program manager; (v) instituting employer-sponsored incentives (financial or inkind) to encourage employees to rideshare; and (vi) utilizing flexible work shifts for employees.

19.27 Compliance With Law. Tenant shall not do anything or suffer anything to be done in or about the Premises which will in any way conflict with any law, statute, ordinance or other governmental rule, regulation or requirement now in force or which may hereafter be enacted or promulgated ("LAWS"). Landlord shall be responsible, as part of Operating Expenses to the extent permitted under Article 3, for making all alterations to the following portions of the

Premises and Project required by Laws: (i) structural portions of the Premises but not including Tenant Improvements or any Alterations installed by or at the request of Tenant, and (ii) those portions of the Building and Project located outside the Premises; provided, however, Landlord shall not be obligated to make alterations to any such portions of the Premises and Project described in clause (i) or (ii) above to the extent such alterations are necessary due to the installation of Alterations to the Premises by or at the request of Tenant and Tenant shall, at its sole cost and expense, be responsible therefor. Except for Landlord's obligations described in the immediately preceding sentence, Tenant shall, at its sole cost and expense, be responsible for compliance with all Laws affecting the Premises, including the making of all required alterations thereto. Should any standard or regulation now or hereafter be imposed on Landlord or Tenant by a state, federal or local governmental body charged with the establishment, regulation and enforcement of occupational, health or safety standards for employers, employees, landlords or tenants, then Tenant agrees, at its sole cost and expense, to comply promptly with such standards or regulations. The judgment of any court of competent jurisdiction or the admission of Tenant in any judicial action, regardless of whether Landlord is a party thereto, that Tenant has violated any of said governmental measures, shall

be conclusive of that fact as between Landlord and Tenant.

19.28 Late Charges. If any installment of Rent or any other sum due from Tenant shall not be received by Landlord or Landlord's designee within ten (10) days after said amount is due, then Tenant shall pay to Landlord a late charge equal to five percent (5%) of the overdue amount. In addition, if such installment of Rent or other sum due from Tenant shall still not be received by Landlord or Landlord's designee within the first three (3) days of the following calendar month(s), then Tenant shall pay to Landlord an additional late charge equal to five percent (5%) of the overdue amount for each such month. Tenant shall also be responsible for any attorneys' fees incurred by Landlord by reason of Tenant's failure to pay Rent and/or other charges when due hereunder. The late charge shall be deemed Additional Rent and the right to require it shall be in addition to all of Landlord's other rights and remedies hereunder or at law and shall not be construed as liquidated damages or as limiting Landlord's remedies in any manner. Tenant hereby agrees that if Tenant is subject to a late charge for two (2) consecutive months, Rent for the following twelve (12) months shall automatically be adjusted to be payable quarterly, in advance, by cashier's check only, commencing upon the first day of the month following such consecutive late month and continuing for the next twelve (12) months on a quarterly basis in advance. In addition to the late charge described above, any Rent or other amounts owing hereunder which are not paid within ten (10) days after the date they are due shall bear interest from the date when due until paid at a rate per annum equal to the lesser of (i) the rate per annum announced from time to time by Citibank N.A. as its prime rate (or, if such bank fails to announce such a rate, then the prime rate announced by the largest state chartered bank operating in the State of California) plus four (4) percentage points (the "INTEREST RATE"), and (ii) the highest rate permitted by applicable law.

19.29 Hazardous Material. As used herein, the term "HAZARDOUS MATERIAL" means any hazardous or toxic substance, material or waste which is or becomes regulated by, or is dealt with in, any local governmental authority, the State of California or the United States Government. Accordingly, the term "Hazardous Material" includes, without limitation, any material or substance which is (i) defined as a "hazardous waste," "extremely hazardous waste" or "restricted hazardous waste" under Sections 25115, 25117 or 25122.7, or listed pursuant to

Section 25140 of the California Health and Safety Code, Division 20, Chapter 6.5 (Hazardous Waste Control Law), (ii) defined as a "hazardous substance" under Section 25316 of the California Health and Safety Code, Division 20, Chapter 6.95 (Hazardous Materials Release Response Plans and Inventory), (iii) defined as a "hazardous substance" under Section 25281 of the California Health and Safety Code, Division 20, Chapter 6.7 (Underground Storage of Hazardous Substances), (iv) petroleum, (v) asbestos, (vi) listed under Article 9 or defined as hazardous or extremely hazardous pursuant to Article 11 of Title 22 of the California Administrative Code, Division 4, Chapter 20, (vii) designated as a "hazardous substance" pursuant to Section 311 of the Federal Water Pollution Control Act (33 U.S.C. 1317), (viii) defined as a "hazardous waste" pursuant to Section 1004 of the Federal Resource Conservation and Recovery Act, 42 U.S.C. Section 6902 et seq. (42 U.S.C. Section 6903), or (ix) defined as a "hazardous substance" pursuant to Section 101 of the Compensation and Liability Act, 42 U.S.C. Section 9601 et seq. (42 U.S.C. Section 9601). Tenant shall not (either with or without negligence) cause or permit the escape, disposal or release of any Hazardous Materials. Tenant shall not allow the storage or use of Hazardous Materials in any manner not sanctioned by law or by the highest standards prevailing in the industry for the storage or use of such substances or materials, nor allow to be brought into the Project any such materials or substances, except that Tenant may maintain products in the Premises which are incidental to the operation of its offices, such as photocopy supplies, secretarial supplies and limited janitorial supplies which products contain chemicals which are categorized as Hazardous Materials, provided that the use of such products in the Premises by Tenant shall be in compliance with applicable laws and shall be in the manner in which such products are designed to be used and provided further that Tenant must provide prior written notice to Landlord of the identity of such substances or materials. If any lender or governmental agency shall ever require testing to ascertain whether or not there has been any release of Hazardous Materials, then the reasonable cost thereof shall be reimbursed by Tenant to Landlord upon demand as Additional Rent if such

requirement applies to the Premises. In addition, Tenant shall execute affidavits, representations and the like from time to time at Landlord's request concerning Tenant's best knowledge and belief regarding the presence of Hazardous Materials on the Premises. In all events, Tenant shall indemnify Landlord in the manner provided in Section 7.1 above from any release of Hazardous Materials on the Premises occurring while Tenant is in possession, or elsewhere if caused by Tenant or persons acting under Tenant. The covenants of this Section 19.29 shall survive the expiration or earlier termination of the Lease Term.

19.30 Landlord's Right to Cure Default; Payments by Tenant.

19.30.1 Landlord's Cure. All covenants and agreements to be kept or performed by Tenant under this Lease shall be performed by Tenant at Tenant's sole cost and expense and without any reduction of Rent. If Tenant shall fail to perform any of its obligations under this Lease within a reasonable time after such performance is required by the terms of this Lease, Landlord may, but shall not be obligated to, after reasonable prior notice to Tenant (except in the case of an emergency), make any such payment or perform any such act on Tenant's part without waiving its rights based upon any default of Tenant and without releasing Tenant from any obligations hereunder.

19.30.2 Tenant's Reimbursement. Except as may be specifically provided to the contrary in this Lease, Tenant shall pay to Landlord, within fifteen (15) days after

delivery by Landlord to Tenant of statements therefor: (i) sums equal to expenditures reasonably made and obligations incurred by Landlord in connection with the remedying by Landlord of Tenant's defaults pursuant to the provisions of Section 19.30.1; (ii) sums equal to all losses, costs, liabilities, damages and expenses referred to in Article 7 of this Lease; and (iii) sums equal to all expenditures made and obligations incurred by Landlord in collecting or attempting to collect the Rent or in enforcing or attempting to enforce any rights of Landlord under this Lease or pursuant to law, including, without limitation, all legal fees and other amounts so expended. Tenant's obligations under this Section 19.30 shall survive the expiration or sooner termination of the Lease Term.

19.31 No Air Rights. No rights to any view or to light or air over any property, whether belonging to Landlord or any other person, are granted to Tenant by this Lease. If at any time any windows of the Premises are temporarily darkened or the light or view therefrom is obstructed by reason of any repairs, improvements, maintenance or cleaning in or about the Project, the same shall be without liability to Landlord and without any reduction or diminution of Tenant's obligations under this Lease.

19.32 Modification of Lease. Should any current or prospective mortgagee or ground lessor for the Building or Project require a modification or modifications of this Lease, which modification or modifications will not cause an increased cost or expense to Tenant or in any other way materially and adversely change the rights and obligations of Tenant hereunder, then and in such event, Tenant agrees that this Lease may be so modified and agrees to execute whatever documents are reasonably required therefor and to deliver the same to Landlord within ten (10) days following a request therefor. Should Landlord or any such prospective mortgagee or ground lessor require execution of a short form of Lease for recording, containing, among other customary provisions, the names of the parties, a description of the Premises and the Lease Term, Tenant agrees to execute such short form of Lease and deliver the same to Landlord within ten (10) days following the request therefor.

19.33 Transfer of Landlord's Interest. Tenant acknowledges that Landlord has the right to transfer all or any portion of its interest in the Project or Building and in this Lease, and Tenant agrees that in the event of any such transfer, Landlord shall automatically be released from all liability under this Lease and Tenant agrees to look solely to such transferee for the performance of Landlord's obligations hereunder after the date of transfer. Tenant further acknowledges that Landlord may assign its interest in this Lease to the holder of any mortgage or deed of trust as additional security, but agrees that an assignment shall not release Landlord from its obligations hereunder and Tenant

shall continue to look to Landlord for the performance of its obligations hereunder.

19.34 Landlord's Title. Landlord's title is and always shall be paramount to the title of Tenant. Nothing herein contained shall empower Tenant to do any act which can, shall or may encumber the title of Landlord.

19.35 Relationship of Parties. Nothing contained in this Lease shall be deemed or construed by the parties hereto or by any third party to create the relationship of principal and agent, partnership, joint venturer or any association between Landlord and Tenant, it being expressly understood and agreed that neither the method of computation of Rent nor any act of

the parties hereto shall be deemed to create any relationship between Landlord and Tenant other than the relationship of landlord and tenant.

19.36 Application of Payments. Landlord shall have the right to apply payments received from Tenant pursuant to this Lease, regardless of Tenant's designation of such payments, to satisfy any obligations of Tenant hereunder, in such order and amounts as Landlord, in its sole discretion, may elect.

19.37 No Warranty. In executing and delivering this Lease, Tenant has not relied on any representations, including, but not limited to, any representation as to the amount of any item comprising Additional Rent or the amount of the Additional Rent in the aggregate or that Landlord is furnishing the same services to other tenants, at all, on the same level or on the same basis, or any warranty or any statement of Landlord which is not set forth herein or in one or more of the exhibits attached hereto.

19.38 Right to Lease. Landlord reserves the absolute right to effect such other tenancies in the Project as Landlord in the exercise of its sole business judgment shall determine to best promote the interests of the Building or Project. Tenant does not rely on the fact, nor does Landlord represent, that any specific tenant or type or number of tenants shall, during the Lease Term, occupy any space in the Building or Project.

19.39 Submission of Lease. Submission of this instrument for examination or signature by Tenant does not constitute a reservation of or an option for lease, and it is not effective as a lease or otherwise until execution and delivery by both Landlord and Tenant.

19.40 Independent Covenants. This Lease shall be construed as though the covenants herein between Landlord and Tenant are independent and not dependent and Tenant hereby expressly waives the benefit of any statute to the contrary and agrees that if Landlord fails to perform its obligations set forth herein, Tenant shall not be entitled to make any repairs or perform any acts hereunder at Landlord's expense or to any setoff of the Rent or other amounts owing hereunder against Landlord; provided, however, that the foregoing shall in no way impair the right of Tenant to commence a separate action against Landlord for any violation by Landlord of the provisions hereof so long as notice is first given to Landlord and any holder of a mortgage or deed of trust covering the Building or Project or any portion thereof, whose address has theretofore been given to Tenant, and an opportunity is granted to Landlord and such holder to correct such violations as provided above.

19.41 Waiver of Redemption by Tenant. Tenant hereby waives, for Tenant and for all those claiming under Tenant, any and all rights now or hereafter existing to redeem by order or judgment of any court or by any legal process or writ, Tenant's right of occupancy of the Premises after any termination of this Lease.

19.42 Joint and Several. If there is more than one entity which constitutes Tenant, the obligations imposed upon Tenant under this Lease shall be joint and several.

19.43 Project or Building Name and Signage. Landlord shall have the right at any time to change the name of the Project or Building and to install, affix and maintain any and all signs on the exterior and on the interior of the Project or Building as Landlord may, in

Landlord's sole discretion, desire. Tenant shall not use the name of the Project or Building or use pictures or illustrations of the Project or Building in advertising or other publicity, without the prior written consent of Landlord.

19.44 No Discrimination. Tenant covenants by and for itself, its heirs, executors, administrators and assigns, and all persons claiming under or through Tenant, and this Lease is made and accepted upon and subject to the following conditions: that there shall be no discrimination against or segregation of any person or group of persons, on account of race, color, creed, sex, religion, marital status, ancestry or national origin in the leasing, subleasing, transferring, use, or enjoyment of the Premises, nor shall Tenant itself, or any person claiming under or through Tenant, establish or permit such practice or practices of discrimination or segregation with reference to the selection, location, number, use or occupancy, of tenants, lessees, sublessees, subtenants or vendees in the Premises.

19.45 Landlord Renovations. It is specifically understood and agreed that Landlord has no obligation and has made no promises to alter, remodel, improve, renovate, repair or decorate the Premises, Building, Project or any part thereof and that no representations respecting the condition of the Premises, Building or Project have been made by Landlord to Tenant except as specifically set forth herein or in the Tenant Work Letter. However, Tenant acknowledges that Landlord shall have the right, but not the obligation, during the Lease Term to renovate, improve, alter, or modify (collectively, the "RENOVATIONS") the Building, Premises, and/or Project, including without limitation the parking facilities, Common Areas, Systems and Equipment, roof, and structural portions of the same. In connection with such Renovations, Landlord may, among other things, erect scaffolding or other necessary structures in the Building or on the Project, limit or eliminate access to portions of the Project, including portions of the Common Areas and/or parking facilities, or perform work in the Building, which work may create noise, dust or leave debris in the Building. Tenant hereby agrees that such Renovations and Landlord's actions in connection with such Renovations shall in no way constitute a constructive eviction of Tenant nor entitle Tenant to any abatement of Rent. Landlord shall have no responsibility or for any reason be liable to Tenant for any direct or indirect injury to or interference with Tenant's business arising from the Renovations, nor shall Tenant be entitled to any compensation or damages from Landlord for loss of the use of the whole or any part of the Premises or of Tenant's personal property or improvements resulting from the Renovations or Landlord's actions in connection with such Renovations, or for any inconvenience or annoyance occasioned by such Renovations or Landlord's actions in connection with such Renovations.

IN WITNESS WHEREOF, Landlord and Tenant have caused this Lease to be executed the day and date first above written.

"Landlord":

AH WARNER CENTER PROPERTIES,
LIMITED LIABILITY COMPANY,
a Delaware limited liability company

By: COPLEY MANAGEMENT AND ADVISORS,
L.P., a Delaware limited partnership,
Its duly authorized asset manager and advisor

By: AEW INVESTMENT GROUP, INC.
(formerly known as COPLEY
INVESTMENT GROUP, INC.),
a Massachusetts corporation,
Its general partner

By:
_____

Print Name:
---------- Title:

"Tenant":
CAPSTONE TURBINE CORPORATION,
a Delaware corporation

By: /s/ JEFFREY WATTS
---------- JEFFREY WATTS
Its: Chief Financial Officer

EXHIBIT A

WARNER CENTER PLAZA

OUTLINE OF PREMISES

[DIAGRAM OF PREMISES]

EXHIBIT A
-1-

EXHIBIT B

WARNER CENTER PLAZA

SITE PLAN/PROJECT COMMON AREAS

[DIAGRAM OF SITE]

EXHIBIT C

WARNER CENTER PLAZA

TENANT WORK LETTER

This Tenant Work Letter shall set forth the terms and conditions relating to the construction of the tenant improvements in the Premises. This Tenant Work Letter is essentially organized chronologically and addresses the issues of the construction of the Premises, in sequence, as such issues will arise during the actual construction of the Premises. All references in this Tenant Work Letter to Articles or Sections of "this LEASE" shall mean the relevant portion of Articles 1 through 19 of the Standard Form Office Lease to which this Tenant Work Letter is attached as Exhibit C and of which this Tenant Work Letter forms a part, and all references in this Tenant Work Letter to Sections of "this TENANT WORK LETTER" shall mean the relevant portion of Sections 1 through 6 of this Tenant Work Letter.

SECTION 1

LANDLORD'S INITIAL CONSTRUCTION IN THE PREMISES

Landlord has constructed, at its sole cost and expense, the base, shell and core (i) of the Premises, and (ii) of the floor of the Building on which the Premises is located (collectively, the "BASE, SHELL AND CORE"). In addition, improvements in the Premises have been constructed for a previous occupant. Tenant has inspected and hereby approves the condition of the Base, Shell and Core and the Premises, and agrees that the Base, Shell and Core and the Premises shall be delivered to Tenant in their current "as-is" condition. Renovations to the existing improvements in the Premises shall be designed and constructed pursuant to this Tenant Work Letter. Any costs of initial design and construction of such renovations to the existing improvements in the Premises shall be a "Tenant Improvement Allowance Item", as that term is defined in Section 2.2 of this Tenant Work Letter.

SECTION 2

TENANT IMPROVEMENTS

2.1 Tenant Improvement Allowance. Tenant shall be entitled to a one-time tenant improvement allowance (the "TENANT IMPROVEMENT ALLOWANCE") in the amount of $5.00 per usable square foot of the Premises for the costs relating to the initial design and construction of Tenant's improvements which are permanently affixed to the Premises (the "TENANT IMPROVEMENTS"). In no event shall Landlord be obligated to make disbursements pursuant to this Tenant Work Letter in a total amount which exceeds the Tenant Improvement Allowance. All Tenant Improvements for which the Tenant Improvement Allowance has been made available shall be deemed Landlord's property under the terms of Section 6.6 of the Lease. Tenant shall not be entitled to any payment or credit for any portion of the Tenant Improvement Allowance which is not used or requested for Tenant Improvement Allowance Items on or before September 30, 2001.

2.2 Disbursement of the Tenant Improvement Allowance. Except as otherwise set forth in this Tenant Work Letter, the Tenant Improvement Allowance shall be disbursed by Landlord (each of which disbursements shall be made pursuant to Landlord's disbursement process) for costs related to the construction of the Tenant Improvements and for the following items and costs (collectively, the "TENANT IMPROVEMENT ALLOWANCE ITEMS"): (i) payment of the fees of the "Architect" and the "Engineers," as those terms are defined in Section 3.1 of this Tenant Work Letter, and payment of the fees incurred by, and the cost of documents and materials supplied by, Landlord and Landlord's consultants in connection with the preparation and review of the "Construction Drawings," as that term is defined in Section 3.1 of this Tenant Work Letter;

(ii) the cost of any changes in the Base, Shell and Core required by the Construction Drawings; (iii) the cost of any changes to the Construction Drawings or Tenant Improvements required by applicable building codes (the "CODE"); (iv) the "Landlord Supervision Fee", as that term is defined in Section 4.3.2 of this Tenant Work Letter; and (v) a portion of the costs, if any, of the tenant demising walls and public corridor walls and materials on the floor of the Building on which the Premises is located as designated by Landlord.

2.3 Standard Tenant Improvement Package. Landlord has established specifications (the "SPECIFICATIONS") for the Building standard components to be used in the construction of the Tenant Improvements in the Premises (collectively, the "STANDARD IMPROVEMENT PACKAGE"), which Specifications shall be supplied to Tenant by Landlord. The quality of Tenant Improvements shall be equal to or of greater quality than the quality of the Specifications, provided that Landlord may, at Landlord's option, require the Tenant Improvements to comply with certain Specifications. Landlord may make changes to the Specifications for the Standard Improvement Package from time to time.

SECTION 3

CONSTRUCTION DRAWINGS

3.1 Selection of Architect/Construction Drawings. Landlord shall retain the architect/space planner designated by Landlord (the "ARCHITECT") to prepare the "Construction Drawings," as that term is defined in this Section 3.1. Landlord shall retain the engineering consultants designated by Landlord (the "ENGINEERS") to prepare all plans and engineering working drawings relating to the structural, mechanical, electrical, plumbing, HVAC and lifesafety work of the Tenant Improvements. The plans and drawings to be prepared by Architect and the Engineers hereunder shall be known collectively as the "CONSTRUCTION DRAWINGS." All Construction Drawings shall comply with the drawing format and specifications as determined by Landlord, and shall be subject to Landlord's approval. Notwithstanding that any Construction Drawings are reviewed by Landlord or prepared by Landlord's designated space planner, architect, engineers and consultants, and notwithstanding any advice or assistance which may be rendered to Tenant by Landlord or Landlord's space planner, architect, engineers, and consultants, Landlord shall have no liability whatsoever in connection therewith and shall not be responsible for any omissions or errors contained in the Construction Drawings, and Tenant's waiver and indemnity set forth in Section 7.1 of this Lease shall specifically apply to the Construction Drawings.

3.2 Final Space Plan. Promptly after full execution and delivery of this Lease, Landlord and the Architect shall prepare the final space plan for Tenant Improvements in the Premises (collectively, the "FINAL SPACE PLAN"), which Final Space Plan shall include a layout and designation of all offices, rooms and other partitioning, their intended use, and equipment to be contained therein, and shall deliver the Final Space Plan to Tenant for Tenant's approval. Tenant shall approve or reasonably disapprove the Final Space Plan or any revisions thereto within three (3) business days after Landlord delivers the Final Space Plan or such revisions to Tenant. Tenant's failure to reasonably disapprove the Final Space Plan or any revisions thereto by written notice to Landlord (which notice shall specify in detail the reasonable reasons for Tenant's disapproval) within said three (3) business day period shall be deemed to constitute Tenant's approval of the Final Space Plan or such revisions.

3.3 Final Working Drawings. Upon Tenant's approval or deemed approval of the Final Space Plan, Landlord, the Architect and the Engineers shall complete the architectural and engineering drawings for the Premises, and the final architectural working drawings in a form which is complete to allow subcontractors to bid on the work and to obtain all applicable permits (collectively, the "FINAL WORKING DRAWINGS") and shall submit the same to Tenant for Tenant's approval. Tenant shall approve or reasonably disapprove the Final Working Drawings or any revisions thereto within three (3) business days after Landlord delivers the Final Working Drawings or any revisions thereto to Tenant. Tenant's failure to reasonably disapprove the Final Working Drawings or any revisions thereto by written notice to Landlord (which notice shall specify in detail the reasonable reasons for Tenant's disapproval) within said three (3)

business day period shall be deemed to constitute Tenant's approval of the Final Working Drawings or such revisions.

3.4 Permits. The Final Working Drawings shall be approved or deemed approved by Landlord and Tenant (the "APPROVED WORKING DRAWINGS") prior to the commencement of the construction of the Tenant Improvements. Landlord shall cause the Architect to submit the Approved Working Drawings to the appropriate municipal authorities for all applicable building permits necessary to allow "Contractor," as that term is defined in Section 4.1, below, to commence and fully complete the construction of the Tenant Improvements (the "PERMITS"), and, in connection therewith, Tenant shall coordinate with Landlord in order to allow Landlord, at its option, to take part in all phases of the permitting process and shall supply Landlord, as soon as possible, with all plan check numbers and dates of submittal and obtain the Permits on or before the date set forth in Schedule 1. Notwithstanding anything to the contrary set forth in this Section 3.4, Tenant hereby agrees that neither Landlord nor Landlord's consultants shall be responsible for obtaining any building permit or certificate of occupancy for the Premises and that the obtaining of the same shall be Tenant's responsibility; provided however that Landlord shall, in any event, cooperate with Tenant in executing permit applications and performing other ministerial acts reasonably necessary to enable Tenant to obtain any such permit or certificate of occupancy. No changes, modifications or alterations in the Approved Working Drawings may be made without the prior written consent of Landlord, provided that Landlord may withhold its consent, in its sole discretion, to any change in the Approved Working Drawings if such change would directly or indirectly delay the "Substantial Completion" of the Premises as that term is defined in Section 5.1 of this Tenant Work Letter.

3.5 Time Deadlines. Tenant shall use its good faith efforts to cooperate with the Architect, the Engineers, and Landlord to complete all phases of the Construction Drawings and the permitting process and to receive the permits, and with Contractor for approval of the "Cost Proposal," as that term is defined in Section 4.2 of this Tenant Work Letter, as soon as possible after the execution of the Lease, and, in that regard, shall meet with Landlord on a scheduled basis to be determined by Landlord, to discuss Tenant's progress in connection with the same.

SECTION 4

CONSTRUCTION OF THE TENANT IMPROVEMENTS

4.1 Contractor. A contractor designated by Landlord ("CONTRACTOR") shall construct the Tenant Improvements.

4.2 Cost Proposal. After the Approved Working Drawings are signed by Landlord and Tenant, Landlord shall provide Tenant with a cost proposal in accordance with the Approved Working Drawings, which cost proposal shall include, as nearly as possible, the cost of all Tenant Improvement Allowance Items to be incurred by Tenant in connection with the construction of the Tenant Improvements (the "COST PROPOSAL"). Tenant shall approve and deliver the Cost Proposal to Landlord within three (3) business days of the receipt of the same, and upon receipt of the same by Landlord, Landlord shall be released by Tenant to purchase the items set forth in the Cost Proposal and to commence the construction relating to such items. The date by which Tenant must approve and deliver the Cost Proposal to Landlord shall be known hereafter as the "COST PROPOSAL DELIVERY DATE".

4.3 Construction of Tenant Improvements by Contractor under the Supervision of Landlord.

4.3.1 Over-Allowance Amount. On the Cost Proposal Delivery Date, Tenant shall deliver to Landlord cash in an amount (the "OVER-ALLOWANCE AMOUNT") equal to the difference between (i) the amount of the Cost Proposal and (ii) the amount of the Tenant Improvement Allowance (less any portion thereof already disbursed by Landlord, or in the process of being disbursed by Landlord, on or before the Cost Proposal Delivery Date). The Over-Allowance Amount shall be disbursed by Landlord prior to the disbursement of any then remaining portion of the Tenant Improvement Allowance, and such disbursement shall be pursuant to the

same procedure as the Tenant Improvement Allowance. In the event that, after the Cost Proposal Date, any revisions, changes, or substitutions shall be made to the Construction Drawings or the Tenant Improvements, any additional costs which arise in connection with such revisions, changes or substitutions or any other additional costs shall be paid by Tenant to Landlord immediately upon Landlord's request as an addition to the Over-Allowance Amount.

4.3.2 Landlord's Retention of Contractor. Landlord shall independently retain Contractor, on behalf of Tenant, to construct the Tenant Improvements in accordance with the Approved Working Drawings and the Cost Proposal and Landlord shall supervise the construction by Contractor, and Tenant shall pay a construction supervision and management fee (the "LANDLORD SUPERVISION FEE") to Landlord in an amount equal to the product of (i) five

percent (5%) and (ii) an amount equal to the Tenant Improvement Allowance plus the Over-Allowance Amount (as such Over-Allowance Amount may increase pursuant to the terms of this Tenant Work Letter).

4.3.3 Contractor's Warranties and Guaranties. Landlord hereby assigns to Tenant all warranties and guaranties by Contractor relating to the Tenant Improvements, and Tenant hereby waives all claims against Landlord relating to, or arising out of the construction of, the Tenant Improvements. The Contractor shall be required to comply with Landlord's standard construction rules and regulations, which may include, at Landlord's option, a requirement for a payment and performance bond.

4.3.4 Tenant's Covenants. Tenant hereby indemnifies Landlord for any loss, claims, damages or delays arising from the actions of Architect on the Premises or in the Building. Within ten (10) days after completion of construction of the Tenant Improvements, Tenant shall cause Contractor and Architect to cause a Notice of Completion to be recorded in the office of the Recorder of the County of Los Angeles in accordance with Section 3093 of the Civil Code of the State of California or any successor statute and furnish a copy thereof to Landlord upon recordation, failing which, Landlord may itself execute and file the same on behalf of Tenant as Tenant's agent for such purpose. In addition, immediately after the Substantial Completion of the Premises, Tenant shall have prepared and delivered to the Building a copy of the "as built" plans and specifications (including all working drawings) for the Tenant Improvements, which may be a marked copy of the Approved Working Drawings.

SECTION 5

MISCELLANEOUS

5.1 Freight Elevators. Landlord shall, consistent with its obligations to other tenants of the Building, make the freight elevator of the Building, if applicable, reasonably available to Tenant in connection with initial decorating, furnishing and moving into the Premises.

5.2 Tenant's Representative. Prior to the commencement of construction of the Tenant Improvements, Tenant shall designate its representative with respect to the matters set forth in this Tenant Work Letter, who, until further notice to Landlord, shall have full authority and responsibility to act on behalf of the Tenant as required in this Tenant Work Letter.

5.3 Landlord's Representative. Landlord has designated Mary Ann Hansen as its sole representatives with respect to the matters set forth in this Tenant Work Letter, who, until further notice to Tenant, shall have full authority and responsibility to act on behalf of the Landlord as required in this Tenant Work Letter.

5.4 Time of the Essence in This Tenant Work Letter. Unless otherwise indicated, all references herein to a "number of days" shall mean and refer to calendar days. In all instances where Tenant is required to approve or deliver an item, if no written notice of approval is given or the item is not delivered within the stated time period, at Landlord's sole option, at the end of such period the item shall automatically be deemed approved or delivered by Tenant

and the next succeeding time period shall commence.

5.5 Tenant's Lease Default. Notwithstanding any provision to the contrary contained in this Lease, if an event of default as described in Section 12.1 of the Lease, or a default by Tenant under this Tenant Work Letter, has occurred at any time on or before the completion of the Tenant Improvements in the Premises, then (i) in addition to all other rights and remedies granted to Landlord pursuant to the Lease, Landlord shall have the right to withhold payment of all or any portion of the Tenant Improvement Allowance and/or Landlord may cause Contractor to cease the construction of the Premises (in which case Tenant shall be responsible for any delay in the completion of the Premises caused by such work stoppage), and (ii) all other obligations of Landlord under the terms of this Tenant Work Letter shall be forgiven until such time as such default is cured pursuant to the terms of the Lease.

5.7 No Abatement. Tenant hereby acknowledges that the work to be performed by Landlord pursuant to this Tenant Work Letter shall be performed during the Beneficial Occupancy Period and/or the Lease Term. Tenant shall not be deemed constructively evicted, nor shall Tenant be entitled to any abatement of rent due to any interference with Tenant's business and/or operations resulting from the performance of such work.

EXHIBIT D

WARNER CENTER PLAZA

NOTICE OF LEASE TERM DATES

To:

Re: Office Lease dated _____, 20__ between AH WARNER CENTER PROPERTIES, LIMITED LIABILITY COMPANY, a Delaware limited liability company ("Landlord"), and _____ a _____ ("Tenant") concerning Suite _____ on floor(s) _____ of the office building located at _____ Los Angeles, California.

Ladies and Gentlemen:

In accordance with the referenced Office Lease (the "Lease"), we wish to advise you and/or confirm as follows:

1. The Substantial Completion of the Premises has occurred, and the Lease Term shall commence on _____ or has commenced on for a term of _____ ending on _____.

2. Rent commenced to accrue on _____, in the amount of _____.

3. If the Lease Commencement Date is other than the first day of the month, the first billing will contain a pro rata adjustment. Each billing thereafter, with the exception of the final billing, shall be for the full amount of the monthly installment as provided for in the Lease.

4. Your rent checks should be made payable to _____ at _____.

5. The exact number of rentable square feet within the Premises is _____ square feet.

6. Tenant's Share as adjusted based upon the exact number of rentable square feet within the Premises is _____%.

AH WARNER CENTER PROPERTIES,
LIMITED LIABILITY COMPANY,
a Delaware limited liability company

By: COPLEY MANAGEMENT AND ADVISORS,
L.P., a Delaware limited partnership,
Its duly authorized asset manager and advisor

By: AEW INVESTMENT GROUP, INC.
(formerly known as COPLEY
INVESTMENT GROUP, INC.),
a Massachusetts corporation,
Its general partner

By:

Print Name:

Title:

Agreed to and Accepted as
*of , 200_*

"Tenant":

,
- ---
a

By:

Its:

By:

Its:

EXHIBIT E

WARNER CENTER PLAZA

RULES AND REGULATIONS

Tenant shall faithfully observe and comply with the following Rules and Regulations. Landlord shall not be responsible to Tenant for the nonperformance of any of said Rules and Regulations by or otherwise with respect to the acts or omissions of any other tenants or occupants of the Project.

1. Tenant shall not alter any lock or install any new or additional locks or bolts on any doors or windows of the Premises without obtaining Landlord's prior written consent. Tenant shall bear the cost of any lock changes or repairs required by Tenant and Tenant shall utilize only the locksmith

designated by Landlord for such purposes. Two keys will be furnished by Landlord for the Premises, and any additional keys required by Tenant must be obtained from Landlord at a reasonable cost to be established by Landlord.

2. All doors opening to public corridors shall be kept closed at all times except for normal ingress and egress to the Premises.

3. Landlord reserves the right to close and keep locked all entrance and exit doors of the Building during such hours as are customary for comparable buildings in the greater Los Angeles area. Tenant, its employees and agents must be sure that the doors to the Building are securely closed and locked when leaving the Premises if it is after the normal hours of business for the Building. Any tenant, its employees, agents or any other persons entering or leaving the Building at any time when it is so locked, or any time when it is considered to be after normal business hours for the Building, may be required to sign the Building register. Access to the Building may be refused unless the person seeking access has proper identification or has a previously arranged pass for access to the Building. The Landlord and its agents shall in no case be liable for damages for any error with regard to the admission to or exclusion from the Building of any person. In case of invasion, mob, riot, public excitement, or other commotion, Landlord reserves the right to prevent access to the Building or the Project during the continuance thereof by any means it deems appropriate for the safety and protection of life and property.

4. No furniture, freight or equipment of any kind shall be brought into the Building without prior notice to Landlord. All moving activity into or out of the Building shall be scheduled with Landlord and done only at such time and in such manner as Landlord designates. No service deliveries (other than messenger services) will be allowed between hours of 4:00 p.m. to 6:00 p.m., Monday through Friday. Landlord shall have the right to prescribe the weight, size and position of all safes and other heavy property brought into the Building and also the times and manner of moving the same in and out of the Building. Safes and other heavy objects shall, if considered necessary by Landlord, stand on supports of such thickness as is necessary to properly distribute the weight. Landlord will not be responsible for loss of or damage to any such safe or property in any case. Any damage to any part of the Building, its contents,

occupants or visitors by moving or maintaining any such safe or other property shall be the sole responsibility and expense of Tenant.

5. No furniture, packages, supplies, equipment or merchandise will be received in the Building or carried up or down in the elevators, except between such hours, in such specific elevator and by such personnel as shall be designated by Landlord.

6. The requirements of Tenant will be attended to only upon application at the management office for the Project or at such office location designated by Landlord. Employees of Landlord shall not perform any work or do anything outside their regular duties unless under special instructions from Landlord.

7. Tenant shall not disturb, solicit, or canvass any occupant of the Project and shall cooperate with Landlord and its agents of Landlord to prevent same.

8. The toilet rooms, urinals, wash bowls and other apparatus shall not be used for any purpose other than that for which they were constructed, and no foreign substance of any kind whatsoever shall be thrown therein. The expense of any breakage, stoppage or damage resulting from the violation of this rule shall be borne by the tenant who, or whose employees or agents, shall have caused it.

9. Tenant shall not overload the floor of the Premises, nor mark, drive nails or screws, or drill into the partitions, woodwork or plaster or in any way deface the Premises or any part thereof without Landlord's prior written consent.

10. No vending machine or machines shall be installed, maintained or operated upon the Premises without the written consent of Landlord.

11. Tenant shall not use or keep in or on the Premises, the Building, or the Project any kerosene, gasoline or other inflammable or combustible fluid or material.

12. Tenant shall not without the prior written consent of Landlord use any method of heating or air conditioning other than that supplied by Landlord.

13. Tenant shall not use, keep or permit to be used or kept, any foul or noxious gas or substance in or on the Premises, or permit or allow the Premises to be occupied or used in a manner offensive or objectionable to Landlord or other occupants of the Project by reason of noise, odors, or vibrations, or interfere in any way with other tenants or those having business therein.

14. Tenant shall not bring into or keep within the Project, the Building or the Premises any animals, birds, bicycles or other vehicles except as provided in the Office Lease.

15. No cooking shall -be done or permitted on the Premises, nor shall the Premises be used for the storage of merchandise, for lodging or for any improper, objectionable or immoral purposes. Notwithstanding the foregoing, Underwriters' laboratory-approved equipment and microwave ovens may be used in the Premises for heating food and brewing coffee, tea, hot chocolate and similar beverages for employees and visitors, provided that (i) such use is in

accordance with all applicable federal, state and city laws, codes, ordinances, rules and regulations, and (ii) Landlord determines that no odors emanate from the Premises as a result of such use. If Landlord determines that odors have emanated from the Premises as a result of such use, Landlord shall be entitled to require Tenant to discontinue such use or to remove such equipment from the Premises.

16. Landlord will approve where and how telephone and telegraph wires are to be introduced to the Premises. No boring or cutting for wires shall be allowed without the consent of Landlord. The location of telephone, call boxes and other office equipment affixed to the Premises shall be subject to the approval of Landlord.

17. Landlord reserves the right to exclude or expel from the Project any person who, in the judgment of Landlord, is intoxicated or under the influence of liquor or drugs, or who shall in any manner do any act in violation of any of these Rules and Regulations.

18. Tenant, its employees and agents shall not loiter in or on the entrances, corridors, sidewalks, lobbies, halls, stairways, elevators, or any Common Areas for the purpose of smoking tobacco products or for any other purpose, nor in any way obstruct such areas, and shall use them only as a means of ingress and egress for the Premises.

19. Tenant shall not waste electricity, water or air conditioning and agrees to cooperate fully with Landlord to ensure the most effective operation of the Building's heating and air conditioning system, and shall refrain from attempting to adjust any controls.

20. Tenant shall store all its trash and garbage within the interior of the Premises. No material shall be placed in the trash boxes or receptacles if such material is of such nature that it may not be disposed of in the ordinary and customary manner of removing and disposing of trash and garbage in Woodland Hills, California without violation of any law or ordinance governing such disposal. All trash, garbage and refuse disposal shall be made only through entry-ways and elevators provided for such purposes at such times as Landlord shall designate.

21. Tenant shall comply with all safety, fire protection and evacuation procedures and regulations established by Landlord or any governmental agency.

22. Tenant shall assume any and all responsibility for protecting the Premises from theft, robbery and pilferage, which includes keeping doors locked

and other means of entry to the Premises closed.

23. No awnings or other projection shall be attached to the outside walls of the Building without the prior written consent of Landlord. No curtains, blinds, shades or screens shall be attached to or hung in, or used in connection with, any window or door of the Premises without the prior written consent of Landlord. All electrical ceiling fixtures hung in offices or spaces along the perimeter of the Building must be fluorescent and/or of a quality, type, design and bulb color approved by Landlord. Tenant shall abide by Landlord's regulations concerning the opening and closing of window coverings which are attached to the windows in the Premises, if any, which have a view of any interior portion of the Building or Building Common Areas.

24. The sashes, sash doors, skylights, windows, and doors that reflect or admit light and air into the halls, passageways or other public places in the Building shall not be covered or obstructed by Tenant. nor shall any bottles, parcels or other articles be placed on the windowsills.

25. Tenant must comply with requests by the Landlord concerning the informing of their employees of items of importance to the Landlord.

26. Tenant shall comply with any non-smoking ordinance adopted by the City of Los Angeles or any other applicable governmental authority.

Landlord reserves the right at any time to change or rescind any one or more of these Rules and Regulations, or to make such other and further reasonable Rules and Regulations as in Landlord's judgment may from time to time be necessary for the management, safety, care and cleanliness of the Premises, Building, the Common Areas and the Project (including, without limitation, the Project's parking facility), and for the preservation of good order therein, as well as for the convenience of other occupants and tenants therein. Landlord may waive any one or more of these Rules and Regulations for the benefit of any particular tenants, but no such waiver by Landlord shall be construed as a waiver of such Rules and Regulations in favor of any other tenant, nor prevent Landlord from thereafter enforcing any such Rules or Regulations against any or all tenants of the Project. Tenant shall be deemed to have read these Rules and Regulations and to have agreed to abide by them as a condition of its occupancy of the Premises.

EXHIBIT F

WARNER CENTER PLAZA

ESTOPPEL CERTIFICATE

To:

_____, a _____ ("Tenant") hereby certifies as follows:

1. The undersigned is the Tenant under that certain Office Lease dated 20 _____ (the "Lease"), executed by AH WARNER CENTER PROPERTIES, LIMITED LIABILITY COMPANY, a Delaware limited liability company ("Landlord") as Landlord and the undersigned as Tenant, covering a portion of the property located at _____ (the "Property").

2. Pursuant to the Lease, Tenant has leased approximately _____ square feet of space (the "Premises") at the Property and has paid to Landlord a security deposit of $_____. The term of the Lease commenced on _____, 20__ and the expiration date of the Lease is _____, 20__. Tenant has paid rent through _____, 20__. The next rental payment in the amount of $ _____ is due on _____, 20__. Tenant is required to pay _____ percent (__%) of all annual operating expenses for the Property in excess of _____.

3. Tenant is entitled _____ to parking passes at a charge of $_____ per pass.

4. The Lease provides for an option to extend the term of the Lease for ___ years. The rental rate for such extension term is as follows: _____Except as expressly provided in the Lease, and other documents attached hereto. Tenant does not have any right or option to renew or extend the term of the Lease, to lease other space at the Property, nor any preferential right to purchase all or any part of the Premises or the Property.

5. True, correct and complete copies of the Lease and all amendments, modifications and supplements thereto are attached hereto and the Lease, as so amended, modified and supplemented, is in full force and effect, and represents the entire agreement between Tenant and Landlord with respect to the Premises and the Property. There are no amendments, modifications or supplements to the Lease, whether oral or written, except as follows (include the date of such amendment, modification or supplement):_____ _____ _____.

6. All space and improvements leased by the Tenant have been completed and furnished in accordance with the provisions of the Lease, and the Tenant has accepted and taken possession of the Premises.

7. To the best of Tenant's knowledge, Landlord is not in any respect in default in the performance of the terms and provisions of the Lease. Tenant is not in any respect in default under the Lease and has not assigned, transferred or hypothecated the Lease or any interest therein or subleased all or any portion of the Premises

8. There are no offsets or credits against rentals payable under the Lease and no free periods or rental concessions have been granted to Tenant, except as follows:_____ _____ _____.

9. Tenant has no actual or constructive knowledge of any processing, use, storage, disposal, release or treatment of any hazardous or toxic materials or substances on the Premises or the Property except as follows (if none, state "none"):_____ _____ _____.

10. This Certificate is given to _____ with the understanding that _____ will rely hereon in connection with the conveyance of the Property of which the Premises constitute a part to _____. Following any such conveyance, Tenant agrees that the Lease shall remain in full force and effect and shall bind and inure to the benefit of _____ and its successor in interest as if no purchase had occurred.

DATED:_____, 200_ "TENANT"

_____

_____

[ATTACH LEASE AND AMENDMENTS TO THIS CERTIFICATE]

EXHIBIT G

WARNER CENTER PLAZA

SUBORDINATION OF DEED OF TRUST

RECORDING REQUESTED BY
AND WHEN RECORDED MAIL TO:

_____

_____

_____

Attention:
_____

==========

(Space Above For Recorder's Use)

MARINE MIDLAND BANK, as owner and holder of a certain Promissory Note dated July 13, 1995, in the principal sum of One Hundred Forty-One Million Dollars ($141,000,000.00) and of a certain deed of trust, Assignment of Rents, Security Agreement and Fixture Filing Statement ("DEED OF TRUST") of even date therewith and securing the said Note, recorded on July 20, 1995 as Instrument No. 95-175900, Official Records, Los Angeles County, California, now a first lien upon the property described in Exhibit A attached hereto and more particularly demised and described in that certain Lease dated _____ by and between AH WARNER CENTER PROPERTIES, LIMITED LIABILITY COMPANY, a Delaware limited liability company, as Lessor, and _____ , a _____ as Lessee, and upon other property, in consideration of such leasing and of the sum of One Dollar ($1.00) and other good and valuable consideration, receipt of which is hereby acknowledged,

DOES hereby covenant and agree that the said Deed of Trust shall be and the same is hereby SUBORDINATE to the said Lease with the same force and effect as if the said Lease had been executed, delivered and recorded prior to the execution, delivery and recording of the said Deed of Trust;

EXCEPT, HOWEVER, that this Subordination shall not affect nor be applicable to and does hereby expressly exclude:

(a) The prior right, claim and lien of the said Deed of Trust in, to and upon any award or other compensation heretofore or hereafter to be made for any taking by eminent domain of any part of the said premises, and to the right of disposition thereof in accordance with the provisions of the said Deed of Trust,

(b) The prior right, claim and lien of the said Deed of Trust in, to and upon any proceeds payable under all policies of fire and rent insurance upon the said

premises and to the right of disposition thereof in accordance with the terms of the said Deed of Trust, and

(c) Any lien, right, power or interest, if any, which may have arisen or intervened in the period between the recording of the said Deed of Trust and the execution of the said Lease, or any lien or judgment which may arise at any time under the terms of such Lease.

This Subordination shall inure to the benefit of and shall be binding upon the undersigned, its successors and assigns.

IN WITNESS WHEREOF, this Subordination has been duly signed and delivered by the undersigned this _____ day of _____, 20__.

MARINE MIDLAND BANK

By: BANKERS TRUST COMPANY, as Master Servicer under that certain Trust and Servicing Agreement dated as of July 13, 1995

By:
_____
Its:
_____

STATE OF _____)
)ss.
COUNTY OF _____)

On _____, before me, _____, a Notary Public in and for said state, personally appeared _____, personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument and acknowledged to me that he/she executed the same in his/her authorized capacity, and that by his/her signature on the instrument, the person, or the entity upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

_____
Notary Public in and for said State

(SEAL)

EXHIBIT G
-2-

LESSEE'S AGREEMENT

The undersigned, as Lessee under the Lease herein described does hereby accept and agree to the terms of the foregoing Subordination, which shall inure to the benefit of and be binding upon the undersigned and the heirs, executors, administrators, legal representatives, successors and assigns of the undersigned.

_____
a
_____

*By:*_____

*Its:*_____

*By:*_____

*Its:*_____

*STATE OF*_____)
) ss.
*COUNTY OF*_____)

On _____, before me, _____, a Notary Public in and for said state, personally appeared _____, personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument and acknowledged to me that he/she executed the same in his/her authorized capacity, and that by his/her signature

on the instrument, the person, or the entity upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

_____
Notary Public in and for said State

(SEAL)

EXHIBIT G

-3-

STATE OF_____)
) ss.
COUNTY OF_____)

On _____, before me, _____, a Notary Public in and for said state, personally appeared _____, personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument and acknowledged to me that he/she executed the same in his/her authorized capacity, and that by his/her signature on the instrument, the person, or the entity upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

Notary Public in and for said State

(SEAL)

EXHIBIT G
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EXHIBIT A
to EXHIBIT G

LEGAL DESCRIPTION

EXHIBIT G
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EXHIBIT H

WARNER CENTER PLAZA

CERTIFIED COPY OF
BOARD OF DIRECTORS RESOLUTIONS
OF
CAPSTONE TURBINE CORPORATION

The undersigned, being the duly elected Corporate Secretary of Capstone Turbine Corporation, a Delaware corporation ("Corporation"), hereby certifies that the following is a true, full and correct copy of the resolutions adopted by the Corporation by unanimous written consent in lieu of a special meeting of its Board of Directors, and that said resolutions have not been amended or revoked as of the date hereof.

RESOLVED, that the Corporation, is hereby authorized to execute, deliver and fully perform that certain document entitled Standard Office Lease ("Lease") by and between the Corporation and AH Warner Center Properties, Limited

Liability Company, a Delaware limited liability company, for the lease of space at 21700 Oxnard Street, Woodland Hills, California 91367.

RESOLVED FURTHER, that the Corporation is hereby authorized and directed to make, execute and deliver any and all, consents, certificates, documents, instruments, amendments, confirmations, guarantees, papers or writings as may be required in connection with or in furtherance of the Lease (collectively with the Lease, the "Documents") or any transactions described therein, and to do any and all other acts necessary or desirable to effectuate the foregoing resolution.

RESOLVED FURTHER, that the following officers acting together: _____ as _____; and _____ as _____ are authorized to execute and deliver the Documents on behalf of the Corporation, together with any other documents and/or instruments evidencing or ancillary to the Documents, and in such forms and on such terms as such officer(s) shall approve, the execution thereof to be conclusive evidence of such approval and to execute and deliver on behalf of the Corporation all other documents necessary to effectuate said transaction in conformance with these resolutions.

*Date:_____, 200_*

_____

, Corporate Secretary

_____

EXHIBIT 21.1

SUBSIDIARY OF REGISTRANT

Capstone California Corporation, a Delaware corporation, doing business in California as Capstone California Corporation

EXHIBIT 23.1

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement Nos. 333-40838, 333-40846, 333-40868 and 333-66390 of Capstone Turbine Corporation on Form S-8 of our report dated March 28, 2002, appearing in this Annual Report on Form 10-K for the year ended December 31, 2001.

/s/ DELOITTE & TOUCHE LLP

Los Angeles, California
March 29, 2002