UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2007

or

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

For the transition period from to

Commission file number: 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 and zip code)

818-734-5300
(Registrant's telephone number, including area code)

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

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

The number of outstanding shares of the registrant's common stock as of October 31, 2007 was 146,067,943.

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PART I — FINANCIAL INFORMATION

Item 1. ***Financial Statements***

CAPSTONE TURBINE CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)
(Unaudited)

	September 30, 2007	March 31, 2007
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 46,276	$ 60,322
Accounts receivable, net of allowance for doubtful accounts and sales returns of $835 at September 30, 2007 and $789 at March 31, 2007	5,876	3,514
Inventories	18,515	21,283
Prepaid expenses and other current assets	1,391	1,614
Total current assets	72,058	86,733
Property, plant and equipment, net	5,619	6,256
Non-current portion of inventories	3,181	3,005
Intangible asset, net and other long-term assets	911	1,009
Total	$ 81,769	$ 97,003
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		

Accounts payable and accrued expenses	$ 5,804	$ 5,686
Accrued salaries and wages	1,296	1,434
Accrued warranty reserve	6,017	6,554
Deferred revenue	794	937
Current portion of notes payable	13	19
Other current liabilities	1,385	—
Total current liabilities	15,309	14,630
Long-term portion of notes payable	12	27
Other long-term liabilities	515	561
Commitments and contingencies	—	—
Stockholders' Equity:		
Preferred stock, $.001 par value; 10,000,000 shares authorized; none issued	—	—
Common stock, $.001 par value; 415,000,000 shares authorized; 146,067,943 shares issued and 145,474,074 shares outstanding at September 30, 2007; 144,512,997 shares issued and 143,961,789 shares outstanding at March 31, 2007	146	145
Additional paid-in capital	622,476	619,423
Accumulated deficit	(556,130)	(537,270)
Deferred stock compensation	—	—
Treasury stock, at cost; 593,869 shares at September 30, 2007 and 551,208 shares at March 31, 2007	(559)	(513)
Total stockholders' equity	65,933	81,785
Total	$ 81,769	$ 97,003

See accompanying notes to condensed consolidated financial statements.

CAPSTONE TURBINE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2007	2006	2007	2006
Revenue	$ 7,219	$ 2,946	$ 12,834	$ 9,512
Cost of goods sold	7,975	5,282	16,063	13,084
Gross loss	(756)	(2,336)	(3,229)	(3,572)
Operating expenses:				
Research and development	2,433	2,592	5,182	5,398
Selling, general and administrative	5,910	6,061	11,803	11,976
Total operating expenses	8,343	8,653	16,985	17,374
Loss from operations	(9,099)	(10,989)	(20,214)	(20,946)
Interest income	646	571	1,356	1,198
Interest expense	—	(1)	—	(2)
Other income	—	—	—	1
Loss before income taxes	(8,453)	(10,419)	(18,858)	(19,749)
Provision for income taxes	—	—	2	2
Net loss	$ (8,453)	$ (10,419)	$ (18,860)	$ (19,751)
Net loss per share of common stock — Basic and Diluted	$ (0.06)	$ (0.10)	$ (0.13)	$ (0.19)
Weighted average shares used to calculate Basic and Diluted net loss per share	145,440	103,901	144,710	103,612

See accompanying notes to condensed consolidated financial statements.

CAPSTONE TURBINE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended September 30,	
	2007	2006
Cash Flows from Operating Activities:		

Net loss	$ (18,860)	$ (19,751)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,127	1,665
Provision for(benefit from) allowance for doubtful accounts and sales returns	46	(53)
Inventory write-downs	617	989
Provision for warranty expenses	306	1,354
Loss(gain) on disposal of equipment	(28)	203
Stock-based compensation	1,403	1,429
Changes in operating assets and liabilities:		
Accounts receivable	(2,408)	3,390
Inventories	1,975	(6,868)
Prepaid expenses and other assets	187	(645)
Accounts payable and accrued expenses	79	212
Accrued salaries and wages	(138)	(247)
Accrued warranty reserve	(843)	(1,476)
Deferred revenue	(143)	56
Other current liabilities and long-term liabilities	1,339	(34)
Net cash used in operating activities	(15,341)	(19,776)
Cash Flows from Investing Activities:		
Acquisition of and deposits on equipment and leasehold improvements	(330)	(607)
Proceeds from disposal of equipment	41	16
Net cash used in investing activities	(289)	(591)
Cash Flows from Financing Activities:		
Repayment of notes payable and capital lease obligations	(21)	(10)
Net proceeds from employee based stock compensation transactions	1,605	1,655
Net cash provided by financing activities	1,584	1,645
Net Decrease in Cash and Cash Equivalents	(14,046)	(18,722)
Cash and Cash Equivalents, Beginning of Period	60,322	58,051
Cash and Cash Equivalents, End of Period	$ 46,276	$ 39,329
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 1	$ 2
Income taxes	$ 2	$ 2
Supplemental Disclosures of Non-Cash Information:		
During the six months ended September 30, 2007 and 2006, the Company purchased on account $50 and $196 of fixed assets, respectively.		

See accompanying notes to condensed consolidated financial statements.

CAPSTONE TURBINE CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Business and Organization

Capstone Turbine Corporation (the "Company") develops, manufactures, markets and services microturbine technology solutions for use in stationary distributed power generation applications, including cogeneration (combined heat and power ("CHP") and combined cooling, heat and power ("CCHP")), resource recovery and secure power. In addition, the Company's microturbines can be used as generators for hybrid electric vehicle 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 revenue to cover its operating costs. To date, the Company has funded its activities primarily through private and public equity offerings.

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") for interim financial information and with the instructions to Form 10-Q and Regulation S-X promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). They do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The condensed consolidated balance sheet at March 31, 2007 was derived from audited financial statements included in the Company's Annual Report on Form 10-K for the year ended March 31, 2007. In the opinion of management, the interim condensed consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial condition, results of operations and cash flows for such periods. Results of operations for any interim period are not necessarily indicative of results for any other interim period or for the full year. These condensed consolidated financial statements should be read in

conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended March 31, 2007. This Quarterly Report on Form 10-Q (the "Form 10-Q") refers to the Company's fiscal years ending March 31st as its "Fiscal" year.

The condensed consolidated financial statements have been prepared assuming the Company will continue as a going concern. The Company believes that existing cash and cash equivalents are sufficient to meet the Company's anticipated cash needs for working capital and capital expenditures for at least the next twelve months. However, based on the Company's cash usage over the last twelve months, by the end of Fiscal 2008, historical cash burn rates would not support this assertion. Therefore, it is possible, if not likely, that the Company may need or elect to raise additional funds to fund its activities beyond the next year. The Company could raise such funds by selling more stock to the public or to selected investors, or by borrowing money. The Company cannot be assured that it will be able to obtain additional funds on commercially favorable terms, or at all. If the Company raises additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing stockholders would be reduced. In addition, the equity or debt securities that it issues may have rights, preferences or privileges senior to those of the holders of its common stock.

The condensed consolidated financial statements include the accounts of the Company and Capstone Turbine International, Inc., its wholly owned subsidiary that was formed in June 2004, after elimination of inter-company transactions.

3. Recently Issued Accounting Standards

In January 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." This statement permits entities to choose to measure many financial instruments and certain other items at fair value at specified election dates, amends FASB Statement No. 115 "Accounting for Certain Investments in Debt and Equity Securities" and expands disclosures related to the use of fair value measures in financial statements. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is evaluating any impact

that the adoption of this pronouncement may have on the Company's consolidated financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does not require any new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is evaluating any impact that the adoption of this pronouncement may have on the Company's consolidated financial position or results of operations.

4. Customer Concentrations and Accounts Receivable

Individually, three customers accounted for 19%, 13% and 12% of revenue, respectively, for the three months ended September 30, 2007, totaling approximately 44% of revenue. For the three months ended September 30, 2006, two customers accounted for 11% and 10% of revenue, respectively, totaling approximately 21% of revenue. For the three months ended September 30, 2007 and 2006, United Technologies Corporation ("UTC") accounted for approximately 19% and 11% of revenue, respectively (see Note 13).

Individually, three customers accounted for 15%, 15% and 13% of revenues, respectively, for the six months ended September 30, 2007, totaling approximately 43% of revenue. For the same period last year, individually, two customers each accounted for 22% and 11% of revenues, respectively, totaling approximately 33% of revenue. UTC accounted for approximately 15% and 4% of revenues for the six months ended September 30, 2007 and 2006, respectively.

Individually, three customers accounted for 15%, 13% and 11% of net accounts receivable, respectively, as of September 30, 2007, totaling approximately 39% of net accounts receivable and three customers accounted for 23%, 17% and 13%, totaling approximately 53% of net accounts receivable as of March 31, 2007. UTC accounted for approximately 15% and 23% of accounts receivable as of September 30, 2007 and March 31, 2007, respectively.

While the Company has individual customers who, in any given period, may represent a significant portion of the Company's business, overall, the Company is not dependent on any single customer or particular group of customers.

5. Inventories

Inventories are stated at the lower of standard cost (which approximates actual cost on the first-in, first-out method) or market and consisted of the following:

	September 30, 2007	March 31, 2007
	(In thousands)	
Raw materials	$ 18,362	$ 17,581
Work in process	1,083	1,086
Finished goods	2,251	5,621
Total	21,696	24,288

Less non-current portion	3,181	3,005
Current portion	$ 18,515	$ 21,283

The non-current portion of inventories represents that portion of the inventories in excess of amounts expected to be sold or used in the next twelve months.

6. Property, Plant and Equipment

Property, plant and equipment consisted of the following:

	September 30, 2007	March 31, 2007
	(In thousands)	
Machinery, equipment and furniture	$ 18,516	$ 18,198
Leasehold improvements	8,746	8,730
Molds and tooling	3,728	3,713
	30,990	30,641
Less, accumulated depreciation and amortization	(25,371)	(24,385)
Total property, plant and equipment, net	$ 5,619	$ 6,256

7. Intangible Asset

The Company's sole intangible asset is a manufacturing license. The gross carrying amount is $3.7 million. The balance of the intangible asset was $0.8 million and $0.9 million as of September 30 and March 31, 2007, respectively. The intangible asset is being amortized over its estimated useful life of ten years. The Company recorded $67,000 and $0.1 million of amortization expense for each of the three months and six months ended September 30, 2007 and 2006. The manufacturing license is scheduled to be fully amortized by Fiscal 2011 with corresponding amortization estimated to be $0.1 million for the remainder of Fiscal 2008, $0.3 million for each of Fiscal 2009 and 2010, and $91,000 for Fiscal 2011.

The manufacturing license provides the Company with the ability to manufacture recuperator cores previously purchased from the supplier. The Company is required to pay a per-unit royalty fee over a seventeen-year period for cores manufactured and sold by the Company using the technology. Royalties of $9,800 and $3,000 were earned by the supplier for the three months ended September 30, 2007 and 2006, respectively. Royalties of $17,500 and $12,000 were earned by the supplier for the six months ended September 30, 2007 and 2006, respectively. Earned royalties of $17,500 were unpaid as of September 30, 2007 and are included in accrued expenses in the accompanying balance sheet.

8. Stock-Based Compensation

As of September 30, 2007, the Company had outstanding 6,000,000 non-qualified common stock options issued outside of the Amended and Restated 2000 Equity Incentive Plan ("2000 Plan"). These stock options were originally granted at exercise prices equal to the fair market value of its common stock on the grant date, as inducement grants to new executive officers and employees of the Company. Included in the 6,000,000 options were 2,000,000 options to the Company's President and Chief Executive Officer, 1,000,000 options to the Company's Executive Vice President and Chief Financial Officer, 850,000 options to the Company's Executive Vice President of Sales and Marketing, 800,000 options to the Company's former Senior Vice President of Sales and Service, 500,000 options to the Company's Vice President of Operations, and an aggregate of 850,000 options to two employees. Additionally, the Company had outstanding 850,000 restricted stock units issued outside of the 2000 Plan. These restricted stock units were issued as inducement grants to new executive officers and an employee of the Company. Included in the 850,000 units were 500,000 units to the Company's President and Chief Executive Officer, 200,000 units to the Company's Executive Vice President of Sales and Marketing and 150,000 units to another employee. Although the options and units were not granted under the 2000 Plan, they were governed by terms and conditions identical to those under the 2000 Plan. All options granted are subject to the following vesting provision: one-fourth vests one year after the issuance date, and 1/48th vests on the first day of each full month thereafter, so that all shall be vested on the first day of the 48th month after the issuance date. All outstanding options have a contractual term of ten years. All restricted stock units granted are subject to the following vesting provisions: one-fourth vests one year after the issuance date and one-fourth vests on the first day of each full year thereafter, so that all shall be vested on the first day of the fourth year after the issuance date.

Valuation and Expense Information under SFAS 123(R)

In November 2005, the FASB issued Staff Position No. 123(R)-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards." The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation expense pursuant to SFAS 123(R), "Share-Based Payment" ("SFAS 123(R)"). The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee and director stock-based compensation expense, and to determine the subsequent impact on the APIC pool and the consolidated statements of cash flows of the tax effects of employee and director stock-based awards that were

outstanding upon adoption of SFAS 123(R). The Company will limit the use of the simplified method for determining the subsequent impact on the APIC pool to employee awards that were fully vested and outstanding upon the adoption of SFAS 123(R). The Company will track individual option exercises to evaluate if they were fully vested at the adoption date. If option exercises were not fully vested, the Company will offset the related deferred tax asset against the actual tax benefit realized before applying against the APIC pool. The impact on the APIC pool of awards partially vested upon, or granted after, the adoption of SFAS 123(R) is determined in accordance with the guidance in SFAS 123(R).

For each of the three months ended September 30, 2007 and 2006, the Company recognized stock-based compensation expense for all stock-based awards of $0.7 million. For each of the six months ended September 30, 2007 and 2006, the Company recognized stock-based compensation expense for all stock-based awards of $1.4 million. The Company has not capitalized as an asset any stock-based compensation costs. The following table summarizes, by statement of operations line item, stock-based compensation expense for the three months ended September 30, 2007 and 2006 (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2007	2006	2007	2006
Cost of goods sold	$ 102	$ 23	$ 196	$ 51
Research and development	120	56	263	112
Selling, general and administrative	504	591	944	1,266
Stock-based compensation expense	$ 726	$ 670	$ 1,403	$ 1,429

The Company calculated the estimated fair value of each stock option on the date of grant using the Black-Scholes option-pricing model and the following weighted-average assumptions:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2007	2006	2007	2006
Risk-free interest rates	4.4%	5.1%	4.5%	5.0%
Expected lives (in years)	6.1	6.1	6.1	6.1
Dividend yield	—%	—%	—%	—%
Expected volatility	98.2%	102.6%	99.6%	103.4%

A summary of employee and non-employee stock option activity for the six months ended September 30, 2007 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Options outstanding at March 31, 2007	10,317,981	$ 1.93		
Granted	820,000	1.03		
Exercised	(1,394,913)	1.17		
Forfeited	(103,057)	2.68		
Expired	(342,450)	2.08		
Options outstanding at September 30, 2007	9,297,561	$ 1.95	8.12	$ 585,694
Options exercisable at September 30, 2007	3,330,696	$ 2.67	6.68	$ 36,835
Options fully vested at September 30, 2007 and those expected to vest beyond September 30, 2007	8,061,965	$ 2.02	7.99	$ 458,306

The weighted average per share grant date fair value of options granted during the three months ended September 30, 2007 and 2006 was $0.79 and $1.67, respectively. The weighted average per share grant date fair value of options granted during the six months ended September 30, 2007 and 2006 was $0.83 and $2.09, respectively. The total intrinsic value of options exercised during the three months ended September 30, 2007 and 2006 was approximately $0.2 million and $0.3 million, respectively. The total intrinsic value of options exercised during the six months ended September 30, 2007 and 2006, was approximately $0.2 million and $1.4 million, respectively. As of September 30, 2007, there was approximately $4.8 million of total compensation cost related to nonvested stock option awards not yet recognized. It is expected to be recognized over a weighted average period of 1.34 years.

During the six months ended September 30, 2007, the Company issued 30,576 shares of stock to members of the Company's Board of Directors. The stock awards were valued based on the closing price of the Company's common stock on the date of grant and the weighted average grant date fair value for these shares was $1.07.

A summary of restricted stock unit activity for the six months ended September 30, 2007 is as follows:

Weighted

	Shares	Weighted Average Grant-Date Fair Value
Nonvested restricted stock units outstanding at March 31, 2007	1,062,236	$ 1.35
Granted	776,480	1.09
Vested and issued	(116,880)	1.91
Forfeited	(73,200)	1.48
Nonvested restricted stock units outstanding at September 30, 2007	1,648,636	$ 1.18

The restricted stock units vest in equal installments over a period of two to four years. The restricted stock units were valued based on the closing price of the Company's common stock on the date of grant, and compensation cost is recorded on a straight-line basis over the share vesting period. The total fair value of restricted stock units vested and issued by the Company during the three and six months ended September 30, 2007 was approximately $0.1 million. There was no vesting of restricted stock units during the three and six months ended September 30, 2006. As of

September 30, 2007, there was approximately $1.1 million of total compensation cost related to nonvested restricted stock units not yet recognized. It is expected to be recognized over a weighted average period of 1.90 years.

9. Accrued Warranty Reserve

The Company provides for the estimated costs of warranties at the time revenue is recognized. The specific terms and conditions of those warranties vary depending upon the product sold, geography of sale and the length of extended warranties sold. The Company's product warranties generally start from the delivery date and continue for up to eighteen months. Factors that affect the Company's warranty obligation include product failure rates, anticipated hours of product operations and costs of repair or replacement in correcting product failures. These factors are estimates that may change based on new information that becomes available each period. Similarly, the Company also accrues the estimated costs to address reliability repairs on products no longer in warranty when, in the Company's judgment, and in accordance with a specific plan developed by the Company, it is prudent to provide such repairs. The Company assesses the adequacy of recorded warranty liabilities quarterly and makes adjustments to the liability as necessary. When the Company has statistically valid evidence that product changes are altering the historical failure occurrence rates, the impact of such changes is then taken into account in estimating future warranty liabilities.

Changes in accrued warranty reserve during the six months ended September 30, 2007 are as follows:

	(In thousands)
Balance, March 31, 2007	$ 6,554
Warranty provision relating to products shipped during the period	149
Changes for accruals related to preexisting warranties or reliability repair programs	157
Deductions for warranty claims	(843)
Balance, September 30, 2007	$ 6,017

10. Other Current Liabilities

In September 2007, the Company entered into a Development and License Agreement (the "Agreement") with UTC Power Corporation ("UTCP"), a division of UTC. The Agreement engages UTCP to fund and support the Company's continued development and commercialization of the Company's 200 kilowatt ("kW") microturbine product, the C200. The Company received $1.5 million upon the signing of the Agreement in September 2007 and offset $115,000 of R&D expenses with this funding (see Note 13).

11. Commitments and Contingencies

As of September 30, 2007, the Company had firm commitments to purchase inventories of approximately $5.3 million.

The Company leases offices and manufacturing facilities under various non-cancelable operating leases expiring at various times through the year ending March 31, 2011. All of the leases require the Company to pay maintenance, insurance and property taxes. The material lease agreements provide for rent escalation over the lease term and renewal options for five year periods. Rent expense is recognized on a straight-line basis over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent which is included in Other Long-Term Liabilities in the accompanying condensed consolidated balance sheets. Deferred rent amounted to $0.5 million and $0.6 million at September 30, 2007 and March 31, 2007, respectively.

In December 2001, a purported shareholder class action lawsuit was filed in the United States District Court for the Southern District of New York (the "District Court") against the Company, two of its then officers, and certain of the underwriters of the Company's initial and secondary public offerings. The suit purports to be a class action filed on behalf of purchasers of the Company's common stock during the period from June 28, 2000 to December 6, 2000. Approximately 300 other issuers and their underwriters had similar suits filed against them, all of which were included in a single, coordinated proceeding in the District Court. A consolidated amended complaint was filed on April 19, 2002. The Plaintiffs allege that the underwriter defendants agreed to allocate stock in the Company's June 28, 2000 initial public offering and November 16, 2000 secondary 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. The Plaintiffs allege that the prospectuses for these two public offerings were false and misleading in violation of the securities laws because they did not disclose these arrangements. In the summer of 2003, a committee of our Board of Directors approved a proposed partial settlement with the plaintiffs in this matter. The settlement would have provided, among other things, a release of the Company and of the individual defendants for the wrongful conduct alleged in the Amended Complaint in exchange for a guarantee from the Company's insurers regarding recovery from the underwriter defendants and other non-monetary consideration from the Company regarding its underwriters. In June 2004, an agreement of settlement was submitted to the court for preliminary approval, and the court preliminarily approved the issuers' partial settlement with the class on February 15, 2005, subject to certain modifications. The Plaintiffs have continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of "focus cases" rather than all of the 310 cases that have been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied the Plaintiffs' petition for rehearing. In light of the Second Circuit opinion, liaison counsel for all issuer defendants, including the Company, informed the District Court that this settlement cannot be approved because the defined settlement class, like the litigation class, cannot be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaint against the defendants in the focus cases and on September 27, 2007, again moved for class certification. Because of the inherent uncertainties of this litigation, the Company cannot accurately predict the ultimate outcome of the matter.

On October 9, 2007, Vanessa Simmonds, a purported stockholder of the Company, filed suit in the U.S. District Court for the Western District of Washington against The Goldman Sachs Group, Inc., Merrill Lynch & Co., Inc., and Morgan Stanley, the lead underwriters of the Company's initial public offering in June, 1999, and the secondary offering of common stock in November, 2000, alleging violations of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). The complaint seeks to recover from the lead underwriters any "short-swing profits" obtained by them in violation of Section 16(b). The suit names the Company as a nominal defendant, contains no claims against the Company, and seeks no relief from the Company. The Company is considering what, if any, action to take in response to this litigation. Because of the inherent uncertainties of this litigation, the Company cannot accurately predict the ultimate outcome of the matter.

From time to time, the Company may become subject to additional legal proceedings, claims and litigation arising in the ordinary course of business. Other than the matters discussed above, the Company is not a party to any other material legal proceedings, nor is the Company aware of any other pending or threatened litigation that would have a material adverse effect on the Company's business, operating results, cash flows or financial condition should such litigation be resolved unfavorably.

12. Income Taxes

On April 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes – an interpretation of SFAS No. 109." FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. At the date of adoption and as of June 30, 2007, based on the Company's evaluation, the total amount of unrecognized tax benefits was $2.2 million and related to research and development credits. There were no interest or penalties related to unrecognized tax benefits. If the total amount of unrecognized tax benefits was recognized, $2.2 million would impact the effective tax rate. However, this impact would be offset by an equal increase in the deferred tax valuation allowance as the Company has recorded a full valuation allowance against its deferred tax assets due to uncertainty as to future realization. Prior to the adoption of FIN 48, fully reserved federal and state deferred tax assets related to research and development credits had been recorded in the amount of $10.3 million and $7.2 million respectively. Upon adoption of FIN 48, a total of $2.2 million of federal and state deferred tax assets related to research and development credits had been derecognized leaving a fully reserved balance of $8.9 million and $6.4 million, respectively.

The Company files income tax returns in the U.S. federal jurisdiction and various state, local and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state, local or non-U.S. income tax examinations by tax authorities for the years before 2002. However, net operating loss carryforwards remain subject to examination to the extent they are carried forward and impact a year that is open to examination by tax authorities. The Company's evaluation was performed for the tax years which remain subject to examination by major tax jurisdictions as of June 30, 2007. When applicable, the Company accounts for interest and penalties generated by tax contingencies as interest and other expense, in the statement of operations. The adoption of FIN 48 did not have a material impact on the Company's condensed consolidated financial statements.

13. Related Party Transactions

Mr. Eliot Protsch is the Chairman of the Company's Board of Directors. Mr. Protsch is Senior Vice-President and Chief Financial Officer of Alliant Energy Corporation. Alliant Energy Resources, Inc. ("Alliant"), a subsidiary of Alliant Energy Corporation, was a distributor for the Company. The Company purchased $0.1 million of inventory from Alliant during the quarter ended June 30, 2007. This amount was paid as of September 30, 2007. There were no other transactions between the Company and Alliant during the quarter ended September 30,

2007 or 2006.

In September 2007, the Company entered into a Development and License Agreement (the "Development Agreement") with UTCP, a division of UTC, a stockholder. The Development Agreement engages UTCP to fund and support the Company's continued development and commercialization of the Company's 200kW microturbine product (the "C200"). Pursuant to the terms of the Development Agreement, UTCP will contribute $12.0 million in cash and approximately $800,000 of in-kind services toward the Company's efforts to develop the C200. In return, the Company will pay to UTCP an ongoing royalty of 10% of the sales price of the C200 sold to customers other than UTCP until the aggregate of UTCP's cash investment has been recovered and, thereafter, the royalty will be reduced to 5% of the sales price. The Company received $1.5 million upon the signing of the Development Agreement in September 2007 and is scheduled to receive the remaining $10.5 million upon the achievement of certain development milestones as follows: $2.0 million at systems requirements review; $2.5 million at preliminary design review; $2.5 million at critical design review; $2.0 million at microturbine build completion; and $1.5 million at completion of qualification. The Company records the benefits from this Development Agreement as a reduction of R&D expenses. The reduction of R&D expenses is recognized on a percentage of completion basis, limited by the amount of funding received and/or earned based on milestone deliverables. If the Company fails to complete the development and commercialization of the C200, UTCP will receive a non-exclusive, perpetual, world-wide license to the C200 and the Company would receive royalty payments of 3% per unit of the burdened manufacturing cost for C200s sold by UTCP. In addition, the Company entered into a service agreement to act as a sub-contractor for UTCP in providing equipment maintenance for Capstone microturbines for certain UTCP customers.

In October 2002, the Company entered into a strategic alliance with UTC. In March 2005, the Company and UTC replaced the strategic alliance agreement with an original equipment manufacturer ("OEM") agreement (the "OEM Agreement") between the Company and UTCP. The Development Agreement extends the OEM Agreement to ensure that such agreement is in effect during the period of commercialization of the C200 and for an additional six months thereafter. Additionally, as part of the Development Agreement, the Company and UTC resolved the previous disputes related to the OEM Agreement. The OEM Agreement involves the integration, marketing, sales and service of CCHP solutions worldwide. Sales to UTC's affiliated companies were approximately $1.4 million and $0.3 million for the three months ended September 30, 2007 and 2006, respectively. Sales to UTC's affiliated companies were approximately $2.0 million and $0.4 million for the six months ended September 30, 2007 and 2006, respectively. Related accounts receivable were $1.0 million and $0.8 million at September 30, 2007 and March 31, 2007, respectively.

14. Net Loss Per Common Share

Basic loss per share of common stock is computed using the weighted average number of common shares outstanding for the period. For purposes of computing basic loss per share and diluted loss per share, shares of restricted common stock which are contingently returnable and subject to repurchase if the purchaser's status as an employee terminates are not considered outstanding until they are vested. As of September 30, 2007, the Company did not have any restricted stock subject to repurchase. Diluted loss per share is also computed without consideration to potentially dilutive instruments because the Company incurred losses in the period covered by this Form 10-Q which would make these instruments antidilutive. As of September 30, 2007 and 2006, the number of antidilutive stock options and restricted stock units excluded from diluted net loss per common share computations was approximately 10.9 million and 8.1 million shares, respectively.

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

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes included in this Form 10-Q and within the Company's Annual Report on Form 10-K for the year ended March 31, 2007. When used in this Form 10-Q, and 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 Risk Factors in Item 1A of Part II of this Form 10-Q. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. All dollar amounts are approximate.

Critical Accounting Policies and Estimates

The preparation of the Company's condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Management believes the most complex and sensitive judgments, because of their significance to the condensed consolidated financial statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Actual results could differ from management's estimates. We believe the critical accounting policies listed below affect our more significant accounting judgments and estimates used in the preparation of the condensed consolidated financial statements. These policies are described in greater detail in our Annual Report on Form 10-K for Fiscal 2007, (except for our policy regarding deferred tax assets which has been updated below to reflect the adoption of Financial Accounting Standards Board ("FASB") Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes – an interpretation of SFAS No. 109") and continue to include the following areas:

- Impairment of long-lived assets, including intangible assets;
- Inventory write-downs and classification of inventories;
- Estimates of warranty obligations;
- Sales returns and allowances;

- Allowance for doubtful accounts;
- Stock-based compensation expense; and
- Loss contingencies.

Deferred tax assets. We have a history of unprofitable operations. These losses generated significant federal and state net operating loss ("NOL") carryforwards. SFAS No. 109, "Accounting for Income Taxes" requires that we record a valuation allowance against the net deferred income tax assets associated with these NOLs if it is "more likely than not" that we will not be able to utilize them to offset future income taxes. Due to the uncertainty surrounding the timing of realizing the benefits of our favorable tax attributes in future income tax returns, a valuation allowance has been provided against all of our net deferred income 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 could 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 a conclusion, we would record the estimated net realizable value of the deferred income tax asset at that time. Such adjustment would increase income in the period that the determination was made.

Effective April 1, 2007, the company began to measure and record uncertain tax positions in accordance with FIN 48. The expanded disclosure requirements of FIN 48 are presented in Note 12 to the condensed consolidated financial statements in Part I, Item 1.

FIN 48 prescribes a threshold for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Only tax positions meeting the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. FIN 48 also provides guidance on accounting for derecognition, interest and penalties, and classification and disclosure of matters related to uncertainty in income taxes.

New Accounting Pronouncements

In June 2006, the FASB issued FIN 48, "Accounting for Uncertainty in Income Taxes," an interpretation of FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. We adopted the provisions of FIN 48 as of April 1, 2007, as required. The adoption of FIN 48 did not have a material impact on our consolidated financial position or results of operations (see Note 12 to the condensed consolidated financial statements in Part I, Item 1).

In January 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." This statement permits entities to choose to measure many financial instruments and certain other items at fair value at specified election dates, amends FASB Statement No. 115 "Accounting for Certain Investments in Debt and Equity Securities" and expands disclosures related to the use of fair value measures in financial statements. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We are evaluating any impact that the adoption of this pronouncement may have on our consolidated financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does not require any new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are evaluating any impact that the adoption of this pronouncement may have on our consolidated financial position or results of operations.

In November 2005, the FASB issued FASB Staff Position No. 123(R)-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards." We have elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation expense pursuant to SFAS 123(R), "Share-Based Payment" ("SFAS 123(R)"). The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee and director stock-based compensation expense, and to determine the subsequent impact on the APIC pool and the consolidated statements of cash flows of the tax effects of employee and director stock-based awards that were outstanding upon adoption of SFAS 123(R). We will limit the use of the simplified method for determining the subsequent impact on the APIC pool to employee awards that were fully vested and outstanding upon the adoption of SFAS 123(R). We will track individual option exercises to evaluate if they were fully vested at the adoption date. If option exercises were not fully vested, we will offset the related deferred tax asset against the actual tax benefit realized before applying against the APIC pool. The impact on the APIC pool of awards partially vested upon, or granted after, the adoption of SFAS 123(R) is determined in accordance with the guidance in SFAS 123(R).

Overview

We develop, manufacture, market and service microturbine technology solutions for use in stationary distributed power generation applications, including cogeneration (combined heat and power ("CHP") and combined cooling, heat and power ("CCHP")), resource recovery and secure power. In addition, our microturbines can be used as generators for hybrid electric vehicle applications. Microturbines allow customers to produce power on-site in parallel with the electric grid or stand alone. There are several technologies which are used to

provide “on-site power generation”, also called “distributed generation,” such as reciprocating engines, solar power, wind powered systems and fuel cells. For customers

who do not have access to the electric utility grid, microturbines can provide clean, on-site power with lower scheduled maintenance intervals and greater fuel flexibility than competing technologies. For customers with access to the electric grid, microturbines can provide an additional source of continuous duty power, thereby providing additional reliability and in most instances, cost savings. With our stand-alone feature, customers can produce their own energy in the event of a power outage and can use the microturbines as their primary source of power for extended periods. Because our microturbines also produce clean, usable heat energy, they can provide economic advantages to customers who can benefit from the use of hot water, air conditioning and direct hot air. Our microturbines are sold primarily through our distributors and dealers. We, along with our Authorized Service Companies (“ASCs”), provide installation and service. Successful implementation of the microturbine relies on the quality of the microturbine, the ability to sell into appropriate applications, and the quality of the installation and support.

We believe we were the first company to offer a commercially available power source using microturbine technology. Our 30- kilowatt (“Model C30”) and 60 and 65 kilowatt (“C60 Series”) products are designed to produce electricity for commercial and industrial users. A Model C30 product can produce enough electricity to power a small convenience store. The C60 Series products can produce enough heat to provide hot water to a 100-room hotel while also providing about one-third of its electrical requirements. Our microturbines combine patented air-bearing technology, advanced combustion technology and sophisticated power electronics to form efficient and low emission electricity and heat production systems. Because of our air-bearing technology, our microturbines do not require liquid lubricants. This means they do not require routine maintenance to change oil or other lubrications, as do the most common competing products. The Model C30 product can be fueled by various sources including natural gas, propane, sour gas, renewable fuels such as landfill or digester gas, kerosene and diesel. The C60 Series can be fueled by natural gas or renewable fuels such as landfill or digester gas. The C60 Series products are available with an integrated heat exchanger, making it efficient to install in applications where hot water is used. Our products produce exceptionally clean power. In terms of nitrogen oxides (“NOx”) emissions, our microturbines have been shown to consistently produce less NOx than conventional reciprocating engines including those designed for natural gas.

The market for our products is highly competitive and is changing rapidly. 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. Additionally, many of our distributed generation competitors are well-established firms that derive advantages from production economies of scale and have a worldwide presence and greater resources, which they can devote to product development or promotion.

An overview of our direction, targets and key initiatives follows:

1) *Focus on Vertical Markets*— Within the distributed generation markets that we serve, we focus on vertical markets that we identify as having the greatest near-term potential. In our primary products and applications (CHP and CCHP, resource recovery and secure power), we identify specific targeted vertical market segments. Within each of these markets, we identify what we believe to be the critical factors to penetrating these markets and have based our plans on those factors.

   During the second quarter of Fiscal 2008, we booked total orders for 10.4 megawatts, of which 6.2 megawatts are current, and shipped 5.2 megawatts of products, resulting in 11.1 megawatts in total backlog, of which 6.9 megawatts are current, at the end of the second quarter of Fiscal 2008. Our actual product shipments in the second quarter of Fiscal 2008 were: 16% for use in CHP applications, 23% for use in CCHP applications and 47% for use in resource recovery applications. Other markets (including secure power) were 14%.

2) *Sales and Distribution Channel*— We seek out distributors (which includes OEMs, representatives and project resellers) and dealers that have business experience and capabilities to support our growth plans in our targeted markets. In North America, we currently have 21 distributors and one dealer. Internationally, outside of North America, we currently have 24 distributors and one dealer. We continue to refine the distribution channels to address our specific targeted markets.

3) *Geographic Focus*— Within the United States, our focus is on California and the Northeast. We use our corporate headquarters to serve the California market and our sales and service office in the New York area to expand our penetration in the Northeastern market. Based on our belief that the European countries and Russia

will offer significant opportunities, we opened a European headquarters office in Milan, Italy in Fiscal 2005 and an office in Nottingham, England in Fiscal 2007. Accordingly, we expect to continue to develop our distribution base and market presence in Europe. In Japan, we are focused on developing niche opportunities that we believe offer the potential for increasing sales volumes over the next three years. Throughout Asia we are focusing resources on increased distribution channels to the market with the expectation that China will become a significant market in the years ahead. Additionally, we have established an office in Mexico.

4) *Service*— During Fiscal 2005, we entered the direct service business. Previously, our service strategy was to serve all customers through our distributors and ASCs. Distributors were expected to sell the products, provide engineering solutions, and perform as ASCs by providing installation, commissioning and service. Several of our distributors did not provide the level of service desired and a number of end users requested to work directly with us. As a result, we are pursuing a strategy to serve customers directly, as

well as through qualified distributors and ASCs, all of whom will perform their service work using technicians specifically trained by Capstone. In Fiscal 2007, we continued to present alternatives to customers under-served by our distributor and ASC base through Capstone factory direct service. Service revenue in Fiscal 2007 was approximately 4% of total revenue. We also intend to establish spare parts distribution centers in strategic locations to ensure timely delivery of parts.

5) *Product Robustness and Life Cycle Maintenance Costs*— To provide us with the ability to evaluate microturbine performance in the field, we developed a "real-time" remote monitoring and diagnostic feature. This feature will allow us to monitor installed units and rapidly collect operating data on a continual basis. We will use this information to anticipate and more quickly respond to field performance issues, evaluate component robustness and identify areas for continuous improvement. This feature is important in allowing us to better serve our customers.

6) *New Product Development*— Our new product development is targeted specifically to meet the needs of our selected vertical markets. We expect that our existing product platforms, the Model C30 and C60 Series, will be our foundational product lines for the foreseeable future. Our product development efforts are centered on enhancing the features of these base products. We are pleased with the reliability that our C200 product demonstrated during beta testing, which was successfully implemented during Fiscal 2005. A joint development agreement has been reached with UTCP with respect to the commercialization of the C200 product. Our engineering resources are working concurrently with our operations team to launch the C200 product within the next 18 months.

7) *Cost and Core Competencies*— We believe that we can achieve overall cost improvements by outsourcing areas not consistent with our core competencies. We have identified design, assembly, test and installation support as areas where we have opportunities to save costs through outsourcing. In conjunction with these changes, we have launched a strategic supply chain initiative to begin developing suppliers in China and other parts of Asia. Although we are only in the early stages of this initiative, we are encouraged by the improved cost opportunities this effort may produce.

We believe that execution in each of these key areas will be necessary to continue Capstone's transition from an R&D focused company with a promising technology and early market leadership to achieving positive cash flow with growing market presence and improving financial performance. Based on the progress we have achieved, we have established a goal to achieve cash flow positive by December 2008.

Results of Operations

Three Months Ended September 30, 2007 and 2006

Revenue. Revenue for the second quarter of Fiscal 2008 increased $4.3 million, or 145%, to $7.2 million from $2.9 million for the same period last year. Revenue from complete microturbine product shipments increased $3.3 million, or more than 225%, to $4.8 million during the current period from $1.5 million for the same period last year. Shipments of complete microturbine units were 5.2 megawatts during the second quarter of Fiscal 2008 compared with 1.4 megawatts for the same period last year. Revenue from accessories, parts and service for the second quarter of Fiscal 2008 increased $1.0 million, or 68%, to $2.5 million from $1.5 million for the same period last year. Included in

the overall increase was a $2.3 million increase in revenue from the Americas and Asian markets, and an increase from the European market of $1.9 million. While sales have not increased at the expected rate, we continue to pursue market penetration through the development of worldwide distributors, in particular OEMs and our direct sales resources.

Three customers accounted for 19%, 13% and 12% of revenue, respectively, for the second quarter of Fiscal 2008, totaling 44% of revenue. For the same period last year, individually, two customers each accounted for 11% and 10% of revenue, respectively, totaling approximately 21% of revenue. UTC accounted for 19% and 11% of revenue for the three months ended September 30, 2007 and 2006, respectively.

Gross loss. Cost of goods sold includes direct material costs, production overhead (including depreciation and amortization), inventory charges, provision for estimated product warranty expenses and labor and related expense, including stock-based compensation. The gross loss was $0.8 million, or 10% of revenue, for the second quarter of Fiscal 2008 compared to $2.3 million, or 79% of revenue, for the same period last year. Of the $1.5 million improvement in the gross loss, $1.3 million was attributable to a significant charge for cost to repair in the prior period compared to the current period along with lower warranty charges for specific campaigns. Warranty expense is a combination of a per-unit warranty accrual recorded at the time revenue is recognized and changes in estimates for several reliability enhancement programs. Warranty expense decreased $1.3 million over the same period last year primarily because of a decrease in estimated cost for the reliability programs. These changes in program estimates are recorded in the period that new information, such as design changes and product enhancements become available. Additional improvements of $0.2 million in the gross loss was the result of a total volume increase of $1.2 million for both the C60 Series and Model C30 units, offset by $1.0 million of lower absorption of overhead costs into ending inventory.

We expect to continue to incur gross losses until we are able to achieve higher unit sales volumes to cover our fixed manufacturing costs. Additionally, other contributions to profitability include initiatives to further reduce direct material costs and reductions in other manufacturing and warranty costs.

Research and Development ("R&D") Expenses. R&D expenses include compensation expense, including stock-based compensation, engineering department expenses, overhead allocations for administration and facilities and materials costs associated with development. R&D expenses for the second quarter of Fiscal 2008 decreased $0.2 million, or 6%, to $2.4 million from $2.6 million for the same period last year. R&D expenses are reported net of benefits from cost-sharing programs such as the Department of Energy ("DOE") and UTCP

funding. There were approximately $0.1 million of such benefits this quarter and $0.4 million for the same period last year. The overall net decrease in R&D expenses of $0.2 million resulted from decreased spending for labor and consulting of $0.3 million, decreased spending on developmental hardware for various engineering projects of $0.1 million and a decrease of $0.1 million for facility costs, offset by reduced cost-sharing program funding of $0.3 million. Cost-sharing programs vary from period to period depending on the phases of the programs. We expect R&D expense in Fiscal 2008 to be lower than in Fiscal 2007. This change is expected to occur as a result of expected outside funding of our C200 commercialization from UTCP.

Selling, General, and Administrative ("SG&A") Expenses. SG&A expenses for the second quarter of Fiscal 2008 decreased $0.2 million, or 3%, to $5.9 million from $6.1 million for the same period last year. The net decrease was comprised of $0.2 million of decreased professional services including legal, accounting, insurance and consulting, $0.2 million in labor and $0.1 million in marketing costs, offset by an increase of $0.2 million related to travel and $0.1 million in facility costs. We expect SG&A expenses for Fiscal 2008 to be lower than the prior year. The decrease in accounting fees is because of the timing of services, the increase in facilities reflects the increased office space in the New York area and the increase in travel reflects the increased effort in developing worldwide distributors.

Interest Income. Interest income for the second quarter of Fiscal 2008 increased $0.1 million, or 13%, to $0.7 million from $0.6 million for the same period last year. The increase during the current period was attributable to increased investment yields over the same period last year, along with increased aggregate cash balances.

Six Months Ended September 30, 2007 and 2006

Revenue. Revenue for the six months ended September 30, 2007 increased $3.3 million, or 35%, to $12.8 million from $9.5 million for the same period last year. Revenue from complete microturbine product shipments increased $2.0 million, or 30%, to $8.7 million during the current period from $6.7 million for the same period last year.

Shipments of complete microturbine units were 9.5 megawatts during the six months ended September 30, 2007 compared with 6.8 megawatts for the same period last year. Revenue from accessories, parts and service for the six months ended September 30, 2007 increased $1.3 million, or 48%, to $4.1 million from $2.8 million for the same period last year. Included in the overall revenue increase was a $1.0 million increase in revenue from the Americas and Asian markets. Revenue from the European market increased $2.3 million. While sales have not increased as expected, we continue to pursue market penetration through the development of worldwide distributors, in particular OEMs and our direct sales resources.

Individually, three customers accounted for 15%, 15% and 13% of revenues, respectively, for the six months ended September 30, 2007, totaling approximately 43% of revenue. For the same period last year, individually, two customers each accounted for 22% and 11% of revenues, respectively. Banking Production Centre accounted for 15% and 22% of revenues for the six months ended September 30, 2007 and 2006, respectively. UTC accounted for 15% and 4% of revenue for the six months ended September 30, 2007 and 2006, respectively.

Gross loss. For the six months ended September 30, 2007, the gross loss was $3.2 million, or 25% of revenue, compared to $3.6 million, or 38% of revenue, for the same period last year. Of the $0.4 million improvement in the gross loss, $1.5 million was attributable to lower warranty charges. Warranty expense for unit shipments decreased approximately $0.1 million coupled with a decrease of approximately $1.4 million in reliability enhancement programs primarily attributable to a significant charge for cost to repair in the prior period compared to the current period. These program estimates are recorded in the period that new information, such as design changes and product enhancements, becomes available. Gross loss was additionally improved by $0.6 million of contribution margin from increased total volume from both the C60 Series and Model C30 units and $1.0 million of reduced product related costs. These improvements were offset by $2.7 million from lower absorption of overhead costs into ending inventory. These overhead costs include items such as labor, supplies and facilities expenses.

Research and Development ("R&D") Expenses. R&D expenses for the six months ended September 30, 2007 decreased $0.2 million, or 4%, to $5.2 million from $5.4 million for the same period last year. R&D expenses are reported net of benefits from cost-sharing programs such as the DOE and UTCP funding. There were approximately $0.1 million of such benefits for the six months ended September 30, 2007, compared with $0.8 million for the same period last year. These cost-sharing programs vary from period to period depending on the phases of the programs. This decrease in benefits of $0.7 million offsets some of the decreases in R&D expenses. The overall decrease in R&D spending is primarily the result of decreased development hardware costs for various engineering projects of $0.4 million, labor and consulting spending of $0.3 million and facilities expenses of $0.2 million.

Selling, General, and Administrative ("SG&A") Expenses. SG&A expenses for the six months ended September 30, 2007 decreased $0.2 million, or 2%, to $11.8 million from $12.0 million for the same period last year. The overall net decrease of $0.2 million reflects a decrease of approximately $0.3 million related to reduced labor, a decrease of $0.3 million for professional services including legal, accounting, insurance and consulting, offset by an increase of $0.1 million for facilities and $0.3 million for travel.

Interest Income. Interest income for the six months ended September 30, 2007 increased $0.2 million, or 13%, to $1.4 million from $1.2 million for the same period last year. The increase during the current period was attributable to increased investment yields over the same period last year, along with increased aggregate cash balances.

Liquidity and Capital Resources

Our cash requirements depend on many factors, including the execution of our corporate strategies. We expect to continue to devote substantial capital resources to running our business and creating the strategic changes summarized herein.

We have invested our cash in an institutional fund, with maturities of less than sixty days, that invests in high quality short-term money market instruments to provide liquidity for capital preservation and for operations.

Operating Activities. During the six months ended September 30, 2007, we used $15.3 million in cash in our operating activities, which consisted of a net loss for the period of $18.9 million and cash used for working capital of $48,000, offset by non-cash adjustments (primarily depreciation, warranty, stock compensation and inventory charges)

of $3.6 million. During the same period last year operating cash usage was $19.8 million, which consisted of a net loss for the period of $19.8 million and cash used for working capital of $5.6 million, offset by non-cash adjustments of $5.6 million. The decrease in working capital cash usage of $5.6 million is largely attributable to $1.5 million in funds received from the C200 commercialization program, net changes in inventories, and timing of accounts receivable collections offset by a reduction in accounts payable. The net changes in inventories are attributable to shipment of finished goods along with reduced purchases. Additionally, accounts receivable increased because of the timing of shipments and warranty claims spending decreased because of a continued focus on product quality and the timing of claims.

Investing Activities. Net cash used in investing activities relates primarily to the acquisition of fixed assets of $0.4 million and $0.6 million for the six months ended September 30, 2007 and 2006, respectively. Our cash usage for investing activities has been relatively low. Our significant capital expenditures were made in previous periods.

Financing Activities. During the six months ended September 30, 2007, and for the same period last year, we generated $1.6 million in financing activities. In both periods, the funds generated from financing activities were primarily the result of the exercise of stock options. The funds used for financing activities in the six months ended September 30, 2007 and 2006 were primarily the result of repayment of capital lease obligations. Repayments of capital lease obligations were $21,000 during the six months ended September 30, 2007 as compared with $10,000 for the same period a year ago.

We anticipate that, as a result of our efforts to generate sales and margins while controlling costs, we will lower our cash usage in future periods. Our operating plan for Fiscal 2008 calls for less cash used for operating and investing activities than in Fiscal 2007.

Except for scheduled payments made on operating and capital leases during the six months ended September 30, 2007, there have been no material changes in the Company's remaining commitments under non-cancelable operating leases and capital leases as disclosed in our Annual Report on Form 10-K for Fiscal 2007.

We believe that our existing cash and cash equivalents are sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next twelve months. However, based on our cash usage over the last twelve months, by the end of Fiscal 2008, historical cash burn rates would not support this assertion. Therefore, it is possible, if not likely, that we may need or elect to raise additional funds to fund our activities beyond the next year. We could raise such funds by selling more stock to the public or to selected investors, or by borrowing money. We cannot be assured that we will be able to obtain additional funds on commercially favorable terms, or at all. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing stockholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of the holders of our common stock.

Although we believe we have sufficient capital to fund our working capital and capital expenditure needs for at least the next twelve months, our future capital requirements may vary materially from those now planned. The amount of capital that we will need in the future will require us to achieve dramatically increased sales volume which is dependent on many factors, including:

- the market acceptance of our products and services;
- our business, product and capital expenditure plans;
- capital improvements to new and existing facilities;
- our competitors' response to our products and services; and
- our relationships with customers, distributors, dealers and project resellers.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

No material changes have occurred in the quantitative and qualitative market risk disclosure of the Company as presented in its Annual Report on Form 10-K for the year ended March 31, 2007.

Item 4. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation of the effectiveness of the design and operation of our "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934, as amended ("Exchange Act"), Rules 13a-15(e) and 15d-15(e)) under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting

Additionally, our Chief Executive Officer and Chief Financial Officer have determined that there have been no changes to our internal control over financial reporting during the three months ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. ***Legal Proceedings***

In December 2001, a purported shareholder class action lawsuit was filed in the United States District Court for the Southern District of New York (the "District Court") against the Company, two of its then officers, and certain of the underwriters of the Company's initial and secondary public offerings. The suit purports to be a class action filed on behalf of purchasers of the Company's common stock during the period from June 28, 2000 to December 6, 2000. Approximately 300 other issuers and their underwriters had similar suits filed against them, all of which were included in a single, coordinated proceeding in the District Court. A consolidated amended complaint was filed on April 19, 2002. The Plaintiffs allege that the underwriter defendants agreed to allocate stock in the Company's June 28, 2000 initial public offering and November 16, 2000 secondary 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. The Plaintiffs allege that the prospectuses for these two public offerings were false and misleading in violation of the securities laws because they did not disclose these arrangements. In the summer of 2003, a committee of our Board of Directors approved a proposed partial settlement with the plaintiffs in this matter. The settlement would have provided, among other things, a release of the Company and of the individual defendants for the wrongful conduct alleged in the Amended Complaint in exchange for a guarantee from the Company's insurers regarding recovery from the underwriter defendants and other non-monetary consideration from the Company regarding its underwriters. In June 2004, an agreement of settlement was submitted to the court for preliminary approval, and the court preliminarily approved the issuers' partial settlement with the class on February 15, 2005, subject to certain modifications. The Plaintiffs have continued to litigate against the underwriter defendants. The District Court directed that the litigation proceed within a number of "focus cases" rather than all of the 310 cases that have been consolidated. The Company's case is not one of these focus cases. On October 13, 2004, the District Court certified the focus cases as class actions. The underwriter defendants appealed that ruling, and on December 5, 2006, the Court of Appeals for the Second Circuit reversed the District Court's class certification decision. On April 6, 2007, the Second Circuit denied the Plaintiffs' petition for rehearing. In light of the Second Circuit opinion, liaison counsel for all issuer defendants, including the Company, informed the District Court that this settlement cannot be approved because the defined settlement class, like the litigation class, cannot be certified. On June 25, 2007, the District Court entered an order terminating the settlement agreement. On August 14, 2007, the plaintiffs filed their second consolidated amended class action complaints against the defendants in the focus cases and on September 27, 2007, again moved for class certification. Because of the inherent uncertainties of this litigation, we cannot accurately predict the ultimate outcome of the matter.

On October 9, 2007, Vanessa Simmonds, a purported stockholder of the Company, filed suit in the U.S. District Court for the Western District of Washington against The Goldman Sachs Group, Inc., Merrill Lynch & Co., Inc., and Morgan Stanley, the lead underwriters of our initial public offering in June, 1999, and our secondary offering of common stock in November, 2000, alleging violations of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). The complaint seeks to recover from the lead underwriters any "short-swing profits" obtained by them in violation of Section 16(b). The suit names the Company as a nominal defendant, contains no claims against the Company, and seeks no relief from the Company. We are considering what, if any, action to take in response to this litigation. Because of the inherent uncertainties of this litigation, we cannot accurately predict the ultimate outcome of the matter.

Item 1A. ***Risk Factors***

There have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K for the year ended March 31, 2007 except for the risk associated with UTCP, a significant customer.

A significant customer may not achieve its forecasted sales growth or we may fail to complete the development and commercialization of the C200, in which case the significant customer would receive a non-exclusive, perpetual, world-wide license to the C200 or we may incur additional expense related to service contracts we acquired from the significant customer, thereby affecting our revenue levels and cash flow.

Sales to UTC Power, LLC ("UTCP"), an affiliate of United Technologies Corporation, accounted for approximately 12% and 17% of our net revenue for the years ended March 31, 2007 and 2006. Our OEM agreement with UTCP permits UTCP to package the Capstone microturbine products with chillers and heat exchange equipment manufactured

by UTCP and to sell and service the integrated CCHP units. UTCP's performance as it relates to engineering, installation and provision of after-market service could have a significant impact on our reputation and products. Our near-term sales, cash flow and profitability could be adversely affected if UTCP does not achieve its forecasted sales growth. In September 2007, we entered into a Development and License Agreement (the "Agreement") with UTCP. The Agreement engages UTCP to fund and support the Company's continued development and commercialization of our 200kW microturbine product, the C200. Pursuant to the terms of the Agreement UTCP will contribute $12.0 million in cash and approximately $800,000 of in-kind services toward our efforts to develop the C200. In return, we will pay to UTCP an ongoing royalty of 10% of the sales price of the C200 sold to customers other than UTCP until the aggregate of UTCP's cash investment has been recovered and, thereafter, the royalty will be reduced to 5% of the sales price. If we fail to complete the development and commercialization of the C200, UTCP will receive a non-exclusive, perpetual, world-wide license to the C200 and we would receive royalty payments of 3% per unit of the burdened manufacturing cost for C200s sold by UTCP. Our sales, cash flow and profitability could be adversely affected if we fail to complete the development and commercialization of the C200. In addition, we entered into a service agreement to act as a sub-contractor for UTCP in providing equipment maintenance for Capstone microturbines for certain UTCP customers. If these service agreements result in higher occurrence of warranty repairs than expected this could affect our near-term and long-term cash flow and profitability.

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

None

Item 3. ***Defaults Upon Senior Securities***

None

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

(a) The annual meeting of stockholders of the Company was held on August 24, 2007.

(b) Eliot Protsch, Richard Atkinson, John Jaggers, Darren Jamison, Noam Lotan, Gary Simon and Darrell Wilk stood for election, and all were elected as directors.

(c) The only matter voted upon at the meeting was the election of the directors. The votes cast with respect to this matter were as follows:

Election of Directors:

	Votes Cast	
Director	**For**	**Withheld**
Eliot Protsch	110,598,764	3,833,601
Richard Atkinson	110,608,142	3,824,222
John Jaggers	105,905,919	3,526,445
Darren Jamison	110,882,019	3,550,346
Noam Lotan	105,227,922	9,204,443
Gary Simon	105,984,345	8,448,019
Darrell Wilk	110,552,438	3,879,927

Item 5. ***Other Information***

None

Item 6. ***Exhibits***

The following exhibits are filed with, or incorporated by reference into, this Form 10-Q:

Exhibit Number	**Description**
3.1(3)	Second Amended and Restated Certificate of Incorporation of Capstone Turbine Corporation
3.2(4)	Amended and Restated Bylaws of Capstone Turbine Corporation
4.1(2)	Specimen stock certificate
10.1(1)	Amended and Restated 2000 Equity Incentive Plan
10.2(1)	Development and License Agreement between Capstone and UTC Power Corporation, dated September 4, 2007
31.1(1)	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2(1)	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1(1)	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

(1) Filed herewith.

(2) Incorporated by reference to Capstone Turbine Corporation's registration statement on Form S-1/A, dated June 21, 2000 (File No. 333-33024).

(3) Incorporated by reference to Capstone Turbine Corporation's registration statement on Form S-1/A, dated May 8, 2000 (File No. 333-33024).

(4) Incorporated by reference to Capstone Turbine Corporation's Quarterly Report on Form 10-Q, dated February 9, 2006 (File No. 001-15957).

SIGNATURES

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

CAPSTONE TURBINE CORPORATION

By: /s/ WALTER J. McBRIDE
Walter J. McBride
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: November 8, 2007

Exhibit 10.1

CAPSTONE TURBINE CORPORATION

AMENDED AND RESTATED 2000 EQUITY INCENTIVE PLAN

Effective August 24, 2007

RECITALS:

WHEREAS, the Company previously established the Plan as an equity incentive plan, which was last approved by the shareholders of the Company in an amendment and restatement effective on September 10, 2004, and was subsequently amended on March 17, 2005;

WHEREAS, the Company desires to amend and restate the Plan in order to (i) incorporate prior amendments, (ii) modify administrative provisions regarding the calculation of shares approved under the plan that are withheld for taxes and similar purposes and stock redemption, (iii) require an appropriate adjustment by the Committee of outstanding awards and the shares available under the Plan in the event of a stock split, recapitalization or similar transaction, and (iv) require that stock options be issued with a purchase price that is no less than 100% of the market value of Common Stock on the grant date; and

WHEREAS, the Board has determined upon advice of counsel that this amendment to the Plan is effective without further action upon its adoption by the Board;

NOW, THEREFORE, pursuant to authorization by the Board, the Plan is hereby amended and restated as follows, effective as of August 24, 2007:

1. Purposes of the Plan. The purposes of the Capstone Turbine Corporation Amended and Restated 2000 Equity Incentive Plan are to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to Employees, Directors and Consultants and to promote the success of the Company's business. Options granted under the Plan may be Incentive Stock Options or Non-Qualified Stock Options, as determined by the Committee at the time of grant. Restricted Stock, Stock Purchase Rights and Stock Bonuses may also be granted under the Plan.

2. Definitions. As used herein, the following definitions shall apply:

(a) "Acquisition" means, unless specified otherwise in an Agreement,

(i) the successful acquisition by a person or related group of persons, (other than the Company or a person that directly or indirectly controls, is controlled by or is under common control with, the Company) of beneficial ownership (within the meaning of Rule 13d-3 of the Exchange Act) of securities possessing more than 50% of the total combined voting power of the Company's outstanding securities pursuant to a transaction or series of related transactions which the Board does not at any time recommend the Company's stockholders to accept or approve;

(ii) the first date within any period of 18 consecutive months or less on which there is effected a change in the composition of the Board such that a majority of the Board ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been members of the Company's Board continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time such election or nomination was approved by the Board;

(iii) a merger or consolidation in which the Company is not the surviving entity, except for a transaction the principal purpose of which is to change the state in which the Company is incorporated;

(iv) the sale, transfer or other disposition of all or substantially all of the assets of the Company in complete liquidation or dissolution of the Company;

(v) any reverse merger in which the Company is the surviving entity but in which securities possessing more than 50% of the total combined voting power of the Company's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such merger; or

(vi) the issuance by the Company to a single person or related group of persons (other than the Company or a person that directly or indirectly controls, is controlled by or is under common control with, the Company) of securities possessing more than 50% of the total combined voting power of the Company's outstanding securities (determined after such issuance) in a single transaction or a series of related transactions.

(b) "Agreement" means a written agreement between the Company and a Holder evidencing the terms and conditions of an individual award or grant of an Option, Restricted Stock, Stock Bonus, or Stock Purchase Right. Each Agreement is subject to the terms and conditions of the Plan, except as otherwise provided for herein.

(c) "Applicable Laws" means the requirements relating to the administration of stock option plans under U.S. state corporate laws, U.S. federal and state securities laws, the Code, any stock exchange or quotation system on which the Common Stock is

listed or quoted and the applicable laws of any foreign country or jurisdiction where Options, Stock Purchase Rights or Stock Bonuses are granted under the Plan.

(d) "Board" means the Board of Directors of the Company.

(e) "Cause" means the commission of any act of fraud, embezzlement, theft or dishonesty by a Holder, any unauthorized use or disclosure by a Holder of confidential information or trade secrets of the Company (or any parent or subsidiary thereof), or any other intentional misconduct by a Holder adversely affecting the business or affairs of the Company (or any parent or subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Company (or any parent or subsidiary) may consider as grounds for the dismissal or discharge of any Holder.

(f) "Code" means the Internal Revenue Code of 1986, as amended, or any successor statute or statutes thereto. Reference to any particular Code section shall include any successor section.

(g) "Committee" means a committee appointed by the Board in accordance with Section 4 hereof to administer the Plan.

(h) "Common Stock" means the Common Stock of the Company, par value $0.001 per share.

(i) "Company" means Capstone Turbine Corporation, a Delaware corporation.

(j) "Consultant" means any consultant or adviser if: (i) the consultant or adviser renders bona fide services to the Company; (ii) the services rendered by the consultant or adviser are not in connection with the offer or sale of securities in a capital-raising transaction and do not directly or indirectly promote or maintain a market for the Company's securities; and (iii) the consultant or adviser is a natural person who has contracted directly with the Company to render such services.

(k) "Director" means a member of the Board.

(l) "Employee" means any person, including an Officer or Director, who is an employee (as defined in accordance with Section 3401(c) of the Code) of the Company or any Parent or Subsidiary of the Company. A Service Provider shall not cease to be an Employee in the case of (i) any leave of absence approved by the Company or (ii) transfers between locations of the Company or between the Company, its Parent, any Subsidiary, or any successor. For purposes of Incentive Stock Options, no such leave may exceed 90 days, unless reemployment upon expiration of such leave is guaranteed by statute or contract. Neither service as a Director nor payment of a director's fee by the Company shall be sufficient, by itself, to constitute "employment" by the Company.

(m) "Exchange Act" means the Securities Exchange Act of 1934, as amended, or any successor statute or statutes thereto. Reference to any particular Exchange Act section shall include any successor section.

(n) "Fair Market Value" means, as of any date, the value of a share of Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or a national market system, including, without limitation, the Nasdaq National Market or The Nasdaq SmallCap Market of The Nasdaq Stock Market, its Fair Market Value shall be the closing sales price for a share of such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system, as reported in The Wall Street Journal or such other source as the Committee deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, its Fair Market Value shall be the mean between the high bid and low asked prices for a share of the Common Stock; or

(iii) In the absence of an established market for the Common Stock, the Fair Market Value thereof shall be determined in good faith by the Committee.

(o) "Holder" means a person who has been granted or awarded an Option, Restricted Stock or Stock Purchase Right, or who holds Shares acquired pursuant to the exercise of an Option or Stock Purchase Right or pursuant to a Stock Bonus.

(p) "Incentive Stock Option" means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and which is designated as an Incentive Stock Option by the Committee.

(q) "Independent Director" means a Director who is:

(i) An "outside director," within the meaning of Section 162(m) of the Code;

(ii) A "non-employee director" within the meaning of Rule 16b-3; and

(iii) An "independent director" under the listing standards of The Nasdaq Stock Market.

(r) "Non-Qualified Stock Option" means an Option (or portion thereof) that is not designated as an Incentive Stock Option by the Committee, or which is designated as an Incentive Stock Option by the Committee but fails to qualify as an incentive stock option within the meaning of Section 422 of the Code.

(s) "Officer" means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

(t) "Option" means a stock option granted pursuant to the Plan.

(u) "Option Exchange Program" means a program whereby outstanding Options are surrendered or cancelled in exchange for Options that are granted more than six months and one day following such surrender or cancellation and are of the same type (which may have a lower exercise price or purchase price), of a different type and/or cash, and subject to certain conditions (*e.g.*, continued employment).

(v) "Parent" means any corporation, whether now or hereafter existing (other than the Company), in an unbroken chain of corporations ending with the Company if each of the corporations other than the last corporation in the unbroken chain owns stock possessing more than fifty percent of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(w) "Plan" means the Capstone Turbine Corporation Amended and Restated 2000 Equity Incentive Plan.

(x) "Public Trading Date" means the first date upon which Common Stock of the Company is listed (or approved for listing) upon notice of issuance on any securities exchange or designated (or approved for designation) upon notice of issuance as a national market security on an interdealer quotation system.

(y) "Restricted Stock" means Shares acquired pursuant to the exercise of an unvested Option in accordance with Section 10(h), or pursuant to an election pursuant to a Stock Purchase Right granted under Section 12(b) or Section 14.

(z) "Rule 16b-3" means that certain Rule 16b-3 under the Exchange Act, as such Rule may be amended from time to time.

(aa) "Section 16(b)" means Section 16(b) of the Exchange Act, as such Section may be amended from time to time.

(bb) "Securities Act" means the Securities Act of 1933, as amended, or any successor statute or statutes thereto. Reference to any particular Securities Act section shall include any successor section.

(cc) "Service Provider" means an Employee, Director or Consultant.

(dd) "Share" means a share of Common Stock, as adjusted in accordance with Section 15 below.

(ee) "Stock Bonus" means a grant of Common Stock granted pursuant to Section 14(e) or elected pursuant to Section 12(b).

(ff) "Stock Purchase Right" means a right to purchase Common Stock pursuant to Section 14.

(gg) "Subsidiary" means any corporation, whether now or hereafter existing (other than the Company), in an unbroken chain of corporations beginning with the Company if each of the corporations other than the last corporation in the unbroken chain owns stock possessing more than 50% of the total combined voting power of all classes of stock in one of the other corporations in such chain.

3. Stock Subject to the Plan. Subject to the provisions of Section 15, the shares of stock subject to Options, Stock Purchase Rights or Stock Bonuses shall be Common Stock, initially shares of the Company's Common Stock, par value $0.001 per share. Subject to the provisions of Section 15, the maximum aggregate number of Shares which may be issued upon exercise of such Options or Stock Purchase Rights or pursuant to such Stock Bonuses is 6,080,000 Shares, plus the number of Shares previously authorized and remaining available under the Company's 1993 Stock Incentive Plan, as amended, as of the Public Trading Date, plus any Shares covered by options granted under the Company's 1993 Stock Incentive Plan that are forfeited or expire unexercised or otherwise become available after the Public Trading Date;

provided, however, that the maximum aggregate number of Shares which may be issued upon exercise of Incentive Stock Options is 13,880,000 Shares. The total shares originally made available under the 1993 Stock Incentive Plan was 7,800,000. Shares issued upon exercise of Options or Stock Purchase Rights or pursuant to Stock Bonuses may be authorized but unissued, or reacquired Common Stock. If an Option or Stock Purchase Right expires or becomes unexercisable without having been exercised in full, or is surrendered pursuant to an Option Exchange Program, the unpurchased Shares which were subject thereto shall become available for future grant or sale under the Plan (unless the Plan has terminated). Notwithstanding the provisions of this Section 3, no Shares may again be optioned, granted or awarded if such action would cause an Incentive Stock Option to fail to qualify as an Incentive Stock Option under Code Section 422.

4. Administration of the Plan.

(a) Administration Committee. The Plan shall be administered by the Committee that is established and designated by the Board to administer the Plan. Prior to the 2004 annual meeting of shareholders of the Company, the Committee shall be comprised of at least two individuals who are all Independent Directors. Effective at the conclusion of the 2004 annual meeting of shareholders of the Company, the Committee shall be comprised of at least three individuals who are all Independent Directors. The Committee shall have, in connection with the administration of the Plan, the powers theretofore possessed by the Board, including the power to delegate to a subcommittee any of the administrative powers the Committee is authorized to exercise, subject, however, to such resolutions or Committee charter, not inconsistent with the provisions of the Plan, as may be adopted from time to time by the Board. Within the scope of such authority, the Committee may delegate (i) to the chief executive officer of the Company the authority to grant awards under the Plan to eligible persons who are (1) not "covered employees," within the meaning of Section 162(m) of the Code, (2) not expected to be "covered employees" at the time of recognition of income resulting from such award, and (3) not subject to liability under Section 16 of the Exchange Act, and/or (ii) to any officer of the Company any other authority that is included in Sections 4(b)(iv), (viii), (ix) or (xi) or Section 9(b).

(b) Powers of the Committee. Subject to the provisions of the Plan and the specific duties delegated by the Board to such Committee, and subject to the approval of any relevant authorities, the Committee shall have the authority in its sole discretion:

(i) to determine the Fair Market Value;

(ii) to select the Service Providers to whom Options, Stock Purchase Rights, and Stock Bonuses may from time to time be granted hereunder;

(iii) to determine the number of Shares to be covered by each such award granted hereunder;

(iv) to approve forms of Agreement for use under the Plan;

(v) to determine the terms and conditions of any award granted hereunder (such terms and conditions include, but are not limited to, the exercise price, the time or times when Options or Stock Purchase Rights may vest or be exercised (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions, and any restriction or limitation regarding any award granted hereunder or the Common Stock relating thereto, based in each case on such factors as the Committee, in its sole discretion, shall determine);

(vi) to institute an Option Exchange Program that has been approved by the Board; provided, however, that the effectiveness of the Option Exchange Program is subject to the approval of the Company's shareholders;

(vii) to determine whether to offer to buyout a previously granted Option as provided in subsection 10(i) and to determine the terms and conditions of such offer and buyout (including whether payment is to be made in cash or Shares);

(viii) to prescribe, amend and rescind rules and regulations relating to the Plan, including rules and regulations relating to sub-plans established for the purpose of qualifying for preferred tax treatment under foreign tax laws;

(ix) to allow Holders to satisfy withholding tax obligations by electing to have the Company withhold from the Shares to be issued upon exercise of an Option or Stock Purchase Right or pursuant to a Stock Bonus that number of Shares having a Fair Market Value equal to the minimum amount required to be withheld based on the statutory withholding rates for federal and state tax purposes that apply to supplemental taxable income. The Fair Market Value of the Shares to be withheld shall be determined on the date that the amount of tax to be withheld is to be determined. All elections by Holders to have Shares withheld for this purpose shall be made in such form and under such conditions as the Committee may deem necessary or advisable;

(x) to amend any Option or Stock Purchase Right granted under the Plan as provided in Section 14; and

(xi) to construe and interpret the terms of the Plan and awards granted pursuant to the Plan and to exercise such powers and perform such acts as the Committee deems necessary or desirable to promote the best interests of the Company which are not in conflict with the provisions of the Plan.

(c) Effect of Committee's Decision. All decisions, determinations and interpretations of the Committee shall be final and binding on all Holders.

5. Eligibility. Non-Qualified Stock Options, Stock Purchase Rights and Stock Bonuses may be granted to Service Providers. Incentive Stock Options may be granted only to Employees. If otherwise eligible, an Employee or Consultant who has been granted an Option, Stock Purchase Right or Stock Bonus may be granted additional Options, Stock Purchase Rights or Stock Bonuses. In addition to the foregoing, each Non-Employee Director (defined in Section 12) shall be granted Options at the times and in the manner set forth in Section 12 and may receive Stock Bonuses in lieu of cash compensation as described in Section 12.

6. Limitations.

(a) Each Option shall be designated by the Committee in the Agreement as either an Incentive Stock Option or a Non-Qualified Stock Option. However, notwithstanding such designations, to the extent that the aggregate Fair Market Value of Shares subject to a Holder's Incentive Stock Options and other incentive stock options granted by the Company, any Parent or Subsidiary, which become exercisable for the first time during any calendar year (under all plans of the Company or any Parent or Subsidiary) exceeds $100,000, such excess Options or other options shall be treated as Non-Qualified Stock Options.

For purposes of this Section 6(a), Incentive Stock Options shall be taken into account in the order in which they were granted, and the Fair Market Value of the Shares shall be determined as of the time of grant.

(b) None of the Plan, any Option, Stock Purchase Right or Stock Bonus shall confer upon a Holder any right with respect to continuing the Holder's employment or consulting relationship with the Company, nor shall they interfere in any way with the Holder's right or the Company's right to terminate such employment or consulting relationship at any time, with or without cause.

(c) No Service Provider shall be granted, in any calendar year, Options, Stock Purchase Rights or Stock Bonuses to acquire more than 3,000,000 Shares. The foregoing limitation shall be adjusted proportionately in connection with any change in the Company's capitalization as described in Section 15. For purposes of this Section 6(c), if an Option is canceled in the same calendar year it was granted (other than in connection with a transaction described in Section 15), the canceled Option will be counted against the limit set forth in this Section 6(c). For this purpose, if the exercise price of an Option is reduced, the transaction shall be treated as a cancellation of the Option and the grant of a new Option.

7. Term of Plan. The Plan shall become effective upon its initial adoption by the Board and shall continue in effect until it is terminated under Section 17. No Options, Stock Purchase Rights or Stock Bonuses may be issued under the Plan with respect to the shares specified in Section 3 hereof after the tenth anniversary of the earlier of (i) the date upon which the Plan is adopted by the Board or (ii) the date the Plan is approved by the stockholders. If the number of shares specified in Section 3 is increased by an amendment to this Plan, Options Stock Purchase Rights or Stock Bonuses may be awarded with respect to such increased shares for a period of ten years after the earlier of the date that the amendment to the Plan is adopted by the Board or the date that the amendment is approved by the stockholders. Options, Stock Purchase Rights and Stock Bonuses granted before such dates shall remain valid in accordance with their terms.

8. Term of Option. The term of each Option shall be stated in the Agreement; *provided, however*, that the term shall be no more than ten years from the date of grant thereof; and provided further that, in the case of an Incentive Stock Option granted to a Holder who, at the time the Option is granted, owns (or is treated as owning under Code Section 424) stock representing more than 10% of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the term of the Option shall be no more than five years from the date of grant thereof.

9. Option Exercise Price and Consideration.

(a) Except as provided in Section 13, the per share exercise price for the Shares to be issued upon exercise of an Option shall be such price as is determined by the Committee, but shall be subject to the following:

(i) In the case of an Incentive Stock Option

(A) granted to an Employee who, at the time of grant of such Option, owns (or is treated as owning under Code Section 424) stock representing more than 10% of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the per Share exercise price shall be no less than 110% of the Fair Market Value per Share on the date of grant.

(B) granted to any other Employee, the per Share exercise price shall be no less than 100% of the Fair Market Value per Share on the date of grant.

(ii) In the case of a Non-Qualified Stock Option

(A) granted to a Service Provider who, at the time of grant of such Option, owns stock representing more than 10% of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the exercise price shall be no less than 110% of the Fair Market Value per Share on the date of the grant.

(B) granted to any other Service Provider, the per Share exercise price shall be no less than 100% of the Fair Market Value per Share on the date of grant.

(iii) Notwithstanding the foregoing, Options may be granted with a per Share exercise price other than as required in this subsection (a) above pursuant to a merger or other corporate transaction.

(b) The consideration to be paid for the Shares to be issued upon exercise of an Option, including the method of payment, shall be determined by the Committee (and, in the case of an Incentive Stock Option, shall be determined at the time of grant). Such consideration may consist of (1) cash, (2) check, (3) with the consent of the Committee, actual or constructive delivery of Shares which (x) in the case of Shares acquired from the Company, have been owned by the Holder for more than six months on the date of surrender, and (y) have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which such Option shall be exercised, (4) with the consent of the Committee, payment in connection with the pledge of Shares and a loan through a broker in a transaction described in Securities and Exchange Commission Regulation T, (5) any other consideration acceptable to the Committee, or (6) with the consent of the Committee, any combination of the foregoing methods of payment.

10. Exercise of Option.

(a) Vesting; Fractional Exercises. Except as provided in Section 13, Options granted hereunder shall be vested and exercisable according to the terms hereof at such times and under such conditions as determined by the Committee and set forth in the Agreement. An Option may not be exercised for a fraction of a Share.

(b) Deliveries upon Exercise. All or a portion of an exercisable Option shall be deemed exercised upon delivery of all of the following to the Secretary of the Company or his or her office:

(i) A written or electronic notice complying with the applicable rules established by the Committee stating that the Option, or a portion thereof, is exercised. The notice shall be signed by the Holder or other person then entitled to exercise the Option or such portion of the Option;

(ii) Such representations and documents as the Committee, in its sole discretion, deems necessary or advisable to effect compliance with Applicable Laws. The Committee may, in its sole discretion, also take whatever additional actions it deems appropriate to effect such compliance, including, without limitation, placing legends on share certificates and issuing stop transfer notices to agents and registrars;

(iii) Upon the exercise of all or a portion of an unvested Option pursuant to Section 10(h), an Agreement covering the purchase of the Restricted Stock in a form determined by the Committee and signed by the Holder or other person then entitled to exercise the Option or such portion of the Option;

(iv) In the event that the Option shall be exercised pursuant to Section 10(f) by any person or persons other than the Holder, appropriate proof of the right of such person or persons to exercise the Option; and

(v) The receipt by the Company of full payment for such Shares, including payment of any applicable withholding tax. Tax withholding may, in the sole discretion of the Committee, be paid in the form of (i) deduction from wages otherwise payable to the Holder, (ii) consideration used by the Holder to pay for such Shares under Section 9(b), or (iii) Shares that have a Fair Market Value equal to the minimum required withholdings and that would otherwise be deliverable to the Holder upon exercise of the Option.

(c) Conditions to Delivery of Share Certificates. The Company shall not be required to issue or deliver any certificate or certificates for Shares purchased upon the exercise of any Option or portion thereof prior to fulfillment of all of the following conditions:

(i) The admission of such Shares to listing on all stock exchanges on which such class of stock is then listed;

(ii) The completion of any registration or other qualification of such Shares under any state or federal law, or under the rulings or regulations of the Securities and Exchange Commission or any other governmental regulatory body which the Committee shall, in its sole discretion, deem necessary or advisable;

(iii) The obtaining of any approval or other clearance from any state or federal governmental agency which the Committee shall, in its sole discretion, determine to be necessary or advisable; and

(iv) The lapse of such reasonable period of time following the exercise of the Option as the Committee may establish from time to time for reasons of administrative convenience.

(d) Termination of Relationship as a Service Provider. If a Holder ceases to be a Service Provider for any reason, the Holder's continuing rights, if any, to Options, Restricted Stock, Stock Bonuses or Stock Purchase Rights will be as specified in the terms of the Agreement. In the absence of a provision in the Agreement that specifies the date of expiration when the Holder ceases to be a Service Provider, each Option shall remain exercisable in accordance with the provisions set forth herein, as follows: (i) upon termination as a Service Provider for reasons other than Cause, death or disability, the Option shall remain exercisable for three months following the termination of the Holder's relationship as a Service Provider (but in no event later than the expiration of the term of such Option as set forth in the Agreement or terms of the grant) to the extent that the Option is then vested and the Shares covered by the unvested portion of the Option shall immediately become available for issuance under the Plan; (ii) any unexercised portion of the Option shall terminate at the end of the three-month period specified herein and the Shares covered thereby shall immediately become available for issuance under the Plan; (iii) if a Holder's relationship as a Service Provider is terminated for Cause, the entire Option shall immediately terminate, and the Shares covered thereby shall immediately become available for issuance under the Plan, and (iv) if a Holder is terminated for reasons of death or disability, the rights under the Option shall be determined by Sections 10(e) and 10(f).

(e) Disability of Holder. If a Holder ceases to be a Service Provider as a result of the Holder's disability, and the applicable Agreement does not specify the date of expiration when the Holder ceases to be a Service Provider, an Option shall remain exercisable for 12 months following the Holder's termination due to disability (but in no event later than the expiration of the term of such Option as set forth in the Agreement or terms of the grant), but only to the extent that the Option was exercisable on the date of disability, and the Shares covered by the unvested portion of the Option shall immediately become available for issuance under the Plan. To the extent that the Option is not exercised by the end of the 12-month period, the Option shall expire and the Shares covered thereby shall again become

available for issuance under the Plan. For purposes of Incentive Stock Options, the term "disability" shall be defined in accordance with Section 22(e)(3) of the Code.

(f) Death of Holder. If a Holder dies while a Service Provider, and the applicable Agreement does not specify the date of expiration when the Holder ceases to be a Service Provider, an Option shall remain exercisable for 12 months following the Holder's death (but in no event later than the expiration of the term of such Option as set forth in the Agreement or terms of the grant), but only to the extent that the Option was exercisable on the date of death, and the Shares covered by the unvested portion of the Option shall immediately become available for issuance under the Plan. To the extent that the Option is not exercised by the end of the 12-month period, the Option shall expire and the Shares covered thereby shall again become available for issuance under the Plan. The Option may be exercised by the executor or administrator of the Holder's estate or, if applicable, by the person(s) entitled to exercise the Option under the Holder's will or the laws of descent or distribution.

(g) Regulatory Extension. A Holder's Agreement may provide that if the exercise of the Option following the termination of the Holder's status as a Service Provider (other than upon the Holder's death or Disability) would be prohibited at any time solely because the issuance of shares would violate the registration requirements under the Securities Act, then the Option shall terminate on the earlier of (i) the expiration of the term of the Option set forth in Section 8 or (ii) the expiration of a period of three months after the termination of the Holder's status as a Service Provider during which the exercise of the Option would not be in violation of such registration requirements.

11. Non-Transferability. Options, Restricted Stock, Stock Bonuses and Stock Purchase Rights may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Holder, only by the Holder.

12. Granting of Options to and Stock Elections by Non-Employee Directors.

(a) A person who is a Director but is not an employee of the Company or any of its affiliates (a "Non-Employee Director") who is initially elected to the Board shall, during the term of the Plan, be granted an Option to purchase 21,600 Shares (subject to adjustment as provided in Section 15) on such initial election (an "Initial Option"), and (ii) an Option to purchase 10,000 Shares (subject to adjustment as provided in Section 15) on the date of the first annual meeting of stockholders that occurs each year that the Non-Employee Director is reelected to the Board (the "Annual Option"). Members of the Board who are employees of the Company who subsequently retire from the Company and remain on the Board will not receive an Initial Option but, to the extent that they are otherwise eligible as Non-Employee Directors, will receive, after retirement from employment with the Company, the Annual Option.

(b) In the event that the Company provides cash compensation to Non-Employee Directors for service as a Director or for service as a member or chairperson of a committee of the Board (collectively "Cash Compensation"), each Non-Employee Director may elect to receive (subject to limitations in Section 12(b)(i)), in lieu of receiving any portion of his or her Cash Compensation, a Stock Bonus. Such an election shall be made by filing an election with the Company, in accordance with procedures adopted by the Committee, prior to the time that such Cash Compensation is paid. All elections made hereunder are subject to the following:

(i) The number of Shares payable under a Stock Bonus shall be calculated by dividing (A) the amount of the Cash Compensation that would have been payable to the Non-Employee Director in the absence of an election, by (B) the Fair Market Value of a Share on the date that the Cash Compensation would have otherwise been paid; *provided, however*, that no more than 20,000 Shares can be made subject to a Stock Bonus during any 12-month period that begins with the annual meeting of the shareholders of the Company in which Board members are elected. Any amount of the Cash Compensation subject to the election that exceeds the Fair Market Value of the Shares that are calculated hereunder shall be paid in cash to the Non-Employee Director.

(ii) Other than the right of the Non-Employee Director herein to elect to receive a Stock Bonus, the terms thereof shall be subject to the provisions of Section 14.

13. Terms of Non-Employee Director Options. The per Share price of each Option granted to a Non-Employee Director (as defined in Section 12) shall be equal to 100% of the Fair Market Value of a share of Common Stock on the date the Option is granted. Initial Options (as defined in Section 12) granted to Non-Employee Directors shall become exercisable in cumulative annual installments of one-third of the Shares subject to such option on each of the yearly anniversaries of the date of Initial Option grant that the Non-Employee Director remains a Director, commencing with the first such anniversary, such that each Initial Option shall be 100% vested on the third anniversary of its date of grant if the Non-Employee Director continues to be a Director on such date. Annual Options (as defined in Section 12) granted to Non-Employee Directors shall become exercisable in cumulative quarterly installments of one-fourth of the Shares subject to such Option on the first day of each of calendar quarter that follows the date of the Annual Option grant that the Non-Employee Director remains a Director, such that each Annual Option shall be 100% vested on the one-year anniversary of its date of grant if the Non-Employee Director continues to be a Director on such date. Subject to Section 10, the term of each Option granted to a Non-Employee Director shall be ten years from the date the Option is granted. No portion of an Option which is unexercisable at the time of a Non-Employee Director's termination of membership on the Board shall thereafter become exercisable.

14. Stock Purchase Rights and Stock Bonuses.

(a) Rights to Purchase. Stock Purchase Rights may be issued either alone, in addition to, or in tandem with Options granted under the Plan and/or cash awards made outside of the Plan. After the Committee determines that it will offer Stock Purchase Rights under the Plan, it shall advise the offeree in writing of the terms, conditions and restrictions related to the offer, including the number of Shares that such person shall be entitled to purchase, the price to be paid, and the time within which such person must accept such offer. The offer shall be accepted by execution of an Agreement that covers the purchase of Restricted Stock in the form determined by the Committee.

(b) Repurchase Right. Unless the Committee determines otherwise, the Agreement for the purchase of Restricted Stock shall grant the Company the right to repurchase Shares acquired upon exercise of a Stock Purchase Right upon the termination of the purchaser's status as a Service Provider for any reason. Subject to Section 22, the purchase price for Shares repurchased by the Company pursuant to such repurchase right and the rate at which such repurchase right shall lapse shall be determined by the Committee in its sole discretion, and shall be set forth in the Agreement.

(c) Other Provisions. The Agreement shall contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Committee in its sole discretion.

(d) Rights as a Shareholder. Once the Stock Purchase Right is exercised, the purchaser shall have rights equivalent to those of a shareholder and shall be a shareholder when his or her purchase is entered upon the records of the duly authorized transfer agent of the Company. No adjustment shall be made for a dividend or other right for which the record date is prior to the date the Stock Purchase Right is exercised, except as provided in Section 15 of the Plan.

(e) Stock Bonuses. Notwithstanding any other provision of the Plan, the Committee may grant Stock Bonuses, as compensation or as bonuses, to such Service Providers as the Committee may select in its sole discretion from time to time. Such Stock Bonuses may be issued either alone, in addition to, or in tandem with Options or Stock Purchase Rights granted under the Plan and/or cash awards made outside of the Plan. After the Committee determines that it will offer Stock Bonuses under the Plan, it shall advise the offeree in writing of the terms and conditions related to the offer, including the number of Shares that such person shall be entitled to receive, the time within which such person must accept such offer, and the manner of acceptance of such offer.

15. Adjustments upon Changes in Capitalization, Merger or Asset Sale. The terms of this Section 15 will apply to the rights of a Holder under all Agreements issued hereunder; *provided, however*, that the terms of an Agreement will control with respect to the Holder's rights and adjustments that are made with respect to a merger, asset purchase or other acquisition transaction if the Agreement specifically makes provision for rights and adjustments upon the occurrence of any such acquisition transaction.

(a) Upon the occurrence of any dividend or other distribution (whether in the form of cash, Common Stock, other securities, or other property), recapitalization, reclassification, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin off, combination, or other similar corporate transaction or event, the Committee shall make an adjustment that, in its sole and absolute discretion, it deems appropriate and consistent with sections 409A and 424(a) of the Code in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan with respect to any of the following:

(i) the number and kind of shares of Common Stock (or other securities or property) that may be granted with respect to any Option, Stock Bonus, Stock Purchase Right or Restricted Stock award (including, but not limited to, adjustments of the limitations in Section 3 on the maximum number and kind of shares which may be issued and adjustments of the maximum number of Shares that may be purchased by any Holder in any calendar year pursuant to Section 6(c));

(ii) the number and kind of shares of Common Stock (or other securities or property) that may be subject to any Option, Stock Bonus, Stock Purchase Right or Restricted Stock award; and

(iii) the grant or exercise price with respect to any outstanding Option or Stock Purchase Right.

(b) In the event of any transaction or event described in Section 15(a), the Committee, in its sole discretion, and on such terms and conditions as it deems appropriate, either by the terms of the Option, Stock Purchase Right or Restricted Stock or by action taken prior to the occurrence of such transaction or event and either automatically or upon the Holder's request, is hereby authorized to take any one or more of the following actions whenever the Committee determines that such action is appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended by the Company to be made available under the Plan or with respect to any Option, Stock Purchase Right or Restricted Stock granted or issued under the Plan or to facilitate such transaction or event:

(i) To provide for either the purchase of any such Option, Stock Purchase Right or Restricted Stock for an amount of cash equal to the amount that could have been obtained upon the exercise of such Option or Stock Purchase Right or realization of the Holder's rights had such Option, Stock Purchase Right or Restricted Stock been currently exercisable or payable or fully vested or the replacement of such Option, Stock Purchase Right or Restricted Stock with other rights or property selected by the Committee in its sole discretion;

(ii) To provide that such Option or Stock Purchase Right shall be exercisable as to all shares covered thereby, notwithstanding anything to the contrary in the Plan or the provisions of such Option or Stock Purchase Right;

(iii) To provide that such Option, Stock Purchase Right or Restricted Stock be assumed by the successor or survivor corporation, or a parent or subsidiary thereof, or shall be substituted for by similar options, rights or awards covering the stock of the successor or survivor corporation, or a parent or subsidiary thereof, with appropriate adjustments as to the number and kind of shares and prices;

(iv) To make adjustments in the number and type of shares of Common Stock (or other securities or property) subject to outstanding Options and Stock Purchase Rights, and/or in the terms and conditions of (including the grant or exercise price), and the criteria included in, outstanding Options, Stock Purchase Rights or Restricted Stock or Options, Stock Purchase Rights or Restricted Stock which may be granted in the future; and

(v) To provide that immediately upon the consummation of such event, such Option or Stock Purchase Right shall not be exercisable and shall terminate; provided, that for a specified period of time prior to such event, such Option or Stock Purchase Right shall be exercisable as to all Shares covered thereby, and the restrictions imposed under an Agreement upon some or all Shares may be terminated and, in the case of Restricted Stock, some or all shares of such Restricted Stock may cease to be subject to repurchase, notwithstanding anything to the contrary in the Plan or the provisions of such Option, Stock Purchase Right or Restricted Stock or any Agreement.

(c) Subject to Section 3, the Committee may, in its sole discretion, include such further provisions and limitations in any Option, Stock Purchase Right, Restricted Stock, Agreement or certificate, as it may deem equitable and in the best interests of the Company.

(d) If the Company undergoes an Acquisition, then any surviving corporation or entity or acquiring corporation or entity, or affiliate of such corporation or entity, may assume any Options, Stock Purchase Rights or Restricted Stock outstanding under the Plan or may substitute similar stock awards (including an award to acquire the same consideration paid to the stockholders in the transaction described in this subsection 15(d)) for those outstanding under the Plan. In the event any surviving corporation or entity or acquiring corporation or entity in an Acquisition, or affiliate of such corporation or entity, does not assume such Options, Stock Purchase Rights or Restricted Stock or does not substitute similar stock awards for those outstanding under the Plan, then with respect to (i) Options, Stock Purchase Rights or Restricted Stock held by participants in the Plan whose status as a Service Provider has not terminated prior to such event, the vesting of such Options, Stock Purchase Rights or Restricted Stock (and, if applicable, the time during which such awards may be exercised) shall be accelerated and made fully exercisable and all restrictions thereon shall lapse at least ten days prior to the closing of the Acquisition (and the Options or Stock Purchase Rights terminated if not exercised prior to the closing of such Acquisition), and (ii) any other Options or Stock Purchase Rights outstanding under the Plan, such Options or Stock Purchase rights shall be terminated if not exercised prior to the closing of the Acquisition.

(e) In the event the Company undergoes an Acquisition and any surviving corporation or entity or acquiring corporation or entity, or affiliate of such corporation or entity, does assume any Options, Stock Purchase Rights or Restricted Stock outstanding under the Plan (or substitutes similar stock awards, including an award to acquire the same consideration paid to the stockholders in the transaction described in this subsection 15(e), for those outstanding under the Plan), then, with respect to each stock award held by participants in the Plan then performing services as Employees or Directors, the vesting of each such stock award (and, if applicable, the time during which such stock award may be exercised) shall be accelerated and such stock award shall immediately become fully vested and exercisable, if any of the following events occurs within 12 months after the effective date of the Acquisition or within the Trial Period (as defined herein) even if such Trial Period extends beyond 12 months after the effective date of the Acquisition:

(i) the Employee status or Director status, as applicable, of the participant holding such stock award is terminated by the Company without Cause; or

(ii) the Employee holding such stock award terminates his or her Employee status following (A) a change in position with the Company or any reduction in his or her level of responsibility; (B) any reduction in his or her level of compensation (including base salary, fringe benefits, participation in any plans and target bonuses under any corporate-performance based bonus or incentive programs); or (C) a relocation of the place of employment of the Employee by more than 50 miles; provided and only if such change, reduction or relocation is effected without such individual's consent. In the event that an individual consents to such change, the individual enters a trial period (the "Trial Period") of six months from the date of consent. At any time during the Trial Period an individual may revoke his or her consent and meet the conditions of a voluntary resignation following a change as stated in (A), (B), or (C) above, without the individual's consent.

(f) The existence of the Plan, any Agreement and the Options or Stock Purchase Rights granted hereunder shall not affect or restrict in any way the right or power of the Company or the stockholders of the Company to make or authorize any adjustment, recapitalization, reorganization or other change in the Company's capital structure or its business, any merger or consolidation of the Company, any issue of stock or of options, warrants or rights to purchase stock or of bonds, debentures, preferred or prior preference stocks whose rights are superior to or affect the Common Stock or the rights thereof or which are convertible into or exchangeable for Common Stock, or the dissolution or liquidation of the Company, or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding, whether of a similar character or otherwise.

16. Time of Granting Options, Stock Purchase Rights and Stock Bonuses. The date of grant of an Option, Stock Purchase Right or Stock Bonus shall, for all purposes, be the date on which the Committee makes the determination granting such Option, Stock Purchase Right or Stock Bonus, or such other date as is determined by the Committee. Notice of the determination shall be given to each

Employee or Consultant to whom an Option, Stock Purchase Right or Stock Bonus is so granted within a reasonable time after the date of such grant.

17. Amendment and Termination of the Plan.

(a) Amendment and Termination. The Board may at any time wholly or partially amend, alter, suspend or terminate the Plan. However, without approval of the Company's stockholders given within 12 months before or after the action by the Board, no action of the Board may, except as provided in Section 15, increase the limits imposed in Section 3 on the maximum number of Shares which may be issued under the Plan or extend the term of the Plan under Section 7.

(b) Stockholder Approval. The Board shall obtain stockholder approval of any Plan amendment to the extent necessary and desirable to comply with Applicable Laws.

(c) Effect of Amendment or Termination. No amendment, alteration, suspension or termination of the Plan shall impair the rights of any Holder, unless mutually agreed otherwise between the Holder and the Committee, which Agreement must be in writing and signed by the Holder and the Company. Termination of the Plan shall not affect the Committee's ability to exercise the powers granted to it hereunder with respect to Options, Stock Purchase Rights, Stock Bonuses or Restricted Stock granted or awarded under the Plan prior to the date of such termination.

18. Stockholder Approval. The Capstone Turbine Corporation 2000 Equity Incentive Plan, as originally adopted, was submitted for the approval of the Company's stockholders and such approval was received within 12 months after the date of the Board's initial adoption thereof. In addition, amendments to increase the number of Shares authorized for issuance hereunder have been previously approved by the Company's stockholders, and such amendments are incorporated herein.

19. Inability to Obtain Authority. The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

20. Reservation of Shares. The Company, during the term of this Plan, shall at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

21. Investment Intent. The Company may require a Plan participant, as a condition of exercising or acquiring stock under any Option, Stock Purchase Right or Stock Bonus, (i) to give written assurances satisfactory to the Company as to the participant's knowledge and experience in financial and business matters and/or to employ a purchaser representative reasonably satisfactory to the Company who is knowledgeable and experienced in financial and business matters and that he or she is capable of evaluating, alone or together with the purchaser representative, the merits and risks of exercising the Option or Stock Purchase Right, electing or accepting the Stock Bonus; and (ii) to give written assurances satisfactory to the Company stating that the participant is acquiring the stock subject to the Option, Stock Purchase Right or Stock Bonus for the participant's own account and not with any present intention of selling or otherwise distributing the stock. The foregoing requirements, and any assurances given pursuant to such requirements, shall be inoperative if (A) the issuance of the shares upon the exercise or acquisition of stock under the applicable Option, Stock Purchase Right or Stock Bonus has been registered under a then currently effective registration statement under the Securities Act or (B) as to any particular requirement, a determination is made by counsel for the Company that such requirement need not be met in the circumstances under the then applicable securities laws. The Company may, upon advice of counsel to the Company, place legends on stock certificates issued under the Plan as such counsel deems necessary or appropriate in order to comply with applicable securities laws, including, but not limited to, legends restricting the transfer of the stock.

22. Governing Law. The validity and enforceability of this Plan shall be governed by and construed in accordance with the laws of the State of Delaware without regard to otherwise governing principles of conflicts of law.

IN WITNESS WHEREOF, the undersigned officer of Capstone Turbine Corporation has executed this instrument on this the 11th day of October 2007, to be effective as set forth above.

CAPSTONE TURBINE CORPORATION

By: /s/ Walter J. McBride

Its: Executive Vice President & CFO

Exhibit 10.2

DEVELOPMENT AND LICENSE AGREEMENT

THIS DEVELOPMENT AND LICENSE AGREEMENT, including Attachments and Exhibits attached hereto and incorporated herein by reference, (this "Agreement") is entered into as of the 4th day of September, 2007 (the "Effective Date") by and between **UTC Power Corporation**, a corporation organized and existing under the laws of the State of Delaware and the successor in interest to UTC Power, LLC, having its principal office at 195 Governor's Highway, South Windsor, Connecticut ("UTCP") and **Capstone Turbine Corporation**, a corporation organized and existing under the laws of the State of Delaware and having its principal office at 21211 Nordhoff Street, Chatsworth, California ("Capstone"). UTCP and Capstone shall be hereinafter individually referred to as a "Party" and collectively referred to as the "Parties."

RECITALS

WHEREAS, Capstone designs, develops, manufactures and sells certain MicroTurbine generator systems, controls and accessories; and

WHEREAS, Capstone has established a development program for the commercialization of a 200 kW MicroTurbine generator system meeting the C200 System Specifications (defined below in *Article 1*) and may in the future make changes to such 200 kW MicroTurbine and the C200 System Specifications, pursuant to the terms set forth herein. For the purposes of this Agreement, "C200 System" is defined below in *Article 1*; and

WHEREAS, Capstone desires UTCP to invest in Capstone's C200 System development and commercialization efforts and UTCP is willing to make such investment through cash and in-kind contributions; and

WHEREAS, in exchange for UTCP's investment in Capstone's development and commercialization of the C200 System, Capstone is willing to provide UTCP: (1) favorable pricing pursuant to Section 9 of this Agreement and (2) royalty payments for the sale of all other C200 Systems; and

WHEREAS, in exchange for UTCP's investment in Capstone's development and commercialization of the C200 System, Capstone is willing to grant UTCP, subject to the terms and conditions of this Agreement, a non-exclusive, perpetual, fully paid up, worldwide license to the C200 System with royalty payments to Capstone, should Capstone fail to complete the Development and Commercialization of the C200 System as stated herein;

NOW, THEREFORE, in consideration of the foregoing, and of the mutual promises, covenants and undertakings contained herein, the Parties hereto agree as follows:

1. Definitions.

1.1 "Affiliate" shall mean a parent or subsidiary of a corporation or other business entity (e.g., firm, limited liability company, partnership, or joint venture) that directly or indirectly controls or is controlled by a Party, or is under common control with a Party. For the purpose of this definition, "control" means the possession of more than 50% of the voting securities of a Party or to direct or cause the direction of the management and policies of such Party, whether through the ownership of voting securities, by contract or otherwise.

1.2 "Agreement" shall have the meaning as set forth in the Recitals.

1.3 "C200 Data" shall have the meaning as set forth in *Section 7.1*.

1.4 "C200 Investment" shall mean the Cash Payment and the value of the In-Kind Services performed by UTCP pursuant to the terms of this Agreement.

1.5 "C200 System" shall mean a 200 kW MicroTurbine generator system meeting the C200 System Specifications and all engineering supporting documentation, including any future changes to the 200 kW MicroTurbine generator system, the C200 System Specifications, and the engineering supporting documentation.

1.6 "C200 System Specifications" shall mean the technical specifications of the C200 System as set forth in Attachment A hereto and as amended in writing from time to time pursuant to Section 3.3 below.

1.7 "Capstone" shall have the meaning as set forth in the Preamble.

1.8 "Cash Payment" shall have the meaning set forth in *Article 4*.

1.9 "Commercialization" shall have the meaning as set forth in *Section 7.2*.

1.10 "Confidential Information" shall have the meaning set forth in *Section 10.2*.

1.11 "Deliverables" shall mean the deliverables of Development as set forth in Attachment B.

1.12 "Development" shall mean the work necessary to develop the C200 System in accordance with this Agreement and such that the C200 System meets the then current C200 System Specifications.

1.13 "Disclosing Party" shall have the meaning set forth in *Section 10.1*.

1.14 "Dispute" shall mean any dispute, controversy, claim or disagreement between the Parties hereto arising from, relating to or in connection with the Agreement or other document referred to herein or delivered in connection herewith, or the relationships of the Parties hereunder, including questions regarding the interpretation, meaning or performance of the Agreement, the release of the information in the Escrow Account, and including claims based on contract, tort, common law, equity, statute, regulation, order or otherwise.

1.15 "Effective Date" shall have the meaning as set forth in the Preamble.

1.16 "Escrow Account" shall have the meaning as set forth in *Section 7.1*.

1.17 "Force Majeure Events" shall have the meaning as set forth in *Section 15.1*.

1.18 "In-Kind Services" shall mean the Development commitments of UTCP as set forth in Attachment D and Attachment E hereto.

1.19 "Intellectual Property" means all: (i) patents, trademarks, service marks, trade names, patent and trademark applications, utility models, rights in licenses, designs, copyrights (including rights in computer software), and all rights or forms of protection of similar nature or having equivalent effect to any of the foregoing which may subsist anywhere in the world; (ii) whether or not registered and including applications for any of the foregoing; (iii) know-how, Project results and Confidential Information, including trade secrets, industrial models, processes, designs, methodologies, computer programs (including all source code) and related documentation, technical information and manufacturing, engineering and technical drawings; and (iv) the C200 Data.

1.20 "Losses" shall have the meaning set forth in *Section 12.1*.

1.21 "OEM Agreement" shall mean the March 23, 2005 OEM Agreement executed by the Parties, or an OEM Agreement executed by the Parties subsequent to that date (whichever is the most recently executed).

1.22 "Parties" or "Party" shall have the meaning as set forth in the Preamble.

1.23 "Program Task Sheet" shall have the meaning as set forth in *Section 3.4*.

1.24 "Project" shall mean the Development of the C200 System in accordance with this Agreement.

1.25 "Project Change" shall have the meaning set forth in *Section 3.3*.

1.26 "Project Meeting" shall have the meaning set forth in *Section 3.2*.

1.27 "Receiving Party" shall have the meaning set forth in *Section 10.1*.

1.28 "Representatives" shall have the meaning set forth to it in *Section 3.1*.

1.29 "UTCP" shall have the meaning as set forth in the Preamble.

1.30 "Withdrawal Event" shall have the meaning as set forth in *Section 7.2*.

2. Commitments.

2.1 Development Commitments.

2.1.1 Capstone Development Commitments. Capstone shall conduct the Development in accordance with this Agreement and shall deliver to UTCP the Deliverables as set forth in Attachment B hereto. Any time references concerning the delivery of the Deliverables in Attachment B are estimates only and are subject to change upon written notice by Capstone to UTCP and UTCP's written approval of any such changes. UTCP's written approval shall not be unreasonably withheld such that it does not impact Commercialization.

2.1.2 Capstone Right to Subcontract Development Commitments. Capstone may subcontract any part of the Development to a third party. Capstone shall impose on such third party the same obligations as Capstone owes UTCP hereunder and shall ensure that all such subcontractors comply with and abide by the terms and conditions of this Agreement.

2.1.3 UTCP Development Commitments and Right to Subcontract Development Commitments. UTCP shall perform all In-Kind Services hereunder, pursuant to the terms of this Agreement, in support of the Development and shall complete such tasks, or cause such tasks to be completed, at UTCP's sole expense, except as otherwise agreed to by the Parties in writing. UTCP may subcontract any part of the Development to a third party. UTCP shall impose on such third party the same obligations as UTCP owes Capstone hereunder and shall ensure that all such subcontractors comply with and abide by the terms and conditions of this Agreement.

2.1.4 Joint Development Commitments. During Development, the Parties shall work jointly to: (i) reduce costs and improve manufacturability of the C200 System by using each Party's processes to address manufacturing shop floor issues and (ii) facilitate continuous improvement.

2.2 Other Capstone Commitments.

2.2.1 Extension of the OEM Agreement. Capstone agrees to execute an amendment to extend the term of the OEM Agreement as necessary to ensure that the OEM Agreement is in effect for a six (6) month period of time following Commercialization, as defined herein.

2.2.2 Non Compete Provisions. Capstone is prohibited from designing, marketing or selling the C200 System in conjunction with any energy system that would compete with UTCP products in the combined heating, cooling and power market ("the Market"). Capstone is prohibited from collaborating with any third party to design, market, or sell the C200 System in conjunction with any energy system that would compete with UTCP products in the Market. Subject to the foregoing, Capstone may manufacture the C200 System for any third party.

2.2.3 Assignment of Agreements with Solar Turbines, Incorporated. Upon the occurrence of a Withdrawal Event and UTCP's request, Capstone shall use its best efforts to assign to UTCP the agreements executed between Capstone and Solar Turbines, Incorporated, as set forth in Section 1 of Attachment H, attached hereto.

2.2.4 ADG Compatibility. Capstone shall achieve ADG compatibility with respect to the C200 System within twelve (12) months of Commercialization.

3. Project Management.

3.1 Project Representatives. Each Party shall appoint an equal number of representatives to facilitate the Development and management of the Project (the "Representatives"). A Party may replace a Representative by providing prior notice in writing to the other Party of its intent to replace the applicable Representative. The Parties have appointed their initial respective Representatives as listed in Attachment F hereto.

3.2 Project Meetings. At least quarterly, the Parties will conduct face-to-face project meetings (each a "Project Meeting") consistent with the development milestones identified in Attachment B hereto until Commercialization is achieved at Capstone's development facility. Each Project Meeting shall require attendance of at least the project manager, development and commercial Representatives. During a Project Meeting, the Parties shall address the following:

(i) Progress against the then current estimated Project time schedule;
(ii) Achievement of milestones, including, without limitation, milestones related to payments;
(iii) Current list of contractual amendments to date to be considered by the Parties;
(iv) Current list of Disputes between the Parties, with complete description of issue, position, and impact on the Project (including, without limitation, with respect to cost and schedule and a summary of the status of any Dispute);
(v) Current list of identified risks associated with the Project, with complete description of issue, impact on the Project (including, without limitation, with respect to cost and schedule), and mitigating actions to be taken;
(vi) Project Change(s); and
(vii) Joint Development Commitments, as set forth in Section 2.1.4 of this Agreement.

3.3. Project Changes. If either Party wishes to change the scope of the Project (a "Project Change") as identified by the C200 System Specifications, it shall consult with the other Party in a timely manner so that the Parties can study and estimate the feasibility of such change. A Project Change shall be effective and binding only upon execution of a change order signed by a project manager and a corporate officer of each of the Parties. Prior to Commercialization, as defined within this Agreement, Capstone reserves the right to make commercially reasonable changes to the C200 System Specifications; provided, however, any such change that materially affects the fit, form, function, cost, or Commercialization schedule of the C200 System shall be effective only upon 30 days prior written notice to UTCP and the written approval of UTCP.

3.4 In-Kind Services. UTCP shall not provide any In-Kind Services without a "Program Task Sheet" as defined in Attachment G, approved by each of the Parties pursuant to the terms of this Section, setting forth the specific In-Kind Services to be provided, the time and place of such services, the valuation of the work to be provided, the completion date, and such other relevant criteria as may be reasonably specified by the program task sheet, which shall be prepared by Capstone and delivered to UTCP pursuant to Attachment B. Each Program Task Sheet shall be executed by each of the Parties' respective designees as identified in Attachment F and no In-Kind Services shall be provided except pursuant to the applicable Program Task Sheet. Capstone and UTCP have already identified a list of proposed tasks in Attachment D and Attachment E with task descriptions, deliverables, and estimated costs of $829,900, which UTCP has agreed to support and will be confirmed with Program Task Sheets. The value of UTCP's In-Kind Services shall be adjusted, pursuant to mutual written agreement of the Parties, based on actual cost of the In-Kind Services.

4. UTCP Obligations. UTCP shall also make the C200 Investment as follows: (i) $12,000,000 in cash pursuant to the Milestone schedule attached hereto as Attachment B (the "Cash Payment"). UTCP shall not make any subsequent payments, pursuant to the Milestone schedule set forth in Attachment B, after the initial payment of $1,500,000, until any and all due or previously due Milestones and Deliverables (as set forth within the schedule) have been satisfied and delivered, respectively, as agreed upon by both Parties; and (ii) the provision of In-Kind Services as further described in *Section 3.4* above.

5. Purchase of the C200 System. UTCP shall purchase the C200 System in accordance with terms and conditions of the OEM Agreement applicable to equipment purchases only, or, in the event there is no OEM Agreement in effect, terms and conditions that are substantially similar and no less favorable. In addition, UTCP shall provide Capstone twelve (12) month rolling forecasts for its projected C200 System purchases on a monthly basis. C200 System orders shall be accepted by Capstone upon receipt of such orders from UTCP for standard equipment using Capstone's then current published standard lead times. Subsequent to Commercialization, as defined within this Agreement, Capstone reserves the right to make commercially reasonable changes to the C200 System Specifications; provided, however, any such change that materially affects the fit, form, cost, or function of the C200 System shall be effective only upon 90 days prior written notice to UTCP and the written approval of UTCP.

6. Intellectual Property Ownership. Subject to the License granted in *Article 7* hereof, as between the Parties, Capstone shall own all right title and interest in and to all Intellectual Property relating to the C200 System. Each Party shall own all right title and interest in and to its own Background Intellectual Property.

7. C200 System License.

7.1 Escrow Account.

7.1.1 Capstone shall select an escrow agent, subject to UTCP's prior written approval of such escrow agent, and establish and maintain an escrow account within sixty (60) days following the Effective Date of this Agreement (the "Escrow Account") and shall deposit in such Escrow Account all data and information controlled by Capstone relating to the C200 System, including, but not limited to: (i) all design, development, manufacturing, overhaul, repair and maintenance data and information then in its possession or otherwise necessary to design, develop, manufacture, overhaul, repair and maintain the C200 System; and (ii) a written identification of all know-how and trade secrets in its possession or otherwise necessary to design, develop, manufacture, overhaul, repair and maintain the C200 System, which written identification shall include a list of the individuals that possess such information reasonably necessary to practice all such know-how or trade secrets (collectively, the "C200 Data").

7.1.2 For purposes of Section 7.1, "controlled by" means the possession of the ability to grant a license or sublicense as provided herein without violating terms of any third party agreements. For purposes of Section 7.1, "Third Party Agreements" shall mean any and all such agreements or arrangements that would prevent or in any way limit the deposit of any data or information in the Escrow Account, if such data or information would otherwise be deposited into the Escrow Account and included as C200 Data, but for Capstone's inability to grant a license or sublicense pursuant to the definition of "controlled by" set forth above ("Third Party Data"). With respect to any Third Party Agreements existing prior to, or as of, the Effective Date, Capstone shall make all commercially reasonable efforts to secure for UTCP a license or sublicense to any Third Party Data; if Capstone is unable to secure such a license or sublicense for UTCP, then Capstone shall set forth, in Attachment H attached hereto: (i) a description of the Third Party Agreement (including the parties and date of execution) and (ii) a description, reasonably acceptable to UTCP, of the Third Party Data and the information relevant to the development of the C200 System (including information on form, fit and function) which shall be deposited in the Escrow Account. With respect to any Third Party Agreement that may come into existence after the Effective Date, Capstone shall make all commercially reasonable efforts to secure for UTCP a license or sublicense to the Third Party Data; if Capstone is unable to secure such a license or sublicense for UTCP, Capstone shall, prior to execution of the Third Party Agreement: (i) provide written notice to UTCP, (ii) provide UTCP with a description, reasonably acceptable to UTCP, of the Third Party Data and information relevant to the development of the C200 System (including information on form, fit and function) which shall be deposited in the Escrow Account, and (iii) obtain UTCP's written approval of the arrangement.

7.1.3 Both the records of Capstone and the C200 Data deposited in the Escrow Account shall be subject to inspection and audit by a mutually acceptable third party to determine whether the deposited materials represent the C200 Data to comply with this *Section 7.1*. The audit shall be conducted at a time and place reasonably convenient to Capstone, and each Party shall be responsible for fifty percent (50%) of expenses related to the audit. Capstone shall update the Escrow Account at least once every calendar quarter and upon completion of major elements of the continued design, Development and manufacture of the C200 System, upon any material redesign of all or a material portion of the C200 System, or upon the reasonable request of UTCP.

7.2 Escrow Account Release Conditions. Upon the occurrence of any of the following events and ten (10) days prior written notice to Capstone, (each, a "Withdrawal Event") UTCP shall have the right to access the Escrow Account and receive copies of all C200 Data deposited therein:

(i) Failure by Capstone, to complete, or take reasonable action to complete, the Development, commercialization and product readiness of the C200 System; including, but not limited to, the failure by Capstone to make significant capital investment in, or establish, manufacturing facilities and equipment for the C200 System (collectively, "Commercialization") by February 28, 2009. If Capstone fails to meet this Commercialization deadline, Capstone shall be granted a six (6) month grace period in which to cure such

failure. If Capstone fails to achieve Commercialization of the C200 System during the six (6) month grace period, the cure period shall be extended for six (6) months during which time Capstone shall pay to UTCP liquidated damages of $25,000 per week until Commercialization is achieved or the cure period expires, whichever occurs first. UTCP shall have the right to access the Escrow Account only upon the expiration of the cure period; provided, however, if the delay in Commercialization is caused by UTCP's failure to timely deliver the In-Kind Services in accordance with the applicable agreed upon Program Task Sheet, Capstone's supply issues out of Capstone's reasonable control or other issues out of Capstone's reasonable control, or if UTCP fails to make timely Cash Payments pursuant to the terms of this Agreement, all deadlines shall be extended on a day-for-day basis for the period of such delay and the Parties' rights shall remain intact;

(ii) Capstone fails to take reasonable actions to fulfill UTCP purchase orders made in accordance with *Article 5* above. Capstone shall be provided a reasonable time to respond to any material changes to the (12) month rolling forecast in accordance with *Article 5* above. Capstone shall communicate product requirement changes to UTCP with (90) days advanced written notice.

(iii) Capstone voluntarily or involuntarily transfers all or substantially all of its assets or business or all or substantially all of the assets necessary for the continued delivery of the C200 System to UTCP to any third party, including through any merger or acquisition, and such third party is incapable or unwilling to fulfill Capstone's obligations to UTCP related to the C200 System, including delivery of C200 equipment to meet UTCP C200 System order forecast, in accordance with this Agreement.

7.3 Standby License.

7.3.1 License Grant. Upon the occurrence of a Withdrawal Event, Capstone shall grant to UTCP, its successors and assigns, a perpetual, fully paid up, worldwide license to all C200 Data either then deposited in the Escrow Account or otherwise necessary for the exercise of the rights and purposes set forth in this Agreement, as well as all intellectual property rights pertaining to such C200 Data:

(i) To make, or have made, use, sell, or have sold, to end-use customers the C200 System (and any spare parts thereof) in conjunction with any energy systems and excluding the right to make, use or sell individual components of the C200 System separate from an integrated energy system;

and

(ii) To provide, or cause to be provided, all services associated with the installation, maintenance, repair and overhaul of the C200 System in conjunction with energy systems.

Such license to the C200 Data shall be non-exclusive; provided, Capstone shall be prohibited from granting to a third party a license to the C200 Data for the specific purposes set forth above that would compete with UTCP products in the Market. Subject to the provisions of Section 2.2.2, the grant of this license shall not prohibit Capstone or its successors and assigns from: (i) marketing, manufacturing and selling the C200 System, or (ii) granting Licenses to other third parties for purposes other than any of the purposes set forth within this section 7.3.1.

7.3.2 Standby License Fees. In connection with the grant of the foregoing license in *Section 7.3* hereof, UTCP shall pay to Capstone, or its successor, a royalty equal to three percent (3%) of the C200 System burdened manufacturing cost for all C200 Systems sold by UTCP or its Affiliates as part of any energy system.

7.3.3 Termination of License. UTCP's right to withdraw the C200 Data and obtain a license to the C200 Data shall terminate if the Parties mutually agree in writing either: to a proposed alternative product or to product obsolescence. Once the C200 Data has been withdrawn, this Section 7.3.3 shall have no force and effect.

8. UTCP Royalties.

8.1 Upon the sale of each C200 System by Capstone to an entity other than UTCP or its Affiliates, Capstone shall pay to UTCP a royalty equal to ten percent (10%) of the sale price of each such third party C200 System until the aggregate cash value of UTCP's C200 Investment has been recovered by UTCP and, thereafter, the royalty shall be reduced to five percent (5%) of the sale price.

8.2 All royalties shall be paid to UTCP on a quarterly basis and are due when Capstone recognizes such revenue for a sale of a C200 System or when a C200 System is delivered to a party leasing a C200 System from Capstone.

9. C200 System Discounts. With respect to all sales of the C200 System to UTCP by Capstone, UTCP shall receive: (i) a discount of 25% less (or 30% less in the event the C200 System fails to receive CARB 2007 Certification) than the advertised list price at the time of the applicable sale; or (ii) pricing as favorable as any other customer, distributor or other channel partner of Capstone at the time of the applicable sale, whichever results in a lower price to UTCP. All discounts hereunder shall only be provided on a prospective basis and UTCP shall not be entitled to retroactive discounts on the C200 System, unless UTCP demonstrates that lower, or more favorable, pricing was, or has been, previously available to another party; upon such a demonstration, UTCP shall be entitled to the lower, or more favorable pricing, and shall be entitled to credits pursuant to UTCP's past purchases to account for the difference in pricing.

10. Confidentiality.

10.1 Confidentiality Obligations. Each Party (in such capacity, the "Receiving Party") acknowledges and agrees to maintain the confidentiality of Confidential Information provided by the other Party (in such capacity, the "Disclosing Party") hereunder. Unless it has the

prior written consent of the Disclosing Party, the Receiving Party shall not disclose or disseminate the Disclosing Party's Confidential Information to any person other than those employees, and contractors of the Receiving Party who have a need to know it in order to assist the Receiving Party in performing its obligations under this Agreement and the Project. In addition, the Receiving Party (i) shall take all reasonable steps to prevent unauthorized access to the Disclosing Party's Confidential Information, and (ii) shall not use the Disclosing Party's Confidential Information, or authorize other persons or entities to use the Disclosing Party's Confidential Information, for any purposes other than in connection with performing its obligations hereunder. As used herein, "reasonable steps" means steps that a Party takes to protect its own, similarly confidential or proprietary information of a similar nature, which steps shall in no event be less than a reasonable standard of care.

10.2 The term "Confidential Information," as used herein, shall mean the C200 Data, all business strategies, plans and procedures, proprietary information, software, drawings, test data, tools, processes, methodologies, data and trade secrets, and other confidential information and materials of the Disclosing Party and any Intellectual Property that may be developed as a result of this Agreement. Confidential Information specifically includes, without limitations, any technology, data, results, Deliverables or other information developed or created during Capstone's performance under the terms of this Agreement and which relate to the C200 System.

10.3 The provisions of this *Article 10* shall not apply to the extent that such Confidential Information is: (i) already known to the Receiving Party free of any restriction at the time it is obtained from the Disclosing Party, (ii) subsequently learned from an independent third party free of any restriction and without breach of this Agreement; (iii) is or becomes publicly available through no wrongful act of the Receiving Party or any third party; (iv) can be demonstrated by actual written evidence as being independently developed by the Receiving Party without reference to or use of any Confidential Information of the Disclosing Party; or (v) is required to be disclosed pursuant to an applicable law, rule, regulation, government requirement or court order, or the rules of any stock exchange (provided, however, that the Receiving Party shall advise the Disclosing Party of such required disclosure promptly upon learning thereof in order to afford the Disclosing Party a reasonable opportunity to contest, limit and/or assist the Receiving Party in crafting such disclosure).

10.4 The Receiving Party shall advise its employees and contractors of the Receiving Party's obligations of confidentiality and non-use under this *Article 10* and shall be responsible for ensuring compliance by its and its' affiliates employees, agents, contractors, subcontractors and licensees with such obligations. In addition, the Receiving Party shall require all persons and entities who are provided access to the Disclosing Party's Confidential Information, other than the Receiving Party's employees, accountants and legal counsel, to execute confidentiality or non-disclosure agreements containing provisions reasonably similar to those set forth in this *Article 10*. The Receiving Party shall promptly notify the Disclosing Party in writing upon learning of any unauthorized disclosure or use of the Disclosing Party's Confidential Information by such persons or entities and shall be responsible, to the extent of and pursuant to the standards, terms and conditions of Article 10, for any breach of an obligation of confidentiality by its employees who have had access to the Disclosing Party's Confidential Information.

10.5 Upon the Disclosing Party's written request following expiration or termination of this Agreement, the Receiving Party promptly shall return to the Disclosing Party, or destroy, all Confidential Information of the Disclosing Party provided hereunder, including all copies thereof. If requested by the Disclosing Party, the Receiving Party shall certify in writing its compliance with the provisions of this *Article 10*. The obligations of confidentiality and non-use of Confidential Information shall survive termination or expiration of this Agreement for three (3) years or as long as the Confidential Information is protectable as a trade secret under applicable law.

10.6 The Parties shall issue a joint press release concerning this Agreement upon its execution and upon the written approval of both Parties of such joint press release prior to any release or publication.

10.7 Notwithstanding anything to the contrary herein, the Parties acknowledge that a breach or threatened breach of the confidentiality provisions of this Agreement cannot be adequately compensated by monetary damages and would cause irreparable injury and damage. Accordingly, in the event of such breach or threatened breach of confidentiality, the injured Party shall be entitled to seek injunctive or other equitable relief in addition to recovery of monetary damages in accordance with the provisions of Article 11 of this Agreement.

11. Warranties and Limitation of Damages.

11.1 EXCEPT AS PURSUANT TO THE TERMS OF THE OEM AGREEMENT (OR TERMS NO LESS FAVORABLE), CAPSTONE MAKES NO WARRANTIES TO UTCP, EXPRESS OR IMPLIED, WITH RESPECT TO THE C200 SYSTEM AND ANY SERVICES OR DELIVERABLES PROVIDED HEREUNDER INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF MERCHANTABILITY, NON-INFRINGEMENT OR FITNESS FOR A PARTICULAR PURPOSE. ALL SUCH OTHER WARRANTIES ARE HEREBY DISCLAIMED.

11.2 UTCP MAKES NO WARRANTIES TO CAPSTONE, EXPRESS OR IMPLIED, WITH RESPECT TO THE IN KIND SERVICES AND ANY SERVICES OR DELIVERABLES PROVIDED HEREUNDER INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF MERCHANT ABILITY, NON-INFRINGEMENT OR FITNESS FOR A PARTICULAR PURPOSE. ALL SUCH OTHER WARRANTIES ARE HEREBY DISCLAIMED.

11.3 A PARTY SHALL NOT BE LIABLE TO THE OTHER PARTY FOR ANY SPECIAL, INDIRECT, INCIDENTAL, CONSEQUENTIAL, EXEMPLARY OR PUNITIVE DAMAGES WHETHER IN CONTRACT, TORT OR OTHER THEORIES OF LAW, EVEN IF THE PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES.

11.4 THE TOTAL, CUMULATIVE MONETARY LIABILITY OF EITHER PARTY TO THE OTHER PARTY WITH RESPECT TO A BREACH OF THE CONFIDENTIALITY OBLIGATIONS SET FORTH IN ARTICLE 10 OF THIS AGREEMENT SHALL NOT EXCEED TWELVE MILLION DOLLARS ($12,000,000.00). IN THE EVENT OF A BREACH BY UTCP OF ITS CONFIDENTIALITY OBLIGATIONS WITH RESPECT TO CAPSTONE'S AIR BEARING TECHNOLOGY UTCP'S TOTAL, CUMULATIVE MONETARY LIABILITY SHALL NOT EXCEED THIRTY-FIVE MILLION DOLLARS ($35,000,000.00). A PARTY'S RIGHT TO SEEK AND RECOVER MONETARY DAMAGES WITH RESPECT TO THE OTHER PARTY'S BREACH OF ITS CONFIDENTIALITY OBLIGATIONS UNDER ARTICLE 10 OF THIS AGREEMENT SHALL BE WITHOUT PREJUDICE TO RECEIPT OF ADDITIONAL INJUNCTIVE OR OTHER EQUITABLE NON-MONETARY RELIEF.

11.5 EXCEPT FOR A BREACH OF THE CONFIDENTIALITY OBLIGATIONS SET FORTH IN ARTICLE 10 HEREOF, THE TOTAL CUMULATIVE LIABILITY OF EITHER PARTY WITH RESPECT TO ALL OTHER CLAIMS PERTAINING TO THIS AGREEMENT SHALL NOT EXCEED THE LESSER OF: (A) THE TOTAL AMOUNT PAID TO CAPSTONE UNDER THE AGREEMENT AT THE TIME OF SUCH CLAIM OR (B) TWELVE MILLION DOLLARS ($12,000,000.00).

12. Indemnity.

12.1 Capstone Indemnification. Capstone shall indemnify, defend and hold harmless UTCP and its Affiliates and their respective officers, directors, employees, agents, successors and assigns, from any and all costs, expenses, damages, liabilities, losses and judgments, including reasonable attorneys' fees and legal expenses (collectively, "Losses"), and threatened Losses arising from, or in connection with: (i) any intentional misconduct of Capstone or its employees in the design, manufacture, supply or delivery of the C200 System, or execution of this Agreement; (ii) any claims of infringement or misappropriation of any patent, trademark, trade secret, copyright arising out of the Development, the C200 System or Deliverables provided by Capstone to UTCP, or otherwise caused by Capstone; and (iii) Capstone's breach of its obligations with respect to UTCP's Confidential Information. Capstone's obligations under this paragraph shall not apply to any infringement claim or Loss to the extent it is not caused in whole or part by Capstone and arises from or concerns: (a) a Deliverable prepared in accordance with UTCP's specific technical designs or instructions; (b) inclusion in a Deliverable of any content or other materials provided by UTCP and the infringement or Loss relates to or arises from such UTCP provided material; (c) modification of a Deliverable or the C200 System made by UTCP and not approved by Capstone; (d) use of the Deliverable in combination with C200 System not provided by Capstone or otherwise not approved by Capstone under the applicable documentation and specification; or (e) use by UTCP of an outdated or superseded version of a Deliverable.

12.2 UTCP Indemnification. UTCP shall indemnify, defend and hold harmless Capstone and its Affiliates and their respective officers, directors, employees, agents, successors and assigns, from all Losses and threatened Losses arising from, or in connection with, (i) any intentional misconduct of UTCP or its employees in the performance of this Agreement; (ii) UTCP's breach of its obligations with respect to Capstone's Confidential Information; and (iii) any claims of infringement or misappropriation of any patent, trademark, trade secret, copyright to the extent that the Loss or threatened Loss is not caused by Capstone and arises from or concerns: (a) UTCP provided material; (b) modification of a Deliverable or the C200 System made by UTCP and not approved by Capstone; or (iv) use of the Deliverable or the C200 System in combination with products not provided by Capstone or otherwise not approved by Capstone under the applicable documentation and specification; or (iii) UTCP's use of an outdated or superseded version of a Deliverable.

13. Term & Termination.

13.1 Term. Unless earlier terminated pursuant to *Section 13.2*, this Agreement shall, be effective for the product life of the C200 System.

13.2 Termination. Either Party may terminate this Agreement by written notice to the other Party, if any material breach of this Agreement has not been cured within sixty (60) days after delivery of written notice demanding remedy of such material breach. This Agreement shall be deemed immediately terminated without the requirement of further action or notice by either Party in the event the other Party: (i) shall become subject to voluntary or involuntary bankruptcy, insolvency, receivership, conservatorship or like proceedings pursuant to applicable law; (ii) ceases to conduct its normal and customary business operations.

13.3 Survival. The provisions of Sections 1, 6, 8, 10, 11, 12, 13, 14, 15, including subsections, hereof shall survive the termination or expiration of this Agreement. The provisions of *Section 2.2* and *Articles 7* and 9, including subsections, shall also survive termination or expiration of this Agreement, unless the termination of this Agreement is caused, in whole part, by UTCP's breach of its obligation to make payments of the Cash Payment to Capstone, pursuant to the terms and conditions of this Agreement.

13.4 Disputes. Disputes not otherwise resolved by the Parties shall be resolved pursuant to Attachment C hereto.

14. Notices. All notices, demands or other communications to be given or delivered under or by reason of the provisions of this Agreement shall be in writing and shall be deemed to have been duly given if: (a) delivered personally to the recipient; (b) sent to the recipient by reputable express courier service (charges prepaid); (c) mailed to the recipient by certified or registered mail, return receipt requested and postage prepaid; or (d) transmitted by facsimile to the recipient with a confirmation copy to follow the next day to be delivered by express courier. Such notices, demands and other communications shall be sent to the addresses indicated below:

If to Capstone:	If to UTCP:
Capstone Turbine Corporation 21211 Nordhoff Street Chatsworth, CA 91311 United States Ann: EVP & CTO	UTC Power Corporation 195 Governor's Highway South Windsor, CT 06074 United States Attn: Vice President Onsite Power Solutions
With copy to:	With copy to:
Waller Lansden Dortch & Davis, LLP 520 South Grand Avenue Suite 800 Los Angeles, CA 90071 United States Ann E. Lee Horton, Esq.	UTC Power Corporation 195 Governor's Highway South Windsor, CT 06074 United States Attn: Legal Department, Counsel

or to such other address or to the attention of such other person as the recipient party has specified by prior written notice to the sending party. Date of service of such notice shall be: (i) the date such notice is personally delivered; (ii) three (3) days after the date of mailing if sent by certified or registered mail; (iii) the next business day after the date of delivery to the overnight courier if sent by overnight courier; or (iv) the date of transmittal by facsimile, if transmitted on a business day, or the next business day following transmittal, if transmitted other than on a business day.

15. General Provisions.

15.1 In addition to any other provisions of this Agreement regarding due dates or times of performance, neither Party shall be liable to the other Party for, and shall be excused from, any failure or delay in performing an obligation under this Agreement that is due to causes beyond its reasonable control, such as natural catastrophes, governmental acts or omissions, laws or regulations, disruptions in the supply of public utilities, labor strikes or difficulties, transportation stoppages or slowdowns, failures or disruptions caused by suppliers, terrorism, or other similar disruptions or interferences ("Force Majeure Events"). If the occurrence of any of the Force Majeure Events prevent or delay a Party's performance for a period of less than twenty (20) consecutive days, the time for that performance shall be extended on a day-for-day basis. If the Force Majeure events cause a delay of twenty (20) or more consecutive days the Party's time for performance shall be extended on a day-for-day basis plus ten (10) days from the end of the Force Majeure Events. The occurrence of Force Majeure Events shall not, however, excuse the performance of a Party's payment obligations under this Agreement for a period in excess of seven (7) days.

15.2 The Parties may not assign this Agreement except with the other Party's prior written consent or as specifically provided herein.

15.3 Unless otherwise specifically provided herein, nothing in this Agreement, whether express or implied, shall be construed as granting to either Party any license with regard to intellectual property rights of the other Party.

15.4 This Agreement sets forth the entire understanding of the Parties, and supersedes and preempts all prior oral or written understandings and agreements with respect to the subject matter hereof. No modification, termination or attempted waiver of this Agreement shall be valid unless in writing and signed by both parties to this Agreement.

15.5 This Agreement shall be construed and controlled by the laws of the State of New York, without regard to New York's rules relating to conflicts of law, and United States federal law applicable to patents, copyrights and trademarks, as such laws are applied to contracts made and to be performed entirely within the State of New York. In the event either Party brings an action to enforce its rights under this Agreement, the prevailing Party shall be entitled to recover all reasonable attorneys' fees and expenses from the other Party arising out of such action.

15.6 The Parties shall resolve all disputes, controversies or differences that may arise between the Parties in accordance with Attachment C.

15.7 Each Party at its own expense shall keep records of all C200 Systems it sells. From time to time during regular business hours, on reasonable prior written notice, each Party or its authorized representatives may examine the other Party's sales records for the C200 System.

15.8 Failure by either Party to enforce any provisions of this Agreement or any rights that may arise as a result of breach of this Agreement by the other Party shall not be construed as a waiver of any of its rights, nor affect the validity of this Agreement, nor prejudice either Party as regards any subsequent action.

15.9 If any court of competent jurisdiction finds any provision of this Agreement to be unenforceable or invalid, then the provision shall be ineffective to the extent of the court's finding, without affecting the enforceability or validity of this Agreement's remaining provisions.

15.10 In making and performing this Agreement each Party shall be deemed to be acting as an independent contractor and shall not be deemed an employee, agent, legal representative, joint venturer or partner of the other Party. Neither Party is authorized to bind the other to any obligation, affirmation or commitment with respect to any other person or entity.

15.11 This Agreement and shall be deemed executed by both Parties when any one or more counterparts hereof, individually or taken together, bears the signatures of each of the Parties.

15.12 Unless this Agreement expressly provides that an approval, consent, waiver, acceptance, concurrence or permission may be given or withheld in the "sole discretion" of a Party (or words of similar import), then such Party may not unreasonably withhold, delay or condition any approvals, consents, waiver, acceptances, concurrences and permissions required to be given or made by any Party hereunder taking into account relevant business and economic factors.

IN WITNESS WHEREOF, the Parties have caused this Agreement to be executed in duplicate, one executed original to be retained by each Party.

Capstone Turbine Corporation	UTC Power Corporation
Name: Darren R. Jamison	Name: Jan van Dokkum
Signature: /s/ Darren R. Jamison	Signature: /s/ Jan van Dokkum
Title: President & CEO	Title: President
Date: September 4, 2007	Date: September 4, 2007

Attachment A

C200 System Specifications

Item	Specification
High Pressure Natural Gas	
Power Output (1)	200kW net (+01/-10)
Efficiency (1)	32.5 (±2) %
Fuel Pressure	75 psig
Low Pressure Natural Gas	
Power Output (1)	190kW net (±10)
Efficiency (1)	31.0 (±2) %
Fuel Pressure	> 0.25 psig (7 inch WC)
All Configurations	
Fuel Type	Natural Gas or ADG
Fuel Heat Content	36 to 42 MJ/m3 (970 to 1,130 BTU/scf) HHV
Electrical Configuration	Grid Connect and Stand Alone
Electrical Output	480V, 60 Hz, 3 ph
Exhaust Gas Temperature (1)	~ 275°C (527°F)
Exhaust Gas Mass Flow (1)	~1.3 kg/s (2.9 lb/s)
Exhaust Emissions (1)	NOx < 9 ppmV @ 15% O_2
Package Height	< 2.9 m (9.6 ft)
Package Footprint	< 7.5 m^2 (81 ft^2)
Weight	< 3,000 kg (6,614 lbs) Grid Connect < 4,900 kg (10,800 lbs) Standalone
Sound	< 68 dBA @ 10 m (33 ft)
Certifications (2)	UL1741 UL2200 CARB 2007

(1) Specifications given at ISO Conditions (15°C / 59°F at sea level)
(2) CARB2007 version available combined with 80% heat recovery system

Attachment B

Payment Milestones

Milestone	Deliverable	Payment	ECD
Contract Signing	Signed Agreement to Start	$ 1,500,000	Upon contract signing
System Requirements Review	C200 System Requirements Specification C200 System Architecture Specification Review Charts Review Minutes (actions included All Program Task Sheets, agreed upon pursuant to Section 3.4 of the Agreement)	$ 2,000,000	11/19/2007
Preliminary Design Review	Preliminary System Demonstration Engine Performance Model (Baseline Review Charts Review Minutes (actions included)	$ 2,500,000	2/29/2008
Critical Design Review	C200 System Qualification Plan C200 Package Qualification Plan C200 System ATP Specification Prototype System and Package C200 Product Datasheet (Preliminary C200 Product Specification (Preliminary C200 System Price List (Preliminary C200 O&I Drawings (Preliminary Review Charts Review Minutes (actions included)	$ 2,500,000	5/30/2008
MicroTurbine Build Complete	Physical Verification Delivery of one (1 complete C200 System to UTCP)	$ 2,000,000	8/31/2008
Qualification Results	C200 System Qualification Report - including CARB and UL test results that demonstrate the C200 System's ability to receive CARB 2007 Certification. C200 Package Qualification Report Engine Performance Model (Final C200 Preventive Maintenance Schedule Review Charts Review Minutes (actions included)	$ 1,500,000	12/1/2008
	Total	$ 12,000,000	

1. ECDs are target dates only. Capstone will receive payments in connection with providing Deliverables and invoicing for completed milestones.

2. UTCP shall have its assigned program manager or approved alternate present at the technical reviews for each milestone to audit program deliverables. The milestone shall be deemed completed upon written notice by Capstone to UTCP and UTCP's written approval. UTCP's written approval shall not be unreasonably withheld.

3. Capstone will invoice UTCP for the dollar amount specified at the completion of each milestone.

4. Payment is due upon complete delivery of each item required by the milestone and receipt of an invoice.

Attachment C

Dispute Resolution Procedures

Level 1 Dispute Review. Upon the written request of either party, UTCP and Capstone shall each appoint a designated representative whose task shall be to meet the other party's designated representative (by conference telephone call or in person at a mutually agreeable site) in an endeavor to resolve any Dispute ("Level 1 Dispute Review"). The designated representatives shall meet as often as the parties reasonably deem necessary to discuss the Dispute and negotiate in good faith in an effort to resolve the Dispute without the necessity of any formal proceeding. Such Level 1 efforts may include discussion of the Dispute at a regular or ad hoc Project Meeting for the purpose of resolving such Dispute.

Level 2 Dispute Review. If resolution of the Dispute cannot be resolved within the earlier of (a) fifteen (15) days of the first Level 1 Dispute Review meeting and (b) such time as when either party gives the other notice of an impasse ("Level 1 Dispute Termination Date"), the designated executive of UTCP will meet with the designated executive of Capstone (by conference telephone call or in person at a mutually agreeable site) within 72 hours after the Level 1 Dispute Termination Date for the purpose of resolving such unresolved Dispute ("Level 2 Dispute Review").

Arbitration. (a) If the parties are unable to resolve the Dispute within a thirty (30) days after commencement of the Level 2 Dispute

Review, either party may give the other party notice of the existence of a continuing impasse (the date on which both parties are in receipt of such notice, the "Level 2 Dispute Termination Date") and shall thereafter immediately submit the Dispute to binding arbitration in accordance with the following provisions of this Exhibit, regardless of the amount in controversy or whether such Dispute would otherwise be considered justifiable or ripe for resolution by a court or arbitration panel.

(b) Any such arbitration shall be conducted by the American Arbitration Association ("AAA") in accordance with its current Commercial Arbitration Rules (the "AAA Rules"), except to the extent that the AAA Rules conflict with the provisions of this Attachment, in which event the provisions of this Attachment shall control.

(c) Unless otherwise agreed by the parties, the arbitration panel (the "Panel") shall consist of three neutral arbitrators ("Arbitrators"), each of whom shall be an attorney having five or more years experience in the primary area of law as to which the Dispute relates, and shall be appointed in accordance with the AAA Rules (the "Basic Qualifications"); except if the amount in controversy is less than One Million Dollars (US) ($1,000,000.00) the Panel shall consist of one Arbitrator.

(d) Should an Arbitrator refuse or be unable to proceed with arbitration proceedings, a substitute Arbitrator possessing the Basic Qualifications shall be appointed by the AAA. If an Arbitrator is replaced after the arbitration hearing has commenced, then a rehearing shall take place in accordance with the provisions of this Attachment and the AAA Rules.

(e) The arbitration shall be conducted in Chatsworth, California.

(f) The Panel may in its discretion order a pre-exchange of information including production of documents, exchange of summaries of testimony or exchange of statements of position and shall schedule promptly all discovery and other procedural steps and otherwise assume case management initiative and control to effect an efficient and expeditious resolution of the Dispute.

(g) At any oral hearing of evidence in connection with any arbitration conducted pursuant to this Exhibit, each party and its legal counsel shall have the right to examine its witnesses and to cross-examine the witnesses of the other party. No testimony of any witness shall be presented in written form unless the opposing parties shall have the opportunity to cross-examine such witness, except as the parties otherwise agree in writing and except under extraordinary circumstances where, in the opinion of the Panel, the interests of justice require a different procedure.

(h) Within fifteen (15) days after the closing of the arbitration hearing, the Panel shall prepare and distribute to the parties a written award. The Panel shall have the authority to award any remedy or relief that a court of competent jurisdiction could order or grant, and shall award interest on any monetary award from the date that the loss or expense was incurred by the successful party. In addition, the Panel shall have the authority to decide issues relating to the interpretation, meaning or performance of the Agreement, any agreement, certificate or other document referred to herein or delivered in connection herewith, or the relationships of the parties hereunder or thereunder, even if such decision would constitute an advisory opinion in a court proceeding or if the issues would otherwise not be ripe for resolution in a court proceeding, and any such decision shall bind the parties in their performance of the Agreement and such other documents.

(i) Except as necessary in court proceedings to enforce this arbitration provision or an award rendered hereunder, to obtain interim relief, or as otherwise required by law, neither the parties nor any arbitrator shall disclose the existence, content or results of any arbitration conducted hereunder without the prior written consent of the other parties.

(j) To the extent that the relief or remedy granted in an award rendered by the Panel is relief or a remedy on which a court could enter judgment, a judgment upon the award rendered by the Panel may be entered in any court having jurisdiction thereof. Otherwise, the award shall be binding on the parties in connection with their obligations under the Agreement and in any subsequent arbitration or judicial proceedings among any of the parties.

(k) The parties agree to share equally the cost of any arbitration, including the administrative fee, the compensation of the arbitrators and the costs of any neutral witnesses or proof produced at the direct request of the Panel.

Recourse to Courts and Other Remedies. Notwithstanding the Dispute resolution procedures contained in this Attachment, any party may apply to any court having jurisdiction (a) to enforce the Agreement to arbitrate, (b) to seek injunctive relief so as to maintain the status quo until the arbitration award is rendered or the Dispute is otherwise resolved, (c) to avoid the expiration of any applicable limitation period, (c) to protect Confidential Information, or (d) to preserve a superior position with respect to other creditors.

Attachment D

In-Kind Engineering Services

Service	Deliverable	Task Description	Cost Estimate
Casting Support	Advice and support for casting activity to support 40,000 hrs Life	Provide consultation/advice from casting engineer/expert in the development of 5 components	$ 110,000.00

	Requirement.	– turbine rotor, turbine nozzle, bearing supports and generator housing. Work with suppliers and provide input to develop key component characteristics, e.g. grain size, stress rupture strength as required. Assist in qualifying supplier to produce quality components. Review supplier processes and their material data for acceptability. Make recommendations for additional material testing/qualification to ensure component meets durability requirements and consistent casting process output.	
Compressor Analysis	Structural and Thermal Analysis including: Transients Clearance Analysis including Transients Vibration Analysis Life Analysis including Fracture Mechanics as Required	Provide structural and thermal analysis of the compressor rotor and shaft under steady state and transient conditions. Determine acceptability of: clearance during transients, component vibratory response, component life and fracture mechanics life. Capstone to provide first pass geometry and thermal analyses. Review compressor material data with respect to UTC material database to provide a broader statistical basis for the design. Produce review to reduce program risk. Investigate sensitivity of component life and clearances to secondary flow schemes per the performance modeling task.	$ 168,000.00

Service	Deliverable	Task Description	Cost Estimate
Turbine Analysis	Structural and Thermal Analysis including Transients Clearance Analysis including transients Vibration Analysis Life Analysis including Fracture Mechanics as Required	Provide structural and thermal analysis of the turbine rotor under steady state and transient conditions. Determine acceptability of: clearance during transients, component vibratory response, component life and fracture mechanics life. Capstone to provide first pass geometry and thermal analyses. Review turbine rotor material data with respect to UTC material database to provide a broader statistical basis for the design. Provide thorough review to reduce program risk. Investigate sensitivity of component life and clearances to secondary flow schemes per the performance modeling task.	$ 165,000.00
Materials	Review of engine materials utilizing the UTC Materials Database for acceptance to 40,000 hr and 80,000 hr design life targets. Review and Recommend inspection methods and surface treatments, e.g., shot peening & coating to assure component integrity and Damage Tolerance is met.	Review the C200 materials with respect to the UTC material database to better define material characteristics, property statistical variation, etc. Make suggestions for improved material properties and statistical control. Make recommendations for, and help develop processes including but not limited to surface treatments, coatings, and heat treatment to improve component durability. Recommend process changes to reduce turbine rotor porosity. Recomment inspection techniques for the turbine casting to reduce the risk of durability problems stemming from casting porosity or defects.	$ 132,000.00

Service	Deliverable	Task Description	Cost Estimate
Performance Modeling	Support Aerodynamic/thermody namic modeling and engine validation testing	Capstone to provide cycle model. Model will be exercised to understand C200 operational characteristics and to evaluate Capstone provided changes to the cooling flow levels, paths, or sealing schemes. Model output to be used in the thermal modeling tasks to investigate sensitivity to secondary flow schemes on operation and durability.	$ 110,000.00
Approved Supplier List	List of approved suppliers and the ability to procure under the umbrella of UTCs master purchase agreements.	Review Capstone supply base requirements and evaluate opportunities for use of UTC supply base. Identify opportunities for consolidated purchasing with UTC under UTC master purchase agreements.	$ 20,000.00

Attachment E

In-Kind Test Services

Test	Deliverable	Task Description	Cost Estimate
System Performance	*Performance for system integration* - Report containing system performance including ambient temperature, ambient pressure, air flow, exhaust flow, exhaust temperature, and system power over an ambient temperature range. Performance at Cold/Altitude Test — Report containing system performance including ambient temperature, ambient pressure, air flow. exhaust flow, exhaust temperature, and system power over at —20 C to 10 C; altitude to 1000 m	Perform data acquisition for UTC Power system integration. Obtain a performance data point at a UTC owned or contracted facility that simulates cold weather and altitude (to 1000m operation. C200 unit not attached to PureComfort(system)	0 $ 17,600.00 $
Package Acoustic Testing	Report that characterizes sound pressure level.	Obtain sound pressure at 1m and 10m as measured per ANSI methods.	$ 8,800.00
Package Shipping	Report evaluating the ability of C200 system packaging to withstand transportation vibration levels without sustaining damage.	Conduct a vibration test simulating exposure to transportation vibration loads. Vibration table must be capable of testing a C200 unit in its shipping container. C200 unit does not have to be operating during the test. Capstone will provide the shipping vibration test spectrum.	$ 60,000.00
Reliability Demonstration	Reliability Demonstration data	Operate 5000 hours. Maintain log book of all service and faults. Record operating data in CRMS. UTCP's performance of this task is contingent upon Capstone's delivery to UTCP of one (1) complete C200 System, for this purpose.	$ 38,500.00

Attachment F

Bo Halamandaris
Program Manager, C200 Development
Capstone Turbine Corporation

Libby Reynolds
Vice President and Chief Accounting Officer
Capstone Turbine Corporation

George Hirko
Program Management or Engineering

John Fox
Business Level Employee

Attachment G

UTC/Capstone In-Kind Support

Program Task Sheet

Capstone Turbine Corp • 21211 Nordhoff Street • Chatsworth • CA 91311 • USA
Main: (818) 734-5300 • Fax: (818) 734-5321

Task Scope Description:

Performing Organization:

Deliverables:

Acceptance Criteria:

ECD: **Budget:**

Other:

Capstone Designee:
Program:

Officer

UTC Designee:
Program:

Officer

Attachment H

Item	Third Party Agreement:	Description of the Third Party Data and information relevant to the development of the C200 System (including information on form, fit and function) which shall be deposited in the Escrow Account:
1.	August 2, 2000 — Amended and Restated License Agreement and August 2, 2000 — Transition Agreement with Solar Turbines, Incorporated.	• Agreement to license recuperator core technology from Solar Turbine Incorporated for manufacture, use, and sale by Capstone Turbine Corporation in microturbine products. • Licensed technology includes at least the fin fold, cell stacking, and annular design features as well as the manufacturing techniques. • Capstone shall deposit in the Escrow Account data related to the performance of the recuperator module, which shall include flow rate, pressure drop, and thermal effectiveness.

Exhibit 31.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a)
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Darren R. Jamison, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Capstone Turbine Corporation (the "Company");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;

4. The Company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's quarter ended September 30, 2007 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and

5. The Company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: November 8, 2007

By: /s/ DARREN R. JAMISON
Darren R. Jamison
President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER
PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a)
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Walter J. McBride, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Capstone Turbine Corporation (the "Company");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;

4. The Company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's quarter ended September 30, 2007 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and

5. The Company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: November 8, 2007

By: /s/ WALTER J. McBRIDE
Walter J. McBride
Executive Vice President and
Chief Financial Officer

Exhibit 32.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER AND THE CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report on Form 10-Q of Capstone Turbine Corporation ("the Company") for the period ended September 30, 2007, as filed with the Securities and Exchange Commission on the date hereof ("the Report"), Darren R. Jamison, as Chief Executive Officer of the Company, and Walter J. McBride, as Chief Financial Officer, each hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to his knowledge, that:

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

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

Date: November 8, 2007 /s/ DARREN R. JAMISON
Darren R. Jamison
President and Chief Executive Officer

Date: November 8, 2007 /s/ WALTER J. McBRIDE
Walter J. McBride
Executive Vice President and Chief Financial Officer