

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt about the contents of this document, you should consult an independent professional adviser authorised under the Financial Services and Markets Act 2000 who specialises in advising on the acquisition of shares and other securities.

Clean Air Power Limited and its Directors, whose names appear on page 6 of this document, accept responsibility both individually and collectively for the information contained in this document. To the best of the knowledge and belief of the Directors (who have taken all reasonable care to ensure this is the case), the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

Application has been made for the whole of the issued and to be issued Common Shares to be admitted to trading on AIM, a market operated by the London Stock Exchange. It is expected that admission will become effective and that trading in the Common Shares will commence on AIM on 28 February 2006. AIM is a market designed primarily for emerging or smaller companies to which a higher investment risk tends to be attached than to larger or more established companies. AIM Securities are not admitted to the Official List of the UK Listing Authority. A prospective investor should be aware of the risks in investing in such companies and should make the decision to invest only after careful consideration and, if appropriate, consultation with an independent financial adviser. The rules of AIM are less demanding than those of the Official List of the UK Listing Authority and it is emphasised that no application is being made for admission of the Common Shares to the Official List. Furthermore, neither the London Stock Exchange nor the UK Listing Authority has examined or approved the contents of this document. The Common Shares are not dealt on any other recognised investment exchange and no other such applications have been made.

This document, which comprises an AIM admission document, has been drawn up in accordance with the AIM Rules and has been issued in connection with the application for admission to trading of the Common Shares on AIM. This document is not an approved prospectus for the purposes of Part VI of the Financial Services and Markets Act of 2000, as amended.

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# Clean Air Power Limited

*(Incorporated and registered in Bermuda under the Companies Act 1981 of Bermuda with registered No. EC 37542)*

## Placing of 10,000,000 Common Shares, of US\$0.001 per share, at 100p per Common Share

and

## Admission to Trading on AIM

*Nominated Adviser & Broker*  
**Canaccord Adams Limited**

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### Share Capital Immediately Following Placing and Admission

Authorised		Issued and Fully Paid	
Number of Common Shares	Nominal Value	Number of Common Shares	Nominal Value
60,000,000	US\$60,000	26,318,479	US\$26,318

Canaccord Adams Limited, which is authorised and regulated by the Financial Services Authority, is acting exclusively for Clean Air Power Limited in relation to the Placing and Admission. Canaccord Adams Limited is not acting for, nor will it be responsible to anyone other than the Company for providing the protection afforded to clients of Canaccord Adams Limited or for advising any other person in connection with the Placing and Admission. Canaccord Adams Limited has been appointed as nominated adviser and broker to Clean Air Power Limited in relation to the Placing and Admission. No representation or warranty, express or implied, is made by Canaccord Adams Limited as to any of the contents of this document for which Clean Air Power Limited and its Directors are solely responsible. Canaccord Adams Limited does not accept any liability whatsoever for the accuracy of any information or opinions contained in this document or for the omission of any material information (without limiting the statutory rights of any person to whom this document is issued).

This document does not constitute an offer to sell or an invitation to subscribe for, or the solicitation of an offer to buy or subscribe for, the Placing Shares, as defined hereinafter, in any jurisdiction where such an offer or solicitation is unlawful and is not for distribution in or into Canada, Australia, the Republic of Ireland or Japan or to any national, resident or citizen of Canada, Australia, the Republic of Ireland or Japan or into any jurisdiction where it would be unlawful to do so. The Placing Shares have not been, and will not be, registered under the securities laws of the United States, Canada, Australia, the Republic of Ireland or Japan and, subject to certain exceptions, may not be offered for subscription, or subscribed, directly or indirectly, within the United States, Canada, Australia, the Republic of Ireland or Japan or to or by any national, resident, or citizen of Canada, Australia, the Republic of Ireland, Japan or the United States. The distribution of this document in other jurisdictions may be restricted by law and, therefore, the person into whose possession this document comes should inform themselves about and observe any such restriction. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdictions.

Prospective investors should read the whole text and contents of this document and should be aware that an investment in the Company is speculative and involves a degree of risk. In particular, prospective investors' attention is drawn to the section entitled "Risk factors" in Part II of this document.

Copies of this document will be available during normal business hours on any day (except Saturdays, Sundays and public holidays) free of charge to the public at the offices of Canaccord Adams Limited, First Floor, 27 Upper Brook Street, London W1K 7QF for one month from the date of Admission.

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# NOTICE TO INVESTORS

The placement of Common Shares (the “Placing Shares”) of Clean Air Power Limited (the “Company”) is being made by the Company in a private placement, within and outside the United States, solely to “accredited investors” (as defined in Rule 501 (a) of Regulation D under the United States Securities Act of 1933, as amended (the “US Securities Act”). This Admission Document is not, and under no circumstances is to be construed as, an advertisement or a public offering of the Placing Shares. No securities commission or similar authority in the United States has reviewed or in any way passed upon this Admission Document or the merits of Placing Shares and any representation to the contrary is an offence.

The offer of and subscription for the Placing Shares is intended to be exempt from the registration requirements of the US Securities Act by reason of Regulation D promulgated thereunder (“Reg D”) and Section 4(2) of the US Securities Act. Each subscriber for the Placing Shares will be required to execute and deliver documentation for the benefit of the Company and the Agent whereby such subscriber represents, warrants, undertakes or acknowledges, as the case may be, that:

1. it is an “accredited investor” as that term is defined under Reg D;
2. it is purchasing the Placing Shares (i) for investment purposes, (ii) not with a view to any resale, distribution or other disposition of the Placing Shares in violation of the US Securities Act, and (iii) for its own account or for the account of another “accredited investor” as defined in Regulation D with respect to which it exercises investment discretion; and, in particular, it has no agreement, understanding or intention to resell or transfer any of the Placing Shares or interests in those shares within the United States or to “US Persons” as that term is defined under Regulation S promulgated under the US Securities Act;
3. in the normal course of its business, it invests in or purchases securities similar to the Placing Shares, it has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of an investment in the Placing Shares and it is able to bear the economic risk of an investment in the Placing Shares for an indefinite period;
4. it has received a copy of this Admission Document and it agrees that it has held and will hold this Admission Document in confidence, it being understood that this Admission Document is solely for its use and is not to be redistributed or duplicated by it;
5. it is not purchasing Placing Shares as a result of any general solicitation or general advertising, including advertisements, articles, notices or other communications published in any newspaper, magazine or similar media or broadcast over radio or television, or any seminar or meeting whose attendees have been invited by general solicitation or general advertising;
6. it has conducted its own investigation with respect to the Company and the Placing Shares and has had access to such financial and other information concerning the Company and the Placing Shares as it has deemed necessary to evaluate the merits and risks of an investment in the Placing Shares, including the opportunity to ask questions and receive answers from the Company concerning the terms and conditions of the placing and to obtain additional information;
7. it has made its own assessment and has satisfied itself concerning the relevant tax, legal, currency, and other considerations relevant to its investment in Placing Shares;
8. the Placing Shares have not been and will not be registered under the US Securities Act or the securities laws of any state or other jurisdiction of the United States and may not be offered, sold, pledged, hedged or otherwise transferred except (a) in an offshore transaction in accordance with Rule 904 under Regulation S, (b) pursuant to an exemption from registration under the US Securities Act provided by Rule 144 thereunder (if available), or (c) pursuant to another available exemption from the registration requirements of the US Securities Act and subject to the right of the Company in the cases of clauses (a), (b) or (c) to require the delivery of an opinion of counsel in form and substance and from counsel satisfactory to the Company at the expense of the owner of the Placing Shares (or in the discretion of the Company, delivery of other evidence satisfactory to it), that such registration is not required, in each case, in accordance with the US Securities Act and any other applicable securities laws of any state of the United States; and
9. the Company, the Company’s registrar, the Agent and their affiliates will rely upon the truth and accuracy of the foregoing representations, warranties, undertakings and acknowledgements.

## Notice to Investors

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The Placing Shares shall be considered “restricted securities” within the meaning of Rule 144(a)(3) under the US Securities Act and, for a period of two years after the date of the Placing, any certificate that is materialised to evidence the Placing Shares, by way of transfer, substitution or otherwise, shall bear a legend as follows:

**“THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”) OR THE SECURITIES LAWS OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES, AND MAY NOT BE OFFERED, SOLD, PLEDGED, HEDGED OR OTHERWISE TRANSFERRED EXCEPT (A) IN AN OFFSHORE TRANSACTION IF THE SELLER IS NOT AN “AFFILIATE” OF THE COMPANY (OTHER THAN AN AFFILIATE SOLELY BY REASON OF BEING AN OFFICER OR DIRECTOR OF THE COMPANY) IN ACCORDANCE WITH RULE 904 UNDER REGULATION S PROMULGATED UNDER THE SECURITIES ACT; (B) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE); OR (C) PURSUANT TO ANOTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT, SUBJECT, IN THE CASES OF CLAUSES (A), (B) AND (C), TO THE RIGHT OF THE COMPANY TO REQUIRE AN OPINION OF COUNSEL IN FORM AND SUBSTANCE AND FROM COUNSEL SATISFACTORY TO THE COMPANY AT THE EXPENSE OF THE HOLDER OF THIS CERTIFICATE (OR IN THE DISCRETION OF THE COMPANY, DELIVERY OF OTHER EVIDENCE SATISFACTORY TO IT) THAT SUCH REGISTRATION IS NOT REQUIRED, IN EACH CASE, IN ACCORDANCE WITH THE SECURITIES ACT OR ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES.”**

The Company may make a notation on its records, including stop transfer instructions noted on the stock transfer records, or give instructions to its registrar and its transfer agent of the Placing Shares in order to implement these transfer restrictions and certificate legend requirements. The registrar and the transfer agent for the Placing Shares will not be required to accept the registration of transfer of any Placing Shares in a transaction that is not consummated on AIM, except upon presentation of evidence satisfactory to the Company that the applicable transfer restrictions have been complied with.

Pursuant to Rule 904 under Regulation S, the Placing Shares and any Depositary Interests issued in respect thereof may be sold in the ordinary course of secondary market trading on AIM, so long as (i) the offer of sale is not made to a person in the United States, (ii) neither the seller nor any person acting on its behalf, knows that the transaction has been prearranged with a buyer in the United States, and (iii) no directed selling efforts are made in the United States with respect to the Placing Shares. Notwithstanding sub transfer, however, the Placing Shares will remain “restricted securities” for the balance of such two year period.

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**THE OFFER OF AND SUBSCRIPTION FOR THE PLACING SHARES OFFERED BY THE COMPANY HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE US SECURITIES ACT, OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES, AND, SUBJECT TO CERTAIN EXCEPTIONS, MAY NOT BE OFFERED FOR PURCHASE OR SALE, SOLD OR OTHERWISE DISPOSED OF, BY A HOLDER OF SUCH SHARES, DIRECTLY OR INDIRECTLY, WITHIN THE UNITED STATES OR ITS TERRITORIES OR POSSESSIONS. OFFERS AND SALES OF THE PLACING SHARES WITHIN THE UNITED STATES WOULD CONSTITUTE A VIOLATION OF THE US SECURITIES ACT UNLESS THAT OFFER AND SALE OF SUCH PLACING SHARES IS MADE IN COMPLIANCE WITH THE REGISTRATION REQUIREMENTS OF THE US SECURITIES ACT OR AN EXEMPTION THEREFROM.**

**THE PLACING SHARES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION (THE “SEC”) OR BY ANY STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY, NOR HAVE ANY OF THE FOREGOING AUTHORITIES OR ANY SECURITIES COMMISSION PASSED ON THE ACCURACY OR ADEQUACY OF THIS PLACEMENT MEMORANDUM OR THE ADMISSION DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE.**

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The information contained in this Admission Document is delivered on a confidential basis solely to enable such recipient to evaluate the Company and investment in the Placing Shares and does not constitute a

## **Notice to Investors**

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general offer to the public of, or the general solicitation from the public of offers to subscribe for any securities. Distribution of this information to any other person other than those persons, if any, retained to advise the recipient with respect hereto is unauthorised and any disclosure of any of this information without the prior written consent of the Company is prohibited. Each recipient of this Admission Document, by accepting delivery hereof, agrees to the foregoing and further agrees to make no photocopies of this Admission Document.

No recipient of this Admission Document should construe anything in this Admission Document as legal, business or tax advice. Each recipient, prior to purchasing any securities, should perform its own investigation and analysis of the Company and the terms of the offering of the Placing Shares and should be aware that they may be required to bear the financial risks of this investment for an indefinite period of time.

All solicitations or acceptances of offers to subscribe for the Placing Shares will be made through Canaccord Adams Limited (the “Agent”), or such broker-dealer affiliates as the Agent may designate from time to time, including Canaccord Adams Inc., (the “Affiliates”).

Neither the Company, the Agent, the Affiliates nor any other dealer makes any representation or warranty, express or implied, relating to the accuracy or completeness of the information set forth herein or in any other written or oral communication transmitted or made available to any recipient of this Admission Document, and each of them expressly disclaims any and all liability based on such information or omissions therefrom. No dealer, salesman or any other person has been authorised by the Company, the Agent or the Affiliates, or any other dealer to give any information other than this Admission Document or to make any representations in connection with the issue of or subscription for the Placing Shares and, if given or made, such information or representation must not be relied upon as having been authorised by the Company, the Agent or any Affiliates. Neither the delivery of the Admission Document nor any subscription made in connection herewith shall, under any circumstances, constitute a representation or create any implication that the information contained in this Admission Document is correct as of any time subsequent to the date hereof or the date of such subscription made in connection herewith.

### **Special Notice to Affiliates**

If you are a stockholder who is an “affiliate” of the Company as such term is defined in Rule 405 of the US Securities Act, and not an affiliate solely by virtue of being an officer or director of the Company, the offshore resale exemption under Rule 904 of the US Securities Act is not available to you. In the absence of an effective registration statement filed by or on behalf of the Company, you must consult with your counsel regarding the availability of an exemption for the resale at the time you are contemplating such a transaction.

### **Forward-Looking Statements**

Certain statements in the Admission Document constitute “forward-looking statements”. Forward-looking statements include statements concerning the plans, objectives, goals, strategies and future operations and performance of the Company and the assumptions underlying these forward-looking statements. The Company uses the words “anticipates,” “estimates,” “expects,” “believes,” “intends,” “plans,” “may,” “will,” “should,” and any similar expressions to identify forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the Company’s actual results, performance and achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such forward-looking statements are based on numerous assumptions regarding present and future business strategies and the environment in which the Company will operate in the future. As a result of these risks, uncertainties and assumptions, a prospective investor should not place undue reliance on these forward-looking statements. See “Risk Factors” in Part II of the Admission Document.

These forward-looking statements speak only as of the date of the Admission Document. The Company is not obliged, and does not intend, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. All subsequent written and oral forward-looking statements attributable to the Company, or persons acting on behalf of the Company, are expressly qualified in their entirety by the cautionary statements contained throughout the Admission Document.

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## Placing Statistics

Placing Price	100p
Number of Common Shares in issue prior to the Placing	16,318,479
Number of Placing Shares being placed on behalf of the Company	10,000,000
Number of Common Shares in issue following Admission	26,318,479
Gross proceeds of the Placing receivable by the Company	£10,000,000
Net proceeds of the Placing receivable by the Company	£8,655,846
Market Capitalisation of the Company at the Placing Price on Admission	£26,318,479
Percentage of enlarged issued share capital subject to the Placing	38%

## Expected Timetable of Principal Events

Publication of this document	22 February 2006
Effective date of merger between Clean Air Power, Inc. and Clean Air Power Merger Sub, Inc.	27 February 2006
Admission effective and commencement of dealings in Common Shares on AIM	28 February 2006
CREST accounts credited with Depository Interests	28 February 2006
Expected date of dispatch of definitive certificates for Common Shares (where applicable)	10 March 2006

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# Directors, Secretary and Advisers

Directors	Rodney James Westhead ( <i>Non-Executive Chairman</i> ) John Francis Pettitt ( <i>Chief Executive Officer</i> ) Peter David Rowse ( <i>Financial Director</i> ) Wallace William Hunter ( <i>Non-Executive Director</i> ) Scott Bruce Ungerer ( <i>Non-Executive Director</i> ) Larry Rhodell Wilson ( <i>Non-Executive Director</i> )
Officers	John Pettitt ( <i>Chief Executive Officer</i> ) Peter Rowse ( <i>Financial Director</i> ) Steven Whelan ( <i>Technology Director</i> ) Robert Taylor ( <i>Operations Director</i> ) Kevin Campbell ( <i>Business Development Director</i> ) Michael Ellithorn ( <i>European Business Development Director</i> )
Registered Office	Clarendon House 2 Church Street Hamilton HM11 Bermuda
Chief Executive Office	Little Baldon House, Little Baldon, Oxford OX44 9PU
Secretary	Elaine Colmet
Nominated Adviser & Broker	Canaccord Adams Limited First Floor 27 Upper Brook Street London W1K 7QF United Kingdom
Reporting Accountants	Ernst & Young LLP 100 Barbirolli Square Manchester M2 3EY United Kingdom
Auditors	Ernst & Young LLP 4370 La Jolla Village Drive, Suite 500 San Diego, CA 92122 USA
Solicitors to the Company	As to US law: Baker & McKenzie LLP 101 West Broadway Twelfth Floor San Diego, CA 92101 USA As to English law: Baker & McKenzie LLP 100 New Bridge Street London EC4V 6JA United Kingdom
Solicitors to the Placing	Reed Smith Rambaud Charot LLP Minerva House 5 Montague Close London SE1 9BB United Kingdom
Registrars	Capita IRG (Offshore) Limited Victoria Chambers, Liberation Square, 1/3 The Esplanade, St Helier, Jersey

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# Definitions

The following definitions apply throughout this document, unless the context otherwise requires:

“A\$”	Australian dollars, the lawful currency of Australia;
“Admission”	admission of the issued and to be issued Common Shares (including the Placing) to trading on AIM becoming effective in accordance with the AIM Rules;
“AIM”	the AIM market of the London Stock Exchange;
“AIM Rules”	the rules for AIM companies published by London Stock Exchange;
“BMA”	the Bermuda Monetary Authority;
“Bermuda Companies Act”	the Companies Act 1981 of Bermuda (as amended);
“the Board” or “the Directors”	the directors of the Company (save as stated otherwise) whose names are set out on page 6 of this document;
“Business Day”	a day, other than a Saturday, Sunday or public holidays, on which banks are generally open in London for the transaction of normal business;
“Bye-Laws”	the Bye-Laws of the Company, adopted 17 January 2006;
“Canaccord”	Canaccord Adams Limited;
“CAP US Common Stock”	voting and non-voting common stock of US\$0.001 each in Clean Air Power US;
“CAP US Series C Preferred Stock”	series C-1 preferred stock and series C-2 non-voting preferred stock of US\$0.001 each in Clean Air Power US;
“CAP US Series D Preferred Stock”	series D-1 preferred stock and series D-2 non-voting preferred stock of US\$0.001 each in Clean Air Power US;
“Clean Air Power”	refers to the group of entities comprised of the Company and its direct and indirect subsidiaries;
“Clean Air Power UK”	Clean Air Power Limited, a limited liability company incorporated and registered in England and Wales;
“Clean Air Power US”	Clean Air Power, Inc., incorporated in Delaware;
“CNG”	Compressed natural gas;
“Combined Code”	the Combined Code on the principles of good corporate governance and code of best practice published in 2003, issued by the Financial Reporting Council;
“Common Shares”	common shares with par value of \$0.001 each in the capital of the Company;
“Company”	Clean Air Power Limited, a limited liability company incorporated and registered in Bermuda under the Bermuda Companies Act;
“CREST”	the computerised settlement system to facilitate the transfer of title to or interests in securities in uncertificated form, operated by CRESTCo Limited;

## Definitions

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“CRESTCo”	CRESTCo Limited, the operator of CREST;
“CREST Member”	a person who has been admitted by CRESTCo as a system member (as defined in the Regulations);
“CREST Participant”	a person who is, in relation to CREST, a system participant (as defined in the Regulations);
“Depository Interests” or “DIs”	depository interests issued by Capita IRG Trustees Limited in respect of underlying Common Shares, which may be traded and settled on CREST;
“ECU”	electronic control unit;
“Genesis”	generic Dual-Fuel™ system designed to be installed on major existing diesel engine platforms;
“Internal Revenue Code”	US Internal Revenue Code of 1986, as amended;
“IRS”	US Internal Revenue Service;
“LNG”	Liquefied natural gas;
“London Stock Exchange”	London Stock Exchange plc;
“Members”	persons registered as Shareholders;
“Memorandum of Association”	the Memorandum of Association of the Company;
“Merger”	the merger between Clean Air Power US with and into Merger Sub immediately prior to the Admission pursuant to the Merger Agreement;
“Merger Agreement”	the merger agreement dated as of 11 January 2006, and made between the Company, Clean Air Power US and Merger Sub relating to the restructuring of Clean Air Power, details of which are set out in Part I of this document;
“Merger Sub”	Clean Air Power Merger Corporation, a wholly-owned subsidiary of the Company incorporated in Delaware for the purpose of consummating the Merger;
“OEM”	an original equipment manufacturer;
“Official List”	the Official List of the UKLA;
“Options”	options to acquire Common Shares;
“Placees”	persons subscribing for Common Shares in the Placing at the Placing Price;
“Placing”	the conditional placing by Canaccord as agent for the Company of the Placing Shares at the Placing Price pursuant to the Placing Agreement;
“Placing Agreement”	the conditional agreement dated 22 February 2006 between the Company, the Directors, Clean Air Power US and Canaccord relating to the Placing, a summary of principal terms and conditions of which is set out in Section 12.3 of Part VI of this document;
“Placing Price”	100p per Placing Share;

## Definitions

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“Placing Shares”	the 10,000,000 Common Shares to be issued by the Company pursuant to the Placing;
“Regulations”	the Uncertificated Securities Regulations 2001;
“Shareholders”	holders of Common Shares in the Company from this time;
“Share Plans”	the 2005 Share Plan and the 2006 Share Option Plan;
“2005 Share Plan”	the 2005 Share Plan of Clean Air Power Limited;
“2006 Share Option Plan”	the 2006 Share Option Plan of Clean Air Power Limited;
“UK”	the United Kingdom of Great Britain and Northern Ireland;
“UK Companies Act”	the Companies Act of 1985 of Great Britain, as amended;
“UKLA”	the Financial Services Authority, acting in its capacity as the competent authority for the purposes of Part VI of the Financial Services and Markets Act 2000;
“US”	the United States of America, its territories and possessions, any state of the United States of America and the District of Columbia;
“US Energy and Highway Bills”	Energy Policy Act of 2005, Public Law No. 109-58, and Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005: A Legacy for Users, Public Law No. 109-59;
“US Share Plan”	the 2001 Stock Option/Stock Issuance Plan of Clean Air Power US; and
“\$” or “US\$”	US dollars, the lawful currency of the United States.

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# Key Information

*This summary highlights information contained elsewhere in this Admission Document. This summary does not contain all of the information investors should consider before investing in Common Shares. The following information is extracted from, and should be read in conjunction with, the full text of this document. Investors should read the whole document including the “Risk Factors” set out in Part II and not rely solely on the information in the “Key Information” section or any other summarised information in this document.*

## **The Business**

Through its subsidiaries, the Company provides technology that enables heavy-duty diesel engines to operate on a combination of diesel and natural gas Dual-Fuel™ technology without jeopardising diesel engine performance.

Clean Air Power focuses on three product lines:

- combined diesel and natural gas fuel systems for heavy-duty vehicles;
- natural gas engine components; and
- emissions reduction technology.

## **Key strengths**

Utilising its existing business lines as a base, the Company plans to increase its market penetration in the UK, Australia and the US. Clean Air Power’s goal is to become a major global provider of combined diesel and natural gas technology solutions to truck hauliers worldwide by offering operators a generic retrofit Dual-Fuel™ solution, known as “Genesis” while developing partnerships with leading engine OEMs.

Clean Air Power’s competitive advantages which distinguish the Company from other solutions to the environmental and economic costs of diesel engines include:

- the technology provides significant fuel cost savings to operators resulting in a conversion cost payback period as short as 12 months and an average payback period between one and two years;
- Dual-Fuel™ retains diesel-like performance and efficiency and has the benefit of emissions reduction associated with natural gas vehicles;
- more than 1,600 trucks have been fitted with Dual-Fuel™ converted engines worldwide;
- the application of Dual-Fuel™ technology does not require any major modifications to the existing engine platform and it can switch seamlessly between natural gas and diesel;
- recent price forecasts predict that a price differential between diesel and natural gas will continue over the next 25 years; and
- the Company has proprietary technology, know-how, and strategic relationships in all three primary business lines.

## **Directors and Management**

The management team was significantly enhanced in 2005 and early 2006 with the addition of John Pettitt as CEO, Steven Whelan as Technology Director and Peter Rowse as Financial Director. The management team has significant technical and commercial experience. Collectively the management team has over 25 years of experience in diesel engineering and dual-fuel technology. The non-executive Chairman is the recently retired CEO of Ricardo plc, a leading automotive engineering consultancy in the UK.

## **The Placing**

The Placing comprises the issue of 10,000,000 Placing Shares by the Company to raise approximately £10,000,000 before expenses.

On Admission the Company will have 26,318,479 Common Shares in issue and a market capitalisation of approximately £26.3 million at the Placing Price. The Placing Shares will represent approximately 38 per cent of the enlarged issued share capital of the Company

## **Use of proceeds**

The proceeds being raised by the Company pursuant to the Placing will be used for product development, test facilities, marketing and for general corporate purposes.

## **Key Information**

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### **Dividend policy**

Initially following Admission, the Company intends to retain future earnings to finance continued development of its business and therefore does not expect that it will pay dividends on its Common Shares in the immediate future. The declaration and payment by the Company of any dividends, and the amount thereof, in the future will depend on the Company's operations, its financial position, cash needs, profits and other factors relevant at the time.

**YOUR ATTENTION IS DRAWN TO THE RISK FACTORS REFERRED TO IN PART II OF THIS DOCUMENT.**

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# Part I — Information on Clean Air Power

## 1. Introduction

Diesel engines are fundamental to the transportation, construction, resource, agriculture and power generation industries. Approximately 20 million new diesel engines are sold annually, generating approximately \$40 billion in sales revenue and more than 200 million diesel engines are currently in service around the world. However, operators of diesel-powered truck fleets are being challenged by the increased cost of diesel fuel and stringent emissions regulations. Natural gas has emerged as a clean and less expensive alternative to diesel fuel, but current natural gas engines provide insufficient power for heavy-duty applications, and the public access to natural gas refuelling infrastructure is in early stage development in most countries around the globe.

Clean Air Power develops engine and emissions reduction technologies that enable heavy-duty diesel engines to operate on a combination of diesel and natural gas, which offers the vehicle owner significant lifecycle cost savings and assistance with environmental standards compliance. Clean Air Power currently focuses on three product lines: (1) combined diesel and natural gas fuel systems for heavy-duty vehicles, (2) gas engine components, and (3) emissions reduction technology.

Clean Air Power's primary technology, known as Dual-Fuel™, allows diesel engines to operate using mainly compressed or liquefied natural gas without jeopardising diesel engine performance. The application of Dual-Fuel™ technology does not require any major modifications to the existing engine platform. By using Dual-Fuel™ truck operators are not limited by the natural gas refuelling infrastructure. The technology provides significant fuel cost savings to operators, which the Company estimates could result in a conversion cost payback period as short as 12 months, and an average payback period between one and two years. In addition to fuel cost savings, natural gas vehicle operators may realise economic benefits from tax credits and other government incentive programmes.

Clean Air Power's Dual-Fuel™ has been installed in over 1,600 vehicles worldwide by more than 50 customers. While heavy-duty vehicle operators initially adopted Dual-Fuel™ to reduce their emissions of diesel exhaust, since 2003, Clean Air Power's customers have increasingly employed Dual-Fuel™ to capitalise on the economic benefits resulting from the lower cost of natural gas compared to diesel. The Directors believe that the diesel engine will remain the world's commercial work-horse for many years to come, and that Dual-Fuel™ will continue to provide benefits as diesel technology continues to advance.

The Dual-Fuel™ technology can address opportunities in countries which have a large price differential between natural gas and diesel (in some cases up to 50 per cent), including the UK, US, the Netherlands and Australia. As a result of the savings on fuel costs, the Directors believe Dual-Fuel™ will be very compelling to fleet operators in these countries. Based upon available forecasts in the market, the Directors believe that the price differential between natural gas and diesel will continue. Due to the lower emissions resulting from the combustion of natural gas, the Clean Air Power technology can also meet the emissions reduction needs of diesel engine users in various low emissions vehicle markets. Recent legislation such as the US Energy and Highways Bills provide an economic incentive to fleet operators to reduce emissions.

In addition, Clean Air Power offers specialist components for use in natural gas engines and supplies a number of well-known OEM customers including Daimler Chrysler, Volvo, General Dynamics and John Deere. Finally, Clean Air Power designs and manufactures a variety of emissions treatment systems for use in mobile and stationary applications, including vehicular, marine and power generation applications.

## 2. History of Clean Air Power

Clean Air Power Limited was incorporated and registered in Bermuda on 4 November 2005 as an exempted company limited by shares, with registered number 37542. Upon Admission, the Company will become the holding company of Clean Air Power US and Clean Air Power UK by way of the Merger. Further details on the Merger are set out in Section 20 of Part I of this document.

Clean Air Power's origins can be traced to a consulting firm named BKM Business Development Corp., founded in 1975 to engage in engineering design and consultancy in connection with hydraulic and gaseous fuel injection applications. BKM specialised in the design and development of advanced electronic fuel injection systems, and successfully developed and commercialised natural gas fuel injection components. BKM was founded by Dr. N. John Beck who, prior to founding BKM, served as Vice President Research of Cummins Engine Co., Inc., held senior positions at a number of engine companies and had extensive research and development experience in energy systems with particular emphasis on internal combustion engines. Dr. Beck remains involved with Clean Air Power and is currently acting as technical adviser to the Company.

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Clean Air Power was originally incorporated in 1991 under the name Clean Air Partners, as a California corporation to commercialise technology developed by BKM allowing the conversion of medium and heavy-duty diesel fuel engines to run on a combination of diesel and natural gas fuel. The conversion system was developed for use on stationary applications such as power generators and has since been adapted for use on heavy-duty highway truck engines.

In 1996, Clean Air Power entered into a licence agreement with Caterpillar, Inc., one of the largest heavy-duty engine manufacturers in the US, giving Caterpillar limited exclusive rights to the Dual-Fuel™ technology. The licence relationship allowed Clean Air Power to develop and market Dual-Fuel™ conversions for the heavy-duty US vehicle market. In 2005, Caterpillar elected to terminate the agreement due to differences with respect to product and warranty standards and obligations, as well as a result of a shift in internal priorities. Both Clean Air Power and Caterpillar remain open to future opportunities in other forms which might be beneficial to both companies. As a result of the termination, Clean Air Power is able to establish commercial relationships with other vehicle manufacturers and distributors in North America.

In June 2001, Clean Air Power acquired substantially all the assets of BKM, principally consisting of machinery and equipment, certain know-how and patents and out-licence agreements relating thereto, which allowed Clean Air Power to further develop and commercialise the Dual-Fuel™ technology and expand upon its manufacturing and sale of engine components.

In June 2002, Clean Air Power entered the UK market through a joint venture with a local truck dealership, pursuant to which the joint venture installed the Dual-Fuel™ conversion kits on vehicles provided by the dealership. In July 2003, Clean Air Power opted to work directly with Foden Trucks, a division of Paccar Ltd, whereby Foden supplied Clean Air Power with vehicles powered by the Caterpillar C12 diesel engine and, after Clean Air Power had installed the Dual-Fuel™ conversion kit, Foden assisted in the marketing and sale of the Dual-Fuel™ vehicles through its dealer network. In order to deal efficiently with the increased demand for Dual-Fuel™ vehicles generated in connection with the Foden relationship, Clean Air Power established a subsidiary, Clean Air Power UK, in the United Kingdom to engage in the broad marketing and sales of Dual-Fuel™ vehicles in the UK, as well as installing the Dual-Fuel™ conversion kits on Foden vehicles.

In September 2002, Clean Air Power acquired substantially all the assets of Harris International Sales Corp., a company engaged in the development and commercialisation of diesel engine emissions reduction technology. The assets acquired by Clean Air Power included a patent portfolio covering catalytic converters and silencer products, customer lists and certain contracts. The Harris International acquisition allowed Clean Air Power to broaden its technical and commercial capabilities in the area of emissions treatment for stationary power generators, thereby complementing the Company's stationary power generation business.

Since 2003, and influenced by Clean Air Power's success with Foden in the UK, Clean Air Power has redirected its business focus toward the manufacturers, distributors and users of diesel engines in heavy-duty vehicles in the UK and, more broadly, Europe. Although the emissions advantages provided by using Dual-Fuel™ technology on heavy-duty vehicles continues to be an important incentive, cost efficiencies resulting from higher diesel prices have become the primary commercial driver for adoption of the Dual-Fuel™ technology.

Since its inception in 1991, Clean Air Power has funded its operations largely through capital investments totalling approximately \$47.6 million from venture capital firms and other investors in the United States and Canada. In 2005, Clean Air Power raised approximately \$7.1 million from several existing investors with EnerTech Capital Partners, RBC Capital Partners, and Endeavor Capital Partners, LLC, leading the investment. Beginning in 2005, Clean Air Power has undergone a significant restructuring by hiring experienced management in the UK, such as the Chief Executive Officer John Pettitt, to run its business operations. In addition, the Company has developed the Genesis product which, when commercially introduced to the market in 2006, will allow the Company to market and sell retrofitted Dual-Fuel™ conversion kits that can be installed on any major OEM's engine.

### **3. The Business**

#### **3.1 Current Business**

Clean Air Power currently focuses on three product lines: combined diesel and natural gas fuel systems for heavy-duty vehicles, natural gas engine components and diesel engine emissions reduction technology.

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### *Combined Diesel and Natural Gas Fuel Systems; Dual-Fuel™*

Driven by the original goals of providing fleet operators with cost savings based upon the lower price of natural gas, and providing heavy-duty vehicles that can meet the stringent emissions restrictions imposed in many industrialised nations, Clean Air Power has developed technology that allows a heavy-duty diesel engine to run on a combination of natural gas and diesel, where the fuel substitution of diesel for natural gas ranges from 60 to 79 per cent. The Dual-Fuel™ solution switches from diesel to natural gas with diesel-like power, and the technology can be installed on both new and used diesel engines. Dual-Fuel™ has been fitted on over 1,600 vehicles in several markets and has secured a strong following.

Adoption of Dual-Fuel™ technology provides cost savings that operators may rapidly realise. Approximately two-thirds of the operating costs of a vehicle to the operator consist of fixed costs such as drivers' wages and holding costs, which the operator has little ability to control. Fuel costs usually represent the remainder of a truck's annual operating expenses, and fuel constitutes the only significant variable cost element to the operator. The savings realised with Dual-Fuel™ engines are largely the result of natural gas prices being less than diesel in many of the world's largest truck markets compounded by the distances that long-haul heavy-duty trucks cover annually. In addition to fuel cost savings, further savings can also be realised through using tax credits and other governmental incentives. As a result of these savings, the Directors believe that a Dual-Fuel™ truck may pay back the conversion cost in only 18-24 months, and that the pay-back period could decrease to a year in some markets. In addition to the cost savings, Dual-Fuel™ delivers a cleaner, lower CO<sub>2</sub> exhaust diesel engine that operates more quietly, while providing the driver with near equal performance to a standard diesel engine. Further, residual values are not compromised.

A Clean Air Power Dual-Fuel™ installation has four main components: the proprietary fuel injection hardware; the engine management unit, which are assembled by Clean Air Power in San Diego; the natural gas fuel tanks, which are sourced from a third party; and the installation itself, which is mostly labour. Additionally, some markets require extra exhaust treatment which is sourced from Clean Air Power's own emissions reduction technology business unit in Houston as well as externally.

Clean Air Power's Dual-Fuel™ conversions were historically designed for installation on Caterpillar engines, and the 3126, C10, C12 and C15 engines have successfully been converted to Dual-Fuel™. Clean Air Power has developed Genesis, which represents a new generation of Dual-Fuel™ conversion systems. Genesis is a generic Dual-Fuel™ system that is designed to work on any major diesel engine platform. Genesis is currently being developed at the Company's Leyland facility.

Vehicle manufacturers in Clean Air Power's primary markets, Australia, the US and UK, have distinct operating models and as a result Clean Air Power's sales and distribution strategy has varied to reflect these differences. In Australia, sales and distribution are generally outsourced by engine manufacturers to specialist distributors. Clean Air Power has commercial relationships with two of the largest engine distributors in Australia, WesTrac and William Adams. In the UK, as in the rest of Europe, manufacturers generally are vertically integrated whereby they manufacture their own engines and most components. By comparison, in the US, vehicle manufacturers generally purchase their engines according to the customer's specifications from an external supplier such as Caterpillar, Cummins or Detroit Diesel, or, in the case of MACK, from its parent company Volvo.

#### *UK Market*

In the UK, Clean Air Power has been selling Dual-Fuel™ truck conversions since 2002. Clean Air Power initially targeted the market due to the historically high differential between gas and diesel prices, the size of the market and the stringent EU emission standards. Truck haulage is the primary mode of goods distribution in the UK, and the installation of the Dual-Fuel™ technology has most recently been driven by the cost savings available to operators. Over the last two years, the Directors believe that the adoption of the Clean Air Power technology has resulted in fuel substitution cost savings to the operator of as much as £11,000 per truck per annum. Dual-Fuel™ vehicles also qualify for a £500 annual road fund licence discount upon application for a reduced pollution certificate.

Clean Air Power's conversions in the UK are currently installed on Foden trucks with Caterpillar engines. To date, 213 trucks have been converted to Dual-Fuel™. In June 2005, Paccar Inc, Foden's parent company, announced that it intended to make a decision about continuing the Foden line within 12 months, and that Paccar's evaluation of Foden and production at its Leyland plant will probably result in Foden's closure the following year. According to Paccar, the review of Foden's future centres on the need to free up production capacity for DAF trucks at the Leyland plant. Orders for Dual-Fuel™ Foden Trucks have declined from

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88 in 2003 to 55 in 2004 and 31 in 2005. Clean Air Power anticipates that all new orders for Foden trucks fitted with Dual-Fuel™ technology will cease by the end of June 2006. However, as discussed in more detail below, the Directors believe that Genesis will replace the lost revenues caused by the discontinuation of the Foden brand in the UK and create new opportunities.

### *Australian Market*

Australia is presently Clean Air Power's fastest growing market with more than \$400,000 of sales for 2005 representing an approximately three-fold growth increase since 2004. To date, there have been 62 Dual-Fuel™ systems sold in Australia since entry into the market in 2000. A significant Australian dairy producer with a total fleet of 160 trucks, of which 25 are already converted to Dual-Fuel™, has recently informed Clean Air Power that it is converting a further eight trucks at present. In addition it has budgeted to convert a further 22 trucks in the current quarter and has indicated that it intends to pursue a continuing roll out across the remainder of its entire fleet. In 2004, Clean Air Power first began selling a Dual-Fuel™ product specifically tailored to the Australian market. Dual-Fuel™ offers considerable cost benefits to the long-range haulage industry, where road trains comprising a high horse power tractor vehicle and two or three heavy trailers are used to cover long distances in a market where an attractive cost differential currently exists between gas and diesel.

In Australia, the Dual-Fuel™ engine system and engine management unit are purchased from Clean Air Power by leading vehicle dealers WesTrac and William Adams, which arrange for their installation. Generally, the fuel tanks required for installations in Australia are supplied by the gas infrastructure company Kleenheat Gas. The distributors are supported by a Clean Air Power sales engineer. As the costs to the Company are limited to providing the engine kits, the Company's Australian business model has the potential to result in stronger margins than the business models currently used in other markets.

The Directors believe that Clean Air Power's recent success in Australia has been driven by the economic savings experienced by its customers and that on average over the last two years, the adoption of the Clean Air Power technology has resulted in substitution fuel cost savings of up to £40,000 per truck per annum. The Directors believe that this market will continue to grow due to the economic benefits operators will continue to achieve using the technology. The Directors believe these cost savings coupled with existing government incentives will continue to make Australia a high growth market for Dual-Fuel™.

### *US Market*

Traditionally, sales in the US market have been driven by emissions compliance. To date there have been 858 trucks converted to Dual-Fuel™ in the US, primarily in the state of California to meet the stringent emissions requirements. Although Clean Air Power currently does not sell Dual-Fuel™ conversions in the US, the newly adopted Energy and Highways Bills have made a compelling economic case for adoption of the Dual-Fuel™ technology nationwide. The Energy and Highway Bills provide, among other things, a tax credit to cover a portion of the incremental cost of an alternative fuel vehicle and a \$0.50 per gallon excise tax credit to providers of natural gas. The Directors believe that adoption of Dual-Fuel™ may now result in a substitution fuel cost saving estimated at up to £10,000 per truck per annum.

Clean Air Power developed Dual-Fuel™ installations for the US market on several Caterpillar engine platforms including: the C10 and C12 engines. Caterpillar never developed these engines to meet the new emission standards introduced by the EPA in October 2002 and January 2004. Rather, these engines were withdrawn and replaced with the C11 and C13 ACERT engines.



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### ***Gas Engine Components***

Vehicle components continue to be a highly profitable business unit based on Clean Air Power's core competency in natural gas engine technology. Clean Air Power's component customers include Daimler Chrysler, Volvo, General Dynamics and John Deere.

Clean Air Power supplies a number of components including hydraulic valves, gas injectors, coalescing filter assemblies, shut-off valves, pressure regulators, and turbo air bypass (TAB) valve assemblies to market leading natural gas engine manufacturers. While these components constitute an important aspect of Clean Air Power's Dual-Fuel™ offering, they are also critical to the spark-ignited natural gas vehicle platforms of other companies. Thus, the Directors believe that the unit is poised to take advantage of the upcoming rapid growth in the production and deployment of natural gas vehicles worldwide. Based on the forecasted significant increase in natural gas engine demand, the Company expects strong growth over the next few years.

### ***Emissions Reduction Technology***

Clean Air Power provides emissions reduction technology solutions for both mobile and stationary diesel engine applications. Clean Air Power presently supplies and services several products, and will continue to develop and identify cost-effective emissions reduction technologies. The Directors believe that as emission regulations become increasingly stringent worldwide, the need for cost-effective and reliable emissions treatment will increase.

Clean Air Power's existing emissions reduction technology offers solutions to customers across North America, South America, and Europe. Clean Air Power expects to expand its sales force to take advantage of emerging business opportunities worldwide. Clean Air Power believes that the after treatment market is potentially significant, as emissions control devices can be retrofitted onto existing vehicles thereby offering fleet operators a rapid and inexpensive means to comply with newly enacted emissions regulations. Thus, Clean Air Power will continue to develop technologies that can improve the performance, reliability, and cost of these solutions.

### **3.2 Strategy**

Clean Air Power's goal is to become a major global provider of Dual-Fuel™ technology solutions to truck hauliers worldwide by offering operators a generic retrofit Dual-Fuel™ solution while developing partnerships with leading engine OEMs. The Company's strategy involves:

- Development and commercialisation of the Genesis Dual-Fuel™ technology, a generic engine DualFuel™ solution that can be installed on major vehicle diesel engine platforms;
- Partnering with OEMs to develop, promote and sell products, either by using the OEM distribution systems to expand industry acceptance of Dual-Fuel™ wherever possible, or establishing comprehensive third-party distributor networks in markets where the OEM channel is not commercially practical, or, from time-to-time, as a market entry strategy;
- Re-entering the US market and expansion into untapped markets;
- Further expansion of Clean Air Power's product portfolio through internal development, product licensing, strategic acquisitions; and
- Growing the existing vehicle component business by being a first-choice provider to OEM manufacturers of spark-ignited natural gas engines.

### ***Genesis***

Genesis is a generic Dual-Fuel™ system that has been designed to be installed on major existing diesel engine platforms. Genesis will be marketed directly to fleet operators. By offering Genesis on popular brands of trucks, the benefits of natural gas will be accessible to a wide range of operators. Clean Air Power believes that the availability of Genesis will not only produce a near-term revenue stream, but also create market demand for Dual-Fuel™ trucks thereby creating interest among OEMs to integrate the Dual-Fuel™ technology on the engine assembly line.

Genesis was initially developed for the DAF CF 85 engine platform, as DAF represents one of the major fleet tractors in the UK and Europe. In the short term, the Company intends to market Genesis conversions to own-account operators (companies with their own distribution operations) of fleets of DAF trucks,

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thereby opening up the DAF truck market to the Company. DAF trucks currently constitute approximately 28 per cent of the UK tractor market, with average sales of more than 5,000 trucks in 2005, compared to Foden whose market share is approximately 1 per cent.

Clean Air Power has installed the Genesis technology on a DAF CF85 engine at its Leyland facility in collaboration with William West & Sons, an English transport firm. The truck is currently being road tested, and the Company believes that the calibration will be finalised by the end of the first quarter of 2006, after which it will be turned over to William West for further evaluation.

Further, Clean Air Power recently initiated a collaboration with Tesco, whereby Clean Air Power is installing the Genesis technology on a Mercedes AXOR truck. Tesco is the largest retailer in the UK, currently running a fleet of over 1,800 trucks. The Company anticipates that the converted vehicle will be completed early in the second quarter of 2006, after which Tesco will conduct additional tests and evaluations for a three to six month period.

The Company believes the UK heavy-duty vehicle market is significant, as truck haulage remains the primary mode of goods distribution in the UK. The generic nature of Genesis provides the Company access to the entire UK heavy-duty vehicle market. Europe is also a prime target market for the Genesis application driven by cost savings available to operators and stringent emissions regulations. In Europe, DAF accounts for approximately 12.8 per cent of the heavy-duty diesel truck market. The Company intends to expand in Europe initially by targeting own-account fleet operators using DAF heavy-duty vehicles, and later to fleet operators using other major engine platforms.

### ***OEM Relationships***

The Company aims to penetrate the UK vehicle market by developing partnership agreements with OEMs to become an integrated supplier of Dual-Fuel™ technology. Clean Air Power is currently pursuing possible OEM partnerships with the goal of integrating the Dual-Fuel™ technology on the OEM's engine platform. The process of working with an OEM begins with a co-development technology effort on a particular engine line. Clean Air Power anticipates that the co-development effort will take approximately 12 months for each initial OEM engine platform, with future engine models per OEM requiring significantly less time. The development programme will involve minor hardware modifications, software programming to interface Clean Air Power's technology with the engine ECU, and durability and performance testing. Once commercially introduced, the Company expects that its OEM partners will have rapid penetration of the market.

In the longer term, Clean Air Power aims to fully integrate its technology into OEMs' product lines through licensing transactions, pursuant to which Clean Air Power's technology would be built into engines as part of the manufacturing process. The Directors believe that installing the Dual-Fuel™ technology on the assembly line has several advantages, most importantly, increased net cost savings and facilitation of customer acceptance through incorporation into an OEM product. The Directors believe that the economic incentive for an OEM to move to assembly line installation begins when the OEM can expect annual sales volumes of 5,000 or more on the line. Prior to assembly line integration, the Company believes such volumes can be achieved through sales of conversion kits and Genesis units to OEMs, and subsequent sales of converted vehicles to the OEM's customers.

Moreover, Clean Air Power believes that encouraging OEM interest through the OEM's customers is a critical path to early adoption of the technology by OEMs. Clean Air Power believes that as Genesis gains commercial traction and the operators realise cost-savings, they will be inclined to encourage OEMs to provide primary products that integrate the Dual-Fuel™ technology so that greater savings might be realised. Given the competitive truck-sales environment, the Company believes having a Dual-Fuel™ solution will be important to OEMs wanting to maintain market share. This demand-pull approach connects Clean Air Power's near term revenue model for offering Genesis products on several different engine platforms with laying the groundwork for partnerships with various OEM manufacturers and eventually become integrated on the assembly lines of their respective engine platforms.

### ***Re-entry into US Market and Further Expansion***

Clean Air Power currently does not sell Dual-Fuel™ conversions in the US however, the recent enactment of the US Energy and Highway Bills, strong demand from existing customers and the large volume of heavy-duty trucks make the US an attractive and viable market. The Company is considering two strategies for re-entering the US market:

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- Develop a Clean Air Power Dual-Fuel™ engine based on an engine obtained from one of the three major US engine manufacturers, which the Company would market independently; and
- Re-engage in a new commercial relationship with Caterpillar, or begin discussions with a new engine OEM, to support the development of a Dual-Fuel™ version of their current engine.

As a step in its US marketing strategy, the Company is considering a collaboration with Clean Energy, a leading supplier of CNG and LNG in the United States. Clean Energy recently proposed to the Company a joint development programme for a 400 plus hp Dual-Fuel™ engine for on-highway applications. Clean Energy is committed to raising \$1,600,000 for development costs of the engine through its own investment, federal, state and local grants, with the Company investing \$180,000. In addition, under the proposal, Clean Energy would commit to actively market Dual-Fuel™ products. Clean Air Power is also formulating a proposal to involve a commercial provider of electronic control systems and an independent automotive engineering organisation to cooperate in Clean Air Power's development plans for the US Dual-Fuel™ engine.

As the natural gas market continues to develop, and, as federal and local regulations compel the use of alternative fuels, the Directors anticipate that other natural gas producers and market participants will present the Company with opportunities to collaboratively develop and commercialise Dual-Fuel™ products. The Company has significant possibilities for global expansion due to the economic and regulatory demand for its product. Specifically China offers a large market, driven by energy supply and pollution issues. Thailand also offers substantial growth, as the government is promoting the use of its substantial indigenous gas, rather than imported oil.

### 3.3 Clean Air Power's Competitive Advantage

Clean Air Power's Dual-Fuel™ technology allows for the conversion of an existing diesel engine into an engine running on a combination of natural gas and diesel fuel, leading to cost savings while producing lower emissions. Clean Air Power's competitive advantages include the following:

- *Commercialised Dual-Fuel conversion system.* Over 1,600 Dual-Fuel™ conversion systems have been installed worldwide, allowing owners and operators to benefit from the current and historical price differential between diesel and natural gas while meeting or exceeding local emissions standards. The technology has been successfully adopted by operators and Clean Air Power has received many repeat orders for its products. In addition, the Genesis Dual-Fuel™ products will be available in the near term for retrofitting on any heavy-duty diesel engine or power generator, thereby making Dual-Fuel™ technology available to any current operator of diesel-powered vehicles or power generators.
- *Cost and efficiency advantages over other advanced technology alternatives.* The cost of converting a diesel engine to Dual-Fuel™ is significantly less than converting the same engine to spark-ignited natural gas operation. In addition Dual-Fuel™ retains diesel-like performance and efficiency. Further, installation requires no modification to any significant or moving component of the base diesel engine.
- *Fuel Flexibility.* Dual-Fuel™ can switch seamlessly between natural gas diesel operation and run on 100 per cent diesel if needed, thus Dual-Fuel™ engines can operate without a highly developed natural gas infrastructure.
- *Comprehensive IP protection.* Comprehensive patent protection in the US and China for Clean Air Power's current products, together with patent applications pending in the US, EU and Australia will, when issued, offer meaningful protection for the Company's products. Furthermore the periods of exclusivity for the most significant patents do not expire until 2014, resulting in a strong barrier to entry. Further details are set out below in section 3.6.
- *Greater market opportunity.* The Company's gas injectors are recognised worldwide as being one of few gas injectors to operate with both CNG and LNG, making them ideal for natural gas engines regardless of fuel source.

### 3.4 Competition

Clean Air Power's competition comes from one of three solutions to the environmental and economic costs of diesel: advanced diesel engines, single-fuel dedicated natural gas engines and other producers of heavy-duty diesel dual-fuel engines. However, the Directors believe Dual-Fuel™ is the strongest natural gas solution for the heavy-duty diesel market.

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Advanced diesel engines focus on incremental improvements in performance and offsetting the reduction in efficiency usually caused by emissions reduction technologies. Due to their diesel-only fuel usage, Clean Air Power's economic case is unaffected and, accordingly, an advanced diesel engine should also benefit from a Dual-Fuel™ conversion.

Single injector natural gas engines have been available for some time. While these engines have lower emissions than a diesel engine, they are inherently less efficient and cannot deliver the performance required by heavy-duty commercial users. Most sales have been for refuse vehicle, transit bus and local delivery applications, where environmental considerations outweigh the economic disadvantages.

Two other producers of heavy-duty dual-fuel engines are known to the Directors to exist. Whilst Westport Innovations' primary product is a spark-ignited natural gas engine that does not have the horse power and torque required for heavy-duty transport, it also is developing a high pressure direct injection (HPDI) of gas and diesel that injects gas at high pressure into the cylinder after a diesel pilot. Although there are 13 first generation and five second generation HPDI vehicles currently understood to be running, the Directors believe that the high cost of the systems required for injecting gas at the rate required for commercial use is likely to make commercialisation challenging. Hybrid Fuel Systems offers a simple mechanical dual-fuel retrofit. The Directors believe that Hybrid Fuel Systems has converted only a small number of heavy-duty diesel engines.

Several companies, including IMPCO, Quantum Technologies, Detroit Diesel, John Deere, Caterpillar, Mack and other, smaller companies have developed or are developing components or systems designed to run solely on natural gas. These products usually target the lower horsepower refuse, bus, and other light-duty vehicle applications.

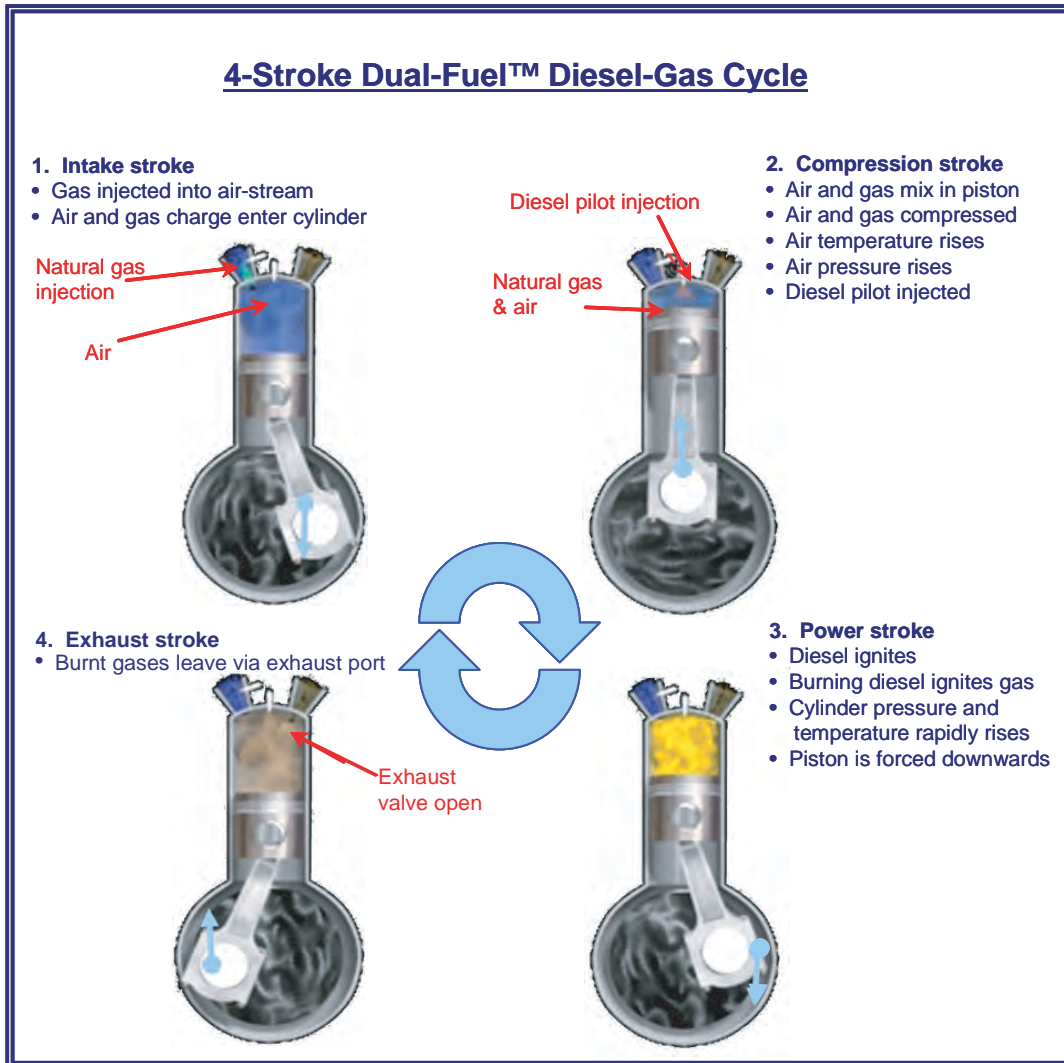
### 3.5 Technology

#### *Dual-Fuel™ Technology for Diesel Engines*

Diesel engine applications cover the transportation, construction, resource, agriculture and power generation industries. Many of these diesel engines are sold, or operate, in jurisdictions that have environmental policies, mandates and regulations regarding the emissions of such engines, which require diesel engine emissions to be reduced and which, in some instances, provide for incentives for such reductions.

#### *Diesel Engine Operation*

The diesel engine cycle begins with air being taken into the engine's cylinders, where it is compressed by a piston to a much higher degree than in a petrol engine. It is this high "compression ratio" that helps make the diesel engine much more efficient than the petrol engine. Near the point of maximum compression, diesel fuel is injected into the cylinder at high pressure. Due to the high pressure and temperature of the compressed air, the diesel fuel ignites spontaneously and burns rapidly, increasing the pressure and temperatures in the cylinder, driving the piston back down the cylinder with great force. This energy release generates the power of the engine. It is this combustion process that also generates the emissions from the engine. The diagram below provides a diagram of the Dual-Fuel™ diesel-gas cycle.



#### Current Dual-Fuel™ Technology

The Dual-Fuel™ engine uses the same diesel engine, but generates power by burning mostly clean natural gas. The diesel engine cycle is unchanged, but from the outset, a measured quantity of natural gas is mixed with the air just before it enters the cylinder. This lean fuel-air mixture is then compressed to the same levels of the diesel engine, thus maintaining efficiency. Unlike diesel, the natural gas mixture does not ignite spontaneously under the compression. Instead, the Dual-Fuel™ engine uses an injection of diesel fuel, between 21 and 40 per cent of the total fuel, to ignite the main charge of gas and air. This “pilot” injection acts like a multitude of microscopic spark-plugs, setting off clean and efficient combustion of the lean gas-air mixture.

Natural gas burns more cleanly than diesel, resulting in much lower environmentally harmful emissions (Figure 1). With fuel efficiency similar to that of the original diesel engine, CO<sub>2</sub> emissions are reduced by up to 23.5 per cent due to the relatively low carbon content of natural gas. Although up to approximately 80 per cent of the diesel is replaced by natural gas, a similar level of power is generated by the energy released from the gas combustion and the efficiency therefore remains similar to the original diesel engine. Thus, Dual-Fuel™ technology enables the diesel engine to operate with comparable efficiency and power on natural gas, benefiting from lower harmful emissions, lower CO<sub>2</sub> and lower fuel costs. Clean Air Power is unaware of any dedicated natural gas trucks that can match a Dual-Fuel™ converted truck for efficiency and performance.

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**Figure 1. Comparison of engine emissions from a regular C-12 diesel engine and Clean Air Power's C-12 Dual-Fuel™ to the current Euro IV standards. The table shows the levels of nitrogen oxides (NO<sub>x</sub>) carbon monoxide (CO), carbon dioxide (CO<sub>2</sub>), methane, non-methane hydrocarbons (NMHC) and particulate in grams per kilowatt hour (g/kW-hr) or in the case of total hydrocarbons (THC) in joules per kilowatt hour (j/kW-hr).**

Engine Type	ETC	NO <sub>x</sub> g/kW-hr	CO g/kW-hr	CO <sub>2</sub> g/kW-hr	THC j/kW-hr	Methane g/kW-hr	NMHC g/kW-hr	particulate g/kW-hr
Diesel	ETC	4.16	1.30	692	0.09	na	na	0.10
Dual-Fuel	ETC	3.30	0.02	529	5.577*	5.314*	0.263*	0.037*
Euro IV	ETC	3.5	4.0			1.1	0.55	0.03

Source: Independent Lab. Test April 2002 – European Transient Cycle (ETC)

\* Reduced to Sub-Euro IV levels by exhaust after-treatment.

With cooperation from the OEM, the Dual-Fuel™ electronic control unit (or ECU) can be integrated within the software communication protocol of the OEM ECU. Thus, the Dual-Fuel™ ECU can take control of the engine ECU and provide the optimum conditions for the control of Dual-Fuel™ combustion. Such integration has successfully been accomplished on Caterpillar engines, and will form the core of any Dual-Fuel™ application to an engine with OEM cooperation. The Genesis product, on the other hand, uses a standard Dual-Fuel™ ECU, which interfaces with the inputs and outputs of the engine ECU rather than with its software. Since Genesis does not directly interface with the OEM software, it can be installed independently of OEM participation

The operating system in the technology automatically switches the engine from using diesel to natural gas when the truck reaches optimal load and, therefore, the technology is most applicable to heavy trucks making long haul journeys with few stops. For added flexibility, the Dual-Fuel™ system can be turned off at any time and the Dual-Fuel™ engine can operate on 100 per cent diesel. The switch from dual-fuel to diesel, or vice versa, is performed almost imperceptibly, while the vehicle is in full operation on the highway.

The diesel engine itself is left virtually unchanged, with the exception of the addition of the gas injection system and the additional Dual-Fuel™ ECU, fitted externally to the engine. The Dual-Fuel™ combustion results in in-cylinder temperatures and pressures that are within the range of those of pure diesel operations and the converted engine therefore operates within the designed limits of the original engine. Therefore, the Dual-Fuel™ components will not cause additional wear on the base engine. Also, the limited changes to the engine allow a quick and economic return to pure diesel at the end of ownership, which maintains residual value.

As part of the development of the Dual-Fuel™ technology, Clean Air Power has developed vehicle systems for the containment and delivery of both CNG and LNG. Clean Air Power and Caterpillar engine dealers around the world have manufactured and installed these systems on vehicles. The systems are integrated from hardware supplied by specialist component suppliers, including LNG tanks, CNG tanks and premium industry-standard fittings and fixtures. Experience with and expert know-how of these systems enables Clean Air Power to offer both CNG and LNG versions of Dual-Fuel™. In an emerging market with varying levels of gas distribution infrastructure, the ability to use both forms of natural gas is regarded as essential to commercial success.

The quality and composition of natural gas is an issue for the transport industry. The presence of heavier gases, such as ethane and propane in the mix, can lead to combustion knock in the engine. If left unchecked, this phenomenon can lead to engine failure. Presently, adequate gas composition cannot be assured as there are no national standards regulating gas quality. Clean Air Power has developed a countermeasure to protect the engine from poor quality gas. The system uses an engine-mounted knock-sensor that is integrated into the electronic control system. If a combustion knock is detected, the system will automatically change the operating mode to the combustion of diesel-only, which will immediately stop the knock. The engine is thus protected from the effects of poor quality gas.

### *MicroPilot® — Next Generation Dual-Fuel™ Technology*

Beyond Clean Air Power's existing and near term product offerings, the Company has significant core intellectual property that offers the promise of even more compelling dual fuel solutions in the future. Clean Air Power has published a milestone technical paper that shows how engine emissions can be dramatically reduced when lowering the quantities of diesel pilot injections. This pioneering work showed that smaller

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diesel pilot injections comprising 1-2 per cent of the total fuel (a so-called “micropilot” injection), can reduce  $\text{NO}_x$  emissions by over 80 per cent while also reducing  $\text{CO}_2$  emissions. Thus, the Micropilot® engine combines the advantages of the low emissions realised with a spark-ignited lean-burn natural gas engine, with the high efficiency and power output of a diesel engine. With recent advances in diesel fuel injection technology, the Directors believe that Micropilot® could be applied to heavy-duty engines in around 2010. The Company intends for Micropilot® engines to be compliant with Euro V and beyond, and thus provide the authoritative Dual-Fuel™ solution into the next decade.

### ***Engine Components***

As part of the development of Dual-Fuel™ technology, Clean Air Power has developed a number of engine components which are independently commercialised as part of the component business. Such components include gas injectors and high speed hydraulic valves.

Clean Air Power’s gas injectors have been used in commercial natural gas engines for several years and have developed into one of the world’s leading injectors in terms of capability, robustness and adaptability. The injectors have proven durability with use of LNG, which is a quality which the Directors believe is not demonstrated by any other gas injector product. The fundamental design and principles of this injector are patented in the US and China. In connection with its injector technology, Clean Air Power assembles coalescing filters that ensure maximum gas filtration and maintenance of gas flow.

Since diesel and natural gas require different fuel to air ratios for optimal combustion, Clean Air Power has developed the turbocharger air bypass (TAB) system that controls the air-fuel ratio when the Dual-Fuel™ engine operates in gas mode.

Clean Air Power also offers specialised solenoid-operated valves and pressure regulators integrated into the Dual-Fuel™ solution. The valves and gas injectors stem from the same technology principles, but have been optimised for different applications. The Clean Air Power valve and regulator technology is useful for any product that requires rapid switching of hydraulic systems, such as automatic transmissions for the automotive industry.

### ***Emissions Reduction Technology***

Clean Air Power offers technology solutions to reduce regulated engine emissions by treatment of the exhaust gas. This emissions reduction technology is integrated into the exhaust system of the engine. Clean Air Power has developed emissions reduction technology for application with mobile emissions sources, on and off-highway vehicles and stationary/marine sources. These systems incorporate filtration and catalysed substrates supplied by specialist manufacturers and can be integrated during the original manufacture or construction, or retrofitted to older, existing vehicles and plants.

Clean Air Power has developed the following three main technologies for controlling the major pollutants from diesel engines: (a) filtration and trapping of diesel particulate matter (PM) and soot emission; (b) oxidation of hydrocarbon (HC) and carbon monoxide (CO) emission; and (c) reduction of nitrogen oxide ( $\text{NO}_x$ ) emission.

Clean Air Power offers a PM filtering system for use with diesel and Dual-Fuel™ engines, that uses a catalyst-coated, porous ceramic substrate. Particulate matter is filtered out as the exhaust gas passes through the microscopic pores of the ceramic substrate. Products of incomplete combustion, HC and CO, are oxidised in the exhaust system by a catalyst that promotes oxidation at much lower temperatures. Clean Air Power’s system uses a third party provider’s catalyst-coated ceramic substrate, integrated into the exhaust system, over which the exhaust gas flows. On the surface of the substrate, the gas interacts with the catalyst, oxidising CO and unburnt HC.  $\text{NO}_x$  is reduced over a catalyst in the presence of ammonia, whereby oxygen is stripped from the  $\text{NO}_x$  resulting in harmless nitrogen and water. A secondary oxidation catalyst is fitted after the  $\text{NO}_x$  catalyst to remove any excess ammonia that has passed through.

New and more stringent legislation is driving the development and application of exhaust after-treatment in all areas where internal combustion engines operate. It is extremely unlikely that developments in base-engine technology alone will be sufficient to meet more stringent regulations, thus ensuring a need and a market for emissions reduction technology.

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### **3.6 Intellectual Property**

#### ***Patents***

Clean Air Power enjoys strong protection for its key products in the US and in China, as it holds rights under nearly 20 patents in these countries, covering many of its systems and components. These patents are all in good standing in their respective jurisdictions, and Clean Air Power has a valid legal interest in all its patents. Clean Air Power also has pending patent applications in the US, EU and Australia that, when issued, will offer meaningful protection for its future products, including all systems that have separate controllers for controlling gas and diesel fuel supply which are connected to one another by a broadband communications link. However, none of the European or Australian applications separately cover the Genesis system. Clean Air Power has a strong commitment to pursue patenting of new inventions and improvements to its current technology.

Clean Air Power is currently co-owner of six Chinese patents together with the component manufacturer Honglin Manufacturing (Honglin), with which Clean Air Power has a long-standing commercial relationship. These patents are Clean Air Power patents that were filed by Honglin with Clean Air Power's consent, but which were erroneously applied for by Honglin as being co-owned. Clean Air Power is endeavouring to resolve the ownership issue and to transfer full ownership back to the Company. While the ownership issue is pending, Clean Air Power may be subject to certain restrictions on licensing to third parties in China and Honglin may manufacture and sell patented products without prior consent.

Clean Air Power is unaware of any patents that block or have the potential to block sales of its key products or systems in its target markets.

#### ***Licences***

Prior to being acquired by Clean Air Power, BKM, Inc. granted non-exclusive licences to certain patents relating to single plunger system (SPS) technology to five licensees. Although the Company currently does not expect to receive royalties under these licence agreements, Clean Air Power will receive royalties in the event a licensee commercialises an SPS product. For the duration of the licences, Clean Air Power cannot assign or transfer the underlying patents without obtaining each licensee's consent.

#### ***Trademarks***

The Company has a California state registration for the name Dual-Fuel™. Clean Air Power has pending applications for the Clean Air Power™ mark and the related logo in Australia, Canada and the US. The US application is approved and the trademark should issue shortly. A corresponding European mark has been registered. Clean Air Power has one issued US trademark for MicroPilot®, which is set to expire in 2006 but which the Directors intend to seek renewal of.

## **4. The Market**

### **4.1 Global Market Need for a Dual-Fuel™ Vehicle**

Globally, and in particular in the countries Clean Air Power is targeting, governments, municipalities and corporations are striving to achieve the goals of reducing reliance on imported petroleum products and diminishing harmful emissions from engines powered with such products. In addition to the key economic benefits to the operator set out below, these trends create an opportunity for Dual-Fuel™ engines.

### **4.2 Long Haul Transportation Industry**

Around 590,000 heavy-duty diesel trucks are sold each year in the world and in 2004, Class 6-8 truck power train sales were worth \$8.2 billion in North America. The total global diesel engine market is worth \$40 billion and, diesel engines form the backbone of most economies: both the UK and the US move 80 per cent or more of all freight by heavy-duty diesel engine powered transport.

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**Figure 2: Annual Vehicle Sales by Country**

Country	Classification	Vehicle Sales (units)
UK	>32t	18,800
Europe (ex UK)	>32t	60,000
US	>27t	199,000
Australia	>400bhp	3,300

Source: Ward, Paccar, Foden, Scania, SMMT and CAT

Long haul transportation is a highly competitive and fragmented market. Operators compete to achieve tight margins and have little control over fixed costs, their drivers' wages, or the holding cost (depreciation, maintenance, insurance) of their fleets. Operators can be exposed to absorbing a meaningful portion of increased fuel costs. In this environment of rising diesel prices, many hauliers have struggled to maintain even historically low margins and, in some cases, profitability. Fuel is therefore the area where an operator can make a noticeable change in the economics of his business.

In almost every country, natural gas is cheaper than diesel (and petrol), on an energy equivalent basis. In November 2005, only Iran's CNG price was higher than its diesel price. Everywhere else CNG was sold for less than diesel, with differentials ranging from 96.7 per cent in Venezuela downwards.

**Figure 3: CNG price as a % of diesel price**

Thailand	27.3%
The Netherlands	35.7%
Italy	42.1%
Australia	43.8%
China	47.4%
United Kingdom	52.7%
USA	64.0%
France	87.3%

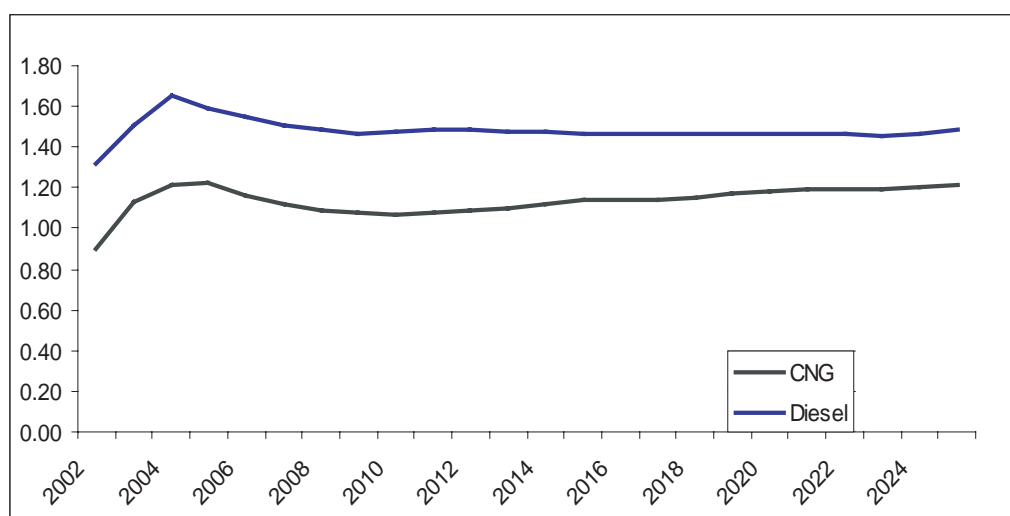
Source: Gas Vehicle Report December 2005 (ENGVA);

Australian diesel price is as at the end of October, 2005, sourced from <http://www.aip.com.au/pricing>;

Australian CNG price is as at October, 2000, sourced from <http://www.iangv.org/html/sources/sources/ANGVC.doc>.

The EIA has forecasted that in the US, a price differential between diesel and natural gas will continue over the next 25 years (see Figure 4) and the Directors believe that natural gas should remain fundamentally cheaper on an energy-equivalent basis in its other principal markets. In addition to the market price differential, natural gas vehicle operators can realise economic benefits through the excise tax credits and other incentives provided by regulatory and legislative bodies.

**Figure 4: EIA forecast of retail price differential between CNG and diesel between 2002 and 2025, in US\$/gallon equivalent.**



Source: EIA, 2005

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### 4.3 Natural Gas Vehicle Markets

The European Union has up to 7,000 heavy-duty natural gas vehicles on the road. Penetration has largely been due to the difference between natural gas and diesel prices in several large EU markets, local government directives, as well as the stringent Euro III, IV and V emissions standards. Existing Dual-Fuel™ engines currently meet Euro III and IV standards.

Globally, natural gas infrastructure is slowly developing. From natural gas exploration to vehicle fuelling sites, there continues to be investment in natural gas as an energy source. For the heavy-duty market, the weight and density benefits of LNG continue to drive the market. LNG production and availability is growing with additional liquefiers and import terminals planned in the US, Europe, Australia and China. Also, many improvements have been made in the method of converting methane from landfills, to LNG, which will increase the viability of LNG vehicles that are anchored to those same landfills. These improvements and investments bode well for increased availability of vehicle grade LNG. Also, there are government funds available in Europe, Australia and the US to increase the rate of fuelling station investments.

However, current natural gas engines provide inadequate power for heavy applications, and the infrastructure of natural gas fuel stations is currently insufficient to allow fleet operators to switch to vehicles powered exclusively by natural gas. The Dual-Fuel™ engine alleviates both concerns, as it maintains the power of a traditional diesel-powered engine while allowing the operator to switch between fuel sources in case a natural gas refuelling station is not immediately available.

### 5. Regulatory Framework

Beginning in the 1970s, political and socio-economic changes increasingly put pressure on governments and industry to reduce the dependence on imported petroleum and to reduce the production of greenhouse gases and other compounds that may contribute to global warming. Currently, governments and regulatory authorities around the globe are implementing environmental policies and regulations which regulate the emissions from heavy-duty diesel vehicles, while providing economic incentives to develop and use alternative fuels such as natural gas. In addition, recent increases in fuel prices create incentives for owners and operators of heavy-duty vehicle fleets to consider alternatives to traditional diesel-powered heavy-duty engines. In spite of this, most industrialised nations remain heavily dependent on heavy-duty diesel engines in the transportation, construction, resource, agriculture and power generation sectors.

Because of the significant investments governments and industry have made into the existing inventory of diesel powered engines, and the poorly developed infrastructure for alternative fuels, the reduction in diesel dependence will likely remain gradual and meet significant resistance. In view of this, Clean Air Power believes there exists a significant market for a Dual-Fuel™ product that can be retrofitted onto existing diesel engines, and that will allow the owner or operator the flexibility to use natural gas while meeting or exceeding prevailing emissions standards.

#### 5.1 United States

In the US, local, state and federal governments can impose restrictions on emissions from internal combustion engines, and many states actively monitor the emissions levels from commercial vehicles through both emissions certification testing in the laboratory and periodic vehicle controls. Vehicles in California of model year 2005 and later must also undergo a supplemental emission test (SET), a 13-mode steady-state test that was introduced to help ensure that heavy-duty engine emissions are controlled during steady-state type driving, such as a line-haul truck operating on a freeway. Effective in 2007 for vehicles produced for sale that year or thereafter, federal regulations will require the SET from all engine manufacturers.

In 2004, the Environmental Protection Agency (the “EPA”) reduced the levels of permitted NO<sub>x</sub> emissions from heavy-duty vehicles from four grams per brake horsepower hour (g/bhp-hr) to 2.5 g/bhp-hr of NO<sub>x</sub> combined with non-methane hydrocarbons (NMHC), while the CO<sub>2</sub> (15.5 g/bhp-hr), HC (1.3 g/bhp-hr) and PM (0.10 g/bhp-hr) remained at the 1998 levels. These emissions levels must be maintained for the useful life of the engine, which for a heavy-duty vehicle (gross vehicle weight of more than 8,500lb) is 435,000 miles, 10 years or 22,000 hours (whichever occurs first).

Starting in model year 2007, the permitted emissions levels will be significantly reduced as follows: PM to 0.01 g/bhp-hr; NO<sub>x</sub> to 0.20 g/bhp-hr and NMHC to 0.14 g/bhp-hr. The new PM emission standard will take full effect in the 2007 model year, while the new NO<sub>x</sub> and NMHC standards will be phased in for diesel engines between 2007 and 2010 on a percent-of-sales basis.

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The 2007 diesel fuel regulation also reduces the sulphur content in on-highway diesel fuel from 500 parts per million (ppm) to 15ppm. Refiners will be required to start producing the 15ppm fuel beginning 1 June 2006. At the retail level, highway diesel fuel sold as low sulphur fuel must meet the 15ppm sulphur standard as of 15 July 2006. For retail stations and wholesale purchasers, highway diesel fuel sold as low sulphur fuel must meet the 15 ppm sulphur standard by 1 September 2006. Ultra low sulphur diesel fuel has been introduced as a “technology enabler” to pave the way for advanced, sulphur-intolerant exhaust emission control technologies, such as catalytic diesel particulate filters and NO<sub>x</sub> catalysts, which will be necessary to meet the 2007 emission standards.

The EPA estimates the cost of reducing the sulphur content of diesel fuel will result in a fuel price increase of approximately 4.5 to 5 cents per gallon. The EPA also estimates that the new emission standards will cause an increase in new vehicle costs of between \$1,200 to \$1,900. In July 2005, Congress enacted the US Energy and Highway Bills, which contain provisions aimed at encouraging the use of alternative fuels in the transportation sector. Among other things, the US Energy and Highway Bills provide:

- a tax credit of 50 per cent of the incremental cost of the vehicle (over a comparable standard vehicle) and an additional 30 per cent of the cost if the vehicle meets a tighter emissions standard. The credits will range from \$2,500 to \$32,000 depending on the size of the vehicle;
- a tax credit of up to 30 per cent of the cost of alternative fuel refuelling equipment. The credit can be up to \$30,000 for large stations;
- a \$0.50 per gallon (or gallon equivalent) excise tax credit paid to the sellers of LNG or CNG;
- a Clean School Bus Programme which will pay up to 50 per cent of the cost of a new bus that meets the emissions criteria; and
- fleet modernisation grant programmes and mandatory use of alternative fuel by federal fleets.

The Annual Energy Outlook 2005 prepared by the US Department of Energy projects a 64 per cent increase in petroleum import over the next 20 years, and that the increase in domestic consumption of petroleum products will mainly come from the transportation sector. Taken together with the lower price of natural gas, the stringent emissions and sulphur content restrictions that become effective in 2007, and the alternative fuel incentives provided in the Energy and Highway Bills, the Directors believe that natural gas vehicles will increasingly receive attention from US fleet owners. Indeed, the global market consulting and research firm Frost and Sullivan estimate that as much as 10 per cent of heavy-duty engine production in the US in 2008 could be natural gas.

### 5.2 Europe

The European regulations for new heavy-duty diesel engines are commonly referred to as Euro I through to Euro V. Current regulations require new heavy-duty diesel engines to be Euro IV compliant, meeting the following emissions levels: CO — 4.0 g/kWh; NMHC — 0.55 g/kWh; NO<sub>x</sub> — 2.0 g/kWh and PM — 0.03 g/kWh. The engines have to meet these standards both on a stationary cycle and a transient cycle test.

The EU has further mandated that 10 per cent of all vehicles must have natural gas engines by 2020. Many EU countries offer, or are in the process of offering, grants for natural gas vehicle purchases and conversions. For example, the French government and car makers have signed a protocol aimed at increasing the number of natural gas vehicles on the roads. To this end, the French government will introduce tax incentives to buyers of natural gas-powered vehicles, and will offer tax breaks on natural gas at the pumps.

In the UK, the Energy Savings Trust has prepared a grant proposal, the Air Quality Vehicle Incentive Programme, that proposes grants for the retrofitting of emissions control equipment on existing vehicles over 3.5 tonnes. The proposed grant provides up to 30 per cent of the cost of retrofitting a vehicle with an emissions reduction system. The grant proposal is currently under review by the European Commission, and an answer is pending. If approved by the EC in its current form, the Air Quality Vehicle Incentive Programme will have an annual budget of £3,000,000.

Many EU nations further subsidise the development of natural gas infrastructure, and plans for natural gas corridors through Europe are progressing. Between Germany and Italy alone, there are nearly 1,100 natural gas refuelling stations; however, many other countries have yet to establish a significant number of natural gas stations. The Company expects that the cultural mandate of lower emissions and better air quality in general will continue to create a regulatory environment favourable to alternative fuel vehicles, and in particular, to natural gas.

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### 5.3 Australia

Australia's emissions regulations currently require compliance either with the EPA's 1998 standards or with Euro III. For vehicles manufactured after 2000, testing must be used to ensure that the vehicle does not employ any device that causes engines to switch to a more fuel efficient, but higher NO<sub>x</sub> emitting driving mode. Heavy-duty diesel engine models that are introduced in 2006 must comply with EPA 2004 or Euro IV standards. These standards will be applied to all new engines (regardless of when first introduced) starting 2007.

Australia has implemented the alternative fuels conversion programme (AFCP) to assist operators and manufacturers of heavy commercial vehicles and buses to convert to natural gas or liquefied petroleum gas (LPG). The programme provides grants to vehicle owners to offset costs of fuel conversions and upgrades and to purchase new vehicles. Clean Air Power's Dual-Fuel™ 500bhp C-15 engine qualifies for grants under the AFCP programme.

### 5.4 China

China's pollution problem has prompted significant interest in natural gas vehicles, and the country is likely to adopt Euro III emissions standards in the near term. It is planned that Beijing will implement Euro IV standards for light duty vehicles by 2008, the year of the Beijing Olympics. The Chinese government is offering significant economic incentives for the development of alternative fuel vehicles, with a particular focus on natural gas. Large infrastructure developments are expected over the next 15 years, one proposed project being a \$2.5 billion cross-country natural gas pipeline. The general increase in demand for haulage in China, combined with the need for vehicles with improved emissions profiles, should create an excellent opportunity for Dual-Fuel™ technology.

## 6. Summary of Financial Information, Historical Trading and Future Prospects

The following summary financial information is extracted without material adjustment from the financial information contained in Part III of this document.

### 6.1 Clean Air Power US Financial Information

	Year ended 31 December 2002 \$000	Year ended 31 December 2003 \$000	Year ended 31 December 2004 \$000	9 months ended 30 September 2005 \$000
Total revenue	6,605	13,185	8,004	5,095
Costs and expenses	(16,710)	(21,835)	(18,659)	(9,279)
Loss from operations	(10,105)	(8,650)	(10,655)	(4,184)
Other income (expense)	(4)	461	(2,797)	(3,206)
Net loss	(10,109)	(8,189)	(13,452)	(7,390)
Total assets	13,482	15,007	8,079	8,249
Stockholders' equity	(21,361)	(29,794)	(38,449)	(5,418)

The results for the year ended 31 December 2003, with revenue rising from \$6.6 million for the year ended December 2002 to \$13.2 million, marked a transitional point for Clean Air Power US. This was the first year of substantial sales in the UK as Clean Air Power US sought to focus on markets where Dual-Fuel™ technology provided a significant economic advantage and also the last year of sales in the US of the previous generation of Caterpillar diesel engines. As Dual-Fuel™ was not adapted for the next generation of Caterpillar engines (C-13), sales in the US effectively terminated and the effect of this is reflected in the decline in revenue to \$8 million for the year ended December 2004. The further decline in revenue to \$5.1 million in the nine months ended 30 September 2005 was largely due to:

- the announcement of withdrawal by Paccar of the Foden truck, the only truck to which Dual-Fuel™ technology has been applied in commercial numbers in the UK; and
- a decline in after treatment sales in Clean Air Power US.

There has been a significant decline in costs and expenses in the nine months ended 30 September 2005, principally due to reductions in sales and administration costs in Clean Air Power US where headcount has been reduced from an average of 43 during the year ended 31 December 2003 to 29 at 30 September 2005.

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Goodwill of \$2.4 million was written off in the year ended 31 December 2004 and is included in other income (expense). The write-off was made due to the declining revenues and profitability of the after treatment division which was acquired by Clean Air Power US in the year ended 31 December 2002.

Further discussion and analysis of Clean Air Power US' financial condition and results of operations is included in Part V of this document.

It should be noted that the one-off costs of the reorganisation contemplated to be effected in advance of the Admission and Placing and estimated to be approximately \$1.08 million, will be included as an exceptional charge in the results for 2006.

The Directors believe that Clean Air Power is well-positioned to penetrate the heavy truck industry in several large markets with Dual-Fuel™ technology and to continue to grow its components and emissions reduction technology businesses. Clean Air Power will continue to provide products which provide meaningful cost savings, superior performance, and reduced emissions.

### 7. Directors and Senior Management

#### 7.1 Directors

The proposed board will comprise six directors: Rodney James Westhead, John Francis Pettitt, Peter David Rowse, Wallace William Hunter, Scott Bruce Ungerer and Larry Rhodell Wilson.

**Rodney James Westhead (Chairman) — aged 62.** Mr. Westhead is currently the Chairman of Carter & Carter plc, a non-executive director of the AEA Technology as well as Chairman of its audit committee and the senior non-executive director of Mouchelparkman plc. During his career in the British automotive industry, Mr. Westhead served as the Group Chief Executive of Ricardo plc, where he was responsible for managing a global range of companies engaged in automotive strategic and technology consulting. Mr. Westhead led Ricardo plc in strategic acquisitions of companies in the UK and the rest of Europe, and established offices throughout the world. Ricardo is the largest automotive consultancy company in Europe with approximately £150 million in annual turnover. Prior to serving as Group Chief Executive, Mr. Westhead served as the Group Finance Director. Mr. Westhead was a partner in Grant Thornton and had served as Managing Partner of the London office.

**John Francis Pettitt (Chief Executive Officer) — aged 56.** John Pettitt joined Clean Air Power in August 2005 as part of the Company's focus on the world truck market. John has over 25 years' senior level experience in general management, sales & marketing within the business-to-business services sector. His career started with Thomson Yellow Pages and Thomson Directories reaching the position of Sales Controller with a staff of 350. Leaving Thomson after 13 years, he joined Lex Service plc as Sales Director of Lex Vehicle Leasing and helped that company grow its fleet from 15,000 to 50,000 vehicles in five-years becoming the UK's leading vehicle leasing company. He left to become Managing Director of Fraikin Ltd, the UK division of Europe's largest independent truck leasing business. After roles with TLS Truck Rental and Iveco-Ford Truck Ltd, he rejoined Lex Service and remained there for five years before joining Clean Air Power. His last role with Lex Service was managing Lex Transfleet Airside Solutions, a company employing over 400 staff and maintaining 6,500 pieces of equipment and vehicles for British Airways at four UK airports.

**Peter David Rowse (Financial Director) — aged 37.** Mr. Rowse joined Clean Air Power on 1 January 2006. Previously he served as Chief Financial Officer of DeLonghi America, Inc, the US subsidiary of the Italian appliance company, where he was responsible for finance, IT management and development, human resource functions, and logistics. Mr. Rowse was integrally involved in all commercial areas and strategic planning and was instrumental in the company's turnaround. Mr. Rowse led several initiatives at DeLonghi to improve internal controls and played an active role in managing relationships with the Canadian and Mexican operations. Mr. Rowse also served as Controller, and, later, Finance Director of DeLonghi Ltd in the UK. During his tenure, the company grew revenue from £5 million to £50 million. Prior to DeLonghi, he held financial and management accounting roles at Alexon Group plc and TNT Express Europe (UK) Ltd. Mr. Rowse is CIMA and FCMA qualified.

**Wallace William Hunter (Non-Executive Director) — aged 38.** Mr. Hunter has been a director of Clean Air US since 2001. He is a Managing Partner with RBC Capital Partners in Toronto and is responsible for the management of over \$100 million of venture capital investments. The portfolio is primarily concentrated on

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investments in technology and energy technology. Mr. Hunter has over 17 years' combined experience in venture capital and the financing of high tech companies. Mr. Hunter is a graduate of the University of Western Ontario and has successfully completed numerous financial and securities related programmes. In addition, Mr. Hunter is host of a weekly financial television show, "Money Week." In 1996, he was appointed by the Lieutenant Governor and Minister of Health to the Council of the Ontario College of Pharmacists, and was elected chairman of the finance committee in 1998. Mr. Hunter also sits on the advisory board for the Communications Industry Research (CIR) Venture Fair and is a director of the Golden Horseshoe Venture Forum.

**Scott Bruce Ungerer (Non-Executive Director) — aged 47.** Mr. Ungerer has been a director of Clean Air Power since 2001. He is Managing Partner and founder of EnerTech Capital and has been a power and energy sector investor for 12 years. Mr. Ungerer was previously an executive with Atlantic Energy for 16 years. During his tenure at Atlantic, he rose from the ranks of the junior engineering staff to become President and COO of the company's non-regulated enterprise, Atlantic Energy Enterprises ("AEE"), and an officer of the parent corporation. Mr. Ungerer currently serves as a director of several EnerTech portfolio companies including Catalytic Solutions, Comverge, Current Communications, Franklin Fuel Cells, Intellon, and The Nanosteel Company. Mr. Ungerer is also a member of the Battelle Energy Advisory Council and a former member of the Cleantech Venture Network Advisory Board. Mr. Ungerer received a BS in mechanical engineering from Princeton University.

**Larry Rhodell Wilson (Non-Executive Director) — Aged 68.** Mr. Wilson has served as a director of Clean Air Power US since 2001. Prior to joining the board, Mr. Wilson worked 43 years for Caterpillar, Inc. The first four years were in the earthmoving division with the remaining 39 in the engine division. His early career was in marketing. In the 1970s he was OEM Sales Manager for Europe, Africa and the Mideast. In the 1980s he became Product Development Manager, responsible for all engine products from 50 to 7,000 horsepower. During this period his organisation spent over \$900 million developing and introducing the new seven and 10 litre truck engines, the new model 3500 (1000 to 3000 horsepower) and model 3600 (3000 to 7,000 horsepower) industrial engines. He then became Strategic Planning Director for Electric Power, which grew from \$400 million annual revenue to \$2,400 million in 12 years. During this period he directed acquisitions of \$400 million and formed a commercial agreement with an outside manufacturer for Caterpillar to offer fuel cells in their electric power product line. After retiring in April, 2002, he has served as a consultant to Caterpillar, Hitachi and new technology companies such as Ion America Corp., Stirling Advantage Inc. and others. He currently owns and operates three restaurants along with his consulting. Mr. Wilson graduated from Rose Polytechnic Institute, Terre Haute, Indiana, with a BSME in 1959 and Bradley University, Peoria, Illinois, with an MBA in 1973. He served eight years in active and reserve military duty in the US Army Corps of Engineers.

### 7.2 Senior Management

#### **John Pettitt, President and Chief Executive Officer**

See above.

#### **Peter Rowse, Financial Director**

See above.

#### **Steven Whelan, Technology Director**

Mr. Whelan joined Clean Air Power on 1 August 2005, having spent 17 years at Ricardo Consulting Engineers where he specialised in diesel powertrain engineering. As a Chief Engineer in the diesel engineering business group, Mr. Whelan managed and directed advanced performance and emissions development programmes for OEMs. Mr. Whelan gained technical project experience in all aspects of engine design and development, including engine test development, structural analysis and software, diesel combustion research, diesel engine performance and emissions development. In addition to his programme leadership roles, Mr. Whelan was involved with technology and business development activities, including generation of diesel technology roadmaps for R&D, planning and developing and executing business development strategies, in particular with Far-Eastern customers. Mr. Whelan graduated from Imperial College, London in 1988. He has done business or made contacts with almost all of the major automotive OEM's and has worked in Europe, the US, Japan, Korea, Russian Federation and China.

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### **Robert Taylor, Operations Director**

Mr. Taylor joined Clean Air Power in April 2002 as quality manager. Shortly after arriving, Mr. Taylor was promoted to general manager of operations and quality adding the areas of procurement, manufacturing and information systems. In April of 2003, under his direction Clean Air Power achieved ISO9001:2000 certification, completing this accomplishment in just six months from inception. Mr. Taylor has worked for various Fortune 500 companies where he has held leadership roles in the areas of logistics, information technology and after sales services. While employed with General Electric he successfully lead the after sales activities of a start up business within the Power Systems Division. Mr. Taylor holds a bachelors degree in Business Management

### **Kevin Campbell, Business Development Director**

Mr. Campbell joined Clean Air Power in November 2001 as sales manager for low-emission vehicles. He was promoted to general manager of vehicle systems in May 2003. The responsibility for Clean Air Power's component business unit was added in 2004. In 2002 Mr. Campbell was instrumental in the formation of our UK Joint Venture, CAP-Hardstaff Ltd. In 2003 Mr. Campbell was part of the transition team that formed the formation of Clean Air Power UK and spent most of 2004 recruiting for and expanding that facility. Currently, he is concentrating his efforts on the growth of the Company's Australian market and its re-entry into the US market. Prior to joining Clean Air Power, Mr. Campbell had 23 years' tenure at Power Systems Associates, a large Southern California Caterpillar dealer. Mr. Campbell held various sales, technical and management positions including Sales Manager for the Caterpillar Dual-Fuel™ engine product. In this position, Mr. Campbell was directly responsible for management of all alternative fuels customers and projects

### **Mike Ellithorn, European Business Development Director**

Mr. Ellithorn joined Clean Air Power in June 2003 and established the after-sales organisation in the UK after which he was appointed Managing Director of UK Operations. Prior to joining Clean Air Power Mr. Ellithorn managed the service operations of Seddon Atkinson, a UK truck manufacturer and later undertook the same role for Volvo Truck & Bus UK Ltd. Following the setting-up of the first sales operation for the engine manufacturer Gardner Engines Ltd he took on the role of after sales manager for Scania GB Ltd, overseeing the service and parts operations plus special responsibility for dealer development. He was appointed Managing Director of a dealership in East London owned by Scania, which he developed into the largest Scania dealer in Europe with 280 employees, 12 depots and a turnover of £54 million. Mr. Ellithorn has a Higher National Certificate in engineering and a management degree from Blackburn College of Technology. He is also a Director of the National Gas Vehicle Association. Mr. Ellithorn has over 30 years of experience in the truck industry.

### **John Bennett, General Manager — Product Support**

Mr. Bennett joined Clean Air Power in May 2004 and has been employed in the commercial vehicle industry for most of his working life. Mr. Bennett has worked for several international truck and bus manufacturer and has held senior management positions in areas of product planning and product support. Mr. Bennett is a member of the Institute of the Motor Industry and an associate member of the Institute of Road Transport Engineers.

### **Marc Vanderslice — General Manager, Engineering**

Mr. Vanderslice joined Clean Air Power with the merging of BKM Inc. and Clean Air Partners in 2001. During this time Mr. Vanderslice has held positions of Testing and Facilities Manager and currently General Manager Engineering. Mr. Vanderslice started his career with BKM in 1985 as a development engineer working on diesel fuel system components and has been involved in electronic fuel systems for a wide variety of applications including development of some of the first Dual-Fuel™ truck engines. While at BKM he has held positions managing technicians, designers, engineers, and production personnel. Mr. Vanderslice has a Bachelors degree from San Diego State University.

### **H.C. Wong — Chief Engineer**

Mr. Wong joined BKM Inc. in 1989, and later joined Clean Air Power with the merger of the two companies. He is currently the Chief Engineer at Clean Air Power. Mr. Wong was the chief engineer of the Caterpillar

## Part I — Information on Clean Air Power

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heavy-duty Dual-Fuel™ engine development project, and as such was responsible for the coordination of the project from concept to market. Mr. Wong graduated from Hong Kong Polytechnic in Hong Kong and became a UK registered chartered engineer in mechanical engineering. He has spent his career in the mobility and transportation industries, either at sea or on ground. He spent over 15 years in the marine and off-shore engineering fields in the Far East, including Mitsubishi Heavy Industry in Singapore as Director of Planning and Estimating. Mr. Wong has several international patents and has published several papers and reports in various professional societies including SAE and National Renewable Energy Laboratory.

### 7.3 Employees

As at 30 September 2005, Clean Air Power had 48 employees. The majority of employees are based at Leyland and Oxford, in the UK and San Diego, in the US, and are employed in the following areas:

Function	Number of employees
Directors	3
Sales	5
Research and Development	6
Products and Servicing	25
Administration and IT	9

### 8. Details of the Placing

The Company is proposing to raise £10,000,000 (before expenses) through a placing by Canaccord of 10,000,000 Placing Shares at 100p per Common Share.

Under the Placing Agreement, Canaccord has agreed to use its reasonable endeavours to procure subscribers for the Placing Shares at the Placing Price. The Placing Shares are being placed by Canaccord with institutions and other investors in the UK, US and Canada. The obligations of Canaccord under the Placing Agreement are conditional upon, *inter alia*, Admission taking place by 28 February 2006 (or such later date, being not later than 31 March 2006, as the Company and Canaccord shall agree) and on the Placing Agreement not being terminated. The Placing has not been underwritten by Canaccord. Commission is payable to Canaccord by the Company in respect of the Placing Shares.

The Placing Shares will represent approximately 38 per cent of the enlarged issued share capital of the Company upon Admission. On the basis of the Placing Price, the Company will have a market capitalisation of approximately £26.3 million upon Admission.

Further details of the Placing Agreement are set forth in Section 12.3 of Part VI of this document.

### 9. Reasons for Admission and Use of Proceeds

Clean Air Power is seeking admission of its Common Shares to trading on the AIM in order to create a public market in the Common Shares, to raise its profile and status, to provide access to capital, and to enable employees to be incentivised by a grant of options in publicly traded shares.

The Directors intend that the net proceeds of the Placing will be used for product development, test facilities and marketing and for general corporate purposes.

### 10. Lock-in Agreements

Each of the Directors and those Shareholders with over two per cent shareholding, in the Company prior to Admission representing in aggregate 94.6 per cent of the Common Shares in issue prior to the Placing at the date of this document, have undertaken to Canaccord and the Company not to dispose, save in limited circumstances, of any interest in Common Shares held at the date of this document for a period of 12 months from Admission and for a further 12 months thereafter only to deal through Canaccord. John Pettitt and Steven Whelan have given similar undertakings in respect of their Options. In addition, EnerTech Capital II, L.P., ECP II Interfund, L.P., Royal Bank Capital Partners and Endeavor Capital Partners, LLC have agreed to deal only through Canaccord for a period of 12 months from Admission in respect of the 3,325,000 aggregate Placing Shares for which they are subscribing in the Placing. Further details of these agreements are set out in Section 12.3 of Part VI of this document.

### 11. Share Plans

The Directors believe that equity incentives are and will continue to be an important means of retaining, attracting and motivating senior management and key employees. Therefore, the Board proposes to offer to senior management and key employees the opportunity to participate in the future of the Company through the Share Plans.

## **Part I — Information on Clean Air Power**

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Under the Share Plans, the Company may grant options or awards over Common Shares to the employees, directors or consultants of Clean Air Power as determined by the Remuneration Committee. Options have been granted under the Share Plans effective upon the Merger covering 2,883,582 Common Shares.

Further details of the Share Plans and the options that will be granted upon the Merger are contained in Sections 5.4 and 5.5 of Part VI of this document.

### **12. Transfer restrictions**

Investors are referred to the notice to investors on pages 1 to 3 of this document (the “Notice to Investors”).

The offer of and subscription for the Placing Shares is intended to be exempt from the registration requirements of the US Securities Act by reason of Regulation D promulgated thereunder. Each subscriber for Placing Shares in the Placing will be required to execute and deliver the documentation described in the Notice to Investors.

The Placing Shares shall be considered “restricted securities” within the meaning of Rule 144(a)(3) of the US Securities Act and, for a period of two years after the date of the Placing, any certificate that is materialised to evidence the Placing Shares shall bear a legend as further described in the Notice to Investors. Notwithstanding the foregoing, the Placing Shares may be sold in the ordinary course of secondary market trading on AIM, so long as neither the seller nor any person acting on its behalf, knows that the transaction has been prearranged with a buyer in the United States.

### **13. Settlement and CREST**

The Company’s Bye-Laws permit the Company’s shares to be issued in uncertificated form. CREST is a computerised share transfer and settlement system. The system allows shares and other securities to be held in electronic form rather than paper form, although a shareholder can continue dealing based on share certificates and stock transfer forms.

CRESTCo is unable to take responsibility for the electronic settlement of shares issued by non-UK or Irish companies. However, to enable investors to settle international securities under the CREST system, CRESTCo has proposed a method whereby a custodian can act as a depository of the international securities and issue dematerialised depository interests representing the underlying international securities which it holds on trust for the holders of the securities.

With effect from Admission, CREST members will be able to hold and transfer interests in Common Shares with CREST, pursuant to a depository interest arrangement established by the Company.

The Common Shares will not themselves be admitted to CREST, rather Capita IRG Trustees Limited will issue Depository Interests which may be traded and settled on CREST. The Depository Interests will be independent securities constituted under English law. Depository Interests will have the same security code (ISIN) as the underlying Common Shares.

Trading in Common Shares on AIM will require Shareholders to deal through a stockbroker or other intermediary who is a member of the London Stock Exchange. Shareholders resident outside the UK should ensure that their stockbroker is either a member of the London Stock Exchange or has in place arrangements allowing them to effect trades on AIM.

It is emphasised that, although the Common Shares will trade on AIM, the Company will not be subject to takeover regulation in the UK. Further details are set out in Section 3.2 of Part VI and a risk factor relating to this, and further risk factors relating to trading in Common Shares, are set out at Part II of this document.

CREST is a voluntary system and Shareholders who wish to retain certificates may elect to do so. In accordance with the US Securities Act of 1933, such certificates will contain a legend setting out certain restrictions on resale and transfer imposed by Regulation D. For more information on resale and transfer restrictions, please consult the Notice to Investors on page 1 of this document.

### **14. Admission and trading of Common Shares**

The Company has made an application for all of its issued share capital and for the Placing Shares to be admitted to trading on AIM. It is expected that Admission will become affective and dealings will commence on 28 February 2006.

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### **15. Share Dealing**

The Company has adopted a share dealing code for the Directors and certain employees, which is appropriate for a company whose shares are admitted to trading on AIM and the Company will take all reasonable steps to ensure compliance by its Directors and any relevant employees.

### **16. Corporate Governance**

Clean Air Power is committed to maintaining high standards of corporate governance. The Directors intend to comply with the Combined Code, so far as they consider appropriate given the Company's size.

### **17. The Board**

The Board will meet regularly throughout the year. To enable the Board to perform its duties, each Director will have full access to all relevant information and to the services of the Company Secretary. If necessary, the non-executive Directors may take independent professional advice at the Company's expense. The Board includes four non-executive Directors. The Board has delegated specific responsibilities to the committees described below:

#### **17.1 The Remuneration Committee**

The remuneration committee, which comprises three of the non-executive Directors, is chaired by Mr. Westhead and will meet as required during the year. It is responsible for reviewing the performance of the executive Directors and for setting the scale and structure of their remuneration, paying due regard to the interests of Shareholders as a whole and the performance of Clean Air Power.

#### **17.2 The Audit Committee**

The audit committee, which comprises three of the non-executive Directors, is chaired by Mr. Hunter and will meet at least twice a year. The Committee will review the Company's interim and annual financial statements before submission to the Board for approval. The committee will also review regular reports from management and the external auditors on accounting and internal control matters. Where appropriate, the committee will monitor the progress of action taken in relation to such matters. The audit committee will also recommend the appointment of and will review the fees of the external auditors.

### **18. Dividend Policy**

Initially following Admission, the Company intends to retain future earnings to finance continued development of its business and therefore does not expect that it will pay dividends on its Common Shares in the immediate future. The declaration and payment by the Company of any dividends, and the amount thereof, in the future will depend on the Company's operations, its financial position, cash needs, profits and other factors relevant at the time.

### **19. Taxation**

Information regarding taxation is set out in Section 13 of Part VI of this document. This information is, however, intended only as a general guide to the current tax position under UK, Bermuda, Canada and US taxation law.

Shareholders who are in any doubt as to their tax position or who are subject to tax in jurisdictions other than the UK are strongly advised to consult their own independent financial adviser immediately.

### **20. The Reorganisation**

The Company has entered into the Merger Agreement, pursuant to which Merger Sub will, in accordance with the provisions of Delaware law, be merged with and into Clean Air Power US. Clean Air Power US will survive to become a wholly-owned subsidiary of the Company.

Merger Sub is a wholly owned subsidiary of the Company that has been formed solely for the purpose of the Merger and has no assets or business operations. Merger Sub will cease to exist upon completion of the Merger.

## **Part I — Information on Clean Air Power**

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The Merger is conditional upon the filing of a Certificate of Merger with the Delaware Secretary of State (which is anticipated to occur at the close of business in Delaware on the business day preceding the date of Admission and which the Company has undertaken to Canaccord under the Placing Agreement to use its reasonable endeavours to satisfy).

Pursuant to the Merger, the holders of CAP US Common Stock, CAP US Series C Preferred Stock and CAP US Series D Preferred Stock will, in return for the cancellation of their securities in Clean Air Power US, be allotted 0.06667 Common Shares for each outstanding share of CAP US Common Stock and each outstanding share of CAP US Series D Preferred Stock and 5.22906 Common Shares for each outstanding share of CAP US Series C Preferred Stock. In addition, the Common Shares issued to Codan Trust Company Limited upon the incorporation of the Company, will be re-purchased by the Company in connection with the Merger for an aggregate consideration of \$12,000 and such Common Shares will be immediately available for issuance under the Placing.

Clean Air Power US's current Stock Option/Stock Issuance Plan will terminate upon the Merger becoming effective, and all options outstanding under such plan will terminate.

Under the Merger, each warrant to purchase CAP US Common Stock shall continue to have, and be subject to, the same terms and conditions as were applicable to such warrant except that each warrant will, upon the Merger becoming effective, be exercisable or convertible into Common Shares for the per share price as such warrant is deemed to be convertible into pursuant to such warrant's terms in the event of a merger of Clean Air Power US.

Pursuant to a number of agreements each dated as of 11 January 2006, the holders of all of the outstanding secured, convertible promissory notes issued by Clean Air Power US, certain of the outstanding warrants to subscribe for CAP US Series C Preferred Stock and all of the outstanding warrants to purchase CAP US Series D Preferred Stock have undertaken to Clean Air Power US to exercise their securities immediately prior to the Merger becoming effective and to receive Common Shares by way of cashless exercise of such securities.

On the assumption that the Merger becomes effective on 27 February 2006 and that all securities issued by Clean Air Power US are cancelled, 16,318,479 Common Shares will be issued pursuant to the Merger. For further details of the Company's share capital, your attention is drawn to Sections 4 and 5 of Part VI of this document.

Immediately upon the Merger, the Company will purchase all of the outstanding share capital of Clean Air Power UK from Clean Air Power US for \$550,000 such that the Company will be the direct holding company of Clean Air Power US and Clean Air Power UK.

### **21. Additional information**

Your attention is drawn to Part II of this document which contains risk factors relating to any investment in the Company and to Parts III, IV, V and VI of this document which contain further information relating to Clean Air Power.

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## Part II — Risk Factors

**The risk factors which should be taken into account in assessing Clean Air Power's activities and investment in the Company include, but are not necessarily limited to, those set out below. Prospective investors should carefully consider the following factors, among others, affecting the proposed activities of Clean Air Power prior to making an investment therein, as well as other matters set forth elsewhere in this document. An investment in the Company may not be suitable for all recipients of this document and prospective investors are advised to consult an independent adviser authorised under the Financial Services and Markets Act 2000 who specialises in investments of this kind before making any investment decision. An investment in the Common Shares is highly speculative and subject to a high degree of risk. Only those who can bear the risk of the loss of all or part of their investment should invest.**

### **Trading on AIM and Liquidity of the Common Shares.**

Prior to Admission there was no public market for the Common Shares. The Placing Price has been agreed between Canaccord and the Company and may not be indicative of the market price for the Common Shares following Admission.

The Common Shares will not be listed on the Official List. Investments in shares traded on AIM carry a higher degree of risk than investments in shares listed on the Official List.

Following Admission, the market price of the Common Shares may be volatile. The Company's operating results may fluctuate significantly in the future due to a variety of factors, many of which are outside the Company's control. Furthermore, stock markets in general and the market for new high growth innovative companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of such companies. The market prices of some high growth innovative companies' shares reflect substantially higher valuations than their operating performance may warrant. There can be no guarantee that these market prices and valuations will be sustained. The Company's performance and broad market and industry factors may substantially and adversely affect the market price of Common Shares.

Due to the limited volume of Common Shares that may be offered for sale or purchase from time to time and the potentially limited number of prospective buyers or sellers of Common Shares, there can be no guarantee that the market for the Common Shares will remain liquid or that all buy or sell orders for the Common Shares will be fulfilled on a timely basis or at all. Any illiquidity of the Common Shares may have an adverse effect on the market price of the Common Shares and an investment in the Common Shares may be difficult to realise.

### **Losses and the Prospect of Sustainable Profitability.**

Clean Air Power US incurred net losses in the fiscal year 2002 (approximately \$10,109,000), fiscal year 2003 (approximately \$8,189,000), fiscal year 2004 (approximately \$13,452,000) and the nine months ending 30 September 2005 (approximately \$7,390,000). Clean Air Power expects to continue to incur additional losses during the years ending 2006 and 2007. These losses have resulted primarily from costs incurred in connection with selling, general and administrative expenses and from historically weak revenues. Clean Air Power anticipates that its expenses will increase in the foreseeable future as the Company follows and develops the strategy described in Part I. The ability to generate revenues is subject to the risks and uncertainties encountered by companies at the initial stage of development and, accordingly, the Company may never become profitable. Once achieved, the Company may not be able to sustain or increase profitability on a quarterly or annual basis.

### **Cost Effectiveness of Clean Air Power Products; Ready Availability and Quality of Natural Gas.**

Dual-Fuel™ technology allows certain engines that normally use diesel fuel to use natural gas in combination with diesel fuel, leading to cost savings due to the low price of natural gas in many countries relative to diesel fuel. Historically, natural gas has been a cheaper fuel than diesel in most parts of the world where it is available. However, if diesel or other fuels become more cost effective than natural gas, users of diesel engines may choose alternatives to Dual-Fuel™. The Directors believe that, worldwide, there is a limited number of distributors of natural gas for vehicles. In the event long term production of natural gas is limited including by reason of a lack of competition or the distribution channels for natural gas are impaired, the cost of natural gas may increase in comparison to other fuels and the strategic value of the Company's core technologies may be reduced such that its business objectives are not achieved. Further,

## **Part II — Risk Factors**

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although the Company's products and its recommendations for the manner of their operation reduce the possibility of poor quality natural gas damaging the engine, if the quality of natural gas, as provided by distributors is poor, this may cause engine damage. Further if the quality of natural gas is viewed publicly as poor or the quality becomes generally uncertain, potential customers for Clean Air Power's technology might be hesitant to adopt such technology.

### **Additional Capital Requirements to Fund On-going Operations.**

The Directors believe that based on the current business plan and expected growth, the estimated net proceeds of the Placing, together with Clean Air Power's existing assets, anticipated debt capacity and future cash flow, will be sufficient to fund Clean Air Power's operations for the foreseeable future. However, if Clean Air Power's working capital needs exceed current expectations, then it may need to raise additional capital from equity or debt sources. Further equity fundings may be dilutive to existing shareholders and further debt fundings may require Clean Air Power to adhere to covenants restricting its future operational and financial activities.

### **Reliance on Genesis System.**

Clean Air Power's business plan relies significantly, in the short term, on the Genesis system. To date, Clean Air Power has received no revenues from the commercialisation of the Genesis system and no orders for the Genesis system exist. To obtain revenues from sales of the Genesis system, Clean Air Power must succeed in developing, obtaining customer adoption of, and manufacturing and marketing the applicable product. There is a risk that the OEMs may consider that the Genesis installation, conducted by third parties and not by the OEM, breaches their vehicle warranty placing additional risk on the vehicle operator. The Company may not succeed in these activities and, as a result, may not generate sufficient revenues to fund its business operations or achieve profitability. Furthermore, patent protection does not afford Clean Air protection against unauthorised use of the intellectual property that makes up the Genesis system by competitors.

### **Dependence on Third Parties and Lack of Strategic Marketing Partners.**

As described in Part I, a key aspect of Clean Air Power's strategy is to enter into collaborations with diesel engine manufacturers. Presently, Clean Air Power does not have any collaborative arrangements evidenced by written agreements with OEMs. The Company may not be able to enter into collaborative agreements with OEMs on acceptable terms. Furthermore, if such a relationship is established contractually, there can be no assurance that Clean Air Power's products can be quickly and cost-effectively adapted to work with engines produced by such OEM. If the Company is unable to develop products that are compatible with new engine designs, Company sales would decline and projected sales would not be achieved. Also, if engine manufacturers were to design products that compete with, or engines that eliminate the need for, Clean Air Power products, it would significantly decrease Clean Air Power's ability to generate revenues. In Australia, the current engine supplier may decide to replace the existing engine in order to meet emission regulation changes expected to become effective on 1 January 2007 which would impact new vehicle sales for Dual-Fuel™.

Further, Clean Air Power depends, and will depend on third parties to market, distribute and support its products. The Company's business objectives may be delayed, suspended or never achieved at all if the third parties that it will rely on do not successfully carry out their duties to the Company or the quality or effectiveness of such third parties' services is not commercially acceptable to Clean Air Power customers and other users of Clean Air Power's products. While the Company believes that there are competitive alternative suppliers available, it may not be able to enter into necessary arrangements with such suppliers without delays or additional expenditures.

In particular, the Company relies on one of two major suppliers of LNG fuel tanks for vehicle applications. Clean Air Power currently has a distribution agreement with Chart Industries that governs the sale of its LNG tanks to Clean Air Power which terminates in September 2007. If Chart were to cease operations or to limit its production of LNG fuel tanks, the Company would have to foster a relationship with another supplier or develop LNG fuel tanks on its own, causing unanticipated delays and expenditures.

### **Concentrated Sales; Winding up of Foden Truck Manufacturing.**

For the nine months ended 30 September 2005, approximately 14 per cent of Clean Air Power's total worldwide sales were to a single customer — Cumbria Truck Centre in the UK. Loss of this customer, or an

## Part II — Risk Factors

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adverse change in the relationship with this customer, could have a material adverse effect on the Company's results of operations. Likewise, Paccar, the parent of Foden Trucks, has recently announced that it intends to discontinue the use of the Foden brand in 2006. As Foden is the only truck sold with a Caterpillar engine in the UK and Caterpillar engines are the only engines using the Clean Air Power's product in the UK, the discontinuation will negatively affect the Company's UK revenues in a material manner.

### **Environmental and Regulatory Requirements.**

Clean Air Power's products fall within a number of heavily regulated areas of law, from emissions output to air and occupational health and safety.

In light of the trend towards more stringent emissions regulations in the US, Europe and Australia, Clean Air Power's major markets, Clean Air Power's products require regular improvement. Also, engine manufacturers regularly are forced to modify their engine designs or introduce new engines forcing Clean Air Power to develop and introduce new products. Clean Air Power is in the process of finding new OEM vehicle manufacturer partners, but if it is not successful then its UK revenues would materially be affected.

If emissions requirements become more stringent, Clean Air Power will face potentially significant research and development expenditures in order to comply with evolving regulations. The inability to meet these and other standards could have a negative impact on Clean Air Power's ability to generate revenues.

### **Protection and Infringement of Intellectual Property Rights.**

Clean Air Power relies on a combination of patent, trade secret, copyright and trademark law, and nondisclosure agreements to establish and protect the intellectual property rights in the Company's products. The Company currently owns 11 US patents and co-owns six patents in China. It has two applications pending in the US and 11 applications pending in foreign jurisdictions. Although one of the patents expired in 2003 and another in 2004, key US patents covering the Dual-Fuel™ technology do not begin to expire until May 2014. The bulk of the patent protection is based in the US and as such the Company faces the risks of its patented technology being used without its consent in foreign jurisdictions. The Company believes that its ability to establish and maintain its position in the market depends on this intellectual property. It is possible that its patents or other intellectual property rights may, in the future, be invalidated, narrowed in scope, circumvented or challenged, which could materially adversely affect its ability to compete effectively against other players in its industry. To enforce any intellectual property rights the Company has, it may have to institute litigation, which can be costly and time-consuming and the outcome of which would be unpredictable.

The initial lack of patent protection for the Genesis system in Europe will require the Company to rely on its know how and market position to maintain a competitive edge with respect to that system.

Hybrid Fuel Systems (HFS) currently holds US patents relating to methods and devices for mixing natural gas and air prior to introduction into the combustion chamber. Because Clean Air Power's Dual-Fuel™ technology presently does not require pre-induction mixing of fuel with air using a mixing device, the HFS patents do not overlap with any Clean Air Power product currently sold in the United States. While the Genesis system will include a pre-injection mixing component, the Company has no plans to install the Genesis system or any other system requiring a mixing device in the United States.

MAN B&W Diesel A.G., a company based in Germany, has a US patent for a diesel pilot injection control for a common rail system. Because Clean Air Power's technology is employed only on non-common rail systems, the MAN patent cannot prevent Clean Air Power from commercialising its Dual-Fuel™ technology in the US.

If the Company is found to infringe on the intellectual property rights of others, it may not be able to continue sales of any of its products that are found to infringe, or it may have to enter into expensive licence or settlement agreements to be able to continue to sell its products. Third parties may allege infringement by the Company with respect to past, current or future intellectual property rights. As the market for emissions reduction technology gets more competitive, intellectual property litigation may increase. Any claim of infringement, regardless of merit, could be costly, time-consuming and require the Company to develop non-infringing technology or enter into royalty, licensing or settlement agreements, which may impose unfavourable terms on it.

The Company's competitiveness also depends on its ability to protect new inventions and other intellectual property assets on a global scale. The Company intends to continue to file patent, copyright and trademark

## **Part II — Risk Factors**

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applications to protect its intellectual property assets in key markets. There is no assurance, however, that the Company will be provided the protection it seeks. In addition, the Company depends on the skill, knowledge and expertise of its employees, advisers and consultants, and on other intellectual property assets that cannot be or which are difficult to patent. Although the Company seeks to protect its trade secrets to the fullest extent permitted by law, it is possible that confidential information will be disclosed to its competitors. Such disclosures could have a materially adverse effect on Clean Air Power's business and its ability to remain competitive in the global marketplace.

### **Sustainable Market for Products.**

While the Directors believe there exists a viable market for Clean Air Power's products there can be no assurance that the targeted customers will accept Clean Air Power's technologies or will purchase its products in sufficient quantities to expand the business. If a sustainable market fails to develop or develops more slowly than anticipated, Clean Air Power may be unable to recover the costs it has incurred in developing its products, meet its operational expenses or achieve profitability. The development of a sustainable market for Clean Air Power systems may be impacted by many factors, including some factors that are out of Clean Air Power's control, such as the continuing availability of government programmes and incentives for consumers to purchase low-emission vehicles and engines, the cost competitiveness of Clean Air Power's products and the installation thereof, and changing domestic and foreign regulatory requirements.

### **International Business.**

As a consequence of international expansion, Clean Air Power will be exposed to risks associated with changes in foreign currency exchange rates. This may result in gains or losses which may be material and may also cause fluctuations in reported financial information that are not necessarily related to Clean Air Power's operating results.

### **Technological Changes.**

The market for Clean Air Power products is characterised by changing technologies and new product introductions. As with any new technology, there are risks associated with the development and long-term operational life of the products. If Clean Air Power fails to develop and introduce new products or enhancements to its existing products that satisfy customer needs and address technological changes in target markets in a timely manner, its products may become non-competitive or obsolete.

Many competitors of Clean Air Power have more resources available to them than Clean Air Power does. As such they may be able to adapt more quickly to new or emerging technologies and changes in customer requirements. Additionally, they will be able to devote greater resources to the promotion and sale of their products.

### **Expansion of Production Capabilities.**

Clean Air Power aims to develop business relationships with major OEMs. If successful in developing a business relationship with a major manufacturer, Clean Air Power anticipates a significant increase in its business operations, which will require the expansion of internal and external production capabilities. There is no guarantee that Clean Air Power will be able to scale-up production effectively and in a cost efficient manner. Additionally, as Clean Air Power grows its production capabilities, its management and technology personnel, systems and facilities currently in place may not be adequate. The need to effectively manage Company operations, including various projects, requires that it continue to improve operational, financial and management controls, reporting systems and procedures and to attract and retain sufficient numbers of talented employees. Clean Air Power may be unable to successfully implement these tasks on a larger scale and, accordingly, may not achieve its commercial goals.

### **Warranty Exposure.**

Clean Air Power sells products with warranties. However, these warranties vary from product to product with respect to the time period covered and the extent of the warranty protection, and malfunctions of Company products could expose the Company to significant warranty expenses. Clean Air Power has established warranty reserves that in the aggregate exceed \$1,300,000, and management believes these reserves to be reasonable and sufficient. However, because Clean Air Power is in the early stages of

## **Part II — Risk Factors**

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production, there is no certainty that the warranty exposure has been adequately provided for. Any new or improved products can expect to experience a certain amount of product malfunction and although the Company reduces its risk of warranty claims through warranty disclaimers, there can be no guarantee that such efforts will effectively limit liability. Any significant incurrence of warranty expense could have a material adverse effect on the Company's financial condition.

### **Insurance.**

While the Company has insurance in place, there can be no guarantee that any net insurance proceeds receivable by the Company would be sufficient to compensate the Company with regard to insured liabilities. Furthermore there can be no guarantee that adequate levels of insurance and at commercially acceptable premiums will continue to be available in the future. Any such circumstances may have a substantial adverse effect on the Company's business, financial condition, trading performance and prospects.

### **The City Code on Takeovers and Mergers.**

The Company is incorporated in Bermuda and its place of central management is in Bermuda. Accordingly, transactions in the Common Shares are not subject to the provisions of the UK City Code on Takeovers and Mergers. Bermuda law does not contain any provisions similar to those applicable in the UK which are designed to regulate the way in which takeovers are conducted. The Bye-laws contain certain takeover protections, although these will not provide the full protection afforded by the City Code. The relevant provisions of the Bye-laws are summarised in Section 6 of Part VI.

### **Enforcement of Judgments.**

As the Company is a Bermuda exempted company, the rights of Shareholders will be governed by Bermuda law and the Company's Memorandum of Association and Bye-laws. The rights of Shareholders under Bermuda law may differ from the rights of shareholders of companies incorporated in other jurisdictions. The majority of the Directors are not residents of the UK and a significant portion of the Company's assets are located outside of the UK. As a result, it may be difficult for investors to effect service of process on those persons in the UK or to enforce in the UK judgments obtained in UK courts against the Company or those persons who may be liable under UK law. The current position with regard to enforcement of judgments in Bermuda is set out below but this may be subject to change.

A final and conclusive judgment of a foreign court against the Company, under which a sum of money is payable (not being a sum of money payable in respect of taxes or other charges of a like nature, in respect of a fine or other penalty, or in respect of multiple damages as defined in The Protection of Trading Interests Act 1981 of Bermuda) may be enforceable in Bermuda if the foreign court is situated in a country to which The Judgments (Reciprocal Enforcement) Act 1958 of Bermuda (the "1958 Act") applies. The procedure provided for in the 1958 Act must be followed if the 1958 Act applies. The 1958 Act applies to the UK. Under the 1958 Act, a judgment obtained in the superior courts of a territory to which it applies would be enforced by the Supreme Court of Bermuda without re-examination of the merits of the case provided that:

- (a) the judgment is final and conclusive, notwithstanding that an appeal may be pending against it or it may still be subject to an appeal in such country;
- (b) the judgment has not been given on appeal from a court which is not a superior court; and
- (c) the judgment is duly registered in the Supreme Court of Bermuda in circumstances in which its registration is not liable thereafter to be set aside.

Under Section 3(4) of the 1958 Act, the registration of such a court's judgment in the Supreme Court of Bermuda involves the conversion of the judgment debt into Bermuda dollars as of the date of the foreign court's judgment, but the Bermuda Monetary Authority (BMA) has indicated that its present policy is to give the consents necessary for any Bermuda dollar award made by the Supreme Court of Bermuda as aforesaid to be recovered in external currency.

No stamp duty or similar or other tax or duty is payable in Bermuda on the enforcement of a foreign judgment. Court fees will be payable in connection with proceedings for enforcement.

### **BMA Approval.**

The Bermuda Monetary Authority (BMA) must approve all issues and transfers of securities of a Bermuda exempted company. Where any equity securities (meaning shares which entitle the holder to vote for or

## **Part II — Risk Factors**

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appoint one or more directors or securities which by their terms are convertible into shares which entitle the holder to vote for or appoint one or more directors) of a Bermuda company are listed on an appointed stock exchange (which includes AIM) the BMA has given general permission for the issue and subsequent transfer of any securities of the company from and/or to a non-resident of Bermuda for so long as any such equity securities of the company remain so listed.

### **Indemnification of Directors.**

The Company has entered into an Indemnification Agreement with each Director against liability incurred by the Director as a director of the Company and/or subsidiary of the Company to the extent permitted by the Bermuda Companies Act. In addition under the Company's Bye-Laws, the Directors, secretary and other officers of the Company are indemnified out of the assets of the Company as further described in section 7.9 of Part VI. The agreement sets out the circumstances in which the Company is liable to indemnify the Director and may provide a Director with indemnification in circumstances where such indemnification would not be lawful or market practice in non-Bermudian jurisdictions.

### **California Lease.**

The Company relies on the availability and condition of its research and production facility, located in San Diego, California. The lease that entitles the Company to use these premises is scheduled to expire on 30 September 2006. After that time, the Company may not be able to negotiate a new lease for the facility and may not find a suitable replacement in San Diego without undergoing unexpected costs. Any dislocation of the operation housed at the San Diego facility could be disruptive to the Company's operations which could materially adversely effect the overall profitability of the Company.

### **Product Liability.**

Clean Air Power may be exposed to the risk of product liability claims that is inherent in the manufacturing, testing and sales of engines for heavy-duty vehicles. A product liability claim may damage Clean Air Power's reputation by raising questions about a product's safety and could limit the Company's ability to sell one or more products. Clean Air Power has not been the subject of any product liability claims to date. However, the Company does not carry product liability insurance and is consequently faced with the risk of incurring the cost and expense of defending product liability claims and paying any settlements and adverse judgments.

### **Successful Admission and Placing.**

Admission and Placing are subject to certain conditions including, for example, the consummation of the Merger is conditional upon the completion of the Merger Agreement as further described in paragraph 19 of Part I of this document. Since the completion of the Merger could be delayed or prevented by the existing stockholders of Clean Air Power US pursuant to civil action or by governmental action, there is a risk that the Merger will not be consummated in a timely fashion and the Admission and the Placing may not take place.

### **Taxation.**

#### Bermuda

At the present time, there is no Bermuda income or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by the Company. The Company has obtained an assurance from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act 1966 that, in the event that any legislation is enacted in Bermuda imposing any tax computed on profits or income, or computed on any capital asset, gain or appreciation or any tax in the nature of estate duty or inheritance tax, such tax shall not, until 28 March 2016, be applicable to us or to any of our operations or to our shares, debentures or other obligations except insofar as such tax applies to persons ordinarily resident in Bermuda or is payable by us in respect of real property owned or leased by us in Bermuda. The Company pays annual Bermuda Government fees. In addition all entities employing individuals in Bermuda are required to pay a payroll tax and there are sundry taxes payable, directly or indirectly to the Bermuda Government.

Currently there is no Bermuda withholding or other tax payable on dividends paid to the holders of the Company's shares.

## Part II — Risk Factors

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The foregoing comments are intended as a general guide to the Bermuda tax treatment of the acquisition, ownership and disposal of shares for persons who are the absolute beneficial owners of those shares. All persons are advised to obtain their own professional advice on the tax implications of acquiring, owning and/or disposing of shares.

### United States

As discussed at Section 13.4 of Part VI of this document, Clean Air Power Limited will elect to be classified as a partnership for US federal income tax purposes. As a partnership, Clean Air Power Limited will not pay any US federal income tax, although Clean Air Power US generally will be subject to US federal income tax on a net income basis. Instead, each shareholder that files a US federal income tax return will be required to report on such tax return an allocable share of Clean Air Power Limited's income, gains, losses and deductions. There is a risk that net income allocable to a shareholder could exceed dividends paid to such shareholder during the taxable year.

### **Planning Uncertainty.**

This document contains certain forward-looking statements that are subject to certain risks and uncertainties, in particular statements regarding Clean Air Power's plans, goals and prospects. Clean Air Power's actual results and operations could differ materially from those anticipated in such forward looking statements as a result of many factors including the risks faced by Clean Air Power which are described below and elsewhere in this document. These statements and the assumptions that underlie them are based on the current expectations of the Directors and are subject to a number of factors, many of which are beyond their control. As a result, there can be no assurance that actual results will not differ materially from those described in this document.

### **Dependence on Key Executives and Personnel.**

The Directors believe that the future success of the Group will depend greatly upon the expertise and continued service of certain key executives and technical personnel, including the executive Directors. Furthermore, the Group's ability to successfully develop commercial products will also depend on the Group's ability to attract and retain suitable management, marketing and sales personnel. Competition for these types of employees is often intense due to the limited number of qualified professionals. The Group has attempted to reduce this risk by (i) offering incentive schemes to such employees, such as the Share Plan, and (ii) entering into contracts which contain limited non-competition provisions with certain of its key employees. However, these measures do not guarantee that such employees will stay employed with Clean Air Power.

If Clean Air Power fails to attract and retain key personnel, it may be difficult for the Group to manage its business and meet its objectives and as a consequence its business, results of operations or financial condition may be adversely affected.

**The list of risk factors set out above is not exhaustive, does not necessarily comprise all those risks associated with an investment in the Company and is not presented in any order of priority.**

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# Part III — Historical financial information on the Company and Clean Air Power Inc.

## 1. ACCOUNTANT'S REPORT ON THE COMPANY



Ernst & Young LLP  
100 Barbirolli Square  
Manchester  
M2 3EY

The Directors  
Clean Air Power Limited  
Clarendon House  
2 Church Street  
Hamilton HM11  
Bermuda

22 February 2006

Dear Sirs

### **Clean Air Power Limited**

We report on the financial information set out on page 43. This financial information has been prepared for inclusion in the AIM admission document dated 22 February 2006 of Clean Air Power Limited on the basis of the accounting policies set out in paragraph 1.2. This report is required by Schedule Two of the AIM Rules and is given for the purpose of complying with that schedule and for no other purpose.

### **Responsibilities**

The Directors of Clean Air Power Limited are responsible for preparing the financial information on the basis of preparation set out in paragraph 1.2 to the financial information and in accordance with accounting principles generally accepted in the United States of America.

It is our responsibility to form an opinion as to whether the financial information gives a true and fair view, for the purposes of the AIM admission document, and to report our opinion to you.

### **Basis of opinion**

We conducted our work in accordance with Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Our work has not been carried out in accordance with auditing standards generally accepted in the United States of America and accordingly should not be relied upon as if it had been carried out in accordance with those standards.

### **Opinion**

In our opinion, the financial information gives, for the purposes of the AIM admission document dated 22 February 2006, a true and fair view of the state of affairs of Clean Air Power Limited as at 4 November 2005 in conformity with accounting principles generally accepted in the United States of America.

### **Declaration**

We are responsible for this report as part of the AIM admission document and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the AIM admission document in compliance with Schedule Two of the AIM Rules.

Yours faithfully

Ernst & Young LLP

## Part III — Historical financial information on the Company and Clean Air Power Inc.

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### 1.1 Financial information on the Company

The financial information is unaudited.

#### BALANCE SHEET

	<i>Note</i>	<b>As at 4 November 2005 \$000</b>
<b>CURRENT ASSETS</b>		
Cash		<u>12</u>
		<u>12</u>
<b>CAPITAL AND RESERVES</b>		
Called up share capital	(ii)	<u>12</u>
Equity shareholders' funds		<u>12</u>

### 1.2 Notes to the Financial Information

(i) Accounting policies

*Basis of preparation.* The financial information has been prepared in accordance with accounting principles generally accepted in the United States of America. Clean Air Power Limited was incorporated on 4 November 2005 in Bermuda. Clean Air Power Limited has not traded.

(ii) Share capital

	<b>As at 4 November 2005 \$000</b>
<i>Authorised</i>	
12,000,000 common shares of \$0.001 each	<u>12</u>
<i>Issued and fully paid</i>	
12,000,000 common shares of \$0.001 each	<u>12</u>

On incorporation, the authorised share capital of \$12,000 was divided into 12,000,000 common shares of \$0.001 each, each of which was issued fully paid.

(iii) Post balance sheet events

On 11 January 2006, Clean Air Power Limited entered into a merger agreement whereby Merger Sub, a wholly owned subsidiary of Clean Air Power Limited will be merged with and into Clean Air Power, Inc., conditional upon Admission. Clean Air Power, Inc. will survive to become a wholly owned subsidiary of Clean Air Power Limited.

## Part III — Historical financial information on the Company and Clean Air Power Inc.

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### 2. ACCOUNTANT'S REPORT ON CLEAN AIR POWER, INC.



Ernst & Young LLP  
100 Barbirolli Square  
Manchester  
M2 3EY

The Directors  
Clean Air Power Limited  
Clarendon House  
2 Church Street  
Hamilton HM11  
Bermuda

22 February 2006

Dear Sirs

#### **Clean Air Power, Inc.**

We report on the financial information set out on pages 45 to 62. This financial information has been prepared for inclusion in the AIM admission document dated 22 February 2006 of Clean Air Power Limited on the basis of the accounting policies set out in paragraph 2.2. This report is required by Schedule Two of the AIM Rules and is given for the purpose of complying with Schedule Two of the AIM Rules and for no other purpose.

#### **Responsibilities**

The Directors of Clean Air Power Limited are responsible for preparing the financial information on the basis of preparation set out in paragraph 2.2 to the financial information and in accordance with accounting principles generally accepted in the United States of America.

It is our responsibility to form an opinion as to whether the financial information gives a true and fair view for the purposes of the AIM admission document, and to report our opinion to you.

#### **Basis of opinion**

We conducted our work in accordance with Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Our work has not been carried out in accordance with auditing standards generally accepted in the United States of America and accordingly should not be relied upon as if it had been carried out in accordance with those standards.

#### **Opinion**

In our opinion, the financial information gives, for the purposes of the AIM admission document dated 22 February 2006, a true and fair view of the consolidated state of affairs of Clean Air Power Inc. as at the dates stated and the consolidated results of its operations and cash flows for the periods then ended in conformity with accounting principles generally accepted in the United States of America.

#### **Declaration**

We are responsible for this report as part of the AIM admission document and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the AIM admission document in compliance with Schedule Two of the AIM Rules.

Yours faithfully

Ernst & Young LLP

## Part III — Historical financial information on the Company and Clean Air Power Inc.

### 2.1 Clean Air Power, Inc. financial information

The financial information for Clean Air Power, Inc. (hereafter referred to as Clean Air Power US), for the three years and nine months ended 30 September 2005 has been prepared in accordance with accounting principles generally applicable in the United States of America.

#### CONSOLIDATED BALANCE SHEETS

	At 31 December 2002 \$000	At 31 December 2003 \$000	At 31 December 2004 \$000	At 30 September 2005 \$000
<b>ASSETS</b>				
<b>Current assets:</b>				
Cash and cash equivalents	2,325	5,132	1,875	1,936
Cash and cash equivalents – restricted	—	30	165	40
Marketable securities	2,309	—	—	—
Accounts receivable, net	2,214	2,493	728	493
Notes receivable from officer	458	268	—	—
Inventories, net	2,241	3,435	3,352	1,997
Other current assets	281	55	440	198
<b>Total current assets</b>	<u>9,828</u>	<u>11,413</u>	<u>6,560</u>	<u>4,664</u>
Property and equipment, net	1,257	1,179	844	554
Other assets	2,397	2,415	675	3,031
<b>Total assets</b>	<u>13,482</u>	<u>15,007</u>	<u>8,079</u>	<u>8,249</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>				
<b>Current liabilities:</b>				
Accounts payable	3,170	1,904	2,100	755
Accrued liabilities	2,498	2,085	3,193	2,668
Due to Hardstaff	288	1,399	—	—
Current portion of notes payable	<u>2,892</u>	<u>1,993</u>	<u>1,712</u>	<u>6,318</u>
<b>Total current liabilities</b>	8,848	7,380	7,005	9,741
Notes payable, net current portion	1,117	662	97	—
<b>Convertible preferred stock, \$0.001 par value, 1,107,660,000 shares authorised:</b>				
Redeemable Series A-1 Preferred Stock	23,744	1,039	—	—
Series A-2 Non-Voting Preferred Stock	1,134	—	—	—
Redeemable Series A-3 Voting Preferred Stock	—	21,988	19,252	—
Series A-4 Non-Voting Preferred Stock	—	2,031	2,031	—
Redeemable Series B-1 Voting Preferred Stock	—	10,971	10,981	—
Series B-2 Non-Voting Preferred Stock	—	729	729	—
Redeemable Series C-1 Voting Preferred Stock, 766,133 and 1,201,016 issued and outstanding at 30 September 2005 and 31 December 2004, respectively; \$10.25 per share liquidation preference	—	—	6,155	3,926
Series C-2 Non-Voting Preferred Stock	<u>—</u>	<u>—</u>	<u>278</u>	<u>—</u>
	24,878	36,758	39,426	3,926
<b>Stockholders' equity (deficit)</b>				
Voting common stock, \$0.001 par value, 561,000,000 shares authorised; 8,365,806 and 1,569,400 shares issued and outstanding at 30 September 2005 and 31 December 2004, respectively	—	—	2	8
Non-voting common stock, \$0.001 par value, 561,000,000 shares authorised; 635,481 and no shares issued and outstanding at 30 September 2005 and 31 December 2004, respectively	—	—	—	1
Common stock, no par value, 8,000,000 shares authorised; 825,594 and 825,000 shares issued and outstanding at 31 December 2003 and 2002, respectively	—	1	—	—
Additional paid-in capital	7,110	6,857	11,646	52,064
Accumulated deficit	(28,475)	(36,664)	(50,116)	(57,506)
Accumulated other comprehensive income	4	12	19	15
<b>Total stockholders' equity (deficit)</b>	<u>(21,361)</u>	<u>(29,794)</u>	<u>(38,449)</u>	<u>(5,418)</u>
<b>Total liabilities and stockholders' equity (deficit)</b>	<u>13,482</u>	<u>15,007</u>	<u>8,079</u>	<u>8,249</u>

## Part III — Historical financial information on the Company and Clean Air Power Inc.

### CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended 31 December 2002 \$000	Year ended 31 December 2003 \$000	Year ended 31 December 2004 \$000	Nine months ended 30 September 2005 \$000
<b>Revenues:</b>				
Sales	6,191	13,180	7,932	5,095
Contract and grant	414	5	72	—
<b>Total revenues</b>	<u>6,605</u>	<u>13,185</u>	<u>8,004</u>	<u>5,095</u>
<b>Costs and expenses:</b>				
Cost of sales	4,560	8,785	7,063	3,223
Research and product development	6,316	6,096	1,777	952
Selling, general and administrative	5,834	6,954	9,819	5,104
<b>Total costs and expenses</b>	<u>16,710</u>	<u>21,835</u>	<u>18,659</u>	<u>9,279</u>
<b>Loss from operations</b>	(10,105)	(8,650)	(10,655)	(4,184)
<b>Other income (expense):</b>				
Interest expense	(212)	(228)	(472)	(3,262)
Interest and other income	208	189	62	56
Gain on extinguishment of debt	—	500	—	—
Asset impairment charge	—	—	(2,387)	—
<b>Net loss</b>	<u>(10,109)</u>	<u>(8,189)</u>	<u>(13,452)</u>	<u>(7,390)</u>

## Part III — Historical financial information on the Company and Clean Air Power Inc.

### STATEMENT OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

	Common Stock				Additional Paid-in Capital \$000	Accumulated Deficit \$000	Accumulated Other Comprehensive Income \$000	Total Stockholders' Deficit \$000	Comprehensive Income \$000
	Voting Shares 000	Amount \$000	Non-voting Shares 000	Amount \$000					
<b>Balance at 1 January 2002</b>	825	—	—	—	7,110	(18,366)	—	(11,256)	—
Foreign currency translation	—	—	—	—	—	—	4	—	4
Net loss	—	—	—	—	—	(10,109)	—	(10,109)	(10,109)
<b>Balance at 31 December 2002</b>	825	—	—	—	7,110	(28,475)	4	(21,361)	(10,105)
Foreign currency translation	—	—	—	—	—	—	8	8	8
Issuance of Series A Preferred Stock for cash	—	—	—	—	(253)	—	—	(253)	—
Exercise of stock option for cash	1	1	—	—	—	—	—	—	—
Net loss	—	—	—	—	—	(8,189)	—	(8,189)	(8,189)
<b>Balance at 31 December 2003</b>	826	1	—	—	6,857	(36,664)	12	(29,794)	(8,181)
Cost relating to the issuance of Series C preferred stock	—	—	—	—	(86)	—	—	(86)	—
Series A-1 and A-3 preferred stock anti-dilution reclassification	743	1	—	—	3,875	—	—	3,876	—
Issuance of Series D warrants in connection with convertible promissory notes, including beneficial conversion	—	—	—	—	1,000	—	—	1,000	—
Foreign currency translation	—	—	—	—	—	—	7	7	7
Net loss	—	—	—	—	—	(13,452)	—	(13,452)	(13,452)
<b>Balance at 31 December 2004</b>	1,569	2	—	—	11,646	(50,116)	19	(38,449)	(13,445)
Series A-3, B-1 and C-1 preferred stock anti-dilution reclassification	6,797	6	—	—	32,530	—	—	32,536	—
Series A-4, B-2 and C-2 preferred stock anti-dilution reclassification	—	—	635	1	3,038	—	—	3,039	—
Issuance of Series D warrants in connection with convertible promissory notes, including beneficial conversion	—	—	—	—	4,850	—	—	4,850	—
Foreign currency translation	—	—	—	—	—	—	(4)	(4)	(4)
Net loss	—	—	—	—	—	(7,390)	—	(7,390)	(7,390)
<b>Balance at 30 September 2005</b>	8,366	8	635	1	52,064	(57,506)	15	(5,418)	(7,394)

## Part III — Historical financial information on the Company and Clean Air Power Inc.

### CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended 31 December 2002 \$000	Year ended 31 December 2003 \$000	Year ended 31 December 2004 \$000	Nine months ended 30 September 2005 \$000
<b>OPERATING ACTIVITIES</b>				
Net loss	(10,109)	(8,189)	(13,452)	(7,390)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation	219	431	500	316
Gain on debt and related interest forgiveness	—	(500)	—	—
Net gain on disposal of property and equipment	—	—	—	(12)
Interest imputed on notes payable	78	—	—	—
Stock compensation	—	—	10	—
Write down of assets	—	—	2,387	—
Interest expense in connection with preferred stock warrants and beneficial conversion	—	—	333	2,907
Changes in operating assets and liabilities:				
Accounts receivable	(1,325)	(280)	1,766	234
Inventories	(223)	(1,587)	83	1,355
Other assets	165	205	(373)	252
Accounts payable	1,574	(1,267)	197	(1,345)
Accrued liabilities	727	(90)	(280)	(372)
Due to Hardstaff	287	1,112	—	—
Net cash used in operating activities	(8,607)	(10,167)	(8,829)	(4,055)
<b>INVESTING ACTIVITIES</b>				
Purchases of marketable securities	(91,339)	—	—	—
Maturities of marketable securities	96,234	2,309	—	—
Notes receivable from officer	(408)	190	268	—
Purchases of property and equipment	(962)	(356)	(162)	(40)
Proceeds from the sale of property and equipment	—	8	2	26
Cash and cash equivalents – restricted	—	(30)	(134)	125
Cash paid for acquisition of HIS	(1,500)	—	—	—
Net cash provided by (used in) investing activities	2,024	2,121	(26)	111
<b>FINANCING ACTIVITIES</b>				
Proceeds from notes payable	—	1,835	1,000	4,622
Payments on notes payable	(228)	(2,438)	(1,757)	(266)
Deferred offering costs	—	—	—	(347)
Proceeds from equity financings, net of issuance costs	—	11,448	6,347	—
Net cash (used in) provided by financing activities	(228)	10,844	5,590	4,009
Effect of exchange rate changes on cash	4	8	8	(4)
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(6,807)</b>	<b>2,807</b>	<b>(3,257)</b>	<b>61</b>
Cash and cash equivalents at beginning of period	9,132	2,325	5,132	1,875
<b>Cash and cash equivalents at end of period</b>	<b>2,325</b>	<b>5,132</b>	<b>1,875</b>	<b>1,936</b>
<b>SUPPLEMENTAL INFORMATION</b>				
Interest paid	79	217	115	37
Conversion of debt and accrued interest to equity	—	180	101	75
Extinguishment of debt related to inventory write-down	—	393	—	—

## **Part III — Historical financial information on the Company and Clean Air Power Inc.**

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### **2.2 Notes to Financial Information**

#### **Organisation and Basis of Presentation**

Clean Air Power US is a Delaware corporation providing advanced technology low-emissions energy systems for mobile and stationary markets. Clean Air Power US sells its products principally throughout North America and Europe.

Clean Air Power US formed a wholly-owned subsidiary, Clean Air Power UK, on 15 May 2003, under the laws of England and Wales. Clean Air Power UK was formed to market low emission trucks in the United Kingdom. The consolidated financial statements of Clean Air Power US include the accounts of Clean Air Power UK. Intercompany accounts and transactions have been eliminated upon consolidation. Included in Clean Air Power US's consolidated statements of operations for the nine month period ended 30 September 2005 and the year ended 31 December 2004, are losses incurred by Clean Air Power UK of \$1,036,267 and \$1,699,179, respectively. Clean Air Power UK had assets of \$1,270,855 and \$2,616,785 at 30 September 2005 and 31 December 2004, respectively.

Clean Air Power US formed a joint venture, CAP-Hardstaff, Limited (the "Joint Venture"), a company incorporated under the laws of England and Wales, with T. Baden Hardstaff ("Hardstaff") on 14 June 2002. The Joint Venture was formed to market low emission trucks in the United Kingdom. Clean Air Power US owns 50.01 per cent of the Joint Venture and controls three out of the five Board of Director seats. As a result, the consolidated financial statements of Clean Air Power US includes the accounts of the Joint Venture. Intercompany accounts and transactions have been eliminated upon consolidation. As of 30 September 2005, Clean Air Power US is in the process of separating from the Joint Venture with T. Baden Hardstaff. During the nine month period ended 30 September 2005 and the year ended 31 December 2004, the Joint Venture had no revenues and no expenses. The Joint Venture had assets of \$16,498 and \$23,847 at 30 September 2005 and 31 December 2004, respectively.

The accompanying consolidated financial information has been prepared assuming that Clean Air Power US will continue as a going concern.

The financial statements for the nine months ended 30 September 2005 highlighted that Clean Air Power US has incurred recurring operating losses and had a working capital deficiency, which raised substantial doubt on Clean Air Power US's ability to continue as a going concern. However, on 11 January 2006 Clean Air Power Limited entered into a merger agreement whereby Clean Air Power Limited agreed to acquire the entire voting common stock and convertible preferred stock of Clean Air Power US and has agreed to provide financial support to Clean Air Power US. Clean Air Power Limited has entered into a placing agreement with Canaccord pursuant to which Canaccord has agreed to use its reasonable endeavours to raise £10 million on the AIM of the London Stock Exchange. The Placing is not underwritten.

The accompanying consolidated financial information has been prepared assuming that Clean Air Power US will continue as a going concern.

#### **Significant Accounting Policies**

##### *Use of Estimates*

The preparation of financial information in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial information and reported amounts of revenues and expenses during the reporting period. Examples include provisions for bad debts, warranty reserves and inventory reserves. Actual results could differ from those estimates.

Foden Trucks, a division of Paccar UK Limited supplies trucks that are equipped with Caterpillar engines and Clean Air Power US's dual fuel conversion kits. Foden Trucks is the exclusive supplier of trucks in the UK for Clean Air Power US's dual fuel conversion kits. Clean Air Power US has been advised by Paccar UK Limited that it is currently evaluating the continued use of the Foden Trucks name plate, and that the Foden Trucks brand may be discontinued after August 2006. Clean Air Power US is currently developing a product that utilises engine cross-platform technology enabling a more universal application. The discontinuance of Foden Trucks could adversely affect operating results.

## **Part III — Historical financial information on the Company and Clean Air Power Inc.**

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### *Cash and Cash Equivalents*

Cash and cash equivalents consist of cash, money market funds, and other highly liquid investments with maturities of three months or less when purchased. The carrying value of these instruments approximates to fair value. Clean Air Power US generally invests its excess cash in debt instruments of the U.S. Treasury, government agencies and corporations with strong credit ratings. Such investments are made in accordance with Clean Air Power US's investment policy, which establishes guidelines relative to diversification and maturities designed to maintain safety and liquidity. These guidelines are periodically reviewed and modified to take advantage of trends in yields and interest rates. Clean Air Power US has not experienced any losses on its cash and cash equivalents.

### *Cash and Cash Equivalents — Restricted*

Included in restricted cash are amounts deposited in an escrow account that are to be used for the payment of warranty claims for vehicles converted by the Joint Venture. As of 30 September 2005 and 31 December 2004, Clean Air Power US's share of this escrow account was \$2,724 and \$120,210, respectively.

Clean Air Power US maintains certain deposits restricted for funding the unvested portion of Clean Air Power US's match to the Employee Retirement Plan and to guarantee customer credit card payments.

Clean Air Power US has restricted cash for wind up costs related to the Joint Venture. As of 30 September 2005 and 31 December 2004, these amounts were \$16,498 and \$23,847, respectively.

### *Marketable Securities*

Management determines the appropriate classification of its investments in marketable securities at the time of purchase and re-evaluates such designation as of each balance sheet date. Clean Air Power US has designated all of its marketable securities as available for sale.

### *Fair Value of Financial Instruments*

The carrying values of marketable securities, accounts receivable, accounts payable, accrued liabilities and debt approximate to fair value.

### *Concentration of Credit Risk*

Clean Air Power US's revenues include sales to a significant customer of approximately \$712,000 for the nine month period ended 30 September 2005, two customers totalling approximately \$2,520,000 for the year ended 31 December 2004, and another customer, Power Systems Associates LLC, of approximately \$1,896,205 and \$2,726,703 for the years ended 31 December 2003 and 2002, respectively. Clean Air Power US had net accounts receivable balances due from these customers of \$10,145, \$164,759, \$0 and \$749,816 at 30 September 2005 and 31 December 2004, 2003 and 2002, respectively.

Clean Air Power US performs ongoing credit evaluations of its customers and generally requires no collateral.

### *Allowance for Doubtful Accounts*

Clean Air Power US evaluates the collectibility of its trade receivables based on a combination of factors. Clean Air Power US regularly analyses its significant customer accounts, and, when it becomes aware of a specific customer's inability to meet its obligations to Clean Air Power US, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position, Clean Air Power US records a specific reserve for bad debt to reduce the related receivable to the amount expected to be collected. Clean Air Power US also records reserves for bad debt for all other customers based on a variety of factors including the length of time the receivables are past due, the financial health of the customer, macroeconomic considerations and historical experience. If circumstances related to a specific customer change, Clean Air Power US's estimates of the recoverability of receivables could be further adjusted or the related receivables could be written-off to the allowance as uncollectible.

## **Part III — Historical financial information on the Company and Clean Air Power Inc.**

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### *Inventories*

Inventories are stated at the lower of weighted-average cost or market and consist generally of purchased components to be used in complete fuel systems.

### *Property and Equipment*

Property and equipment are stated at cost and are depreciated on a straight-line basis over the estimated useful lives of the assets, ranging from three to five years. Leasehold improvements are amortised using the straight-line basis over the estimated useful life of the asset or the lease term whichever is shorter. For the nine month period ended 30 September 2005 and the years ended 31 December 2004, 2003 and 2002, depreciation expense was \$316,469, \$494,973, \$430,505 and \$219,399, respectively.

### *Impairment of Long-Lived Assets*

Clean Air Power US assesses potential impairments to its long-lived assets when there is evidence that events or changes in circumstances have made recovery of the asset's carrying value unlikely. An impairment loss would be recognised when the sum of the expected future undiscounted net cash flows is less than the carrying amount of the asset. Should an impairment exist, the impairment loss would be measured based on the excess of the carrying amount of the asset over the asset's fair value. Clean Air Power US has identified no such impairment losses to date.

### *Intangible Assets*

Clean Air Power US adopted Statement of Financial Accounting Standards ("SFAS") 142, "*Goodwill and Other Intangible Assets*," at the beginning of fiscal 2002, which superseded APB 17, "*Intangible Assets*," and eliminated the requirement to amortise goodwill and indefinite-lived intangible assets. Instead, goodwill and other intangibles with indefinite lives are tested for impairment on at least an annual basis utilising a test that begins with an estimate of the fair value of the reporting unit or intangible asset. See page 54 for discussion of Asset Impairment Charge.

### *Revenue Recognition*

Clean Air Power US recognises revenue in accordance with the US Securities and Exchange Commission Staff's Accounting Bulletin 104 ("SAB 104") "*Revenue Recognition*". Revenue is recognised when all four of the following criteria are met: (i) persuasive evidence that an arrangement exists; (ii) delivery of the products and/or services has occurred; (iii) the selling price is fixed or determinable; and (iv) collectability is reasonably assured.

From time to time, Clean Air Power US enters into agreements for financial assistance with government agencies to fund various research and development efforts. Revenue from such research and development activities is recognised systematically over the performance period.

### *Warranty Reserves*

Clean Air Power US provides limited warranties on certain of its products for periods of up to two years. Clean Air Power US recognises warranty reserves when products are shipped based upon an estimate of total warranty costs, and such reserves are included in accrued liabilities.

### *Research and Development Costs*

Costs incurred in connection with research and development are charged to operations as incurred.

### *Shipping and Handling Costs*

Shipping and handling costs are accounted for in accordance with Emerging Issues Task Force Issue No. 00-10, "*Accounting for Shipping and Handling Costs*." Amounts billed to customers in sales transactions related to shipping and handling are reported as revenues and costs incurred are classified as cost of goods sold.

## Part III — Historical financial information on the Company and Clean Air Power Inc.

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### *Advertising Costs*

Advertising costs are expensed as incurred and were \$88,548, \$135,046, \$262,192 and \$136,451 for the nine month period ended 30 September 2005 and the years ended 31 December 2004, 2003 and 2002, respectively.

### *Income Taxes*

Deferred income taxes result primarily from temporary differences between financial and tax reporting. Deferred tax assets and liabilities are determined based on the difference between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes using enacted tax rates. A valuation allowance is established to reduce a deferred tax asset to the amount that is expected more likely than not to be realised.

### *Stock-Based Compensation*

Clean Air Power US measures compensation expense for its stock-based employee compensation plans using the intrinsic-value method and provides pro forma disclosures of net income (loss) as if the fair-value method had been applied in measuring compensation expense.

Pro forma information regarding net income required by SFAS No. 123 “*Accounting for Stock-Based Compensation*” is determined as if Clean Air Power US had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using the minimum-value method for option pricing using weighted-average assumptions of: risk-free interest rate of 4.1 per cent, 3.0 per cent, 3.0 per cent and 5.0 per cent for the nine month period ended 30 September 2005 and years ended 31 December 2004, 2003 and 2002, respectively; dividend yield of 0 per cent for all periods; and weighted-average expected life of the option of five years for all periods.

For the purpose of pro forma disclosure, the estimated fair value of Clean Air Power US’s outstanding stock options is amortised to expense over the life of the options. The effect of applying this SFAS No. 123 resulted in a pro forma net loss that was not materially different from the net loss as reported for all periods.

### *Comprehensive Income*

Clean Air Power US has adopted SFAS 130, “*Reporting Comprehensive Income*,” which requires that all components of comprehensive income, including net loss, be reported in the financial statements in the period in which they are recognised.

Comprehensive income is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Net loss and other comprehensive income, including unrealised gains and losses on investments, shall be reported, net of their related tax effect, to arrive at comprehensive income.

### *New Accounting Pronouncements*

In December 2004, the FASB issued SFAS No. 123(R), “*Share-Based Payment*” (“SFAS 123(R)”), which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. In April 2005, the Securities and Exchange Commission approved a new rule that delays the effective date of SFAS 123(R), which requires companies to expense the value of employee and director stock options and similar awards. SFAS 123(R) is now effective 1 January 2006, for Clean Air Power US. Clean Air Power US has reviewed the methodology for implementation, as well as the fair value model to be used for valuing share-based payments and has determined that its adoption will not have a significant impact on Clean Air Power US.

In December 2004, the FASB issued SFAS No. 53, “*Exchanges of Nonmonetary Assets*” (“SFAS 153”) which eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets and replaces it with a general exception from fair value measurement for exchanges of nonmonetary assets that do not have commercial substance. Clean Air Power US is required to adopt SFAS 153 for nonmonetary asset exchanges occurring in the first quarter of fiscal year 2006 and its adoption is not expected to have a significant impact on Clean Air Power US’s results of operations, financial condition or cash flows.

In May 2005, the FASB issued SFAS No. 154, “*Accounting Changes and Error Corrections*” (“SFAS 154”), a replacement of APB Opinion No. 20 “*Accounting Changes*” and FASB Statement No. 3. SFAS 154 requires retrospective application to prior periods’ financial statements of a voluntary change in accounting

### Part III — Historical financial information on the Company and Clean Air Power Inc.

principle, unless it is impractical. Opinion No. 20 previously required that most voluntary changes in accounting principles be recognised by including, in net income, for the period of the change, the cumulative effect of changing to the newly adopted accounting principle. SFAS 154 also requires that a change in the method of depreciation, amortisation, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. Opinion No. 20 previously required that such a change be reported as a change in accounting principle. SFAS 154 also requires that any errors in the financial statements of a prior period shall be reported as a prior-period adjustment by restating the prior period financial statements. SFAS 154 is effective for accounting changes and corrections or errors made in fiscal years beginning after 15 December 2005. Clean Air Power US does not currently expect this statement to have an impact on its financial statements.

#### Licence Agreement

In 1996, Clean Air Power US entered into a licence agreement with Caterpillar, Inc., giving Caterpillar limited exclusive rights to Dual-Fuel™ technology. The licence agreement was coupled with a \$2,500,000 loan allowing Clean Air Power US to further develop its Dual-Fuel™ technology. The Caterpillar licence agreement was amended in 1998 to expand Caterpillar's licence rights in exchange for royalties. In 2001, the licence agreement was amended again to allow Clean Air Power US to retain non-exclusive rights to develop and commercialise Dual-Fuel™ engines in the power generation area. The exclusive licence agreement was terminated in November 2005 as Caterpillar's current business model necessitates a restructuring of its business relationship with Clean Air Power US. The termination does not affect Clean Air Power US's ability to install the Dual-Fuel™ conversion kit on Caterpillar engines. In addition, the termination of the exclusive licence allows Clean Air Power US to establish new commercial relationships with truck manufacturers and distributors in North America.

#### Marketable Securities

Clean Air Power US has no marketable securities as of 30 September 2005 and years ended 31 December 2004 and 2003. Marketable securities consisted of the following at 31 December 2002:

	Amortised cost	Unrealised gain/(loss)	Aggregate fair value
Corporate Bonds	2,309	—	2,309

#### Composition of Certain Balance Sheet Captions

	At 31 December 2002 \$000	At 31 December 2003 \$000	At 31 December 2004 \$000	At 30 September 2005 \$000
<b>Accounts receivable:</b>				
Trade receivables	2,249	3,016	1,104	840
Accrued interest receivable	65	—	—	—
Allowance for doubtful accounts	(100)	(523)	(376)	(347)
	<u>2,214</u>	<u>2,493</u>	<u>728</u>	<u>493</u>
<b>Inventories:</b>				
Purchased components	1,701	3,623	3,811	2,212
Work in process	1,140	15	135	121
Finished goods	—	—	44	218
Allowance for valuation and obsolescence	(600)	(203)	(638)	(554)
	<u>2,241</u>	<u>3,435</u>	<u>3,352</u>	<u>1,997</u>
<b>Property and equipment:</b>				
Computer equipment and software	529	813	837	843
Machinery and equipment	1,034	1,066	1,094	1,087
Furniture and fixtures	116	96	97	97
Leasehold improvements	—	49	155	157
Accumulated depreciation	(422)	(845)	(1,339)	(1,630)
	<u>1,257</u>	<u>1,179</u>	<u>844</u>	<u>554</u>

## Part III — Historical financial information on the Company and Clean Air Power Inc.

	At 31 December 2002 \$000	At 31 December 2003 \$000	At 31 December 2004 \$000	At 30 September 2005 \$000
<b>Other assets:</b>				
Debt issuance costs in connection with series D warrants, including beneficial conversion	—	—	666	2,610
Deferred issuance costs	—	—	—	421
Goodwill	2,372	2,372	—	—
Internet domain name	25	20	—	—
Loan origination fees	—	23	4	—
Other	—	—	5	—
	<u>2,397</u>	<u>2,415</u>	<u>675</u>	<u>3,031</u>
<b>Accrued liabilities:</b>				
Accrued compensation	897	608	141	151
Accrued warranty	776	1,169	1,625	1,315
Accrued interest	343	11	14	93
Accrued royalty	152	—	—	—
Settlement expenses	—	—	429	—
Due to Hardstaff	—	—	241	279
Deferred revenue	97	—	185	140
Other	233	297	558	690
	<u>2,498</u>	<u>2,085</u>	<u>3,193</u>	<u>2,668</u>

### Acquisitions

In September 2002, Clean Air Power US acquired the assets of Harris International Sales Corporation (“HIS”), a manufacturer of catalytic emissions reductions systems. The acquisition was accounted for using the purchase method. Beginning 13 September 2002, the results of operations of HIS have been included in Clean Air Power US’s statements of operations. The purchase price was \$3 million which consisted of the payment of cash of \$1.5 million and the issuance of a note payable for \$1.5 million to be repaid over two years. Clean Air Power US paid a purchase price in excess of the fair value of the tangible assets acquired and thus recorded goodwill because of the potential synergies in technology and market segments. The purchase price was allocated to the fair value of the assets acquired as follows:

	<b>\$000</b>
Accounts receivable	210
Inventory	368
Other assets	25
Property and equipment	25
Goodwill	<u>2,372</u>
	<u>3,000</u>

### ASSET IMPAIRMENT CHARGE

During 2004, Clean Air Power, Inc. recognised an impairment loss of \$2,387,000 pertaining to the acquisition of Harris HIS. Clean Air Power US identified certain conditions including significantly lower sales and continued operation losses as indications of asset impairment. These conditions led to operating results and forecasted future results that were substantially less than had been anticipated at the time of Clean Air Power US’ acquisition of HIS.

## Part III — Historical financial information on the Company and Clean Air Power Inc.

### DEBT

The following summarises Clean Air Power US's debt:

	At 31 December 2002 \$000	At 31 December 2003 \$000	At 31 December 2004 \$000	At 30 September 2005 \$000
Secured note payable to Power Systems Associates. Note was paid off in full in March 2003.	1,503	—	—	—
Secured promissory note payable to MVE, Inc. was due on 31 May 2001. The note was forgiven in October 2003.	250	—	—	—
12% secured convertible promissory notes	—	—	1,000	5,850
Note payable relating to the acquisition of BKM in 2001	936	335	222	—
8% promissory note	—	—	—	53
8% promissory note	—	—	—	38
Note payable related to acquisition of HIS, bears interest at 5%, payments of \$65,807 are due monthly for 24 months with the last payment due in September 2004. The loan is secured by Clean Air's interest in the patents acquired.	1,320	580	260	260
Equipment line of credit from Comerica Bank not to exceed \$1,000,000; interest accrues at the Prime Rate plus ½%; loan is secured by substantially all the assets of Clean Air Power US.	—	607	327	117
Revolving line of credit from Comerica Bank not to exceed \$3,000,000; interest accrues at the Prime Rate plus ½%; loan is secured by substantially all assets of Clean Air Power US.	—	1,133	—	—
	4,009	2,655	1,809	6,318
Less current portion	(2,892)	(1,993)	(1,712)	(6,318)
	<u>1,117</u>	<u>662</u>	<u>97</u>	<u>—</u>

Secured convertible promissory notes dated 23 August 2005, due to certain shareholders, in the aggregate principal amount of \$5,849,994, bear interest at 12 per cent compounded annually. Notes along with accrued but unpaid interest are due on 31 March 2006. The notes are subordinate to Clean Air Power US's equipment line of credit with Comerica Bank, and are secured by substantially all of the assets of Clean Air Power US including certain patents and trademarks. Additionally, the holders of the notes were issued warrants for the purchase of shares of Clean Air Power US's capital stock. The warrants have a term of 10 years and may be exercised only if a Qualified Financing occurs as defined by the agreement. The notes are convertible at any time, at the option of the holders of two-thirds of the outstanding principal amount of the notes, into shares of Series D preferred stock. The number of shares of Series D preferred stock is determined by taking the outstanding principal of the notes plus any accrued but unpaid interest, divided by the conversion price, currently set at \$0.06534. At 30 September 2005, the notes are convertible into 90,695,492 shares of Series D preferred stock. The terms of the notes contain anti-dilution provisions and other provisions which limit the ability of Clean Air Power US to issue additional equity, or incur indebtedness outside the ordinary course of business, or cause a merger or sale of Clean Air Power US or a material asset, without prior written consent of the holders of at least a majority of the outstanding principal balance of the notes. The notes were issued in three separate tranches, beginning in December, 2004. The notes are accompanied by warrants, which enable the note holders to purchase an additional 89,531,580 shares of Series D preferred stock. Further details of the warrants are set out in the Warrants note on Page 60.

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The note payable relating to the acquisition of BKM in 2001, with an original principal amount of \$1,200,000, has payments of \$60,000 due each calendar quarter for 20 consecutive quarters with the last payment due on 30 June 2006. In 2003, Clean Air Power US entered into an agreement with BKM whereby Clean Air Power US returned approximately \$393,000 of inventory which was accounted for as a reduction to the outstanding debt balance. As a result, the remaining quarterly payments were reduced to \$41,900. Clean Air Power US may at its discretion make each payment in cash or in shares of its Series A preferred stock valued at the then fair value as determined by Clean Air Power US's Board of Directors, provided that no payment shall be comprised of more than 60 per cent preferred stock. The imputed interest rate is approximately eight per cent. On 30 September 2005, the note was cancelled and reissued as two separate notes, in the amounts of \$79,088 and \$56,555, respectively.

The eight per cent promissory notes are due in payments of \$41,900 in each calendar quarter for three consecutive quarters commencing on 30 September 2005 with the last payment due on 30 June 2006 in the amount of \$9,967. Clean Air Power US may at its discretion make each payment in cash or in shares of its Series C-1 preferred stock valued at the then fair value as determined by Clean Air Power US's Board of Directors, provided that no payment shall be comprised of more than 60 per cent preferred stock.

The note payable related to acquisition of HIS, bears interest at five per cent, payments of \$65,807 were due monthly for 24 months with the last payment due in September 2004. The loan is secured by Clean Air Power US's interest in the patents acquired. During 2004, Clean Air Power US ceased making payments on this Note subject to the resolution of a claim by Clean Air Power US against HIS.

The equipment line of credit from Comerica Bank, not to exceed \$1,000,000 bears interest at the Prime Rate plus ½ per cent. The line of credit is secured by substantially all the assets of Clean Air Power US.

Certain of Clean Air Power US's senior credit arrangements contain requirements to maintain a minimum liquidity of cash and cash equivalents of not less than \$1,000,000, plus net accounts receivable under 90 days old, that is the greater of (i) one and twenty-five one-hundredths (1.25) times the sum of total indebtedness to bank plus 50 per cent of current liabilities, or (ii) four months cash burn. Clean Air Power US was out of compliance with the covenants as of 30 September 2005 and has obtained compliance waivers from the bank.

The Joint Venture had a loan agreement with Hardstaff which allowed the Joint Venture to borrow up to \$200,000 from Hardstaff. The interest rate on the loan was the lesser of the interest rate payable by Hardstaff to its bank or 10 per cent. Borrowing under the loan was to be repaid upon the earlier of 14 June 2005 or the distribution by the Joint Venture of profits to its shareholders. The loan was secured by a mortgage debenture on certain assets of the Joint Venture. The loan facility terminated on 14 June 2005. Clean Air Power US had no borrowings under the facility during 2005 or the years ended 31 December 2004, 2003, or 2002.

In October 2003, Clean Air Power US entered into a Mutual Release with Chart, Inc., formerly known as MVE, Inc. In conjunction with the Mutual Release, both parties agreed to release each other from the Distribution agreement entered into in October 2002 and related amendments. Additionally, MVE agreed to cancel the then outstanding debt due to MVE which amounted to \$500,000.

#### COMMITMENTS AND CONTINGENCIES

Clean Air Power US leases certain equipment and facilities under non-cancellable operating leases expiring within the next four years. Future minimum lease payments required under non-cancellable operating leases as of 30 September 2005 are as follows:

Three month period ending 31 December 2005	\$105,445
Year ending 31 December 2006	292,341
Year ending 31 December 2007	11,958
Year ending 31 December 2008	760
Year ending 31 December 2009	760
	<u>\$411,264</u>

Total rent expense charged to operations was \$406,145, \$645,084, \$596,182 and \$539,178 for the nine month period ended 30 September 2005 and the years ended 31 December 2004, 2003 and 2002, respectively.

A third party claim was brought against Clean Air Power US by a major customer, Power Systems Associates LLC, on 25 June 2002 in the Ontario Superior Court of Justice in the matter of Fiba Canning, Inc.

### **Part III — Historical financial information on the Company and Clean Air Power Inc.**

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vs. TRS Ent. Ltd., Caterpillar Commercial Services Ltd., Power Systems Associates LLC, Toromont Industries Limited and Toromont Industries Ltd. Fiba Canning initially sought relief of \$1,250,000 from the defendants for the sale by defendants of allegedly defective tractors that were equipped with Clean Air Power US's Dual-Fuel™ systems. Fiba Canning offered to reduce their claim to \$690,000 without support for the revised amount; regardless, Clean Air Power US believed this case was without merit. In January 2005, Clean Air Power US reached a settlement agreement whereby Clean Air Power US paid \$32,940 to resolve the claim.

During 2004, Clean Air Power US was notified of an indemnity claim related to trucks owned by the City of Los Angeles, which were temporarily idled due to a malfunction of an engine component. Clean Air Power US reached an agreement with various parties involved in the claim during 2005. The full obligation was recorded to expense in 2004 and is included in accrued liabilities at 31 December 2004. No liability remains payable under the settlement agreement at 30 September 2005.

#### **Capital Structure**

##### *Convertible Preferred Stock*

On 18 March 2005, Clean Air Power US's shareholders and directors amended and restated its Certificate of Incorporation. Under the amended and restated Certificate, Clean Air Power US is authorised to issue 2,229,660,000 shares in two classes of stock; 1,122,000,000 of common shares and 1,107,660,000 of preferred shares. Authorised shares of common stock may be issued in two series; 561,000,000 of Voting Common Stock (\$0.001 par value) and 561,000,000 of Non-Voting Common Stock (\$0.001 par value). Authorised shares of preferred stock may be issued in four series; 1,830,000 shares have been designated "Series C-1 Preferred Stock", 1,830,000 shares have been designated "Series C-2 Non-Voting Preferred Stock", 552,000,000 shares have been designated "Series D-1 Preferred Stock", and 552,000,000 shares have been designated "Series D-2 Non-Voting Preferred Stock". The Series C-1 Preferred Stock and the Series C-2 Non-Voting Preferred Stock are collectively referred to herein as "Combined Series C Preferred Stock" and the Series D-1 Preferred Stock and D-2 Non-Voting Preferred Stock are collectively referred to herein as "Combined Series D Preferred Stock".

Upon the filing of the Amended and Restated Certificate of Incorporation, Clean Air Power US's Series A-3 Preferred Stock, Series A-4 Preferred Stock, Series B-1 Preferred Stock and Series B-2 Preferred Stock was automatically converted into shares of Common Stock. Each outstanding share of Series A-3 Preferred Stock and Series A-4 Non-Voting Preferred Stock was converted into 1.95122 shares of Common Stock and each outstanding share of B-1 Preferred Stock and Series B-2 Non-Voting Preferred Stock was converted into one share of Common Stock.

Holders of Series B-1 and B-2 preferred shares whose shares of Series B-1 and B-2 preferred stock were converted into shares of common stock, who did not participate in the purchase of the required amount of the Series D secured convertible promissory notes and warrants, and who entered into a release agreement with Clean Air Power US were given Series C warrants to purchase shares of Series C preferred stock. Each Series C preferred warrant is exercisable for one share of Series C preferred stock for every 10 shares of Series B preferred stock held prior to the conversion. The exercise price of the Series C warrants is \$5.125 per share and the warrants are exercisable until 28 March 2007.

The holders of shares of Combined Series D Preferred Stock are entitled to receive dividends prior to and in preference to any declaration or payment of dividends on the Combined Series C Preferred Stock and/or the Common Stock at the rate of \$0.0052344 per share of Combined Series D Preferred Stock per annum when, as and if declared by Clean Air Power US's Board of Directors. Such dividends are cumulative. If such legally available assets are not sufficient to enable the holders of shares of Combined Series D Preferred Stock to receive their full preferential dividend, the dividend shall be distributed ratably among the holders of the Combined Series D Preferred Stock in proportion to the amount of such stock owned by each such holder. After the distributions to the holders of Combined Series D Preferred Stock have been paid, the holders of shares of Combined Series C Preferred Stock are entitled to receive dividends prior to and in preference to any declaration or payment of dividends on the Common Stock at the rate of \$0.41 per share of Combined Series C Preferred Stock per annum when, as and if declared by Clean Air Power US's Board of Directors. Such dividends are cumulative. If and after dividends in the full preferential amounts have been declared and paid to the Combined Series D Preferred Stock and Combined Series C Preferred Stock, Clean Air Power US may declare additional dividends out of legally available funds. Such dividends are to be paid on a pro rata basis to the holders of the Combined Series D Preferred Stock, Combined Series C Preferred

### **Part III — Historical financial information on the Company and Clean Air Power Inc.**

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Stock and Common Stock on a pari passu basis to the holders of such shares as though all shares are converted to Common Stock on a fully diluted basis. If such legally available assets are not sufficient to enable the holders of shares of Combined Series C Preferred Stock to receive their full preferential dividend, the dividend shall be distributed ratably among the holders of the Combined Series C Preferred Stock in proportion to the amount of such stock owned by each such holder.

In the event of any liquidation, dissolution or winding up of Clean Air Power US, the holders of Combined Series D Preferred Stock shall be entitled to receive, prior and in preference to any distribution of any of the assets to the holders of Combined Series C Preferred Stock and/or Common Stock an amount per share equal to the sum of \$0.13068 for each outstanding share of Combined Series D Preferred Stock and an amount equal to declared but unpaid dividends on such shares. After distribution to holders of Combined Series D Preferred Stock, the holders of Combined Series C Preferred Stock shall be entitled to receive, prior and in preference to any distribution of any of the assets to the holders of Common Stock, an amount per share equal to the sum of \$10.25 and an amount equal to declared but unpaid dividends on such shares. The remaining assets of the corporation available for distribution to stockholders shall be distributed among the holders of Combined Series D Preferred Stock, Combined Series C Preferred Stock and Common Stock pro rata based on the number of shares of Common Stock held by each, assuming the full conversion of all such Preferred Stock to Common Stock at the then applicable conversion price.

On or at any time after 31 January 2008 and upon the receipt by Clean Air Power US of the written request of the holders of not less than a majority of the then outstanding Series D Preferred Stock, Clean Air Power US will redeem the shares of the Combined Series D Preferred Stock at a price per share equal to \$0.0817875 plus any declared but unpaid dividends. If, on or after 31 January 2008, no shares of Combined Series D-1 Preferred Stock are outstanding, then holders of Combined Series C Preferred Stock are entitled to initiate a redemption of Combined Series C Preferred Stock at a per share price of \$6.40625 plus any declared but unpaid dividends.

Each share of Series D-1 Preferred Stock is convertible at any time, at the option of the holder, into shares of Voting Common Stock, and Series D-2 Non-Voting Preferred Stock is convertible at any time, at the option of the holder, into shares of Non-Voting Common Stock, at the ratio determined by dividing \$0.06534 by the Combined Series D Conversion Price (initially and presently, \$0.06534), as adjusted from time to time. The Combined Series D Conversion Price automatically adjust to the per share price of any additional stock issued for no consideration or issued at a per share price lower than the then current respective applicable conversion price.

Each share of Series C-1 Preferred Stock is convertible at any time, at the option of the holder, into shares of Voting Common Stock, and Series C-2 Non-Voting Preferred Stock is convertible at any time, at the option of the holder, into shares of Non-Voting Common Stock at the ratio determined by dividing \$5.125 by the applicable Series C conversion price. On 14 February 2005, the Combined Series C conversion price was adjusted by the issuance of notes and warrants convertible and exercisable into Combined Series D Preferred Stock at an issue price of \$0.06534 per share. Under the certificate of incorporation then in effect, the Combined Series C conversion price was adjusted by dividing the original Combined Series C issue price by the Combined Series D issue price:  $\$5.125/\$0.06534 = \$78.43587$ . Under the Certificate of Incorporation presently in effect, there can be no further price-based adjustments to the Series C conversion price.

Shares of Combined Series D Preferred Stock and Combined Series C Preferred Stock shall automatically be converted into Voting Common Stock or Non-Voting Common Stock, as the case may be, at the conversion price in effect for each such share immediately upon the earlier of (i) sale of Clean Air Power US's Common Stock in a Qualified IPO, indicated by a firm commitment underwritten public offering on a stock exchange or over-the-counter market acceptable to the holders of a majority of the then outstanding Combined Series C-1 Preferred Stock and Combined Series D-1 Preferred Stock (voting together as a single class on an as converted to Common Stock basis), or pursuant to a registration statement under the US Securities Act of 1933, or the public offering price of which is not less than three times the original Combined Series D issue price per share, as adjusted, and which results in aggregate proceeds of fifteen million dollars (\$15,000,000); or (ii) the date (s) specified by written consent or agreement of the holders of a majority of the then outstanding shares of Series D-1 Preferred Stock and Series C-1 Preferred Stock voting together as a single class on an as converted to Common Stock basis.

The holder of each share of Series C-1 Preferred Stock and Series D-1 Preferred Stock has one vote per share of voting Common Stock into which such Series C-1 or D-1 Preferred stock could be converted. For the election of directors, the holders of the outstanding Series C-1 and Series D-1 Preferred Stock, voting as

### **Part III — Historical financial information on the Company and Clean Air Power Inc.**

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a single class on an as-converted basis, are entitled to elect three directors; the holders of voting common stock voting as a single class elect one director; and the holders of the Series C-1 Preferred Stock, Series D-1 Preferred Stock, and voting Common Stock, voting as a single class on an as-converted to common basis, elect the remaining directors.

So long as any shares of the Series C-1 and D-1 Preferred Stock are outstanding, the company cannot undertake the following transactions without obtaining the approval of 2/3 of the then outstanding shares of Series C-1 and D-1 Preferred Stock, voting as a single class on an as converted to common basis: (i) increase or decrease the number of authorised shares of Preferred or Common stock; (ii) create any new class of stock or issue securities convertible into a class of stock senior to or in parity with the Combined Series D Preferred Stock; (iii) effectuate any redemption or repurchase of shares (except for as pursuant to the Charter); (iv) liquidate or dissolve the company; (v) increase or decrease the board of directors; (vi) authorise any dividend or other stock distribution; (vii) issue stock to employees or consultants outside of the Stock Option Plan; (viii) authorise or issue additional shares of Combined Series D stock; (ix) effect any merger, acquisition or transaction in excess of \$1,000,000; (x) substantially change the business of the corporation; (xi) incur any indebtedness greater than \$500,000; or (xii) amend the Charter or bylaws.

The holders or transferees of Clean Air Power US's Common Warrants, Series C Warrants, Combined Series C Preferred Stock, and Combined Series D Preferred Stock (or common stock issued upon conversion of such preferred stock) have a right of first offer with respect to specified future issuances of Clean Air Power US's securities. These holders have a pro rata right, based on their percentage equity interest in Clean Air Power US, to participate in subsequent financings, subject to specified exceptions.

Subject to certain exceptions, before any holder of Clean Air Power US's common or preferred stock (who is a party to the Amended and Restated Shareholders' Agreement), agrees to any sale of Clean Air Power US's securities to a third party, these holders must first offer the securities to Clean Air Power US. If Clean Air Power US does not choose to purchase the securities, the holders of Clean Air Power US's preferred stock (or common stock issued upon conversion of such preferred stock) must be given the opportunity to purchase the shares on the same terms that the third party purchaser was offering. If multiple holders of Clean Air Power US's preferred stock desire to purchase the securities, then the securities shall be divided pro-rata among the various holders of preferred stock desiring to participate in the transaction.

In the event that neither Clean Air Power US nor the holders of its preferred stock desire to purchase the securities being sold, the holders of preferred stock are entitled to sell to the third party purchaser a number of securities equal to their pro-rata portion of the total amount of securities that the third party purchaser is buying from the selling holder.

#### *Stock Options*

Clean Air Power US adopted its 2001 Stock Option/Stock Issuance Plan (the "Plan") in October 2001. Employees, non-employee members of the Board of Directors and consultants are eligible to participate in the Plan. The stock issuable under the Plan are shares authorised but unissued or reacquired common stock and was initially limited to 405,000 shares. The Board of Directors increased the shares in February 2003 and January 2002 to 1,310,000 and 810,000, respectively. The option exercise price per share will be not less than 85 per cent of the fair value per share of common stock on the option grant date. The options will generally vest over four years and will have a term not in excess of ten years from the option grant date.

### Part III — Historical financial information on the Company and Clean Air Power Inc.

The following is a summary of stock option activity:

	Number of shares	Weighted-average exercise price
Balance at 1 January 2002	10,000	\$1.00
Granted	489,593	\$1.00
Forfeited	<u>(14,250)</u>	\$1.00
Balance at 31 December 2002	485,343	\$1.00
Granted	346,052	\$1.30
Forfeited	(58,718)	\$1.20
Exercised	<u>(594)</u>	\$1.10
Balance at 31 December 2003	772,083	\$1.12
Granted	148,227	\$1.25
Forfeited	(182,965)	\$1.24
Exercised	<u>—</u>	—
Balance at 31 December 2004	737,345	\$1.10
Granted	1,500	\$1.25
Forfeited	(502,268)	\$1.07
Exercised	<u>—</u>	—
Balance at 30 September 2005	<u>236,577</u>	<u>\$1.20</u>

At 30 September 2005 and at 31 December 2004, 2003 and 2002, 209,133, 675,975, 467,887 and 82,682 shares, respectively, were vested and exercisable. Exercise prices for options outstanding as of 30 September 2005 ranged from \$1.00 to \$1.25 per share. The weighted-average remaining contractual life of those options is 7.5 years. The fair value for financial reporting purposes of options granted during the nine month period ended 30 September 2005 and the years ended 31 December 2004, 2003 and 2002 was \$0.065, \$0.065, \$0.10 and \$0.20 per share, respectively.

#### Warrants

Clean Air Power US has various outstanding warrants to purchase a total of 204,003 shares of common stock at exercise prices ranging from \$0.10 to \$5.10 per share with expiration dates ranging from January 2006 to March 2013. The warrants are fully vested and exercisable as of 30 September 2005.

In July 2001, Clean Air Power US granted a warrant to purchase 50,000 shares of Series A-1 Preferred Stock at \$10.00 per share to a financial adviser in connection with Clean Air Power US's sale of Series A-1 Preferred Stock. The warrant is exercisable from the date of issuance to the earlier of a public offering or July 2004.

In January 2002, Clean Air Power US granted a warrant to purchase 5,000 shares of common stock at \$10.00 per share to an executive recruitment firm. The warrants are exercisable from the date of issuance to January 2007.

In February 2003, Clean Air Power US granted warrants to purchase 88,600 shares of Series B-1 Preferred Stock at \$5.10 per share to one of its executives. The warrants are exercisable at the date of issuance through March 2013. When Series B-1 Preferred Stock was eliminated in 2005, the remaining vested B-1 warrants were converted to common stock warrants.

On 23 August 2005, in connection with the sale of Series D, secured, convertible promissory notes Clean Air Power US issued Series D warrants that will be exercisable for the purchase of 89,531,580 shares of Series D preferred stock. The initial exercise price per share is \$0.06534. The Series D warrants expire ten years from the issuance date. The warrants may be exercised by the payment of the exercise price per share times the number of warrant shares granted in cash, or in the alternative, warrants may be exercised by cashless net settlement exchange by receiving the number of shares with a market value on the date of exercise equivalent to the fair market value of the warrant shares on the date of exercise, minus the exercise price per share, multiplied by the number of shares granted. The warrant price is adjusted in the event: (i) there is a capital reorganisation or Clean Air Power US merges or consolidates with or into another corporation, or sell its properties and assets as, or substantially as, an entirety to any other person; or (ii) there is a combination, split or subdivision of the outstanding shares of Series D preferred stock. Upon the occurrence of any Qualified IPO (as defined in the Charter) prior to the expiration of the Series D warrants, these

### Part III — Historical financial information on the Company and Clean Air Power Inc.

warrants are immediately exercisable for that number of shares of common stock equal to the number of shares of common stock that would have been received had the warrants been exercised in full and the Series D preferred stock into which such warrants were exercisable had simultaneously been converted into common stock immediately prior to such event.

The Company allocated the proceeds of the convertible promissory notes to the carrying value of the Series D preferred stock warrants and the convertible promissory notes on the basis of their relative fair values. The allocation of fair value created a beneficial conversion feature equal to the fair value of the warrants. The amount of the discount assigned to the beneficial conversion feature is limited to the proceeds allocated to the convertible instrument. As such, the fair value of the warrants was \$4,476,579 and the resulting beneficial conversion feature was \$1,373,415, determined using the Black-Scholes option pricing model with the following assumptions: expected yield of 0 per cent, expected volatility of 60 per cent, risk-free interest rate of 4.14 per cent and expected life of ten years. For the nine-month period ending 30 September 2005 and for the year ending 31 December 2004, Clean Air Power US incurred interest expense associated with the warrants and beneficial conversion feature of \$2,906,332 and \$333,333, respectively.

In February 2005, in connection with sale of Series D secured convertible promissory notes, Clean Air Power US issued to certain holders of Series B preferred stock, Series C warrants to purchase 114,061 shares of Series C preferred stock. The exercise price of Series C warrants is \$5.125 per share and are exercisable until 28 March 2007.

On 19 December 2005, a proportion of the Series D warrants were exercised, raising \$2.5 million of cash.

#### *Capital Shares Reserved for Future Issuance*

The following shares of capital stock are reserved for future issuance as of 30 September 2005:

	<b>Number of shares</b>
Stock options:	
Granted and outstanding	4,853,425
Reserved for future grants	3,246,575
Warrants	1,230,300
Conversion of preferred stock	<u>28,212,948</u>
Balance at 31 December 2002	<u>37,543,248</u>
Stock options:	
Granted and outstanding	772,083
Reserved for future grants	537,323
Common warrants	139,030
Debt and preferred stock convertible to common	<u>7,770,227</u>
Balance at 31 December 2003	<u>9,218,663</u>
Stock options:	
Granted and outstanding	737,345
Reserved for future grants	572,062
Common warrants	141,050
Debt and preferred stock convertible to common	<u>17,633,066</u>
Balance at 31 December 2004	<u>19,083,523</u>
Stock options:	
Granted and outstanding	236,577
Reserved for future grants	1,072,830
Common warrants	311,585
Preferred warrants	89,531,580
Debt and preferred stock convertible to common	<u>159,734,267</u>
Balance at 30 September 2005	<u>250,886,839</u>

## Part III — Historical financial information on the Company and Clean Air Power Inc.

### INCOME TAXES

At 30 September 2005, Clean Air Power US had federal and California net operating loss carryforwards of approximately \$44.7 million and \$23.6 million, respectively. The federal net operating loss carryforwards will begin to expire in 2006 unless previously utilised and the California net operating loss carryforwards will continue to expire through 2011.

At 30 September 2005, Clean Air Power US had federal and California research and development credit carryforwards of approximately \$143,000 and \$33,000, respectively.

Pursuant to Sections 382 and 383 of the Internal Revenue Code, annual use of Clean Air Power US's net operating loss and credit carryforwards may be limited as a result of a cumulative change in ownership of more than 50 per cent within a three-year testing period.

The components of Clean Air Power US's deferred tax assets as of 30 September 2005 and the years ended 31 December 2004, 2003 and 2002 are shown below. A valuation allowance has been recognised to offset the deferred tax assets as realisation of such assets is uncertain.

	At 31 December 2002 \$000	At 31 December 2003 \$000	At 31 December 2004 \$000	At 30 September 2005 \$000
Deferred tax assets:				
Net operating loss carryforwards	7,965	11,661	15,581	18,890
Research and development credits	236	176	176	176
Accruals and reserves	665	852	1,435	1,084
Other, net	290	—	892	840
	<u>9,156</u>	<u>12,689</u>	<u>18,084</u>	<u>20,990</u>
Deferred tax (liability):				
Convertible debt	—	—	(100)	(264)
Basis difference in fixed assets	—	(82)	(139)	(82)
Less valuation allowance	(9,156)	(12,607)	(17,845)	(20,644)
Net deferred tax	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>

### EMPLOYEE RETIREMENT PLAN

During 2001, Clean Air Power US adopted a 401(k) Profit Sharing Plan (the "401(k) Plan") which covers substantially all employees. The 401(k) Plan provides for voluntary employee contributions up to 25 per cent of annual compensation, subject to annual limits. Clean Air Power US may, at its sole discretion, approve Company contributions, which are subject to a vesting schedule based on years of service. During the years ended 31 December 2003 and 2002, Clean Air Power US recognised matching contributions expense of \$182,532 and \$49,019, respectively. During the nine month period ended 30 September 2005 and the year ended 31 December 2004, Clean Air Power US made no material employer matching contributions.

### RELATED PARTY TRANSACTIONS

At 31 December 2003, Clean Air Power US had a note receivable of \$267,971 due from an officer which carries a 2.7 per cent per annum interest rate. The note is secured by a deed of trust on the officer's house and is due in June 2007. The loan was settled during the year ended 31 December 2004.

Included in accounts payable are amounts due to a warrant holder of \$0, \$51,963, \$63,064 and \$61,088 as of 30 September 2005 and 31 December 2004, 2003 and 2002, respectively.

Included in accounts payable are amounts due to shareholders of \$28,327 and \$58,598, as of 30 September 2005 and 31 December 2004, respectively.

Included in sales for the years ended 31 December 2003 and 2002 are \$1,275,721 and \$118,005, respectively, from sales by the Joint Venture to Hardstaff and its affiliates.

Included in accrued liabilities are amounts due to a member of the Board of Directors totalling \$7,688 and \$0 as of 30 September 2005 and 31 December 2004 respectively.

Included in accrued liabilities are amounts due to a warrant holder of \$93,823 and \$163,683 as of 30 September 2005 and 31 December 2004 respectively.

## Part IV — Unaudited Pro Forma Balance Sheet

### Unaudited Pro Forma Balance Sheet of Clean Air Power Limited

Set out below is an unaudited pro forma balance sheet of Clean Air Power Ltd based on the balance sheet of Clean Air Power US as of 30 September 2005, as adjusted to reflect the Merger, the exercise of warrants by certain warrant holders of Clean Air Power US and funds raised by Clean Air Power Limited upon admission to AIM. The pro forma financial information has been prepared for illustrative purposes only. Because of its nature, the pro forma information addresses a hypothetical situation and, therefore, does not represent Clean Air Power Limited's actual financial position or results. The pro forma financial information has been prepared on the basis above to provide information presenting the Company as it would have looked as at 4 November 2005 as though the Merger, Placing, exercise of warrants and conversion of outstanding notes payable into common stock had taken place at that date.

Proforma Statement of Net Assets	The Company as at 4 November 2005 \$000	Clean Air Power US as at 30 September 2005 \$000	Note 2 \$000	Note 3 \$000	Note 4 \$000	Note 5 \$000	Unaudited Pro Forma \$000
<b>ASSETS</b>							
<b>Current assets:</b>							
Cash and cash equivalents	12	1,936	2,500	—	—	15,150	19,598
Cash and cash equivalents – restricted	—	40	—	—	—	—	40
Accounts receivable, net	—	493	—	—	—	—	493
Inventories, net	—	1,997	—	—	—	—	1,997
Other current assets	—	198	—	—	—	—	198
<b>Total current assets</b>	<b>12</b>	<b>4,664</b>	<b>2,500</b>	<b>—</b>	<b>—</b>	<b>15,150</b>	<b>22,326</b>
Property and equipment, net	—	554	—	—	—	—	554
Other assets	—	3,031	—	(2,610)	—	(421)	—
<b>Total assets</b>	<b>12</b>	<b>8,249</b>	<b>2,500</b>	<b>(2,610)</b>	<b>—</b>	<b>14,729</b>	<b>22,880</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>							
<b>Current liabilities:</b>							
Accounts payable	—	755	—	—	—	—	755
Accrued liabilities	—	2,668	—	—	—	—	2,668
Current portion of notes payable	—	6,318	—	(5,850)	—	—	468
<b>Total current liabilities</b>	<b>—</b>	<b>9,741</b>	<b>—</b>	<b>(5,850)</b>	<b>—</b>	<b>—</b>	<b>3,891</b>
<b>Convertible preferred stock</b>							
Redeemable Series C Voting Preferred Stock	—	3,926	—	(3,926)	—	—	—
	—	3,926	—	(3,926)	—	—	—
<b>Stockholders' equity (deficit)</b>							
Voting common stock	—	8	—	—	(8)	—	—
Non-voting common stock	—	1	—	—	(1)	—	—
Common Shares	12	—	3	26	17	10	68
Additional paid-in capital	—	52,064	2,497	10,125	(8)	14,719	79,397
Accumulated deficit	—	(57,506)	—	(2,985)	—	—	(60,491)
Accumulated other comprehensive income	—	15	—	—	—	—	15
<b>Total stockholders' equity (deficit)</b>	<b>12</b>	<b>(5,418)</b>	<b>2,500</b>	<b>7,166</b>	<b>—</b>	<b>14,729</b>	<b>18,989</b>
<b>Total liabilities and stockholders' equity (deficit)</b>	<b>12</b>	<b>8,249</b>	<b>2,500</b>	<b>(2,610)</b>	<b>—</b>	<b>14,729</b>	<b>22,880</b>

## Part IV — Unaudited Pro Forma Balance Sheet

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### Notes

- 1) The financial information for the Company as at 4 November 2005, and of Clean Air Power US as at 30 September 2005, has been extracted from the financial information set out in Part III.
- 2) \$2.5 million raised by Clean Air Power US through the cash exercise of warrants in December 2005.
- 3) The conversion of outstanding notes payable (\$5,850,000) and accrued interest (\$375,000), and C Voting Preferred Stock (\$3,926,000) into Common Shares on the Merger, together with the write off of \$2,610,000 of debt issuance costs.
- 4) The merger of Clean Air Power US with the Company.
- 5) The net proceeds of the Placing to raise \$17.5 million (£10 million translated at £1/\$1.75) with expenses of \$2.35 million (excluding VAT).
- 6) No adjustments have been made to take into account any changes in the financial position of the Company since 4 November 2005 or of Clean Air Power US since 30 September 2005.

## Part V — Management's Discussion and Analysis of Financial Condition and Results of Operations

The following information should be read with the unaudited and audited financial information provided below and the other statements and notes included in Part III of this document.

US\$000	Year ended 31 December 2003	Year ended 31 December 2004	9 months ended 30 Sep 2004 (unaudited)	9 months ended 30 Sep 2005
Total revenue	13,185	8,004	5,611	5,095
Cost of Sales	(8,785)	(7,063)	(3,123)	(3,222)
Research and Product Development Expenses	(6,096)	(1,777)	(1,251)	(952)
Selling, General and Administrative	(6,954)	(9,819)	(6,338)	(5,104)
Interest Expenses	(228)	(472)	(112)	(3,262)
Interest and Other Income	190	62	33	56

### Results of operations

The discussions below compare Clean Air Power US' audited nine month period ended 30 September 2005 with its unaudited nine month period ended 30 September 2004 and its audited fiscal year ended 31 December 2004 with Clean Air Power US' audited fiscal year ended 31 December 2003. The unaudited consolidated financial information has been prepared on the same basis as the audited financial statements contained in this memorandum and include all adjustments, consisting only of normal recurring adjustments, that the Company considers necessary for a fair presentation of its financial position and results of operations for the periods presented. Historical results are not necessarily indicative of the results to be expected in the future.

#### *Nine months ended 30 September 2005 compared to nine months ended 30 September 2004*

*Revenues.* For the nine months ended 30 September 2005 revenues were \$5,095,000. This represents a 9 per cent decrease from 2004 revenues for the nine month period ended 30 September 2004, which were \$5,611,000. The decrease in revenues in the periods is primarily due to the announcement of withdrawal by Paccar of the Foden Truck, the only truck to which Dual-Fuel™ technology has been applied in commercial numbers in the UK and a decline in after treatment sales in Clean Air Power US.

*Cost of Sales.* Cost of sales for the nine months ended 30 September 2005 increased to \$3,222,000 from \$3,123,000 for the nine month period ended 30 September 2004. This 3 per cent increase is primarily due to a switch in the product mix towards lower margin fixed installations and represents an increase as a percentage of revenues from 56 per cent to 63 per cent.

*Research and product development expenses.* Research and product development expenses reduced to \$952,000 for the nine months ended 30 September 2005 from \$1,251,000 for the nine months ended 30 September 2004. This 24 per cent reduction is primarily due to less R&D activity and reduced headcount in that area.

*Selling, general and administrative expenses.* Selling, general and administrative expenses decreased to \$5,104,000 for the nine months ended 30 September 2005 from \$6,338,000 for the nine months ended 30 September 2004. This represents a decrease of 19 per cent. The change was primarily due to improved cost management and headcount reduction.

*Interest expense.* Interest expense for the nine months ended 30 September 2005 was \$3,262,000 compared to \$112,000 for the nine months ended 30 September 2004. The main reason relates to the valuation and beneficial conversion of the Series D warrants issued in connection with the Series D bridge loan.

*Interest and other income.* Interest and other income was \$56,000 for the nine months ended 30 September 2005 compared to \$33,000 for the nine months ended 30 September 2004.

*Income taxes.* As of 30 September 2005, Clean Air Power US had federal and state tax net operating loss carryforwards of approximately \$44.7 million and \$23.6 million, respectively, subject to limitation. As of 30 September 2004, Clean Air Power US had federal and state loss carryforwards of approximately \$35.6 million and \$18.7 million, respectively, subject to limitation.

## Part V — Management's Discussion and Analysis of Financial Condition and Results of Operations

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### *Fiscal year ended 31 December 2004 compared to fiscal year ended 31 December 2003*

*Revenues.* For the fiscal year ended 31 December 2004 revenues were \$8,004,000. This represents a 39 per cent decrease from the fiscal year ended 31 December 2003, which were \$13,185,000. Revenues for the fiscal year ended 31 December 2004 consisted of sales of low emissions vehicle products and industrial component products. The decrease in revenues from low emissions vehicle and industrial components product lines are primarily the result of the winding-down of operations of the CAP-Hardstaff joint venture and the termination of sales in the US of the C-12 generation of Caterpillar engines as the C-13 generation did not support Dual-Fuel™ conversion technology.

*Cost of Sales.* Cost of sales for the fiscal year ended 31 December 2004 decreased to \$7,063,000 from \$8,785,000 for the fiscal year ended 31 December 2003. This 19 per cent decrease is primarily due to the decrease in the number of units sold but represents an increase as a percentage of revenues from 67 per cent to 88 per cent. This is due to increased warranty reserves and reduced efficiency during the start up of the UK business.

*Selling, general and administrative expenses and research and product development expenses.* These expenses reduced to \$11,596,000 for the fiscal year ended 31 December 2004 from \$13,050,000 for the fiscal year ended 31 December 2003. This 11 per cent decrease was due to reduced R&D activity and headcount reductions.

*Interest expenses.* Interest expense for the fiscal year ended 31 December 2004 was \$472,000 compared to \$228,000 for the fiscal year ended 31 December 2003. This increase in interest expense is due to the amortisation in 2004 of a discount on the issue of preferred stock.

*Interest and other income.* Interest and other income was \$62,000 for the fiscal year ended 31 December 2004 compared to \$190,000 for the fiscal year ended 31 December 2003.

*Income taxes.* As of 31 December 2004, Clean Air Power US had federal and state tax net operating loss carry forwards of approximately \$27.9 million and \$16.4 million, respectively, subject to limitation. As of 31 December 2003, Clean Air Power US had federal and state loss carry forwards of approximately \$30 million and \$13.1 million, respectively, subject to limitation.

### **Asset impairment charge**

Goodwill of \$2.4 million was written off in the fiscal year ended 31 December 2004. The write-off was made due to declining revenues and profitability of the aftertreatment division which was acquired by Clean Air Power US in the fiscal year ended 31 December 2002.

### **Liquidity and capital resources**

Net losses for Clean Air Power US were \$7,390,000 in the nine month period ended 30 September 2005 and \$5,551,000 in the nine month period ended 30 September 2004. Net losses for Clean Air Power US were \$13,452,000 in the fiscal year ended 31 December 2004 and \$8,189,000 in the fiscal year ended 31 December 2003.

As of 30 September 2005, Clean Air Power US' cash and cash equivalents were \$1,976,000, compared to \$1,618,000 at 30 September 2004. As of 31 December 2004, Clean Air Power US cash and cash equivalents were \$2,039,000, compared to \$5,162,000 at 31 December 2003.

For the nine months ended 30 September 2005, Clean Air Power US used \$4,054,000 of cash for operations, compared with \$7,692,000 for the nine month period ended 30 September 2004. A net loss of \$7,390,000 for the nine months ended September of 2005 was offset by depreciation and amortisation charges of approximately \$304,000 and net changes in operating assets and liabilities of \$125,000 additionally reduced cash used in operations.

For the fiscal year ended 31 December 2004, Clean Air Power US used \$8,829,000 of cash for operations, compared with \$10,167,000 for the fiscal year ended 31 December 2003. A net loss of \$13,452,000 for the fiscal year ended 31 December 2004 was offset by depreciation charges of \$500,000. Net changes in operating assets and liabilities increased cash used in operating activities by \$1,393,000. The cash used for operations was also offset by a \$2,387,000 writedown of goodwill and \$10,000 stock compensation.

## **Part V — Management’s Discussion and Analysis of Financial Condition and Results of Operations**

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Through the nine month period ended 30 September 2005, Clean Air Power US’ investing activities provided cash of \$111,000 compared to consuming \$81,000 during the nine month period ended in 30 September 2004. During the nine month period ended 30 September 2005, investing activities consisted primarily of purchases of property and equipment offset by sales of property and equipment. The Company expects to continue to make investments in infrastructure, including the purchase of equipment, to support operations. Through the fiscal year ended 31 December 2004, Clean Air Power US’ investing activities consumed cash of \$26,000 compared to providing \$2,121,000 for the fiscal year ended 31 December 2003. These investing activities consisted primarily of purchases of marketable securities, offset by sales and maturities of marketable securities, and by purchases of property and equipment. The maturities of marketable securities of \$2,309,000 in 2003 accounts for the majority of the variance.

Clean Air Power US received \$4,009,000 from financing activities during the nine month period ended 30 September 2005 mainly due to \$4,622,000 proceeds from the sale of notes. In the nine month period ended 30 September 2004 net proceeds from financing was \$4,662,000, mainly due to \$6,443,001 from the sale of equity securities. Clean Air Power US received approximately \$5,590,000 in the whole of 2004 from financing activities mainly due to \$6,347,000 from the sale of equity securities. In 2003 Clean Air Power US received \$10,845,000 from financing activities mainly due to \$11,448,000 net proceeds from equity financing.

### **Off-balance sheet arrangements**

Clean Air Power does not currently have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

### **Critical accounting policies and estimates**

The preparation of financial statements and related disclosures in conformity with generally accepted accounting principles in the United States requires the Company’s management to make estimates, judgments and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The Company’s significant accounting policies are included in Note 1 to the audited Consolidated Financial Statements for the years ended 31 December 2004 and 2003 and the nine month period to September 2005. These policies, along with the underlying assumptions and judgments made by management in its application, have a significant impact on the Company’s consolidated financial statements. The Company identifies its most critical accounting policies as those that are the most pervasive and important to the portrayal of its financial position and results of operations, and that require the most difficult, subjective and/or complex judgments by management regarding estimates about matters that are inherently uncertain. The Company’s most critical accounting policies are those related to the use of estimates and warranty reserves.

#### *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Examples include provisions for bad debts, warranty reserves and inventory reserves. Actual results could differ from those estimates.

#### *Warranty Reserves*

Clean Air Power provides limited warranties on certain of its products for periods of up to two years. The Company recognises warranty reserves when products are shipped based upon an estimate of total warranty costs, and such reserves are included in accrued liabilities.

## **Part V — Management’s Discussion and Analysis of Financial Condition and Results of Operations**

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### **Recent accounting pronouncements**

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment, or SFAS 123R, which replaces SFAS No. 123, Accounting for Stock-Based Compensation, and supercedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognised in the financial statements based on their fair values beginning with the first interim or annual period after 15 June 2005, with early adoption encouraged. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. Under SFAS 123R, the Company must determine the appropriate fair value model to be used for valuing share-based payments, the amortisation method for compensation cost and the transition method to be used at date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive methods would record compensation expense for all unvested stock options and restricted stock beginning in the first period restated. The Company is evaluating the requirements of SFAS 123R and expects that the adoption of SFAS 123R will have a material impact on the Company’s results of operations and earnings per share. The Company has not yet determined the method of adoption or the effect of adopting SFAS 123R, and have not determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS No. 123.

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# Part VI — Additional Information

## 1. Responsibility Statement

The Directors of the Company accept responsibility for the information contained in this document. To the best of the knowledge and belief of the Directors (who have taken all reasonable care to ensure that this is the case) the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

## 2. The Company and its Subsidiary

**2.1** The Company was incorporated and registered in Bermuda on 4 November 2005 as an exempted company limited by shares with the name Clean Air Power Limited and with registration number 37542.

**2.2** The principal legislation under which the Company operates is the Bermuda Companies Act and the regulations made thereunder. The liability of Shareholders is limited. The Company is also obliged to comply with specific obligations arising from other laws that relate to its activities.

**2.3** The registered office of the Company is at Clarendon House, 2 Church Street, Hamilton HM11, Bermuda. The telephone number of the Company's registered office is +(1) 441 295 1422.

**2.4** From Admission, the Company will have two wholly-owned subsidiaries, Clean Air Power, Inc., a corporation with limited liability incorporated in Delaware, USA, and Clean Air Power Ltd., a private limited company incorporated under the laws of England and Wales. Clean Air Power, Inc. holds 51 per cent of the issued shares in a limited liability company incorporated under the laws of England and Wales, CAP-Hardstaff Limited in which T. Baden Hardstaff Limited holds the remaining 49 per cent interest. CAP-Hardstaff Limited is scheduled to be liquidated in March 2006.

## 3. Exchange Controls and The Takeover Code

**3.1** The BMA must approve all issues and transfers of securities of a Bermuda exempted company. Where any equity securities (meaning shares which entitle the holder to vote for or appoint one or more directors or securities which by their terms are convertible into shares which entitle the holder to vote for or appoint one or more directors) of a Bermuda company are listed on an appointed stock exchange (which includes AIM) the BMA has given general permission for the issue and subsequent transfer of any securities of the company from and/or to a non-resident of Bermuda for so long as any such equity securities of the company remain so listed.

**3.2** The Company is not subject to the UK City Code on Takeovers and Mergers (the "City Code") and the rules governing substantial acquisitions of shares, nor will any such transactions be subjected to the scrutiny and sanctions of the Panel on Takeovers and Mergers. To the extent permitted under the Bermuda Companies Act, the Bye-Laws adopt certain of the provisions of the City Code as further described in paragraph 6.3 of this Part VI. Notwithstanding the provisions of the Bye-Laws, the provisions of the substantial acquisition rules of the City Code have not been adopted in the Bye-Laws.

The following provisions of the Bermuda Companies Act apply in relation to acquisition of 90 per cent or 95 per cent of the shares of a Bermuda company:

- (a) Section 102 of the Bermuda Companies Act has application where a scheme or contract involving the transfer of shares of a Bermuda company has been approved by 90 per cent of its shareholders. The offeror can then give notice in the prescribed form to any dissenting shareholder(s) that it desires to acquire their shares, and upon such notice being given unless, on an application made by the dissenting shareholder the Supreme Court thinks fit to order otherwise, the offeror shall be entitled and bound to mandatorily acquire the dissenting shareholder(s) holdings; and
- (b) Under section 103 of the Bermuda Companies Act, holders of 95 per cent of the shares of a Bermuda company can, on giving notice to the minority shareholders, force them to sell their interests to the 95 per cent shareholders provided that the terms offered are the same for all the holders of the shares whose acquisition is involved. The five per cent shareholders can apply to the Supreme Court for an appraisal of their shares. Once notice has been given, the acquiring shareholders are bound to acquire the outstanding shares on the terms set out in the notice.

## 4. Share Capital

**4.1** The authorised share capital of the Company on incorporation was \$12,000 divided into 12,000,000 Common Shares of US\$0.001 per share each of which was issued to the subscriber Codan Trust Company

## Part VI — Additional Information

Limited (as trustee of the Clean Air Power Limited Trust). The rights attaching to the Common Shares are summarised in Section 5 of this Part VI.

**4.2** Pursuant to a sole shareholder resolution by Codan Trust Company Limited duly adopted on 17 February 2006 the authorised share capital of the Company was increased to \$60,000 by the creation of an additional 48,000,000 Common Shares.

**4.3** By a resolution of the Board at a meeting held on 11 January 2006, the Company has, conditional upon the completion of the Merger, allotted 16,318,479 Common Shares to the former holders of capital stock in Clean Air Power, US.

**4.4** By a resolution of the Board at a meeting held on 21 February 2006, the Company has, conditional upon Admission, allotted 10,000,000 Common Shares to Placees pursuant to the Placing.

**4.5** As at the date of this document and immediately following the Merger, Placing and Admission, the authorised and issued share capital of the Company is and will be as follows:

	Authorised Share Capital Number	Nominal Value \$	Issued (fully paid) Share Capital Number	Nominal Value \$
As of the date of this document	60,000,000	\$60,000	12,000,000	\$12,000
On Admission and after Merger	60,000,000	\$60,000	26,318,479	\$26,318

**4.6** The Placing Shares will rank pari passu in all respects with the Common Shares that are currently in issue and will rank in full for all dividends and distributions hereinafter declared, paid or made on the common share capital of the Company.

**4.7** Upon the Merger, the Common Shares issued to Codan Trust Company Limited will be re-purchased by the Company for an aggregate consideration of \$12,000. Such Common Shares will be immediately available for reissue upon such repurchase.

**4.8** Existing stockholders in Clean Air Power US are entitled to appraisal rights pursuant to section 262 of the Delaware General Corporation Law in connection with the Merger. On 10 February 2006, Clean Air Power US solicited the consent of its stockholders to the approval of the Merger and Adoption of the Merger Agreement and, simultaneously therewith, the stockholders of Clean Air Power US were given notice of their appraisal rights under Delaware law and have 20 days from the date of that notice to perfect such rights. Any stockholder that has approved the Merger may not perfect its appraisal rights under Delaware law. In order to perfect their appraisal rights during the 20 day period, a stockholder must deliver to the Company a written demand for appraisal of the shares of Clean Air Power US held thereby. Approximately 90 per cent of the stockholders of Clean Air Power US have approved the Merger and as of the date of this document, one stockholder holding 24,750 shares of CAP US Common Stock has delivered to Clean Air Power US a written demand for appraisal.

Within 120 days after the effective date of the Merger, a stockholder that has perfected his or her appraisal rights may file a petition with the Delaware Court of Chancery demanding a determination of the value of the stock of all such stockholders. The Court of Chancery of Delaware will determine the fair value of the shares and direct payment thereof together with a fair rate of interest. A stockholder who has demanded appraisal rights is not entitled to vote the Common Shares in the Company, nor to receive payment of dividends or other distributions on the Common Shares.

**4.9** Other than as set out above or in Section 4, there are no other listed or unlisted securities issued by the Company representing its share capital.

### 5. Options and Warrants

**5.1** As of 31 December 2005, Clean Air Power US had 230,845 options outstanding which in aggregate give the holders of those options upon exercise, the right to acquire up to 230,845 shares in CAP US Common Stock. These options will automatically terminate pursuant to the Merger.

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**5.2** Conditional upon the Merger becoming effective, the Company has granted a total of 2,883,582 Options under the Share Plans, as follows:

<b>Number of Options</b>	<b>Number of underlying Common Shares that are required to be issued upon exercise of the Options</b>	<b>Exercise Price</b>
1,634,030	1,634,030	\$0.98
1,249,552	1,249,552	\$1.75

**5.3** At the date of this document, there are outstanding warrants to purchase CAP US Common Stock, CAP US Series C Preferred Stock and CAP US Series D Preferred Stock. In addition, Clean Air Power US has outstanding secured, convertible promissory notes. Pursuant to a number of agreements each dated as of 11 January 2006, the holders of all of the outstanding secured, convertible promissory notes issued by Clean Air Power US, certain of the outstanding warrants to purchase CAP US Series C Preferred Stock and all of the outstanding CAP US Series D Preferred Stock have undertaken to Clean Air Power US to exercise their securities immediately prior to the Merger becoming effective and to receive Common Shares by way of cashless exercise or repayment of such securities. Such Common Shares are part of those noted in Section 4.3 of Part VI of this document.

### Series C Warrants

As at the date of this document, there are outstanding warrants to acquire 114,061 shares of CAP US Series C Preferred Stock upon exercise thereof. The terms and conditions of such warrants are described in more detail in Section 2.2 of Part III of this document.

Pursuant to an agreement dated 11 January 2006, certain of the holders of such outstanding warrants have undertaken to Clean Air Power US to exercise their warrants immediately prior to the Merger becoming effective. Following the exercise of such warrants, 67,284 of shares of CAP US Series C Preferred Stock will be issued to the holders of such warrants and, upon completion of the Merger, an aggregate of 351,831 Common Shares will be issued in exchange for the CAP US Series C Preferred Stock issued in connection with the cashless exercise of such warrants. Such Common Shares are part of those noted in Section 4.3 of Part VI of this document.

If a warrant to purchase CAP US Series C Preferred Stock has not been exercised prior to the Merger becoming effective, such warrant will, pursuant to the Merger, convert into a warrant to purchase Common Shares at the conversion rate for CAP US Series C Shares in the Merger. Such warrants to purchase Common Shares will expire on 28 March 2007. The following holder of warrants to purchase CAP US Series C Preferred Stock has not undertaken to the Company to exercise his warrants immediately prior to the Merger:

<b>Warrant Holder</b>	<b>Number of warrants to purchase CAP US Series C Preferred Stock as at the date of this document</b>	<b>Per Share Exercise Price of warrants to purchase CAP US Series C Preferred Stock</b>	<b>Number of warrants to purchase Common Shares upon Admission (assuming no warrants have been exercised)</b>	<b>Per Share Exercise Price of warrants to purchase Common Shares</b>	<b>Number of Common Shares to be issued upon exercise of the Warrants</b>
Peter Winnell	112	\$5.125	586	\$0.98	586

### Series D Warrants

As at the date of this document, there are outstanding warrants to acquire 53,628,772 shares of CAP US Series D Preferred Stock upon exercise thereof. The terms and conditions of such warrants are described in more detail in Section 2.2 of Part III of this document.

Pursuant to an agreement dated as of 11 January 2006, the holders of all of such outstanding warrants have undertaken to Clean Air Power US to exercise their warrants immediately prior to the Merger becoming effective. Following the exercise of such warrants, 31,666,353 of shares of CAP US Series D Preferred Stock will be issued to the holders of such warrants and, upon completion of the Merger, an aggregate of 2,111,090 Common Shares will be issued in exchange for the CAP US Series D Preferred Stock issued in connection with the cashless exercise of such warrants, as noted above, such Common Shares are part of those noted in Section 4.3 of Part VI of this document.

## Part VI — Additional Information

### Common Warrants

At the date of this document, Clean Air Power US has 318,515 outstanding common warrants which upon exercise will give the holders the right to purchase 318,515 shares of CAP US Common Stock. The terms and conditions of the Common Warrants are discussed in more detail in Section 2.2 of Part III of this document

Under the Merger, each warrant to purchase CAP US Common Stock shall continue to have, and be subject to, the same terms and conditions as were applicable to such warrant except that each warrant will, upon the Merger becoming effective, be exercisable or convertible into Common Shares for the per share price as such warrant is deemed to be convertible into pursuant to such warrant's terms in the event of a merger of Clean Air Power US.

On the assumption that none of the warrants to purchase CAP US Common Stock will be exercised in the period between the date of this document and Admission, upon Admission the following warrants to acquire the Company's shares will be outstanding:

Warrant Holder	Number of warrants to purchase CAP US Common Stock as at the date of this document	Exercise Price of warrants to purchase CAP US Common Stock	Termination Date	Number of warrants to purchase Common Shares upon Admission (assuming no warrants have been exercised)	Exercise Price of warrants to purchase Common Shares
Peter Winnell*	N/A	N/A	28 March 2007	586	\$0.98
Business Growth Fund of Southern Cal., LP	81,125	\$14.792	31 May 2006	5,408	\$221.88
Dan W. Kabel	64,975	\$ 5.10	24 March 2012	4,332	\$ 76.50
D.J. Smith	4,812	\$24.935	31 December 2008	321	\$374.03
Hobbs & Towne	5,000	\$ 10.00	11 January 2007	333	\$150.00
Brobeck Phleger & Harrison	15,774	\$ 1.00	30 November 2010	1,052	\$ 15.00
Maria P. Sendra	3,943	\$ 1.00	30 November 2010	263	\$ 15.00
Comerica Bank — California	142,886	\$ 1.40	19 February 2010	9,525	\$ 21.00
Total	<u>318,515</u>			<u>21,820</u>	

\* As of the date of this document, Mr. Winnell holds a warrant to purchase 112 shares of Series C Preferred Stock.

### Secured Convertible Promissory Notes

Pursuant to an agreement dated 11 January 2006, the holders of all of the outstanding secured, convertible promissory notes issued by Clean Air Power US have agreed with Clean Air Power US that all of the outstanding principal and accrued and unpaid interest under such notes will be paid in full through the issuance by Clean Air Power US to each holder that number of CAP US Series D Preferred Stock determined by dividing the aggregate unpaid principal and interest for each note by \$0.06534 immediately prior to the Merger becoming effective. Pursuant to the Merger, each share of CAP US Series D Preferred Stock will be cancelled in return for the issue of 0.06667 Common Shares in respect of each share of CAP US Series D Preferred Stock.

On the assumption that the Merger becomes effective on 27 February 2006, the promissory notes will be satisfied through the issuance by Clean Air Power US of 99,056,636 shares of CAP US Series D Preferred Stock which in turn will be exchanged for 6,603,776 Common Shares in the Merger.

### 5.4 The 2005 Share Plan of Clean Air Power Limited (the "2005 Share Plan")

The Company has, conditional upon the Merger becoming effective, adopted the 2005 Share Plan, details of which are as follows:

#### General

The 2005 Share Plan provides for the grant of options to purchase Common Shares, restricted shares, share appreciation rights, restricted share units, performance award or other share-based award to employees, directors and consultants. Conditional upon the Merger, the Company has granted options covering a total of 1,634,030 Common Shares, which represent all of the Common Shares available under the 2005 Share

## **Part VI — Additional Information**

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Plan, to John Pettitt and Steven Whelan. The terms of Mr. Pettitt's and Mr. Whelan's options are described in Section 9.2 of Part VI of this document.

### Effect of cancellation or forfeiture

If an option, grant of restricted share, restricted share unit, share appreciation right, performance award or other share-based award (each, an "award") is forfeited, cancelled, terminated, exchanged or surrendered or such award is settled in cash or otherwise terminates without a distribution of common shares, any shares counted against the number of shares reserved or available under the plan with respect to such award will, to the extent of any such forfeiture, settlement, termination, cancellation, exchange or surrender, again be available for awards under the 2005 Share Plan, including shares that are not delivered in consideration for applicable tax withholding.

### Administration

The Board, or a committee appointed by the Board (the "Administrator"), will administer the 2005 Share Plan, and such administration will be in accordance with US tax requirements, if necessary. The Administrator has the power to determine the terms of the awards, including the exercise price, the number of shares subject to each award, the vesting and/or exercisability of the awards, the form of consideration payable upon exercise, the individuals eligible to receive awards, the types of award to be granted and the form of each award agreement. The Administrator also has the power to adopt any foreign subplans if necessary or advisable with respect to grants to persons working or resident outside of Bermuda.

### Other Awards

The 2005 Share Plan does afford the Company the ability to grant other incentive awards, such as restricted shares, restricted share units, share appreciation rights, performance awards and other share based awards. However, all of the Common Shares reserved for use under the 2005 Share Plan have been allocated to grants of options to John Pettitt and Steven Whelan made conditional upon the Merger and the Company does not currently intend to grant any other awards under the 2005 Share Plan.

### Options

The Administrator will determine the exercise price of options granted under the 2005 Share Plan. After termination of an employee, director or consultant, he or she may exercise his or her option for the period of time stated in the option agreement, as determined by the Administrator. An option may never be exercised later than the expiration of its term, which shall not exceed ten years.

### Transfer or Assignment

Unless the Administrator determines otherwise, the 2005 Share Plan does not allow for the transfer of awards other than by will or by the laws of descent and distribution or pursuant to a beneficiary designation approved by the Administrator, except in certain limited circumstances to a family member or trust.

### Corporate Events

The 2005 Share Plan provides that in the event of a merger or consolidation in which the Company is not the surviving corporation, a dissolution or liquidation, an asset sale or any other transaction where the shareholders give up all of their equity interest in the Company, the outstanding awards may be assumed or replaced by the successor corporation. Alternatively, the successor corporation may substitute equivalent awards. If the successor corporation refuses to assume or replace the awards or if there is no successor corporation due to a dissolution or liquidation of the Company, the outstanding awards shall become fully vested and then expire on such conditions as the Administrator may determine.

### Termination

The 2005 Share Plan will automatically terminate in 2016, unless terminated sooner. In addition, the Board has the authority to amend, suspend or terminate the 2005 Share Plan provided it does not adversely affect any award previously granted under the plan.

## **5.5 The 2006 Share Option Plan of Clean Air Power Limited (the "2006 Share Option Plan")**

The Company has, conditional upon the Merger becoming effective, adopted the 2006 Share Option Plan, which it intends to use in connection with or following Admission. The Company has granted options covering a total of 1,249,552 Common Shares under the 2006 Share Option Plan upon the Merger. Details of the 2006 Share Option Plan are as follows:

## **Part VI — Additional Information**

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### Eligibility

Executive Directors and other employees of the Company and its subsidiaries will be eligible to participate in the 2006 Share Option Plan at the discretion of the Remuneration Committee.

### Grant of Options

Options may be granted by the Company or by the trustees of an employee benefit trust (if such a trust is established) at the direction or recommendation of the Remuneration Committee of the Company.

Conditional upon the Merger becoming effective, the Company (at the direction of the Remuneration Committee) has granted Options over 1,249,552 Common Shares (in aggregate) to the current employees of the Company, and to the former chairman of Clean Air Power US, with an exercise price which represents the Placing Price (the “pre-flotation options”). The pre-flotation options may in each case, except that granted to Peter Rowse, be exercised in full from the first anniversary of the date of grant provided that the option holder remains as an employee or director of the Company at that time. The pre-flotation option granted to Peter Rowse shall vest as 25 per cent on the first anniversary of the date of grant with the remainder vesting in equal quarterly instalments over the subsequent year after such anniversary. The pre-flotation options do not have any performance conditions attached.

### Plan Limit

The number of Common Shares that can be allocated under the 2006 Share Option Plan, when added to the number of Common Shares previously allocated under the 2006 Share Option Plan or any other employee share plan adopted by the Company in the 10 years following Admission, may not exceed 10% of the Common Shares in issue immediately prior to such allocation (the “Plan Limit”). There shall be excluded from the calculation of the Plan Limit any Common Shares that are allocated under the 2005 Share Plan prior to Admission or any other share arrangement implemented by the Company prior to Admission (including pursuant to the grant under the 2005 Share Plan of Options to John Pettitt and Steven Whelan). Where the right to acquire Common Shares is released or lapses without being exercised (or, in the case of a share award, vested), the Common Shares are ignored when calculating the Plan Limit

For the purposes of the Plan Limit, “allocate” means subject to an option or other right to acquire unissued Common Shares or Common Shares held in treasury or the issue or allotment of unissued Common Shares or Common Shares held in treasury.

### Individual Limit

Other than in respect of Options granted in connection with the Admission, the value of Options granted to an individual employee will be limited such that the market value of Common Shares subject to Options granted in any financial year may not exceed two times annual basic salary, unless the Remuneration Committee considers there are exceptional circumstances justifying a larger multiple of annual basic salary, in which case the market value may not exceed four times annual salary. Without limitation to the above, if the Remuneration Committee so decides, the individual limit will not apply to the grant of Options to an employee or director in connection with his or her appointment.

### Exercise Price

The exercise price of the Options will be the price determined by the Remuneration Committee, but it may not be less than the higher of the nominal value of a Common Share at the date of grant and the market value of a Common Share at the date of grant. The market value will be determined by the Remuneration Committee in its sole discretion but, while the Common Shares are admitted to trading on AIM, the market value will be the average of the middle market value of a Common Share derived from the daily official list three dealing days immediately preceding the date of grant.

Notwithstanding the above, any Options granted in connection with the Admission may be granted with an exercise price which represents the Placing Price.

### Exercise of Options

Unless the Remuneration Committee determines otherwise, Options may not be exercised until the third anniversary of the date of grant and may normally only be exercised if the option holder remains as a director or employee of the Company. The Remuneration Committee may determine in respect of options to be granted in the future at or prior to the date of grant that the right to exercise Options may vest (in whole or in part) other than at the third anniversary of the date of grant and/ or in accordance with such vesting schedule as it considers appropriate. The pre-flotation options are exercisable from the first anniversary of the date of grant.

## **Part VI — Additional Information**

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Early exercise (prior to vesting) will be possible in the event that an option holder ceases to be employed for various “good leaver” reasons (including death, injury or disability, redundancy, retirement or transfer out of the group) or for any other reason which the Remuneration Committee decides in its discretion should justify early exercise.

Early exercise would also be possible if there is a change of control in relation to the Company or if any person becomes bound or entitled to acquire shares in the Company or if a court sanctions that compromise or arrangement in connection with a scheme for the reconstruction of the Company or its amalgamation with another company or if the Company passes a resolution for voluntary winding up or an order is made for the compulsory winding up of the Company. If options become exercisable in such circumstances, they will be exercisable in full.

The Remuneration Committee may determine that Options will normally be exercisable only if performance conditions established by the Remuneration Committee at the date of grant are satisfied. The Remuneration Committee will, however, have discretionary power, acting fairly and reasonably, to treat the performance conditions as having been satisfied having regard to the underlying financial performance of the Company if options have become exercisable because of the cessation of employment for the various reasons mentioned above. In addition, if exercise become possible because of a change of control or the other reasons mentioned above, Options will only be exercisable if the Remuneration Committee treats the performance conditions as having been satisfied in its discretion, acting fairly and reasonably, having regard to the underlying financial performance of the Company up to that time.

### New Issue of Securities

The exercise of options may be met either by the issue of new Common Shares, the transfer of any Common Shares held in treasury (if any) or by the transfer of existing Common Shares (for example if Common Shares are held in an employee benefit trust at the time of exercise).

### Variation

There is provision in the 2006 Share Option Plan for the adjustment of Options in the event of variations in the share capital of the Company which would include capitalisation or rights issues, or the sub-division, consolidation or reduction of capital.

### Lapse of Options

Options will lapse on the earliest of the following dates:

- (i) The tenth anniversary of the date of grant;
- (ii) The expiry of the period of six months following a change of control or a period of one month following the related events mentioned above;
- (iii) Immediately on the termination or cessation of employment of any option holder in circumstances justifying the immediate termination of employment;
- (iv) 12 months after the date of death of the option holder;
- (v) Six months after an option holder ceases employment as a result of any good leaver reason (other than death) or any other reason which the Remuneration Committee has decided in its discretion should justify the early exercise;
- (vi) In respect of unvested Options, immediately on the termination or cessation of employment for any reason other than a good leaver reason or for any other reason which the Remuneration Committee has decided in its discretion should justify early exercise;
- (vii) In respect of vested Options, three months after the cessation of employment of the option holder; or
- (viii) Immediately on the date when the Remuneration Committee determines that any performance conditions imposed on Options at the date of grant have not been satisfied and are no longer capable of being satisfied.

### Amendment

The Rules may be amended from time to time by the Remuneration Committee save that no amendment may be made to the advantage of option holders without the approval of the Company in general meeting, unless it is a minor amendment will benefit the administration of the 2006 Share Option Plan in which case the approval of the Company in general meeting is not necessary.

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Without limitation to the above, the Remuneration Committee can amend the rules of the plan for option holders in any jurisdiction without the approval of the Company in general meeting if it considers it necessary or desirable to take account of or mitigate or comply with taxation, securities or exchange control laws or to improve the tax and/or social security position of the option holders, the Company or any of its subsidiaries. Without prejudice to the above, Options can be granted on terms that are designed to enable UK resident option holders to benefit from tax favourable treatment under the Revenue approved Company Share Option Plan legislation or the legislation relating to Enterprise Management Incentives.

The 2006 Share Option Plan will terminate on the tenth anniversary of its adoption.

### Grants to Consultants

Options may also be granted to consultants under separate arrangements to that of the 2006 Share Option Plan. Except as the Remuneration Committee determines otherwise, the terms of the Options will be the same as those granted to employees of the Company. Any Options granted to Consultants over new issue or treasury shares will count towards the Plan Limit.

## **6. Rights attaching to Common Shares**

**6.1** Save as disclosed in this document, the Common Shares are the only class of shares in issue in the capital of the Company.

**6.2** The rights attaching to the Common Shares are:

- (a) set out in the Memorandum of Association and Bye-Laws of the Company; and
- (b) in certain circumstances, regulated by the Bermuda Companies Act and the general law in force in Bermuda.

**6.3** A summary of the material provisions of the Memorandum of Association and the Bye-Laws relating to the rights attaching to Common Shares follows:

### Issue of Shares

Subject to the Bye-laws and to any resolution of the Shareholders, the Board has the power to issue any unissued shares of the Company on such terms and conditions as it may determine.

### Power to Alter Capital

The Company may, if authorised by resolution of the Shareholders, increase, divide, consolidate, subdivide, change the currency denomination of, diminish or otherwise alter or reduce its share capital in any manner permitted by the Bermuda Companies Act. Where, on any alteration or reduction of share capital, fractions of shares or some other difficulty would arise, the Board may deal with or resolve the same in such manner as it thinks fit.

### Variation of Rights

If, at any time, the share capital is divided into different classes of shares, the rights attached to any class may, whether or not the Company is being wound-up, be varied with the consent in writing of the holders of three-fourths of the issued shares of that class or with the sanction of a resolution passed by a majority of the votes cast at a separate general meeting of the holders of the shares of the class at which meeting the necessary quorum is two persons at least holding or representing by proxy one-third of the issued shares of the class. The rights conferred upon the holders of the shares of any class issued with preferred or other rights does not, unless otherwise expressly provided by the terms of issue of the shares of that class, be deemed to be varied by the creation or issue of further shares ranking *pari passu* therewith.

### No Pre-emption Rights

Shareholders do not have pre-emption rights under the Bye-laws or the Bermuda Companies Act over further issues of any class of shares in the Company.

### Transfer of Common Shares

All transfers of common shares may be effected by an instrument of transfer in writing, in the form specified in the Bye-laws or as near thereto as circumstances admit, or in such other form as the Board may accept. Such instrument of transfer shall be signed by or on behalf of the transferor and transferee, provided that, in the case of a fully paid share, the Board may accept the instrument signed by or on behalf of the transferor

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alone. The Board may in its absolute discretion and without assigning any reason therefore refuse to register the transfer of a share which is not fully paid.

The Board may, in its absolute discretion, decline to register the transfer of any shares if it believes that such transfer may expose the Company, any Group company or any Shareholder to adverse tax or regulatory treatment in any jurisdiction or registration of such transfer is required under the laws of any jurisdiction and such registration has not been effected. The Board may request and rely on an opinion of counsel to the transferor or transferee, in form and substance satisfactory to the Board, that no such registration is required. The Board has the authority to request from any direct or indirect holder of shares, and such holder shall provide, such information as the Board may request for the purpose of determining whether any contemplated transfer should be permitted.

### Disclosure of Interests

Where a Shareholder knows or becomes aware that he has acquired an interest in Common Shares or ceases to be interested in Common Shares with an aggregate par value which is equal to or more than three per cent of the aggregate value of the Company's total share capital (or if the percentage levels of his interest before and immediately after that time are not the same and greater than three per cent of the aggregate value of the Company's total share capital), then such Shareholder shall become obliged to notify the Company of his interest in the Common Shares.

### Mandatory Offers

Except as a result of a permitted acquisition, no person may (other than solely as custodian or depositary (or nominee thereof) under any arrangements implemented and/or approved by the Shareholders):

- (i) whether by himself, or with persons determined by the Board to be acting in concert with him, acquire after the effective date of the bye-laws shares of the Company which, taken together with shares held or acquired by persons determined by the Board to be acting in concert with him, carry 30 per cent or more of the voting rights attributable to Common Shares of the Company; or
- (ii) while he, together with persons determined by the Board to be acting in concert with him, holds not less than 30 per cent but not more than 50 per cent of the voting rights attributable to Common Shares of the Company, acquire (whether by himself or with persons determined by the Board to be acting in concert with him), additional shares which, taken together with shares held by persons determined by the Board to be acting in concert with him, increases his voting rights attributable to Common Shares of the Company; or
- (iii) effect or purport to effect a prohibited acquisition.

An acquisition is a permitted acquisition if it is made in circumstances in which the City Code, if it applied to the Company, would require an offer to be made as a consequence and such offer is made in accordance with Rule 9 of the City Code, as if it so applied, or if the requirement for an offer to be made in accordance with Rule 9 of the City Code, as if it so applied, is waived by an independent vote at a meeting of the Shareholders or the acquisition arises from repayment of a stock borrowing arrangement (on arm's length commercial terms).

An acquisition is a prohibited acquisition if Rules 4, 5, 6 or 8 of the City Code would in whole or part apply to the acquisition if the Company was subject to the City Code and the acquisition was made (or, if not yet made, would if and when made be) in breach of or otherwise not comply with Rules 4, 5, 6 or 8 of the City Code.

The Board has full authority to determine the application of the mandatory offer provisions, including the deemed application of the whole or any part of the City Code. Any resolution or determination of, or decision or exercise of any discretion or power by, the Board or any Director or by the chairman of any meeting acting in good faith under or pursuant to the provisions of the mandatory offer provisions are final and conclusive. In case of a violation of the mandatory offer provisions, the Board has a number of remedies and sanctions at its disposal, including determining that some or all of the Shares held in excess of the mandatory offer provisions must be sold or that the voting rights attached to the excess shares will from a particular time be incapable of being exercised for a definite or indefinite period.

### Dividend rights

The Board may, subject to the Bye-laws and in accordance with the Bermuda Companies Act, declare a dividend to be paid to the Members, in proportion to the number of shares held by them, and such dividend

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may be paid in cash or wholly or partly in specie in which case the Board may fix the value for distribution in specie of any assets. The Board may declare and make such other distributions (in cash or in specie) to the Shareholders as may be lawfully made out of the assets of the Company. The Company may pay dividends in proportion to the amount paid up on each share where a larger amount is paid up on some shares than on others. No unpaid dividend or distribution will bear interest as against the Company. The Board may fix any date as the record date for determining the Members entitled to receive any dividend.

Any dividend and or other monies payable in respect of a share which has remained unclaimed for seven years from the date when it became due for payment shall, if the Board so resolves, be forfeited and cease to remain owing by the Company. The payment of any unclaimed dividend or other moneys payable in respect of a share may (but need not) be paid by the Company into an account separate from the Company's own account. Such payment shall not constitute the Company a trustee in respect thereof.

The Company shall be entitled to cease sending dividend cheques and warrants by post or otherwise to a Member if those instruments have been returned undelivered to, or left uncashed by, that member on at least two consecutive occasions, or, following one such occasion, reasonable enquiries have failed to establish the member's new address. The entitlement conferred on the Company in respect of any Member shall cease if the Member claims a dividend or cashes a dividend cheque or warrant.

### Voting rights

Each common share is entitled to one vote per share subject to certain adjustments to or restrictions on the exercise of voting rights attached to shares. The holders of common shares are entitled to receive notice of, and to attend and vote at, any general meeting of the Company.

### General Meetings

The Board may fix any date as the record date for determining the Members entitled to receive notice of and to vote at any general meeting of the Company. The board may call the following general meetings:

#### *Annual General Meeting*

The annual general meeting of the Company is held in each year (other than the year of incorporation) at such time and place (outside of the United Kingdom) as the President or the Chairman or the Board appoints. Notice of an annual general meeting must be given to each Member entitled to attend and vote thereat at least 14 days prior to the meeting, stating the date, place and time at which the meeting is to be held, that the election of Directors will take place thereat, and as far as practicable, the other business to be conducted at the meeting.

#### *Special General Meetings*

The President or the Chairman or the Board may convene a special general meeting of the Company whenever in their judgment such a meeting is necessary. At least 14 days' notice must be given of a special general meeting to each Member entitled to attend and vote thereat, stating the date, time, place and the general nature of the business to be considered at the meeting. Special general meetings must be held outside the United Kingdom.

#### *Requisitioned General Meetings*

The Board must, on the requisition of Members holding at the date of the deposit of the requisition not less than one-tenth of such of the paid-up share capital of the Company as at the date of the deposit carries the right to vote at general meetings of the Company, forthwith proceed to convene a special general meeting of the Company.

### Quorum

The quorum necessary for the transaction of business at a meeting of the Board is two Directors. No meetings of the Board shall be quorate if the majority of the Directors present consists of persons who are resident in the United Kingdom for United Kingdom tax purposes.

### Other Obligations of the Company

For so long as the Company is classified as a partnership pursuant to the US tax code, the Company must use best efforts to: (i) ensure that no Member, as a result of the activities or investments of the Company or any of its direct or indirect subsidiaries, is deemed to have "unrelated business taxable income," under the

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US tax code; (ii) not to acquire any “debt financed” property or to incur any “acquisition indebtedness” within the meaning of the US tax code; and (iii) conduct the affairs of the Company (and to cause each of its subsidiaries to conduct its affairs) so as to avoid having the Company or any Member treated as engaged in a trade or business within the US for purposes of the US tax code. Moreover, the Company must make due inquiry with its tax advisors regarding its status (or the status of any of its subsidiaries) as (i) a “controlled foreign corporation” and to use commercially reasonable efforts to minimize the “subpart F income” of such controlled foreign corporation; and (ii) a “passive foreign investment company.” For a description of the Company’s US tax considerations, please refer to Section 13.4 of this Part VI.

### Rights on winding up

If the Company is winding up the liquidator may, with the sanction of a resolution of the Members, divide amongst the Members in specie or in kind the whole or any part of the assets of the Company and may, for such purpose, set such value as he deems fair upon any property to be divided as aforesaid and may determine how such division shall be carried out as between the Members or different classes of Members. The liquidator may, with the like sanction, vest the whole or any part of such assets in the trustees upon such trusts for the benefit of the Members as the liquidator deems fit, but so that no Member will be compelled to accept any shares or other securities or assets whereon there is any liability.

## **7. Rights and Powers of the Company**

### **7.1 Company**

The Company, being incorporated under the Bermuda Companies Act, has legal capacity both in and outside Bermuda. The Company also has all of the powers of a body corporate, including the power to:

- (a) issue and cancel shares and other securities in the Company;
- (b) issue debentures;
- (c) grant Options over unissued shares in the Company;
- (d) distribute any of the Company’s property among shareholders, in kind or otherwise;
- (e) give security by charging uncalled capital;
- (f) grant a floating charge over the Company’s property;
- (g) borrowing money and to give security in respect thereof; and
- (h) do anything that it is authorised to do by any other law (including the law of a foreign country).

### **7.2 Directors**

Under the Bermuda Companies Act, the Company must have at least two Directors (not counting alternate directors) and a secretary. Under its bye-laws, the Company must not have more than 10 directors.

### **7.3 Election of Directors**

Any Member or the Board may propose any person for election as a Director. If any person, other than a Director retiring at the meeting or a person proposed for re-election or election as a Director by the Board, is proposed for election as a Director, notice must be given to the Company of the intention to propose him and of his willingness to serve as a Director. Where the number of persons validly proposed for re-election or election is greater than the number of Directors to be elected, the persons receiving the most votes will be elected as Directors. The Board must at all times comprise a majority of Directors who are not resident in the UK for UK tax purposes.

At any general meeting the Members may authorise the Board to fill any vacancy in their number left unfilled at a general meeting. The Board may further appoint any person as a Director to fill a casual vacancy on the Board. Any Director so appointed by the Board holds office only until the next annual general meeting of the Company and is eligible for re-election.

### **7.4 Powers of Directors**

The Board of Directors of the Company has wide powers of management of the Company, including hiring employees, paying expenses and appointing agents.

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### **7.5 Limitations on Borrowing**

The Directors may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property and uncalled capital, or any part thereof, and may issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the Company or any third party.

The Board must restrict the borrowings of the Company and exercise all voting and other rights or powers of control exercisable by the Company in relation to its subsidiary undertakings (if any) so as to secure that the aggregate principal amount outstanding at any time in respect of all borrowings by Clean Air Power (exclusive of any borrowings which are owed by one Clean Air Power company to another company) after deducting the amount of cash deposited will not, without the previous authority of the Company in general meeting, exceed: (i) an amount equal to four times adjusted capital and reserves; or (ii) any higher limit fixed by the shareholders which is applicable at the relevant time. Adjusted capital and reserves means the aggregate of (i) the amount paid up on the allotted share capital of the Company; and (ii) the amounts standing to the credit of the reserves of Clean Air Power after adding or deducting any balance standing to the credit or debit of Clean Air Power's profit and loss account, all as shown in the relevant balance sheet after having made appropriate adjustments.

### **7.6 Retirement and Re-election of Directors**

The Directors have been divided into three classes designated Class I, Class II and Class III. Each class of Directors shall consist, as nearly as possible, of one third of the total number of Directors constituting the entire Board. At the first general meeting which is held after the date of adoption of the Bye-laws for the purpose of electing Directors, the Class I Directors shall be elected for a three year term of office, the Class II Directors shall be elected for a two year term of office and the Class III Directors shall be elected for a one year term of office. At each succeeding annual general meeting, successors to the class of Directors whose term expires at that annual general meeting shall be elected for a three year term. A Director holds office until the annual general meeting for the year in which his term expires or in which his 70<sup>th</sup> birthday occurs (whichever is earlier). A retiring director is eligible for re-election.

### **7.7 Permitted Interests of Directors**

Any Director, or any Director's firm, partner or any company with whom any Director is associated, may act in any capacity for, be employed by or render services to the Company and such Director or such Director's firm, partner or company is entitled to remuneration as if such Director were not a Director. However, a Director or Director's firm, partner or company cannot act as auditor to the Company.

### **7.8 Restrictions on Voting**

Unless qualified by the chairman of the relevant Board meeting, a director is restricted from voting in respect of any contract or proposed contract or arrangement in which such Director is interested, and may not be counted in the quorum for such meeting. Directors are required to declare the nature of their interest by the Bermuda Companies Act.

### **7.9 Directors' Indemnity and Insurance**

Under the Company's bye-laws the Directors, secretary and other officers of the Company are indemnified out of the assets of the Company against all liabilities incurred by them by reason of any act done, concurred in or omitted in the conduct of the Company's business or in the discharge of their duties save where there has been fraud or dishonesty on the part of such persons. Under the bye-laws each Member agrees to waive any claim or right of action such Member may have against a Director or officer on account of any action taken by such Director or officer in the performance of his duties save where there has been fraud or dishonesty on the part of such Director or officer. The Company may purchase and maintain insurance for the benefit of any Director or Officer of the Company against any liability incurred by him under the Bermuda Companies Act in his capacity as a Director or Officer of the Company.

## Part VI — Additional Information

### 8. Shareholders

8.1 So far as is known to the Directors, or could with reasonable due diligence be ascertained by them, as of 21 February 2006, the latest practicable date prior to the publication of this document, the following persons will have interests (other than the Directors and their immediate families' interests) in the issued share capital of the Company which, directly or indirectly, represent or will upon completion of the Merger or on Admission represent, three per cent or more of the issued share capital of the Company:

Shareholder	Upon completion of the Merger		Upon Admission (taking the enlarged issued share capital into account)	
	Number of Common Shares	% of issued share capital	Number of Common Shares	% of issued share capital
EnerTech Capital Partners, II L.P.	7,116,103	37.02	8,782,536	33.37
Endeavor Capital Partners, LLC	3,958,942	20.59	4,978,942	18.92
Royal Bank of Canada	3,392,459	17.65	3,967,459	15.07

In the Placing, EnerTech Capital Partners, II L.P. will invest £1,666,433, ECP II Interfund, L.P. will invest £63,567 Royal Bank of Canada will invest £575,000 and Endeavor Capital Partners, LLC will invest £1,020,000, to subscribe for Placing Shares. The post-Admission numbers set out above take into account the Placing Shares subscribed for by these entities.

8.2 None of the Company's major holders of Common Shares, listed either as substantial shareholders in paragraph 8.1 or as Directors in Section 9.1, has voting rights different from the other holders of Common Shares.

8.3 Save as disclosed in Section 8.1 and 9.1 of this Part VI, the Directors are not aware of any person who, directly or indirectly, is or will upon completion of the Merger or on Admission, be interested in three per cent or more of the Company's issued ordinary share capital.

8.4 The Directors are not aware of any person who, directly or indirectly owns or controls the Company, or who will upon completion of the Merger or on Admission own or control the Company.

8.5 The Directors are not aware of any arrangements, the operation of which may at a subsequent date result in a change in control of the Company.

8.6 Save as set out in Section 9.1 of this Part VI, none of the Directors, their immediate families and persons connected with them, has any interest in the share or loan capital of the Company or in any related financial products referenced to the Common Shares beneficial or non beneficial.

### 9. Directors' and Other Interests

9.1 So far as is known to the Directors, or could with reasonable due diligence be ascertained by them, as of 21 February 2006, the latest practicable date prior to the publication of this document, the interests of the Directors (all of which are beneficial), including their immediate families and persons connected with them (within the meaning of section 346 of the UK Companies Act), in the issued share capital of the Company, upon completion of the Merger or as expected to be immediately following Admission, are as follows:

Director	Upon completion of the Merger		Upon Admission (taking the enlarged issued share capital into account)	
	Number of Common Shares	% of issued share capital	Number of Common Shares	% of issued share capital
Scott Ungerer*	7,387,546	38.43	9,117,546	34.64
John Pettitt	n/a	n/a	5,000	0.02
Rodney Westhead	n/a	n/a	5,000	0.02

\*Scott Ungerer is a limited partner in EnerTech Capital Partners II, L.P. and ECP Interfund II, L.P. which will own 9,117,546 Common Shares in aggregate upon Admission.

9.2 So far as is known to the Directors, or could with reasonable due diligence be ascertained by them, as of 21 February 2006, the latest practicable date prior to the publication of this document, the names of the Directors and of the persons connected with them (within the meaning of section 346 of the UK Companies Act) with an interest in Options granted by the Company (all of which are beneficial), upon completion of the Merger or as expected to be immediately following Admission, are as follows:

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Shareholder	Upon completion of the Merger		Upon Admission (taking the enlarged issued share capital into account)	
	Number of Common Shares	% of issued share capital	Common Shares	% of issued share capital
John Pettitt	1,441,791	7.5	1,441,791	5.48
Steven Whelan	192,239	1.0	192,239	0.73
Peter Rowse	192,239	1.0	192,239	0.73

Mr. Pettitt and Mr. Whelan's options were granted under the 2005 Share Plan effective upon the Merger and shall be fully vested at the time of the granting thereof. The option price per share for Mr. Pettitt's and Mr. Whelan's options is \$0.98. Mr. Rowse's options were granted under the 2006 Share Option Plan effective upon the Merger, have an exercise price which represents the Placing Price and shall vest 25 per cent on the first anniversary of the grant thereof with the remainder vesting in equal quarterly instalments over the subsequent year after such anniversary.

Mr. Pettitt is also entitled, pursuant to his contractual arrangements with the Company, to receive a bonus grant of options for that number of Common Shares equal to 0.75 per cent of the outstanding Common Shares (determined on a fully diluted basis after taking into account such grant) subject to the satisfaction of the following performance goals being met by the conclusion of calendar year 2006: (i) Clean Air Power revenues of at least \$11,000,000 for the calendar year 2006; (ii) 35 per cent gross margin for Clean Air Power in the calendar year 2006; (iii) Clean Air Power having a cash balance of \$14,000,000; (iv) successful commercialisation on or before July 1, 2006 of the Genesis system; and (v) causing Clean Air Power to successfully enter into an OEM partner arrangement by the conclusion of 2006.

**9.3** Save as disclosed above, none of the Directors or any person connected with them has any interest in the share capital or loan capital of the Company or any of its subsidiaries.

**9.4** In addition to their directorships in the Company, the Directors hold or have held the following directorships or have been a partner in the following partnerships within the five years prior to the date of this document:

Name	Current directorships and partnerships	Past directorships and partnerships
Rodney Westhead	Clean Air Power UK Carter & Carter plc Mouchelparkman plc AEA Technology plc Forgehour Ltd. Bilton Grange Trust Ltd.	Sussex Enterprise Council Ltd; and Quoted Companies Alliance Ricardo plc Playboy Ltd. Finansa Ltd. Grant Thornton UK LLP.
John Pettitt	Clean Air Power UK	Clean Air Power US
Peter Rowse	Clean Air Power UK	
Larry Wilson	Clean Air Power UK Clean Air Power US Epicurean Delights, Inc.	Metro Mushroom Farms, Inc.
Scott Ungerer	Clean Air Power UK Clean Air Power US Catalytic Solutions, Inc. Comerge, Inc. Current Communications Group Franklin Fuel Cells, Inc. Intellon Corporation The Nanosteel Company EnerTech Manager LLC EnerTech Capital Holding Company Manager LLC EnerTech, Inc. EnerTech Management Company Manager LLC ECP II Management LLC. EnerTech Capital Partners, II L.P.	Transportation.com Netuitive Software, Inc. Interactive Media Systems, Inc. Intelligent Systems, Inc. essential.com Coastal Security Systems, Inc. Enerwise Global Technologies, Inc.

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Name	Current directorships and partnerships	Past directorships and partnerships
Wallace Hunter	Clean Air Power UK Clean Air Power US Agile Systems Brampton Engineering, Inc. Hyd-Mech, Inc. Strataflex Corporation Teraxion, Inc. Aligo, Inc. IE Engine, Inc IMX Communications, Inc. Meriton Networks, Inc. Hunter Capital Management Ltd. Hunter Capital Investments Ltd.	

**9.5** EnerTech was an investor in, and Mr. Ungerer was a director of, essential.com when it filed a voluntary petition for insolvency in June 2001. Essential.com was a provider of bundled utility services such as electricity, telephone services and internet access. The company was unable to raise operating capital and elected to voluntarily wind down its operations. Essential.com's assets and customer lists were sold pursuant to the insolvency, however, the funds realised in the liquidation were insufficient to cover the full amounts of the claims filed by the company's creditors.

**9.6** Save as disclosed in this Section 9.6, no Director:

- (i) has any unspent convictions in relation to indictable offenses;
- (ii) has been bankrupt or the subject of any individual voluntary arrangement, or has had a receiver appointed to any asset of such director;
- (iii) has been a director of a company which, while he was a director or within 12 months after he ceased to be a director, had a receiver appointed or went into compulsory liquidation, creditors voluntary liquidation, administration or company voluntary arrangement, or made any composition or arrangement with its creditors generally or with any class of its creditors;
- (iv) has been a partner of any partnership which, while he was a partner or within 12 months after he ceased to be a partner, went into compulsory liquidation, administration or partnership voluntary arrangement, or had a receiver appointed to any partnership asset;
- (v) has had any public criticism by statutory or regulatory authorities (including recognised professional bodies); or
- (vi) has been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of any company.

**9.7** No loans made or guarantees granted or provided by any member of Clean Air Power to or for the benefit of any Director are outstanding.

**9.8** Save as disclosed in this document, no Director has or has had, any direct or indirect interest in any:

- (a) transaction which is or was unusual in its nature or conditions or significant to the business of Clean Air Power taken as a whole and which has been effected by the Company in the current or immediately preceding financial period or was effected during any earlier financial period and remains in any respect outstanding or unperformed;
- (b) asset which has been acquired or disposed, or leased to, any member of Clean Air Power or which is proposed to be so acquired, disposed of, or leased; or
- (c) contract of arrangement existing at the date of this document which is significant to the business of Clean Air Power.

### 10. Directors' Service Agreements and Remuneration

**10.1** Clean Air Power UK has entered into an executive service agreement with John Pettitt to act as Chief Executive Officer of the Company, pursuant to which he agrees to devote all normal working hours and any

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additional time, if reasonably required, to the business of the Company. This agreement can be terminated on one year's notice. Pursuant to the agreement, Mr. Pettitt's gross annual salary will be £165,000. In addition, Mr. Pettitt is eligible to participate in a bonus programme based on performance targets as determined and approved by the remuneration committee, and is entitled to a car allowance of £1,000 per month.

**10.2** Clean Air Power UK has entered into an executive service agreement with Peter Rowse to act as Financial Director of the Company, pursuant to which he agrees to devote all normal working hours and any additional time, if reasonably required, to the business of the Company. This agreement can be terminated on six months' notice. Pursuant to the agreement, Mr. Rowse's gross annual salary will be £95,000. In addition, Mr. Rowse is eligible to participate in a bonus programme based on performance targets as determined and approved by the remuneration committee, and is entitled to a car allowance of £750 per month.

**10.3** The Company has entered into letters of appointment with the non-executive Directors who comprise the rest of the Board.

### Rodney Westhead

Mr. Westhead was appointed non-executive Chairman of the Company on 11 January 2006. His current annual fee is £42,000 per annum with a time commitment of three days per month.

### Scott Ungerer

Mr. Ungerer was appointed a non-executive Director of the Company on 11 January 2006. His current annual fee is £12,000, with a time commitment of three days per month.

### Wallace Hunter

Mr. Hunter was appointed a non-executive Director of the Company on 11 January 2006. His current annual fee is £12,000, with a time commitment of three days per month.

### Larry Wilson

Mr. Wilson was appointed a non-executive Director of the Company on 11 January 2006. His current annual fee is £12,000, with a time commitment of three days per month.

**10.4** The Company has entered into Indemnification Agreement with each Director against liability incurred by the Director as a director of the Company and/or subsidiary of the Company to the extent permitted by the Companies Act. The agreement sets out the circumstances in which the Company is liable to indemnify the Director. The indemnity continues after the Director ceases to be a director of the Company. The Company also agrees to, subject to availability, take out director's and officer's insurance for the Director.

**10.5** Save as disclosed in this document, none of the Directors are entitled to any benefits upon termination of their employment with Clean Air Power.

## **11. Settlement and CREST**

### **11.1 Introduction**

CREST is a paperless settlement system allowing English law securities to be transferred from one person's CREST account to another without the need to use share certificates or written instruments of transfer. Securities issued by non-UK or Irish registered companies, such as the Company, cannot be held or transferred in the CREST system. However, to enable investors to settle such securities through CREST, a depositary or custodian can hold the relevant securities and issue dematerialised DIs representing the underlying securities which are held on trust for the holders of the DIs.

With effect from Admission, it will be possible for CREST members to hold and transfer interests in Common Shares within CREST pursuant to a DI arrangement established by the Company. CREST is a voluntary system and holders of Common Shares who wish to receive and retain share certificates will also be able to do so. No temporary documents of title will be issued.

The Common Shares will not themselves be admitted to CREST. Instead a commonly-owned sister company of the Registrars, Capita IRG Trustees Limited, acting as depositary (the "Depositary"), will issue DIs in respect of the underlying Common Shares. The DIs will be independent securities constituted under English

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law which may be held and transferred through CREST. DIs will have the same international security identification number (ISIN) as the underlying Common Shares and will not require a separate application for admission to trading on AIM. The DIs will be created and issued pursuant to a deed poll (the “Deed Poll”) entered into by the Depositary which will govern the relationship between the Depositary and the holders of DIs.

Application has been made for the DIs in respect of the underlying Common Shares to be admitted to CREST with effect from Admission.

Holders of Common Shares in certificated form who wish to hold DIs through the CREST system may be able to do so and should contact the Registrars. Any certificates issued to evidence Common Shares shall, for a period of two years from the date of Admission, shall have a legend as to its restricted nature as set forth in the Notice to Investors on page 1 of this document.

### **11.2 Summary of the Deed Poll**

As mentioned above, the DIs will be created pursuant to and issued on the terms of the Deed Poll. The Deed Poll is executed by the Depositary in favour of the holders of the DIs from time to time. Prospective holders of DIs should note that they will have no rights against CRESTCo or its subsidiaries in respect of the underlying Common Shares or the DIs representing them.

Common Shares will be transferred to an account of the Depositary or its nominated custodian (the “Custodian”) and the Depositary will issue DIs to participating members.

Each DI will be treated as one Common Share for the purposes of determining, for example, eligibility for any dividends. The Depositary will pass on to holders of DIs any stock or cash benefits received by it as holder of Common Shares on trust for such DI holder. DI holders will also be able to receive from the Depositary notices of meetings of holders of Common Shares and other information issued by the Company to the Shareholders to make choices and elections. In summary, the Deed Poll contains, inter alia, provisions to the following effect:

- (a) The Depositary will hold (itself or through the Custodian), as bare trustee, the underlying securities issued by the Company and all and any rights and other securities, property and cash attributable to the underlying securities for the time being held by the Depositary or Custodian pertaining to the DIs for the benefit of the holders of the DIs. The Depositary will re-allocate securities or distributions allocated to the Depositary or the Custodian pro rata to the Common Shares held for the respective accounts of the holders of DIs but will not be required to account for fractional entitlements arising from such re-allocation.
- (b) Holders of DIs warrant, inter alia, that the securities in the Company transferred or issued to the Depositary or Custodian on behalf of the Depositary for the account of the DI holder are free and clear of all liens, charges, encumbrances or third party interests and that such transfers or issues are not in contravention of the Company’s memorandum of association or bye-laws or any contractual obligations, or applicable law or regulation binding or affecting such holder and each holder indemnifies the Depositary against any losses incurred by reason of a breach of the warranty.
- (c) The Depositary and any Custodian must pass on to DI holders, or exercise on their behalf, all rights and entitlements received by the Depositary or the Custodian in respect of the underlying securities. Rights and entitlements to cash distributions, to information, to make choices and elections and to attend and vote at meetings shall, subject to the Deed Poll, be passed on in the form which they are received, together with amendments and additional documentation necessary to effect such passing-on, or exercised in accordance with the Deed Poll. If arrangements are made which allow a holder to take up rights in the Company’s securities requiring further payment, the holder must put the Depositary in cleared funds before the relevant payment date or other date notified by the Depositary if it wishes the Depositary to exercise such rights.
- (d) The Depositary will be entitled to cancel DIs and treat the holders as having requested a withdrawal of the underlying securities in certain circumstances including where a DI holder fails to furnish to the Depositary such certificates or representations as to material matters of fact, including his identity, as the Depositary deems appropriate.
- (e) The Deed Poll contains provisions excluding and limiting the Depositary’s liability. For example, the Depositary shall not be liable to any DI holder or any other person for liabilities in connection with the

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performance or non-performance of obligations under the Deed Poll or otherwise except as may result from its negligence or willful default or fraud or that of any person for whom it is vicariously liable, provided that the Depositary shall not be liable for the negligence, willful default or fraud of any Custodian or agent which is not a member of its group unless it has failed to exercise reasonable care in the appointment and continued use and supervision of such Custodian or agent. Furthermore, the Depositary's liability to a holder of DIs will be limited to the lesser of:

- (i) the value of the shares and other deposited property properly attributable to the DIs to which the liability relates; and
  - (ii) that proportion of £10 million which corresponds to the portion which the amount the Depositary would otherwise be liable to pay to the DI holder bears to the aggregate of the amounts the Depositary would otherwise be liable to pay to all such holders in respect of the same act, omission, or event or, if there are no such amounts, £10 million.
- (f) the Depositary is entitled to charge holders of DIs fees and expenses for the provision of its services under the Deed Poll.
- (g) The holders of DIs are required to agree and acknowledge with the Depositary that it is their responsibility to ensure that any transfer of DIs by them which is identified by the CREST system as exempt from stamp duty reserve tax is so exempt, and to notify the Depositary if this is not the case, and to pay to CRESTCo any interest, charges or penalties arising from nonpayment of stamp duty reserve tax in respect of such transaction.
- (h) Each holder of DIs is liable to indemnify the Depositary and any Custodian (and their agents, officers and employees) against all liabilities arising from or incurred in connection with, or arising from any act related to, the Deed Poll so far as they relate to the DIs (and any property or rights held by the Depositary or Custodian in connection with the DIs) held by that holder, other than those resulting from the willful default, negligence or fraud of the Depositary, or the Custodian or any agent if such custodian or agent is a member of the Depositary's group or if, not being a member of the same group, the Depositary shall have failed to exercise reasonable care in the appointment and continued use of such Custodian or agent.
- (i) The Depositary is entitled to make deductions from any income or capital arising from the underlying securities, or to sell such underlying securities and make deductions from the sale proceeds therefrom, in order to discharge the indemnification obligations of DI holders.
- (j) The Depositary may terminate the Deed Poll by giving 30 days' notice. During such notice period holders may cancel their DIs and withdraw their deposited property and, if any DIs remain outstanding after termination, the Depositary must, among other things, deliver the deposited property in respect of the DIs to the relevant DI holders or, at its discretion sell all or part of such deposited property. It shall, as soon as reasonably practicable, deliver the net proceeds of any such sale, after deducting any sums due to the Depositary, together with any other cash held by it under the Deed Poll pro rata to holders of DIs in respect of their DIs.
- (k) the Depositary or the Custodian may require from any holder information as to the capacity in which DIs are or were owned and the identity of any other person with or previously having any interest in such DIs and the nature of such interest and evidence or declaration of nationality or residence of the legal or beneficial owners of DIs and such information as is required for the transfer of the relevant Common Shares to the holders. Holders agree to provide such information requested and consent to the disclosure of such information by the Depositary or Custodian to the extent necessary or desirable to comply with their legal or regulatory obligations. Furthermore, to the extent that the Company's memorandum of association and/or bye-laws require disclosure to the Company of, or limitations in relation to, beneficial or other ownership of the Company's securities, the holders of DIs are to comply with the Company's instructions with respect thereto.

It should also be noted that holders of DIs may not have the opportunity to exercise all of the rights and entitlement available to holders of Common Shares including, for example, the ability to vote on a show of hands. In relation to voting, it will be important for holders of DIs to give prompt instructions to the Depositary to vote the underlying shares on their behalf.

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### **12. Material Contracts**

The following contracts, not being contracts entered into in the ordinary course of business, have been entered into by the Company and/or its subsidiaries during the two years preceding the date of this document and are or may be material:

#### **12.1 Constituent Documents**

- (a) A secured convertible promissory note and warrant purchase agreement entered into on 14 February 2005 by and among Clean Air Power US and the purchasers of such notes including EnerTech Capital Partners II, L.P., Endeavor Capital Partners, LLC and Royal Bank of Canada, pursuant to which the investors purchased secured promissory notes convertible into Series D Preferred stock and received warrants to purchase additional Series D Preferred Stock.
- (b) A second amended and restated security agreement dated 23 August 2005 by and among Clean Air Power US and the Royal Bank of Canada as agent for the secured parties, pursuant to which Clean Air Power US pledged all its assets including its stock in Clean Air Power UK as collateral for the principal of the secured promissory notes.
- (c) A Patent and Trademark Security Agreement dated 14 December 2004 by and among Clean Air Power US and the Royal Bank of Canada as agent for the secured parties, pursuant to which Clean Air Power US pledged all its intellectual property as collateral for the principal of the secured promissory notes.
- (d) A fifth amended and restated investors' rights agreement dated 14 February 2005 by and among Clean Air Power US and the holders of registrable securities, granting the holders of registrable securities certain demand and piggyback registration rights, inspection and information rights, and a right of first offer with respect to certain future issuances of Clean Air Power US's stock.
- (e) A third amended and restated voting agreement dated 14 February 2005 by and among Clean Air Power US and preferred and common shareholders, whereby the preferred and common shareholders agreed to certain voting arrangements with respect to electing Clean Air Power's board of directors. Under the agreement, EnerTech Capital Partners II L.P., Royal Bank of Canada and Endeavor Capital Partners, LLC each have the right to have one director elected to the board, the common shareholders have the right to elect one director, and the remaining three directors are elected by the holders of the outstanding share capital.
- (f) A fourth amended and restated shareholders' agreement dated 14 February 2005 by and among Clean Air Power US and the holders of common and preferred stock, and certain future stockholders including warrant holders. Under the agreement, the company is granted a right of first refusal in case any stockholder has been offered to sell its shares to a third party, and the non-selling stockholders are granted co-sale rights and drag-along rights in connection with any such sale.
- (g) An omnibus termination agreement dated 11 January 2006 by and among Clean Air Power US and certain principal shareholders including EnerTech Capital Partners II, L.P., Endeavor Capital Partners, LLC and Royal Bank of Canada, pursuant to which the constituent documents enumerated in this Section 12.1 will be terminated and declared to be of no further force and effect upon completion of the Merger.

#### **12.2 Merger**

A merger agreement by and between Clean Air Power US and Merger Sub dated as of 11 January 2006, pursuant to which Merger Sub merges with and into Clean Air Power US with the effect that following the implementation of the merger, Clean Air Power US would assume all the assets and liabilities of the surviving corporation and Merger Sub would cease to exist as a separate entity pursuant to Delaware General Corporation Law section 264. Under the agreement, the issued share capital of Clean Air Power US will be reverse split at a ratio of 15:1, and then automatically exchanged for Common Shares in the Company. All outstanding warrants of Clean Air Power US would be assumed by the Company (subject to the reverse split) but all options issued under Clean Air Power US's 2001 Stock Option/Stock Issuance Plan would be terminated in connection with the Merger. The merger agreement is anticipated to become unconditional on 27 February 2006. The merger agreement is governed by the laws of the State of Delaware.

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### 12.3 Admission and Placing

- (a) A nominated adviser and broker agreement dated 22 February 2006 between the Company and Canaccord pursuant to which the Company has appointed Canaccord as the Company's nominated adviser and broker in connection with Admission and thereafter (the "Nomad Agreement"). Canaccord's obligations under the Nomad Agreement are conditional upon the Placing Agreement becoming unconditional and Admission. The Nomad Agreement shall continue for a period of 12 months from the date of the Nomad Agreement and shall continue thereafter unless and until terminated by either party on three months' prior written notice. The Nomad Agreement contains provision for early termination in certain circumstances and also contains an indemnity given by the Company to Canaccord in relation to the provision by Canaccord of its services under the Nomad Agreement. The Company has agreed to pay Canaccord an ongoing retainer for the provision of these services of £50,000 per annum in addition to expenses incurred by Canaccord in the performance of its services.
- (b) Individual lock-in deeds each to be dated 27 February 2006 entered into between the Company, Canaccord and each of John Pettitt, Steven Whelan, Peter Rowse, Ross Dueber, EnerTech Capital Partners II, L.P., ECP Interfund II L.P., Endeavor Capital Partners, LLC, Royal Bank Capital Partners, Angelino Investors, L.P., Pilot Holdings, L.P., VisionQuest, Corp. and Hobbs & Towne, Inc., respectively (each a "Covenantor") pursuant to which each Covenantor has undertaken not at any time prior to the first anniversary of Admission without the prior written consent of Canaccord, to dispose of any Common Shares obtained by virtue of the Merger. Each lock-in deed also contains orderly market provisions preventing each Covenantor from disposing of any of its interests in these Common Shares except through Canaccord during the period from the first anniversary of Admission until the second anniversary of Admission. Such lock-in arrangements cease to apply in certain limited circumstances, such as in the event of acceptance of an offer for the entire issued share capital of the Company or an intervening court order.

Moreover, EnerTech Capital II, L.P., ECP II Interfund, L.P., Royal Bank Capital Partners and Endeavor Capital Partners, LLC have agreed, in respect of the 3,325,000 aggregate Placing Shares for which they are subscribing in the Placing, to deal only through Canaccord for a period of 12 months from Admission in accordance with Canaccord's reasonable requirements to maintain an orderly market in the Common Shares.

- (c) The Placing Agreement dated 22 February 2006 between the Company, the Directors, Clean Air Power US and Canaccord pursuant to which Canaccord has agreed to use its reasonable endeavours to procure subscribers to subscribe for the Common Shares at the Placing Price. The agreement is conditional, inter alia, upon the fulfillment of the obligations of the Company and each of the Directors under the Placing Agreement and Admission taking place on or before 28 February 2006 or such later date as the Company and Canaccord may agree in writing but in any event no later than 31 March 2006. Clean Air Power US guarantees to Canaccord the Company's performance of its obligations under the Placing Agreement.

The Company will pay to Canaccord a commission of 5.5 per cent on the aggregate value of Placing Shares at the Placing Price. The Company will also pay a fee of £100,000 to Canaccord and Canaccord will be granted broker warrants to subscribe for such number of Common Shares at the Placing Price as is equal in aggregate to 5 per cent of the Placing Shares. The Company will pay certain other costs and expenses (including any applicable VAT) of, or incidental to, the Placing including all fees and expenses payable in connection with the Admission.

The Placing Agreement contains warranties and indemnities given by the Company and the Directors to Canaccord as to the accuracy of the information contained within this document and other matters relating to Clean Air Power and its business. Canaccord may terminate the Placing Agreement in specified circumstances prior to Admission, principally in the event of a material breach of the placing agreement or any of the warranties contained in it being untrue or inaccurate or where any change in national or international, financial, monetary, economic, political or market conditions is, or could be in the opinion of Canaccord, materially prejudicial to the Company or to the successful outcome of the Placing.

### 12.4 Third Party Agreements

- (a) A compromise agreement between Clean Air Power US and Hobbs & Towne dated 17 October 2005, whereby the Company agreed to issue Hobbs & Towne 1,433,941 shares of the Company's Series D-1 Preferred Stock for executive recruiting services rendered from January 2002 to present. The Series D Preferred Stock will be issued by the Company to Hobbs & Towne immediately before the Merger,

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when all of the outstanding principal of the secured, convertible Series D notes is converted to Series D Preferred Stock. The Series D Preferred Stock will automatically be converted into Common Shares of the Company upon the merger, at a rate of .06667 Common Shares for each share of Series D Preferred Stock held prior to the Merger. Please refer to Section 20 of Part I for a description of the Merger.

### **13. Taxation**

#### **13.1 Material Tax Considerations**

Under current Bermuda law, there is no Bermuda withholding or other tax payable on dividends paid to the holders of common shares.

The Company has elected to be classified as a partnership for US federal income tax purposes. Accordingly, the Company will not pay any US federal income tax, although Clean Air Power US generally will be subject to US federal income tax on a net income basis. In addition, each shareholder that files a US federal income tax return will be required to report its allocable share of the Company's income, gains, losses and deductions. The Company intends to operate its business so that, with respect to its Common Shares, each shareholder generally will be required to report on its US federal income tax return only the amount of cash actually distributed to such shareholder.

For additional information concerning the material tax consequences of investing in our Common Shares, see "Bermuda Tax Considerations," "Material UK Tax Considerations," "Material US Federal Income Tax Considerations" and "Material Canadian Federal Income Tax Considerations."

#### **13.2 Bermuda Tax Considerations**

##### Tax Status of Clean Air Power Limited

At the present time, there is no Bermuda income or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by the Company. The Company has obtained an assurance from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act 1966 that, in the event that any legislation is enacted in Bermuda imposing any tax computed on profits or income, or computed on any capital asset, gain or appreciation or any tax in the nature of estate duty or inheritance tax, such tax shall not, until 28 March 2016, be applicable to us or to any of our operations or to our shares, debentures or other obligations except insofar as such tax applies to persons ordinarily resident in Bermuda or is payable by us in respect of real property owned or leased by us in Bermuda. The Company pays annual Bermuda government fees. In addition all entities employing individuals in Bermuda are required to pay a payroll tax and there are sundry taxes payable, directly or indirectly to the Bermuda government.

Currently there is no Bermuda withholding or other tax payable on dividends paid to the Shareholders.

##### Taxation of Clean Air Power Limited's Shareholders

Under current Bermuda law, there is no Bermuda income or profits tax, withholding tax, capital gains transfer tax, estate duty or inheritance tax payable by the stockholders of Clean Air Power Limited in respect of their Common Shares.

#### **13.3 Material UK Tax Considerations**

The following summary is intended as a general guide only for Shareholders who are individuals who are resident or ordinarily resident, and companies which are resident, in the UK for UK tax purposes. This summary applies only to Shareholders as investors and not to those who hold their shares in the course of a trade. The summary also does not apply to certain other categories of shareholder, including companies which hold at least 10 per cent of the issued share capital of the Company. Special rules apply to individuals who are resident but not domiciled in the UK for UK tax purposes and these individuals should seek further advice. The summary is based on current legislation and HM Revenue & Customs practice.

Owners of Common Shares who are in any doubt about their tax position, or who are subject to taxation in a jurisdiction other than the UK, should consult their own professional adviser immediately.

UK resident shareholders should also be aware of the US tax implications of holding the Common Shares, summarised in section 13.4 below.

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### Taxation of chargeable gains

If a shareholder disposes of Common Shares, a liability to tax on chargeable gains may arise, depending on the shareholder's circumstances. In the case of individuals and trustees, the chargeable gain may be reduced as a result of taper relief, the amount of which depends on various factors, in particular the length of the period of ownership of the Common Shares by the shareholder. Companies are not entitled to taper relief but are eligible for indexation allowance which may also reduce the chargeable gain.

Special rules may apply to tax gains realised on a disposal of Common Shares by individuals at a time when they are temporarily not resident nor ordinarily resident in the UK.

### Taxation of dividends

Dividends paid by the Company will normally be assessable to income tax under Part 4 of the Income Tax (Trading and Other Income) Act 2005 in the case of shareholders who are individuals or corporation tax under Schedule D Case V in the case of shareholders which are companies.

US federal withholding tax on dividends paid by Clean Air Power US (or another US subsidiary) to the Company will not be creditable against UK tax payable in respect of dividends paid by the Company. See "Material US Federal Income Tax Considerations—Additional Considerations for Non-US Investors."

### Stamp duty and stamp duty reserve tax

No stamp duty or stamp duty reserve tax is payable on the issue of Common Shares by the Company.

Any subsequent disposal or transfer of Depository Interests held in CREST will give rise to stamp duty reserve tax ("SDRT") generally at the rate of 0.5 per cent of the amount or value of the consideration paid.

A transfer of Common Shares will be subject to stamp duty normally at the rate of 0.5 per cent if the transfer is executed in the UK or the transfer relates to any matter or thing done or to be done in any part of the UK, but will not otherwise be subject to stamp duty. An agreement to transfer Common Shares held otherwise than in the form of Depository Interests held in CREST will not be subject to stamp duty reserve tax.

### Inheritance tax

If any individual shareholder is or is deemed to be domiciled in the UK for inheritance tax purposes, inheritance tax may be payable in respect of the Common Shares on the death of the shareholder or on any gift of the Common Shares during the shareholder's lifetime which qualifies as a chargeable lifetime transfer.

### **13.4 Material US Federal Income Tax Considerations**

The following is a summary of certain US federal income tax considerations relevant to the purchase, ownership and disposition of Common Shares. This summary is general and may not apply to all categories of investors, some of which may be subject to special rules (e.g., tax-exempt organisations, banks, thrifts, insurance companies, dealers and other investors that do not hold their Common Shares as a capital asset). The actual tax and financial consequences of the purchase, ownership and disposition of Common Shares will vary depending upon the investor's particular circumstances. This summary is based upon the Internal Revenue Code, the regulations promulgated thereunder, court decisions, and published rulings of the IRS currently in effect and does not take into account the possible effect of future legislative or administrative changes or court decisions. This summary is not a complete analysis of all possible US federal income tax considerations relevant to the purchase, ownership and disposition of Common Shares. Clean Air Power Limited will not request any rulings from the IRS on the transactions or issues addressed herein. A court might reach a contrary conclusion with respect to the conclusions expressed herein if the matter were contested by the IRS. Future legislative or administrative changes or court decisions may significantly change the conclusions expressed herein, and any such changes or decisions may have a retroactive effect.

**THE INCOME TAX LAWS APPLICABLE TO CLEAN AIR POWER LIMITED AND TO INVESTORS THEREIN ARE EXTREMELY COMPLEX, AND THE FOLLOWING SUMMARY IS NOT EXHAUSTIVE AND DOES NOT CONSTITUTE TAX ADVICE. AN INVESTOR CONSIDERING AN INVESTMENT IN COMMON SHARES SHOULD CONSULT AN INDEPENDENT TAX ADVISER REGARDING THE TAX ISSUES RELEVANT TO THE INVESTOR'S PARTICULAR SITUATION.**

### **US Classification of Clean Air Power Limited**

#### ***Partnership Election***

Clean Air Power Limited will elect to be classified as a partnership for US federal income tax purposes. Accordingly, Clean Air Power Limited expects that it will not be a taxable entity, and will not incur any US

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federal income tax liability. Instead, for US federal income tax purposes, Common Shares should be viewed as partnership interests, and each shareholder of Clean Air Power Limited should be viewed as a partner. See “— Tax Considerations for Investors in Common Shares — Flow Through of Taxable Income and Losses.”

### *Qualifying Income Requirement*

To preserve its partnership classification for US federal income tax purposes, Clean Air Power Limited must comply with special rules applicable to “publicly traded partnerships.” A publicly traded partnership is any partnership whose interests are traded on an established securities market or are readily tradable on a secondary market (or the substantial equivalent thereof). A publicly traded partnership is classified as a corporation unless at least 90 per cent of its gross income consists of “qualifying income” for each year it is a publicly traded partnership. For this purpose, qualifying income includes dividends and interest. Because Common Shares will be publicly traded, Clean Air Power Limited will be a publicly traded partnership. Clean Air Power Limited intends to satisfy the “qualifying income” requirement for each year it is a publicly traded partnership, although there can be no assurance it will be able to do so.

### *Reclassification as Corporation*

If Clean Air Power Limited does not satisfy the “qualifying income” requirement, Clean Air Power Limited would be reclassified as a corporation for US federal income tax purposes. If Clean Air Power Limited were reclassified as a corporation:

- There is a risk that Clean Air Power Limited could be classified as a US corporation under Section 7874 of the Internal Revenue Code. Due to currently proposed legislation, however, that result is uncertain. Each investor considering an investment in Common Shares should consult an independent tax adviser regarding the potential application of Section 7874.
- If Clean Air Power Limited were viewed as a US corporation under Section 7874, it would be subject to US federal income tax on a net income basis. In particular, Clean Air Power Limited would be taxable on dividends received from its non-US subsidiaries. In addition, Clean Air Power Limited would be currently taxable on certain income derived directly by its non-US subsidiaries. Thus, classification as a US corporation could decrease cash available for reinvestment or distribution to shareholders. Moreover, dividend payments from Clean Air Power Limited to Non-US Investors would be subject to US federal withholding tax at a rate of 30 per cent (unless reduced by an applicable income tax treaty).
- If Clean Air Power Limited were viewed as a foreign corporation, it would be taxable on income effectively connected with a trade or business within the United States. See “— Taxation of Non-US Investors — Income Derived from a US Trade or Business.” In addition, dividend payments from Clean Air Power US to Clean Air Power Limited would be subject to US federal withholding tax at a rate of 30 per cent. Thus, classification as a foreign corporation could decrease cash available for reinvestment or distribution to shareholders.

The remainder of this discussion assumes that Clean Air Power Limited will satisfy the “qualifying income” requirement, and will be treated as a partnership for US federal income tax purposes.

### **Tax Considerations for Investors in Common Shares**

This section discusses certain considerations relevant to US Investors and Non-US Investors that file US federal income tax returns (collectively, “US Taxpayers”). For purposes of this discussion, a “US Investor” means a beneficial owner of Common Shares that is:

- an individual Non-US Investor (as defined below) and present in the United States for 183 days or more in a taxable year;
- an individual citizen or resident of the United States;
- a corporation (or any other entity treated as a corporation for US federal income tax purposes) created or organised in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate the income of which is subject to US federal income taxation regardless of its source; or
- a trust if it (1) is subject to the primary supervision of a court within the United States and one or more US persons have the authority to control all substantial decisions of the trust or (2) has a valid election in effect under applicable US Treasury regulations to be treated as a US person.

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A “Non-US Investor” means a beneficial owner of Common Shares (other than a partnership) that is not a US Investor. If a partnership is a beneficial owner of Common Shares, the tax treatment of a partner in such partnership generally will depend on the status of such partner and the activities of such partnership. A partner in a partnership that is considering an investment in Common Shares should consult an independent tax adviser regarding the US federal income tax consequences of the investment.

### *Partner Status of Shareholders*

Beneficial owners of Common Shares who are shareholders of record will be treated as partners of Clean Air Power Limited for US federal income tax purposes. Beneficial owners whose Common Shares are held by a nominee and who have the right to direct the nominee in the exercise of all substantive rights attendant to the ownership of such Shares will also be treated as partners of Clean Air Power Limited for US federal income tax purposes.

If a shareholder’s Common Shares are transferred by its broker to a short seller to complete a short sale, the shareholder may lose its status as a partner of Clean Air Power Limited for US federal income tax purposes. See “— Treatment of Common Shares Lent to Short Sellers.”

### *Flow Through of Taxable Income and Losses*

As a partnership, Clean Air Power Limited will not pay any US federal income tax. Instead, each US Taxpayer who owns Common Shares will be required to report for such purposes a *pro rata* share of income, gains, losses, deductions and credits recognised by Clean Air Power Limited during the taxable year. The character of such taxable income or loss (*e.g.*, capital or ordinary) will be determined by reference to its character in the hands of Clean Air Power Limited. There is a risk that net income allocable with respect to a shareholder’s Common Shares during a taxable year may exceed dividends paid with respect to such shares.

Special allocation rules apply to gain or loss attributable to “contributed property” other than cash. These special rules will have limited relevance to a shareholder that purchases Common Shares for cash in the offering.

### *Computation of Partnership Income*

For US federal income tax purposes, Clean Air Power Limited will compute its items of income, gain, loss, deduction and credit as an entity separate from its corporate subsidiaries. Accordingly, income or losses of Clean Air Power US (or any corporate subsidiary subsequently established or acquired by Clean Air Power Limited) will not be allocable to US Taxpayers who own Common Shares.

### *Limitations on Deductibility of Losses*

As described above, each US Taxpayer who owns Common Shares will be required to report for US federal income tax purposes a *pro rata* share of losses recognised by Clean Air Power Limited during the taxable year. The deductibility of such losses will be limited to the shareholder’s adjusted tax basis in its Common Shares. Moreover, if the shareholder is an individual or a closely held corporation, the shareholder may also be subject to the “at risk” limitation rules of Section 465 of the Internal Revenue Code. Such rules could further limit the shareholder’s ability to deduct its share of Clean Air Power Limited’s losses on the shareholder’s income tax return.

Clean Air Power Limited expects that its business activities will not constitute the “conduct of a trade or business” for purposes of Section 469 of the Internal Revenue Code. Thus, the “passive activity loss” limitation rules under Section 469 of the Internal Revenue Code should not be applicable to a shareholder that is an individual, estate, trust, a certain type of a closely held corporation or a personal service corporation. There can be no assurance, however, that Clean Air Power Limited’s holding company focus will remain unchanged and that such a shareholder will not become subject to the “passive activity loss” limitation rules in the future.

**Each investor considering an investment in Common Shares should consult an independent tax adviser regarding the allocation of losses from a partnership and the possible application of the various loss limitation rules to such investor.**

### *Dividends from Subsidiaries of Clean Air Power Limited*

Clean Air Power Limited expects that its gross income (which will flow through to shareholders for US federal income tax purposes) will primarily consist of distributions from direct subsidiaries and interest from

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short-term investments. A distribution from a subsidiary will be taxed as a dividend to the extent of the subsidiary's earnings and profits, determined under US federal income tax principles. A distribution that exceeds the subsidiary's earnings and profits but does not exceed Clean Air Power Limited's basis in the stock of such subsidiary will not be taxable, but will be applied against and reduce the basis of such stock. A distribution that exceeds Clean Air Power Limited's basis in the stock of such subsidiary will be taxed as capital gain.

If Clean Air Power Limited receives dividends from Clean Air Power US (or another US subsidiary) before 2009, the amount of income allocable to US Taxpayers who own Common Shares should be eligible for reduced rates of tax on "qualified dividend income," provided that the US Taxpayer is an individual and satisfies certain holding period requirements. Subject to the passive foreign investment company rules, described below, if Clean Air Power Limited receives dividends from a direct non-US subsidiary before 2009, a US Taxpayer's share of such income should be characterised as "qualified dividend income," provided that (i) the US Taxpayer is an individual who satisfies certain holding period requirements, and (ii) the distributing non-US subsidiary is a "qualified resident" of a relevant income tax treaty partner.

If Clean Air Power Limited receives dividends from Clean Air Power US (or another US subsidiary) that are allocable to Non-US Investors, such dividends generally will be subject to US federal withholding tax at a rate of 30 per cent (unless reduced by an applicable income tax treaty). Amounts withheld will be treated as cash distributions to the Non-US Investors, and will reduce the amount of cash available for distribution to shareholders of Clean Air Power Limited. See "— Treatment of Amounts Withheld" and "— Additional Considerations for Non-US Investors — US Federal Withholding Tax on Dividends."

### ***Basis of Common Shares***

A shareholder will have an initial tax basis in Common Shares equal to the amount paid for such Common Shares, plus the shareholder's initial share of Clean Air Power Limited's liabilities. A shareholder's tax basis in Common Shares will be increased by the shareholder's allocable share of Clean Air Power Limited's income, and any increase in the shareholder's allocable share of Clean Air Power Limited's liabilities. A shareholder's tax basis will be decreased, but not below zero, by distributions from Clean Air Power Limited, by the shareholder's share of Clean Air Power Limited's losses, if any, and by any decrease in the shareholder's share of Clean Air Power Limited's liabilities.

A partner who acquires interests in a partnership in separate transactions must combine those interests and maintain a single adjusted tax basis for all of those partnership interests. Upon a sale or other disposition of less than all of those interests (see "— Disposition of Common Shares"), a shareholder generally must allocate the unified basis in its Common Shares between the shares that are sold and the retained shares based upon the fair market value of the Common Shares at the time they are sold.

### ***Distributions from Clean Air Power Limited***

For US federal income tax purposes, distributions from Clean Air Power Limited generally will not be taxable, to the extent such distributions do not exceed the tax basis of a shareholder's Common Shares. If such distributions exceed a shareholder's basis in Common Shares, the excess generally will be taxable as gain from the sale or exchange of Common Shares. See "Disposition of Common Shares" below.

Clean Air Power Limited does not expect to incur direct nonrecourse liabilities. If Clean Air Power Limited incurs any direct nonrecourse liabilities, a shareholder's share of such liabilities will be deemed to be a cash contribution to Clean Air Power Limited, and will increase the shareholder's tax basis in the Common Shares. A reduction in the shareholder's share of Clean Air Power Limited's nonrecourse liabilities, if any, will be treated as a deemed cash distribution to the shareholder. If Clean Air Power Limited issues additional Common Shares, each shareholder's percentage interest in Clean Air Power Limited would decrease, and the corresponding decrease in a shareholder's share of its nonrecourse liabilities would be treated as a deemed cash distribution to the shareholder.

### ***Disposition of Common Shares***

Absent a nonrecognition rule, a shareholder will recognise gain or loss on a disposition of Common Shares equal to the difference between the amount realised and the tax basis of such Common Shares. The amount realised will be measured by the sum of the cash or the fair market value of other property received, plus the shareholder's share of Clean Air Power Limited's nonrecourse liabilities, if any. Because the amount realised includes a shareholder's share of Clean Air Power Limited's nonrecourse liabilities, if any, gain recognised on the sale of Common Shares could result in a tax liability in excess of any cash received from the sale.

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Subject to the passive foreign investment company rules, described below, gain or loss recognised by a shareholder on the sale or exchange of Common Shares generally will be taxable as capital gain or loss, and as long-term capital gain or loss if the shareholder owns such Common Shares for more than a year. Individual shareholders currently are taxed on long-term capital gains at a maximum rate of 15 per cent. By contrast, individual and corporate shareholders are currently taxed on short-term capital gains at the same rates as ordinary income. The deductibility of capital losses is subject to limitations.

### **Section 754 Election**

Clean Air Power Limited may make the election permitted by Section 754 of the Internal Revenue Code. This election is irrevocable without the consent of the IRS. The election generally permits Clean Air Power Limited to adjust a shareholder's allocable share of tax basis in Clean Air Power Limited's assets ("inside basis") under Section 743(b) of the Internal Revenue Code to reflect the shareholder's purchase price. The election does not apply to a shareholder if it purchases Common Shares directly from Clean Air Power Limited. The Section 743(b) adjustment is made solely with respect to the purchaser and does not affect any other shareholder. For purposes of this discussion, a shareholder's inside basis in Clean Air Power Limited's assets will be considered to have two components, (i) its share of Clean Air Power Limited's tax basis in Clean Air Power Limited's assets ("common basis") and (ii) its Section 743(b) adjustment to such common basis.

Because Clean Air Power Limited does not expect to hold any significant assets other than stock of its subsidiaries, a Section 754 election will likely not be relevant to its shareholders unless Clean Air Power Limited disposes of such stock in a taxable transaction. Generally, a Section 754 election is advantageous to a transferee partner if the partner's tax basis in its partnership interest is higher than the applicable share of the aggregate tax basis of Clean Air Power Limited's assets immediately prior to the transfer. In that case, as a result of the election, the transferee partner would have a higher tax basis in its share of Clean Air Power Limited's assets for purposes of calculating, among other items, its share of any gain or loss on a sale of Clean Air Power Limited's assets. Conversely, a Section 754 election is disadvantageous to a transferee partner if the partner's tax basis in its partnership interest is lower than the applicable share of the aggregate tax basis of Clean Air Power Limited's assets immediately prior to the transfer. Thus, the fair market value of Common Shares may be affected either favorably or adversely by the Section 754 election.

### **PFIC Considerations**

Generally, a non-US corporation is treated as a passive foreign investment company ("PFIC") for US federal income tax purposes for any tax year if, in such tax year, either (i) 75% or more of its gross income is passive in nature (the "Income Test"), or (ii) 50% or more of its assets during such tax year produce, or are held for the production of, passive income (the "Asset Test"). Because the Income Test and Asset Test are fundamentally factual in nature, the determination of PFIC status cannot be made until the close of the applicable taxable year.

As a partnership, Clean Air Power Limited will not be treated as a PFIC. However, if Clean Air Power Limited owns stock in a PFIC, that stock will be considered to be owned proportionately by its shareholders (*i.e.*, partners). For example, following the Merger, Clean Air Power Limited will acquire the outstanding stock of Clean Air Power UK, a non-US corporation. If Clean Air Power UK were treated as a PFIC for US federal income tax purposes, each US Taxpayer would be deemed to own a proportionate interest in the PFIC. There is a risk that Clean Air Power UK, or any other non-US subsidiary established or acquired by Clean Air Power Limited, may be characterized as a PFIC.

If a non-US subsidiary of Clean Air Power Limited (including Clean Air Power UK) were characterized as a PFIC:

- Upon the disposition of Common Shares at a gain, a US Taxpayer will be treated as selling its proportionate interest in the PFIC, and generally will be subject to additional tax on the gain attributable to the PFIC. Similarly, a US Taxpayer generally will be subject to additional tax on its proportionate share of any "excess distribution" from the PFIC. A distribution with respect to stock of a PFIC generally constitutes an "excess distribution" if it exceeds 125% of the average distributions with respect to such stock during a three-year base period.
- To avoid the additional taxes imposed on gains or "excess distributions" attributable to the PFIC, a US Taxpayer must make a qualified electing fund ("QEF") election with respect to the PFIC. Clean Air Power Limited may not be able to provide US Taxpayers with the information necessary to make a QEF

## **Part VI — Additional Information**

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election with respect to any non-US subsidiary (including Clean Air Power UK). Accordingly, a US Taxpayer may be required to pay additional taxes on gains or “excess distributions” attributable to the PFIC.

- Although reduced tax rates may apply to “qualified dividend income” paid by a subsidiary of Clean Air Power Limited prior to 2009, a distribution from the PFIC will not be considered “qualified dividend income” for such purposes.

The rules applicable to PFICs are extremely complex. Each shareholder should consult an independent tax adviser regarding the application of the PFIC rules to that shareholder.

### ***Treatment of Common Shares Lent to Short Sellers***

If a shareholder’s Common Shares were loaned to a “short seller” to cover a short sale of Common Shares, the shareholder may be considered as having disposed of such Shares for US federal income tax purposes. If so, the shareholder would no longer be a partner of Clean Air Power Limited with respect to those Common Shares during the period of the loan of those Shares and, although the shareholder would receive no cash, the shareholder may recognise gain or loss from the disposition, which will generally be capital gain or loss as described above under “— Disposition of Common Shares.” As a result, during this loan period:

- any of Clean Air Power Limited’s income, gain, deduction or loss with respect to those Common Shares would not be reportable by the lending shareholder,
- any cash distributions received by the shareholder with respect to those Shares would be fully taxable to the lending shareholder, and
- all of these distributions would appear to be treated as ordinary income.

A shareholder’s holding period in the Common Shares loaned to a “short seller” to cover a short sale of such Common Shares will restart when the Common Shares are returned to the lending shareholder. To avoid the risk of gain recognition, each shareholder should amend any applicable brokerage account agreements to prohibit the broker from borrowing the shareholder’s Common Shares. Each investor considering an investment in Common Shares should consult an independent tax adviser regarding the tax consequences of loans to short sellers.

### ***Backup Withholding and Information Reporting***

Unless a shareholder is an exempt recipient such as a corporation, an allocable share of dividends from Clean Air Power US may be subject to US information reporting. In addition, such payments may be subject to US federal backup withholding tax (currently at a rate of 28 per cent) if the shareholder fails to comply with applicable US information reporting or certification requirements or if the shareholder is a US person and fails to supply a taxpayer identification number (*e.g.*, an individual’s Social Security number). Backup withholding is not an additional tax. Thus, any amounts so withheld will be allowed as a credit against the shareholder’s federal income tax liability.

### ***Treatment of Amounts Withheld***

If Clean Air Power Limited or its subsidiaries must withhold any US tax on distributions made to shareholders, or to Clean Air Power Limited that are allocable to shareholders, Clean Air Power Limited or such subsidiaries will pay such withheld amount to the IRS. That payment, if made, will be treated as a distribution to the shareholder with respect to whom the tax was withheld, and will reduce the amount of cash paid to such shareholder.

### **Additional Considerations for Non-US Investors**

This section discusses tax considerations relevant to Non-US Investors (as defined above). Non-US Investors are urged to consult an independent tax adviser regarding the US tax consequences of an investment in Common Shares.

### ***Income Derived from US Trade or Business***

Clean Air Power Limited intends to avoid engaging in a trade or business within the United States. If Clean Air Power Limited were engaged, or deemed to be engaged, in a trade or business within the United States, each Non-US Investor would also be deemed to be engaged in such trade or business. Consequently, a Non-US Investor would be subject to US federal income tax (but not US federal withholding tax) on a net

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basis on the amount of income that is “effectively connected” with such trade or business. If the Non-US Investor is a foreign corporation, the Non-US Investor would also be subject to a 30 per cent US branch profits tax (unless reduced by an applicable income tax treaty).

### ***US Federal Withholding Tax on Dividends***

As a partnership, Clean Air Power Limited will allocate taxable income and losses *pro rata* among its partners (*i.e.*, its shareholders). As described above, Clean Air Power Limited expects that its gross income will primarily consist of distributions from direct subsidiaries and interest from short-term investments. If distributions from Clean Air Power US (or another US subsidiary) constitute taxable dividends, the amount allocable to Non-US Investors will be subject to US federal withholding tax at a rate of 30 per cent (unless reduced by an applicable income tax treaty).

If Clean Air Power US (or another US subsidiary) must withhold any US tax on dividends to Clean Air Power Limited that are allocable to Non-US Investors, Clean Air Power US (or such other subsidiary) will pay the amount withheld to the IRS. That payment, if made, will be treated as a cash distribution to Clean Air Power Limited, and will reduce the amount of cash available for distribution to the shareholders. See above “— Tax Considerations for Investors in Common Shares — Treatment of Amounts Withheld.”

### ***Tax on Gain from Dispositions***

Any gain recognised by a Non-US Investor from the disposition of Common Shares generally should not be subject to US federal withholding tax. In addition, any such gain generally should not be subject to US federal income tax unless the gain is effectively connected with the Non-US Investor’s conduct of a trade or business within the United States, and, if required by an applicable income tax treaty, is attributable to the Non-US Investor’s permanent establishment within the United States.

Despite this general rule, the IRS has ruled that a partner’s gain upon the disposition of a partnership interest will be treated as effectively connected with a trade or business within the United States if the partnership is treated as engaged in a trade or business within the United States, and if the partner’s gain is attributable to the partnership’s US source property. As described above, Clean Air Power Limited has elected to be classified as a partnership for US federal income tax purposes. If Clean Air Power Limited were engaged (or deemed to be engaged) in a trade or business within the United States, a Non-US Investor’s gain from the disposition of Common Shares would be subject to US federal income tax to the extent such gain is effectively connected with such trade or business.

### **Additional Considerations for Tax-Exempt Investors**

Clean Air Power Limited intends to avoid generating “unrelated business taxable income” (“UBTI”) and incurring “acquisition indebtedness” as defined in Sections 512 and 514 of the Internal Revenue Code, respectively. There can be no assurance, however, that Clean Air Power Limited will be able to satisfy those objectives. If the activities of Clean Air Power Limited result in UBTI, a tax-exempt organisation which holds Common Shares would be subject to tax on its proportionate share of such UBTI. In addition, if a tax-exempt organisation borrows funds to acquire Common Shares, such organisation would be subject to tax on the portion of its income which is unrelated debt-financed income even though such income may constitute an item otherwise excludable from UBTI, such as dividends.

**Any tax-exempt organisation considering an investment in Common Shares should consult an independent tax adviser regarding the US tax consequences of such investment.**

### **Administrative Matters**

After the close of each calendar year, Clean Air Power Limited intends to furnish US federal income tax information to each shareholder. The tax information will describe such shareholder’s allocable share of Clean Air Power Limited’s income, gain, loss and deductions for the preceding taxable year. In preparing this information, Clean Air Power Limited will use various accounting and reporting conventions. The IRS may successfully challenge the use of such conventions as impermissible. Any successful challenge by the IRS could negatively affect the value of Common Shares.

The Code allows large partnerships to elect streamlined procedures for US federal income tax reporting. When eligible, Clean Air Power Limited may make such an election.

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**This discussion of material US federal income tax considerations was not intended or written to be used, and it cannot be used by any person for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code. This discussion was written to support the promotion or marketing of this transaction, and each investor should seek advice based upon its own particular circumstances from an independent tax adviser.**

### **13.5 Material Canadian Federal Income Tax Considerations**

The following is a summary, as of the date hereof, of Canadian federal income tax considerations generally relevant to an investment in the Common Shares by investors under this Admission Document who, at all relevant times, are individuals or corporations resident in Canada, deal at arm's length with the Company and hold the Common Shares acquired hereunder as capital property, all within the meaning of the Income Tax Act (Canada) (the "ITA"). The Common Shares generally will constitute capital property to a shareholder unless the Common Shares are held or were acquired in the course of carrying on the business of trading or dealing in securities, in an adventure in the nature of trade or as "mark to market property" for the purposes of the ITA. Shareholders who do not hold their Common Shares as capital property should consult their own tax advisors regarding their particular circumstances. This summary is not applicable to a shareholder (i) that is a "specified financial institution," (ii) an interest in which is a "tax shelter investment," or (iii) if the Company is a "foreign affiliate" of such shareholder, as each of these terms is defined in the ITA.

This summary is based on the ITA and the regulations enacted under the ITA taking into account all published specific proposals for the amendments thereof to the date hereof (the "Proposed Amendments") and the current administrative practices of the Canada Revenue Agency ("CRA"). This summary does not otherwise take into account or anticipate any change in law or administrative practice, nor does it take into account provincial or territorial tax laws of Canada or tax laws of any foreign country. No assurances can be given that the Proposed Amendments will be enacted as proposed or at all, or that legislative, judicial or administrative changes will not modify or change the statements expressed herein.

This summary is of a general nature only and is not intended to be, nor should it be construed to be, legal or tax advice to any particular investor. Accordingly, an investor considering an investment in Common Shares should consult an independent tax advisor regarding the tax issues relevant to the investor's particular situation.

#### **Acquisition of Common Shares**

A Common Share will be considered to have been acquired by a shareholder for an initial cost equal to the subscription price of the Common Share, and the adjusted cost base to a shareholder of a Common Share will be determined at any time by averaging the cost of the Common Share with the adjusted cost base of all other Common Shares held by such shareholder as capital property at such time.

#### **Disposition of Common Shares**

A disposition or deemed disposition of a Common Share will result in the realisation of a capital gain or capital loss equal to the amount by which the proceeds of disposition exceed or are less than, respectively, the adjusted cost base of the Common Share and reasonable expenses incurred by the shareholder for the purposes of making such disposition. Generally, one half of any capital gain (a taxable capital gain) must be included in computing the income of a taxpayer for the taxation year in which the disposition takes place, while one half of any capital loss (an allowable capital loss) will be required to be deducted against taxable capital gains realised by the shareholder in the same taxation year. Allowable capital losses in excess of taxable capital gains for the taxation year in which they are realised may generally be deducted by a taxpayer from net taxable capital gains realised in any of the three preceding years, or any subsequent year, subject to the detailed provisions of the ITA in that regard.

Capital gains realised by a shareholder who is an individual or a trust, other than certain specified trusts, may give rise to alternative minimum tax under the ITA.

A shareholder that is a Canadian-controlled private corporation as defined in the ITA may be liable to pay an additional refundable tax of 6 $\frac{2}{3}$  per cent on its "aggregate investment income" for the year, which will include an amount in respect of taxable capital gains.

#### **Dividends Received on Common Shares**

A shareholder who is an individual (including most trusts) who receives or is deemed to receive a dividend paid on the Common Shares will be required to include the dividend in the shareholder's income for the

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taxation year in which such dividend is received and such dividend will not be subject to the gross-up and dividend tax credit rules in the ITA generally applicable to taxable dividends received from taxable Canadian corporations.

A shareholder that is a corporation who receives or is deemed to receive a dividend paid on the Common Shares will be required to include the dividend in the shareholder's income for the taxation year in which such dividend is received and such dividends will not be deductible in computing the corporation's taxable income.

A shareholder that is a Canadian-controlled private corporation as defined in the ITA may be liable to pay an additional refundable tax of 6 $\frac{2}{3}$  per cent on its "aggregate investment income" for the year, which will include an amount in respect of dividends from foreign corporations that are not foreign affiliates.

US federal withholding tax on dividends paid by Clean Air Power US (or another US subsidiary) to the Company will not be creditable against Canadian tax payable in respect of dividends paid by the Company. See "Material US Federal Income Tax Considerations—Additional Considerations for Non-US Investors."

### **Not Qualified Investments**

The Common Shares will not be qualified investments under the ITA for trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans.

### **Proposals Regarding Foreign Investment Entities**

On July 18, 2005, the Minister of Finance released draft legislation to amend the ITA, including revised proposed amendments to the ITA generally applicable for taxation years commencing after 2002, regarding the taxation of certain interests in non-resident entities that are "foreign investment entities" (the "FIE Proposals"). A corporation is not a foreign investment entity if the "carrying value" of all of its "investment property" is not greater than one half of the "carrying value" of all its property or if its principal business is not an "investment business" as such terms are defined in the FIE Proposals. The determination of whether the Company is a foreign investment entity must be made on an annual basis at the end of each taxation year end of the Company.

Although the Company expects that it should not be considered a foreign investment entity under the FIE Proposals, there can be no assurance that the Company will not be a foreign investment entity at the end of any of its taxation years. If the FIE Proposals were enacted as proposed and applied to the Common Shares, a shareholder may be required to include in income for each taxation year an amount of income or gains relating to the Common Shares computed in accordance with the FIE Proposals, regardless of whether or not the shareholder actually receives any income from or realizes any gains relating to the Common Shares.

The FIE Proposals are complex and have been subject to extensive commentary and amendment. There can be no assurance that the new rules will be enacted in the form anticipated. Potential investors should consult an independent tax adviser regarding the application of the new rules in their particular circumstances.

### **Foreign Property Information Reporting**

In general, a "specified Canadian entity" (as defined in the ITA) for a taxation year or fiscal period whose total cost amount of "specified foreign property" (as defined in the ITA) at any time in the year or fiscal period exceeds C\$100,000, is required to file an information return for the year or fiscal period disclosing prescribed information, including the cost amount and any income in the year, in respect of such property. A shareholder resident in Canada in a taxation year generally will be a specified Canadian entity, and the Common Shares generally will constitute specified foreign property with respect to the shareholder. Shareholders should consult their own tax advisers regarding compliance with these rules.

### **14. Working Capital**

In the opinion of the Directors, having made due and careful enquiry taking into account the net proceeds of the Placing, the working capital available to Clean Air Power will be sufficient for its present requirements, that is for a period of at least 12 months from Admission.

### **15. Litigation**

No legal or arbitration proceedings are active, pending or threatened against, or being brought by, any member of the Clean Air Power group which are having or may have a significant effect on Clean Air

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Power's financial position, and there have been no such proceedings during the previous 12 months which have had or may have had a significant effect on Clean Air Power's financial position.

### **16. General**

**16.1** Other than as disclosed in this document, there are no investments in progress by Clean Air Power which are significant.

**16.2** Other than as disclosed in this document, the Directors are not aware of any exceptional factors which have influenced Clean Air Power's recent activities.

**16.3** Other than as disclosed in this document, there are no patents or other intellectual property rights, licences or particular commercial, financial or other contracts or new manufacturing processes which are or may be of fundamental importance to Clean Air Power's business or profitability.

**16.4** Other than as disclosed in this document, the Company is not aware of any environmental issues or risks affecting the utilisation of the Company's property, plant or machinery.

**16.5** The total costs, charges and expenses payable by the Company in connection with or incidental to the Placing and Admission, including registration fees, London Stock Exchange fees and fees for printing, advertising, distribution, legal and accounting fees and expenses are estimated to be £1.34 million (excluding VAT)

**16.6** The minimum gross amount which, in the opinion of the Directors, must be raised pursuant to the Placing to provide the sums required in respect of the matters specified in paragraph 9 of Part I is £10 million.

**16.7** Other than as disclosed in this document, no person (other than a professional adviser referred to in this document or trade supplier) has:

- (a) received, directly or indirectly, from the Company within the 12 months preceding the application for Admission; or
- (b) entered into any contractual arrangements (not otherwise disclosed in this document) to receive, directly or indirectly from the Company on or after Admission any of the following:
  - (i) fees totalling £10,000 or more;
  - (ii) securities in the Company with a value of £10,000 or more calculated by reference to the expected opening price of the Common Shares on AIM; or
  - (iii) any other benefit with a value of £10,000 or more at the date of Admission.

**16.8** Management's routine financial reporting procedures revealed in early February 2006 that an accounts payable clerk had misappropriated funds in the amount of approximately US\$300,000 from Clean Air Power, Inc. primarily by means of payments made to an existing but dormant supplier. Clean Air Power conducted an internal investigation. The findings of the investigation have been reported to the audit committee and the auditors, which concluded that no material adjustment was required to the Clean Air Power Inc audited financial statements for the nine months ended 30 September 2005.

A portion of Clean Air Power's losses are expected to be recoverable through claims under its insurance policies. The amount of the net loss will be reflected in the financial statements for the year ended 31 December 2005 and for the year ending 31 December 2006, as appropriate.

Clean Air Power's payment authorisation procedures have been enhanced following the discovery of the misappropriation. The Directors' believe that any uninsured portion of such losses will not have a significant effect on Clean Air Power's working capital or net assets.

**16.9** Other than as disclosed in this document, there has been no significant change in the financial or trading position of the Company since 4 November 2005, or of Clean Air Power US since 30 September 2005, the date to which its most recent financial information has been drawn up.

**16.10** The financial information set out in this document does not constitute statutory accounts within the meaning of section 240 of the UK Companies Act.

**16.11** When information in this document has been sourced from third parties, it is confirmed that this information has been accurately reproduced and as far as the Company is aware, no facts have been omitted which would render the reproduced information inaccurate or misleading.

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**16.12** Canaccord Adams Limited has been appointed nominated adviser and broker to the Company. Canaccord Adams Limited's principal place of business is at First Floor, 27 Upper Brook Street, London W1K 7QF.

**16.13** Baker & McKenzie LLP has given and has not withdrawn its written consent to being named in the Corporate Directory of this document as English law solicitors to the Company, but does not make any statement in this document, nor is any statement in this document based on any statement made by Baker & McKenzie LLP.

**16.14** Ernst & Young LLP, of 100 Barbirolli Square, Manchester M2 3EY, UK, has given and not withdrawn its written consent to the inclusion in this document of its reports set out in Part III of this document and to the references to its name in the form and context in which it appears.

**16.15** Canaccord Adams Limited has given and has not withdrawn its written consent to be named in this document as the Company's nominated adviser and broker (as defined in the AIM Rules). It has not authorised or caused the issue of this document and has not made any statement in this document excepting this paragraph.

**16.16** Save as disclosed in this document, no payment (including commissions) or other benefit has been or is to be paid or given to any promoter of the Company.

**16.17** The current accounting reference period of the Company will end on 31 December 2006.

**16.18** The arrangements for paying for the Placing Shares are set out in the placing letter to be sent to potential applicants. All monies received from applicants will be held by Canaccord prior to delivery of the Placing Shares. If any application is unsuccessful or scaled down, any monies returned will be sent by cheque crossed "A/C Payee" in favour of the first named applicant. Any monies returned will be sent by first class post at the risk of the addressee within three days of the completion of the Placing. Share certificates will be sent to successful applicants by first class post at the risk of the applicant within seven days of the completion of the Placing. The offer constituted by the Placing will open on the date of this document and may be closed at any time thereafter.

### **17. Inspection of documents**

Copies of the following documents may be inspected at the offices of Baker & McKenzie LLP at 100 New Bridge Street, London EC4V 6JA during usual business hours on any week day for a period of 14 days following the date of Admission:

- (a) the Memorandum of Association;
- (b) the Bye-laws;
- (c) the audited accounts of Clean Air Power US for the three years and nine months ended 30 September 2005;
- (d) the consents of the advisers referred to in section 16;
- (e) reports of the Reporting Accountants set out in Part III of this document;
- (f) the service agreements and letters of appointment referenced in Section 10 of this Part VI; and
- (g) the material contracts referenced in Section 12 of this Part VI and the Deed Poll.

### **18. Availability of Documents**

**18.1** Copies of this document will be available free of charge to the public at the offices of Canaccord Adams Limited, during normal business hours on any weekday (Saturdays, Sundays and public holidays excepted) until close of business on 22 March 2006.

Dated: 22 February 2006

## **EXCHANGE RATE**

The exchange rate used for the purpose of this document is £1.00: \$1.75

### **Notes**

In this document, the symbols “£” and “p” refer to pounds and pence sterling respectively.

Any reference to any provision of any legislation in any jurisdiction shall include any amendment, modification, re-enactment or extension thereof.

Unless otherwise stated, all references to legislation refer to the laws of the United Kingdom.

Words importing the singular shall include the plural and vice versa and words importing the masculine gender shall include the feminine or neutral gender.



