

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended **September 30, 2013**

OR

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

For the transition period from _____ to _____

Commission File Number: 000-33155



COATES INTERNATIONAL, LTD.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

22-2925432

(I.R.S. Employer
Identification No.)

Highway 34 & Ridgewood Road, Wall Township, New Jersey 07719

(Address of principal executive offices) (Zip Code)

N/A

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

(732) 449-7717

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer

Accelerated filer Non-accelerated filer

Non-accelerated filer (Do not check if a smaller reporting

Smaller reporting company

company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

Yes No

As of November 11, 2013, the Registrant had 323,177,210 shares of its common stock, par value \$0.0001 per share issued and outstanding.

COATES INTERNATIONAL, LTD. AND SUBSIDIARIES
QUARTERLY REPORT ON FORM 10-Q

CONTENTS

SEPTEMBER 30, 2013

	<u>Page</u>
<u>PART 1 – FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements:</u>	
<u>Balance Sheets</u>	3
<u>Statements of Operations</u>	4
<u>Condensed Statements of Cash Flows</u>	5
<u>Notes to Financial Statements</u>	6-24
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25-32
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	32
<u>Item 4. Controls and Procedures</u>	32
<u>PART II - OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	33
<u>Item 1A. Risk Factors</u>	33
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	33
<u>Item 3. Defaults Upon Senior Securities</u>	34
<u>Item 4. Mine Safety Disclosures</u>	34
<u>Item 5. Other Information</u>	34
<u>Item 6. Exhibits</u>	34
<u>SIGNATURES</u>	35

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Coates International, Ltd. Balance Sheets

	<u>September 30, 2013</u>	<u>December 31, 2012</u>
	(Unaudited)	
Assets		
Current Assets		
Cash	\$ 45,225	\$ 13,303
Inventory, net	111,115	111,115
Deferred offering costs	14,986	16,207
Total Current Assets	<u>171,326</u>	<u>140,625</u>
Property, plant and equipment, net	2,195,196	2,241,847
Deferred licensing costs, net	52,087	55,299
Total Assets	<u>\$ 2,418,609</u>	<u>\$ 2,437,771</u>
Liabilities and Stockholders' Deficiency		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 2,199,106	\$ 1,797,439
Current portion of finance lease obligation	38,766	-
Mortgage loan payable	1,528,284	1,575,000
Promissory notes to related parties	628,081	507,694
Deferred compensation payable	358,954	1,911,775
Convertible promissory notes, net of unamortized discount	144,358	77,363
Estimated fair value of embedded derivative liabilities related to convertible promissory notes	402,899	135,263
Unearned revenue	19,124	19,124
10% Convertible note	10,000	10,000
Total Current Liabilities	<u>5,329,572</u>	<u>6,033,658</u>
Noncurrent portion of finance lease obligation	93,784	-
License deposits	327,000	341,400
Total Liabilities	<u>5,750,356</u>	<u>6,375,058</u>
Commitments and Contingencies		
	-	-
Stockholders' Deficiency		
Preferred Stock, \$0.001 par value, 100,000,000 shares authorized, 128,410 and 72,883 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	129	73
Common Stock, \$0.0001 par value, 1,000,000,000 shares authorized, 319,965,903 and 305,078,818 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	31,997	30,508
Additional paid-in capital	30,286,222	27,259,253
Accumulated deficit	(33,650,095)	(31,227,121)
Total Stockholders' Deficiency	<u>(3,331,747)</u>	<u>(3,937,287)</u>
Total Liabilities and Stockholders' Deficiency	<u>\$ 2,418,609</u>	<u>\$ 2,437,771</u>

The accompanying notes are an integral part of these financial statements.

Coates International, Ltd.
Statements of Operations
Unaudited

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
Sublicensing fee revenue	\$ 4,800	\$ 4,800	\$ 14,400	\$ 14,400
Expenses:				
Research and development costs	94,856	94,021	174,220	415,879
General and administrative expenses	383,664	571,213	1,577,612	2,835,691
Depreciation and amortization	16,621	22,173	49,863	48,754
Total Expenses	495,141	687,407	1,801,695	3,300,324
Loss from Operations	(490,341)	(682,607)	(1,787,295)	(3,285,924)
Other Income (Expense):				
(Increase) decrease in estimated fair value of embedded derivative liabilities	224,854	(17,151)	(258,074)	(25,960)
Interest expense	(175,468)	(104,477)	(377,605)	(380,193)
Total other income (expense)	49,386	(121,628)	(635,679)	(406,153)
Loss Before Income Taxes	(440,955)	(804,235)	(2,422,974)	(3,692,077)
Provision for income taxes	-	-	-	-
Net Loss	\$ (440,955)	\$ (804,235)	\$ (2,422,974)	\$ (3,692,077)
Basic net loss per share	\$ -	\$ -	\$ (0.01)	\$ (0.01)
Basic weighted average shares outstanding	341,097,005	314,543,467	337,627,476	299,894,284
Diluted net loss per share	\$ -	\$ -	\$ (0.01)	\$ (0.01)
Diluted weighted average shares outstanding	341,097,005	314,543,467	337,627,476	299,894,284

The accompanying notes are an integral part of these financial statements.

Coates International Ltd.
Condensed Statements of Cash Flows
Unaudited

	For the Nine Months Ended September 30,	
	<u>2013</u>	<u>2012</u>
Net Cash (Used in) Operating Activities	\$ (511,718)	\$ (906,317)
Net Cash Provided by (Used in) Investing Activities	-	-
Cash Flows Provided by (Used in) Financing Activities:		
Issuance of promissory notes to related parties	169,094	194,255
Repayment of promissory notes to related parties	(48,708)	(40,500)
Issuance of convertible promissory notes	160,000	212,000
Issuance of common stock and warrants	105,000	543,722
Issuance of common stock under equity line of credit	72,420	-
Proceeds from sale/leaseback of equipment	132,550	-
Repayment of Mortgage Loan	(46,716)	(40,000)
Net Cash Provided by Financing Activities	<u>543,640</u>	<u>869,477</u>
Net Increase (Decrease) in Cash	31,922	(36,840)
Cash, beginning of period	13,303	52,955
Cash, end of period	<u>\$ 45,225</u>	<u>\$ 16,115</u>
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for interest	<u>\$ 89,171</u>	<u>\$ 81,976</u>
Supplemental Disclosure of Non-cash Financing Activities:		
Deferred compensation paid with common stock	\$ -	\$ 297,960
Conversion of convertible promissory notes	134,688	184,471
	<u>\$ 134,688</u>	<u>\$ 482,431</u>

The accompanying notes are an integral part of these condensed financial statements.

Coates International, Ltd.
Notes to Financial Statements
(All amounts rounded to thousands of dollars)
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited financial statements of Coates International, Ltd. (the “Company”, or “CIL”) have been prepared in accordance with accounting principles generally accepted for interim financial information and rules and regulations of the Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and notes required by generally accepted accounting principles in the United States (“GAAP”) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three and nine months ended September 30, 2013 and 2012 are not necessarily indicative of the results that may be expected for any other interim period or for the full year. The unaudited financial statements should be read in conjunction with the financial statements and notes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2012 and the unaudited financial statements and notes thereto included in the Company’s quarterly reports on Form 10-Q for the three months ended March 31, 2013 and June 30, 2013.

Going Concern

As shown in the accompanying financial statements, the Company has incurred recurring losses from operations of (\$33,651,000), primarily consisting of research and development expenses and, as of September 30, 2013, had a stockholders’ deficiency of (\$3,332,000). In addition, the current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest their funds and low investor confidence, has introduced additional risk and difficulty to the Company’s challenge to secure needed additional working capital. These factors raise substantial doubt about the Company’s ability to continue as a going concern. The financial statements do not include any adjustments that might be necessary should the Company become unable to continue as a going concern.

Management has instituted a cost control program intended to restrict variable costs to only those expenses that are necessary to carry out the Company’s activities related to entering the production phase of operations, develop additional commercially feasible applications of the CSRV system technology, seek additional sources of working capital and cover general and administrative costs in support of such activities. The Company continues to actively undertake efforts to secure new sources of working capital. At September 30, 2013, the Company had negative working capital of (\$5,158,000) compared with negative working capital of (\$5,893,000) at December 31, 2012.

2. ACCOUNTING POLICIES

Principles of Consolidation

CIL is currently the majority shareholder in Coates Hi-Tech Engines, Ltd. (“Coates Hi-Tech”), a Delaware corporation which was formed in July 2012. It has not commenced operations and has no assets. Accordingly, this subsidiary has not been consolidated with the accounts of CIL. In August 2013, the Company decided to cancel its previously announced plans to spin-off certain of its operations and assets to Coates Hi-Tech.

Since July 2011, the financial statements of CIL were consolidated with the accounts of Coates Oklahoma Engine Manufacturing, Ltd. (“Coates Oklahoma”). In May 2013, Coates Oklahoma was shuttered and has since been formally dissolved. There were no outstanding obligations or expenses in dissolving this company. It is no longer being consolidated with the financial statements of the Company.

Loss per Share

Basic net loss per share is based on the weighted average number of common shares outstanding without consideration of potentially dilutive shares of common stock. There were no shares of preferred stock outstanding with rights to share in the Company's net income during the nine-month periods ended September 30, 2013 and 2012. Diluted net income per share is based on the weighted average number of common and potentially dilutive common shares outstanding, when applicable.

Use of Estimates

The preparation of the Company's financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These significant estimates include determining the fair value of convertible promissory notes containing embedded derivatives and variable conversion rates, assigning useful lives to the Company's property, plant and equipment, determining an appropriate amount to reserve for obsolete and slow moving inventory, estimating a valuation allowance for deferred tax assets, assigning expected lives to, and estimating the rate of forfeitures of, stock options granted and selecting a trading price volatility factor for the Company's common stock in order to estimate the fair value of the Company's stock options on the date of grant or other appropriate measurement date. Actual results could differ from those estimates.

3. CONCENTRATIONS OF CREDIT AND BUSINESS RISK

The Company maintains cash balances with one financial institution. Accounts at this institution are currently fully insured by the Federal Deposit Insurance Corporation.

The Company's operations are devoted to the development, application and marketing of the CSRV system technology which was invented by George J. Coates, the Company's founder, Chairman, Chief Executive Officer, President and controlling stockholder. Development efforts have been conducted continuously during this time. From July 1982 through May 1993, seven U.S. patents as well as a number of foreign patents were issued with respect to the CSRV system technology. Since inception of the Company in 1988, all aspects of the business have been completely dependent upon the activities of George J. Coates. The loss of George J. Coates' availability or service due to death, incapacity or otherwise would have a material adverse effect on the Company's business and operations. The Company does not presently have any key-man life insurance in force for Mr. Coates.

4. LICENSING AGREEMENT AND DEFERRED LICENSING COSTS

The Company holds a manufacturing, use, lease and sale license from George J. Coates and Gregory Coates for the CSRV system technology in the territory defined as the Western Hemisphere (the "License Agreement"). Under the License Agreement, George J. Coates and Gregory Coates granted to the Company an exclusive, perpetual, royalty-free, fully paid-up license to the intellectual property that specifically relates to an internal combustion engine that incorporates the CSRV system technology (the "CSRV Engine") and that is currently owned or controlled by them (the "CSRV Intellectual Property"), plus any CSRV Intellectual Property that is developed by them during their employment with the Company. In the event of insolvency or bankruptcy of the Company, the licensed rights would terminate and ownership would revert back to George J. Coates and Gregory Coates.

Under the License Agreement, George J. Coates and Gregory Coates agreed that they will not grant any licenses to any other party not controlled by the Company, with respect to the CSRV Intellectual Property.

At September 30, 2013, deferred licensing costs, comprised of expenditures for patent costs incurred pursuant to the CSRV licensing agreement, net of accumulated amortization, amounted to \$52,000. Amortization expense for the three months ended September 30, 2013 and 2012 amounted to \$1,000 and \$1,000, respectively. Amortization expense for the nine months ended September 30, 2013 and 2012 amounted to \$3,000 and \$3,000, respectively.

5. AGREEMENTS ASSIGNED TO ALMONT ENERGY INC.

Almont Energy Inc. (“Almont”), a privately held, independent third-party entity based in Alberta, Canada is the assignee of a sublicense which provides for a \$5,000,000 license fee to be paid to the Company and covers the use of the CSRV system technology in the territory of Canada in the oil and gas industry (the “Canadian License”). Almont is also the assignee of a separate research and development agreement (“R&D Agreement”) which requires that Almont pay the remaining balance of an additional \$5,000,000 fee to the Company in consideration for the development and delivery of certain prototype engines. The Company completed development of the prototypes in accordance with this agreement at the end of 2007. The R&D Agreement had not been reduced to the form of a signed, written agreement.

Almont is also the assignee of an escrow agreement (the “Escrow Agreement”) that provides conditional rights to a second sublicense agreement from the Company for the territory of the United States (the “US License”). The US License has been deposited into an escrow account and the grant of the license will not become effective until the conditions for release from escrow are satisfied. The US License provides for a license fee of \$50 million.

The Escrow Agreement requires that Almont, as the assignee, make a payment (“Release Payment”) to the Company equal to the then remaining unpaid balance of the Canadian License licensing fee, the R&D Agreement fee and the down payment of \$1,000,000 required under the US License. It is not likely that Almont will be able to make additional payments of the Release Payment until the Company can raise sufficient new working capital to commence production and shipment of Gen Sets to Almont. At September 30, 2013, the remaining balance of the Release Payment due to the Company was \$5,847,000.

In connection with the assignment of the Canadian License and the rights to the US License, Almont has also assumed all of the obligations set forth in the Escrow Agreement, with the following modifications:

- The Release Payment Date, as defined in the Escrow Agreement had been extended to March 2014 to compensate for the delay caused by the late delivery of Gen Sets. Provided that Almont remits this entire unpaid balance to the Company on or before the Release Payment Date, the US License will be released from escrow and granted to Almont. Almont is required to remit to the Company 60% of all monies it raises from future equity or debt transactions, exclusive of proceeds from equipment purchase financing transactions, until the Release Payment is paid in full.
- Almont also became obligated to pay the \$49 million balance of the US License Fee to the Company. Payment shall be made quarterly in an amount equal to 5% of Almont’s quarterly net profits. In addition, Almont is required to remit a portion of the proceeds it receives from equity or debt transactions, exclusive of equipment financing transactions to the Company until the entire balance of the US License fee is paid in full. However, the entire \$49 million licensing fee is required to be paid on or before February 19, 2016.

The inability of Almont to make additional payments towards the balance of the Release Payment at this time is having an adverse effect on the Company’s cash flow, results of operations and financial condition.

The Canadian License

The Canadian License exclusively sublicenses within Canada, the use of the CSRV system technology for industrial engines designed to generate electrical power. Additional provisions of the Canadian License agreement are as follows:

- Sublicensee shall have the exclusive right to use, lease and sell electric power generators designed with the CSRV system technology within Canada.
- Sublicensee will have a specified right of first refusal to market the electric power generators worldwide.
- Upon commencement of the production and distribution of the electric power generators, the minimum annual number of generators to be purchased by Sublicensee in order to maintain exclusivity is 120. The Company has temporarily waived this provision due to the delay in delivery of Gen Sets. In the event Sublicensee fails to purchase the minimum 120 CSRV generator engines during any year, Sublicensee will automatically lose its exclusivity. In such a case, Sublicensee would retain non-exclusive rights to continue to use and sell the CSRV generator engines in the territory of Canada. Until otherwise agreed between the parties, the price per generator shall be \$159,000.
- Sublicensee is required to pay a royalty to the Company equal to 5% of its annual modified gross profit (which has been defined as sales, less cost of sales, plus \$400,000).
- All licensed rights under this license agreement related to the CSRV system technology will remain with the Company.

The US License

The US License will, upon Almont satisfying the Release Payment, grant to Almont the right to use, sell and lease within the defined territory, Licensed Products manufactured by the Company which are designed to generate electrical power. Licensed Products consist of CSRV Valve Systems, CSRV Valve Seals, CSRV Rotary Valve Spheres, CSRV Valve Components and CSRV Engines. Almont is also obligated to pay a royalty to the Company equal to 2.5% of its annual modified gross profit (which has been defined as sales, less cost of sales, plus \$400,000).

The manufacture of any Licensed Products by Sublicensee is prohibited. Sublicensee is required to procure all internal combustion engines incorporating the CSRV Valve System from the Company or its designee. The license granted to Sublicensee is exclusive within the Territory, provided that Sublicensee satisfies the minimum annual purchase commitment of 120 internal combustion engines incorporating the CSRV system technology, the Coates Engines and all component parts. The Company has temporarily waived this provision due to the delay in delivery of Gen Sets. The agreement also grants Sublicensee a right of first refusal in the event that the Company negotiates an offer with another third party for a worldwide license to use the Licensed Products for the generation of electrical power.

The business plan of Almont, which is highly dependent on its ability to raise sufficient additional working capital, is based on its projected assessment of the marketplace demand for industrial generators of various sizes and kilowatt output. Almont projects Gen Set purchases of up to 11,000 CSRV Units per year over the next 5 years. The Company would not be able to accommodate that demand until it ramps up its production capacity, which would likely require several years, once it enters into large scale production. Almont intends to issue standard purchase orders, based on market and customer demand. The Company is unable to confirm any orders until it has sufficient working capital in place to commence manufacturing of the Gen Sets. Almont plans to finance its purchases from cash flow and by way of project and/or equipment financing, proceeds from issuance of equity or corporate debt instruments and conventional bank financing.

6. COOPERATION AGREEMENT WITH TONGJI UNIVERSITY OF CHINA

The Company and the Coates Trust (collectively “Coates”) entered into a Cooperation Agreement with Tongji University of China (the “University”) for the purpose of enabling the University to undertake an evaluation and testing of the CSRV engine technology. The results of the evaluation and testing would be used to determine if, and to what extent, the engine technology could be applied in the manufacture and distribution of products in China. At this time, the parties are not actively working on this cooperation agreement, but may agree to do so at some point in the future.

7. LICENSE DEPOSITS

License deposits, which are non-refundable, primarily relate to a \$300,000 sublicense deposit received in prior years as a down payment on the Canadian License. This sublicense deposit is being recognized as revenue on a straight-line basis over the remaining life until 2027 of the last CSRV technology patent in force, at that date. Sublicensing fee revenue for the three months ended September 30, 2013 and 2012 amounted to \$5,000 and \$5,000, respectively. Sublicensing fee revenue for the nine months ended September 30, 2013 and 2012 amounted to \$15,000 and \$15,000, respectively.

8. INVENTORY

Inventory was comprised of the following:

	September 30, 2013	December 31, 2012
Raw materials	\$ 439,000	\$ 439,000
Work-in-process	59,000	59,000
Finished goods	-	-
Reserve for obsolescence	(387,000)	(387,000)
Total	<u>\$ 111,000</u>	<u>\$ 111,000</u>

9. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment were comprised of the following:

	September 30, 2013	December 31, 2012
Land	\$ 1,235,000	\$ 1,235,000
Building	964,000	964,000
Building improvements	83,000	83,000
Machinery and equipment	658,000	658,000
Furniture and fixtures	39,000	39,000
	<u>2,979,000</u>	<u>2,979,000</u>
Less: Accumulated depreciation	(784,000)	(737,000)
Total	<u>\$ 2,195,000</u>	<u>\$ 2,242,000</u>

Depreciation expense for the three months ended September 30, 2013 and 2012 was \$16,000 and \$21,000, respectively. Depreciation expense for the nine months ended September 30, 2013 and 2012 was \$47,000 and \$46,000, respectively.

10. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consisted of the following:

	September 30, 2013	December 31, 2012
Legal and professional fees	\$ 1,393,000	\$ 1,240,000
Accrued compensation and benefits	229,000	175,000
General and administrative expenses	228,000	149,000
Accrued interest payable	234,000	118,000

Research and development
Total

<u>115,000</u>	<u>115,000</u>
<u>\$ 2,199,000</u>	<u>\$ 1,797,000</u>

11. MORTGAGE LOAN PAYABLE

The Company has a mortgage loan on the land and building that serves as its headquarters and research and development facility which bears interest at the rate of 7.5% per annum and matures in July 2014. The loan requires monthly payments of interest, plus \$5,000 which is being applied to the principal balance. The remaining principal balance at September 30, 2013 was \$1,528,000.

Interest expense for the three months ended September 30, 2013 and 2012 amounted to \$28,000 and \$31,000, respectively. Interest expense for the nine months ended September 30, 2013 and 2012 amounted to \$87,000 and \$92,000, respectively.

The loan is collateralized by a security interest in all of the Company's assets, the pledge of five million shares of common stock of the Company owned by George J. Coates, which were deposited into escrow for the benefit of the lender and the personal guarantee of George J. Coates. The Company is not permitted to create or permit any secondary mortgage or similar liens on the property or improvements thereon without prior consent of the lender. Up to \$500,000 of the principal balance of the mortgage loan may be prepaid each year without penalty. A prepayment penalty of 2% of the outstanding loan amount would be imposed if the loan is repaid in full at or before maturity unless such prepayment funds are obtained from a permanent mortgage loan with the lender.

12. FINANCE LEASE OBLIGATION

In August 2013, the Company entered into a sale/leaseback financing arrangement with Paradigm Commercial Capital Group Corp ("Paradigm") pursuant to which it sold its research and development and manufacturing equipment in consideration for net cash proceeds of \$133,000. These cash proceeds were net of a deposit on the lease of \$15,000 and transaction costs of \$5,000. Under this arrangement, The Company is leasing back the equipment over a 24-month period, with an option to extend the lease for an additional six months. The fixed recurring monthly lease payment amount is \$8,000. If the Company does not exercise the six-month extension option, then the parties will negotiate a repurchase price to be paid by the Company for the equipment. If the Company does exercise its option to extend, then ownership of the equipment will automatically revert back to the Company at the end of the option period. The effective interest rate on this lease is 36.6%. In accordance with generally accepted accounting principles, this sale/leaseback is required to be accounted for as a financing lease. Under this accounting method, the equipment and accumulated depreciation remains on the Company's books and records as if the Company still owned the equipment. This accounting treatment is in accordance with the ASC 840-40-25-4, Accounting for Sale-Leaseback Transactions. In addition, the discounted present value of the lease payments is recorded as a lease finance obligation. The difference between the gross sales price for the equipment and the net proceeds received amounted to \$20,000, which has been recorded as unamortized discount on finance lease obligation. This amount is being amortized to interest expense using the interest method over the 30-month term of the lease, including the option period. The finance lease obligation is secured by all of the equipment included in the sale/leaseback transaction.

13. PROMISSORY NOTES TO RELATED PARTIES

During the nine months ended September 30, 2013 and 2012, the Company issued, in a series of transactions, promissory notes to George J. Coates and received cash proceeds of \$102,000 and \$118,000, respectively, and repaid promissory notes in the aggregate principal amount of \$39,000 and \$31,000, respectively, bringing the outstanding principal balance at September 30, 2013 to \$505,000. The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly.

During the nine months ended September 30, 2013 and 2012, the Company issued, in a series of transactions, promissory notes to Bernadette Coates, spouse of George J. Coates and received cash proceeds of \$68,000 and \$76,000, respectively, and repaid promissory notes in the aggregate principal amount of \$10,000 and \$10,000, respectively, bringing the outstanding balance at September 30, 2013 to \$123,000. The promissory notes are payable on demand and provide for interest at the rate of 17% per annum, compounded monthly.

During the nine months ended September 30, 2012, the Company had outstanding promissory notes with two of its directors, Dr. Richard W. Evans and Dr. Frank J. Adipietro with principal balances of \$120,000 and \$50,000, respectively. In June 2012, by mutual agreement, the \$120,000 principal amount promissory note issued to Dr. Evans and \$10,000 principal amount of the promissory note issued to Dr. Adipietro was converted into 2,000,000 and 166,667 shares of common stock, respectively, at a conversion price of \$0.06 per share. The \$40,000 principal balance, plus accrued interest on the promissory note due to Dr. Adipietro was converted into 473,372 shares of common stock in October 2012. These notes were due on demand and provided for interest at the rate of 17% per annum, compounded monthly.

For the three months ended September 30, 2013 and 2012, aggregate interest expense on all promissory notes to related parties amounted to \$26,000 and \$20,000, respectively. For the nine months ended September 30, 2013 and 2012, aggregate interest expense on all promissory notes to related parties amounted to \$88,000 and \$53,000, respectively. Unpaid accrued interest on these promissory notes amounting to \$195,000 is included in accounts payable and accrued liabilities in the accompanying balance sheet at September 30, 2013.

14. CONVERTIBLE PROMISSORY NOTES AND EMBEDDED DERIVATIVE LIABILITIES

From time to time, the Company issues convertible promissory notes. The net proceeds from these transactions are used for general working capital purposes. The conversion formula for these notes meets the conditions that require accounting for these notes as derivative liability instruments.

8% Convertible Promissory Notes

At September 30, 2013, there were three 8% convertible promissory notes (“8% Notes”) in the principal amounts of \$43,000, \$32,000 and \$53,000 which mature in February 2014, March 2014 and May 2014, respectively, if not converted prior thereto. The 8% Notes may be converted into unregistered shares of the Company’s common stock, par value \$0.0001 per share (the “Common Stock”), at the Conversion Price, as defined below, in whole, or in part, at any time beginning 180 days after the date of issuance of the Notes, at the option of the holder. The Conversion Price shall be equal to 61% multiplied by the Variable Conversion Rate which is equal to the average of the three (3) lowest closing bid prices of the Common Stock during the ten (10) trading day period prior to the date of conversion. The 8% Notes also contain a prepayment option whereby the Company may, during the first 179 days the note is outstanding, prepay the 8% Note by paying 130% during the first 60 days, increasing in 5% increments each month to a maximum of 150% of the then outstanding unpaid principal, interest and any other amounts that might be due for penalties or any event of a default.

In a series of transactions during 2013, 8% convertible promissory notes with an aggregate principal balance of \$120,000, plus accrued interest of \$6,000 were converted into 8,329,989 unregistered shares of common stock.

The 61% discounted Conversion Price establishes a beneficial conversion feature (“BCF”) or unamortized discount which is required to be valued and accreted to interest expense over the six-month period until the conversion of the 8% Notes into common stock is permitted. The Company has reserved 46,750,000 shares of its unissued common stock for potential conversion of these 8% Notes.

12% Convertible Promissory Notes

The Company has also entered into an agreement whereby it is permitted to issue in a series of tranches up to \$335,000 of convertible promissory notes which bear interest at 12% per annum and mature on the one-year anniversary date of the funding (“12% Notes”). In March 2013, the Company issued a \$67,000, 12% Note under this arrangement and received cash proceeds of \$60,000. In June 2013, the Company issued a \$28,000, 12% Note under this arrangement and received cash proceeds of \$25,000. In August 2013, the Company issued another \$28,000, 12% Note under this arrangement and received cash proceeds of \$25,000. These notes mature in March 2014, June 2014 and August 2014, respectively, if not converted prior thereto. The arrangement provides for an approximately 10.5% original issue discount on the principal amount of each tranche, which is netted against the amount funded to the Company. Each drawdown of the promissory note may be prepaid at any time within the first 90 days after funding, upon which the interest for the outstanding period will be forgiven. The lender may convert the 12% Notes into shares of the Company’s common stock at any time beginning 180 days after the date of funding. The conversion rate shall be equal to the lesser of \$0.035 per share or 60% of the lowest trade price of the Company’s common stock in the 25 trading days prior to the date of conversion. The Company has reserved 35 million shares of its unissued common stock for potential conversion of this 12% Note agreement.

In September 2013, 12% convertible promissory notes with a principal balance of \$8,700 were converted into 400,000 unregistered shares of common stock.

In accordance with GAAP, the estimated fair value of the embedded derivative liability related to the 8% Notes and 12% Notes is required to be remeasured at each balance sheet date. The estimated fair value of the embedded derivative liabilities related to promissory notes outstanding was measured as the aggregate estimated fair value, based on Level 2 inputs, which included the average of the quoted daily yield curve rates on six-month and one-year treasury securities and the calculated 12-month historical volatility rate on the Company’s common stock.

The embedded derivative liability arises because, based on historical trading patterns of the Company’s stock, the formula for determining the Conversion Rate is expected to result in a different Conversion Rate than the closing price of the stock on the actual date of conversion (hereinafter referred to as the “Variable Conversion Rate Differential”). The estimated fair values of the derivative liabilities have been calculated based on a Black-Scholes option pricing model.

The following table presents the details of the outstanding 8% Notes and 12% Notes at September 30, 2013 and December 31, 2012, including the balance of the unamortized discount and the amount of the embedded derivative liability:

Date Issued	Principal Amount		Nominal Interest Rate	Effective Interest Rate ⁽¹⁾	Unamortized Discount		Embedded Derivative Liability	
	September 30, 2013	December 31, 2012			September 30, 2013	December 31, 2012	September 30, 2013	December 31, 2012
8/14/13	\$ 28,000	N/A	12%	147%	\$ 26,000	N/A	\$ 54,000	N/A
8/8/13	53,000	N/A	8%	147%	41,000	N/A	80,000	N/A
6/21/13	32,000	N/A	8%	147%	17,000	N/A	46,000	N/A
6/4/13	28,000	N/A	12%	92%	8,000	N/A	52,000	N/A
4/19/13	43,000	N/A	8%	150%	6,000	N/A	58,000	N/A
3/21/13	58,000	N/A	12%	76%	-	N/A	113,000	N/A
11/23/12	N/A	\$ 33,000	8%	101%	N/A	\$ 17,000	N/A	\$ 41,000
9/24/12	N/A	32,000	8%	122%	N/A	14,000	N/A	41,000
8/6/12	N/A	43,000	8%	142%	N/A	12,000	N/A	53,000
6/12/12	N/A	12,000	8%	142%	N/A	-	N/A	-
	<u>\$ 242,000</u>	<u>\$ 120,000</u>			<u>\$ 98,000</u>	<u>\$ 43,000</u>	<u>\$ 403,000</u>	<u>\$ 135,000</u>

(1) The effective interest rate reflects the rate required to fully amortize the unamortized discount over the six-month period until the Notes become convertible.

Other income (expense) resulting from the change in the estimated fair value of the embedded derivative liabilities amounted to

\$225,000 and (\$17,000) for the three months ended September 30, 2013 and 2012, respectively, and (\$258,000) and (\$26,000) for the nine months ended September 30, 2013 and 2012, respectively. These amounts are included in the accompanying statements of operations as Decrease (increase) in estimated fair value of embedded derivative liabilities. Interest expense resulting from accretion of the unamortized discount for the three months ended September 30, 2013 and 2012 amounted to \$111,000 and \$47,000, respectively. Interest expense resulting from accretion of the unamortized discount for the nine months ended September 30, 2013 and 2012 amounted to \$186,000 and \$213,000, respectively.

The Company made the private placement of these securities in reliance upon Section 4(2) of the Securities Act of 1933, as amended (the “Act”), Rule 506 of Regulation D, and the rules and regulations promulgated thereunder, and/or upon any other exemption from the registration requirements of the Act, as applicable.

15. 10% CONVERTIBLE NOTE TO RELATED PARTY

The 10% Convertible Note, which is held by one of the Company’s directors, is convertible at the option of the holder, into shares of the Company’s common stock at an initial conversion rate that is determined by dividing the principal amount of the note being converted by \$0.45. This convertible note is payable on demand. Interest shall accrue at the rate of 10% per annum and shall be payable at the time of repayment of principal. All interest shall be forfeited upon conversion, in which case the holder would be entitled to dividends declared, if any, on the Company’s common stock during the time the convertible note was outstanding. The Company has reserved 22,222 shares of its common stock for conversion of this note. At September 30, 2013, accrued interest on this convertible note amounted to \$6,000.

16. UNEARNED REVENUE

The Company has received a non-refundable deposit of \$19,000 from Almont in connection with its order for a natural gas fueled electric power CSRV engine generator, which is included in unearned revenue in the accompanying balance sheets at September 30, 2013 and December 31, 2012.

17. CONTRACTUAL OBLIGATIONS

The following table summarizes the Company’s contractual obligations at September 30, 2013:

	Total	Due Within			
		2013	2014	2015	2016
Mortgage loan payable	\$ 1,528,000	\$ -	\$ 1,528,000	\$ -	\$ -
Promissory notes to related parties	628,000	628,000	-	-	-
Finance lease obligation	152,000	9,000	50,000	71,000	22,000
Convertible promissory notes	251,000	-	251,000	-	-
Settlement of litigation	125,000	40,000	75,000	10,000	-
10% promissory note	10,000	10,000	-	-	-
Total	<u>\$ 2,694,000</u>	<u>\$ 687,000</u>	<u>\$ 1,904,000</u>	<u>\$ 81,000</u>	<u>\$ 22,000</u>

18. CAPITAL STOCK

Common Stock and Anti-dilution Rights

The Company’s common stock is traded on OTCQB; the OTC market tier for companies that report to the SEC. Investors can find real-time quotes and market information for the Company at www.otcmart.com market system under the ticker symbol COTE. The Company is authorized to issue up to 1,000,000,000 shares of common stock, par value, \$0.0001 per share (the “Common Stock”).

Pursuant to anti-dilution provisions which became effective January 2012, Mr. Coates was awarded one share of restricted common stock for each new share of stock issued to any individual or entity that was not a member of, or controlled by, the Coates Family. On August 30, 2013, these anti-dilution provisions were canceled and, as discussed hereinafter, Mr. Coates voluntarily returned all shares of common stock awarded to him under these provisions.

The following transactions occurred during the nine months ended September 30, 2013:

In a series of transactions during 2013, the Company made private sales, pursuant to stock purchase agreements of 4,166,666 unregistered shares of its common stock and 5,166,668 common stock warrants to purchase one share of common stock at an exercise prices ranging from \$0.015 to of \$0.035 per share in consideration for \$105,000 received from the son of Richard W. Evans, a director.

In a series of transactions during 2013, the Company issued 1,990,430 registered shares of its common stock to Dutchess Opportunity Fund II, LP under an equity line of credit in consideration for \$72,000.

In a series of transactions in 2013, the Company issued 14,142,085 unregistered shares of its common stock to George J. Coates for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares, based on the closing trading price of the stock on the dates of the issuances was \$420,000. On August 30, 2013, these shares were voluntarily returned to the Company for cancellation, upon which the shares were restored to the authorized, but unissued status.

In January 2013, the Company issued 20,895,046 unregistered shares of its common stock to George J. Coates in satisfaction of a deferred compensation liability consisting of 20,275,046 shares for anti-dilution protection for the year ended December 31, 2012 and a 620,000 share stock award originally granted in 2011. The value of these shares, based on the closing trading price on the dates of the anti-dilution or the date of the stock award was \$1,761,000, of which \$1,674,000 and \$87,000 was charged to stock compensation expense during the years ended December 31, 2012 and 2011, respectively. On August 30, 2013, these shares were voluntarily returned to the Company for cancellation, upon which the shares were restored to the authorized, but unissued status.

In connection with an agreement to issue up to \$335,000 of convertible promissory notes, during 2013, the Company issued a \$67,000 principal amount, 12% convertible promissory note and two \$28,000 principal amount, 12% convertible promissory notes and received cash proceeds of \$110,000, net of original issue discount of \$13,000.

The Company issued a \$43,000 principal amount, 8% convertible promissory note, a \$32,000 principal amount, 8% convertible promissory note and a \$53,000 principal amount, 8% convertible promissory note and received proceeds of \$120,000, net of transaction costs.

In a series of transactions during 2013, 8% convertible promissory notes with an aggregate principal balance of \$120,000, plus accrued interest of \$6,000 were converted into 8,329,989 unregistered shares of common stock.

In September 2013, 12% convertible promissory notes with a principal balance of \$8,700 were converted into 400,000 unregistered shares of common stock.

At September 30, 2013, Company had reserved 113,024,724 shares of its common stock to cover the potential conversion of convertible securities and exercise of stock options and warrants.

Preferred Stock and Anti-dilution Rights

The Company is authorized to issue 100,000,000 new shares of preferred stock, par value, \$0.001 per share (the "Preferred Stock"). The Company may issue any class of the Preferred Stock in any series. The Board shall have authority to establish and designate series, and to fix the number of shares included in each such series and the relative rights, preferences and limitations as between series, provided that, if the stated dividends and amounts payable on liquidation are not paid in full, the shares of all series of the same class shall share ratably in the payment of dividends including accumulations, if any, in accordance with the sums which would be payable on such shares if all dividends were declared and paid in full, and in any distribution of assets other than by way of dividends in accordance with the sums which would be payable on such distribution if all sums payable were discharged in full. Shares of each such series when issued shall be designated to distinguish the shares of each series from shares of all other series.

The Board has designated 1,000,000 shares of Preferred Stock as Series A Preferred Stock, \$0.001 par value per share. Each share of Series A Preferred Stock entitles the holder of record to the right to vote 10,000 shares of common stock with respect to all matters that are submitted to a vote of shareholders. The Series A Preferred Stock does not provide the holder any rights to share in dividends or any distribution of assets to any other shareholders of any other class of the Company's securities in a liquidation or for any other purpose.

Effective May 17, 2013, new anti-dilution provisions for the Coates family were put into place. Under these provisions, new shares of Series A Preferred Stock are to be issued to George J. Coates upon issuance of new shares of the Company's common stock to any person or entity that is not a Coates family member. The anti-dilution provisions do not apply to any secondary public offerings of the Company's common stock. The anti-dilution is calculated as the number of shares needed to ensure that the Coates family percentage of total eligible votes at all matters brought before the shareholders for a vote remains fixed at 93.93%.

During the nine months ended September 30, 2013 and 2012, 55,527 and no shares of Series A Preferred Stock, respectively, were issued to George J. Coates under the anti-dilution provisions.

At September 30, 2013, George J. Coates held 128,410 shares of Series A Preferred Stock which provides him with the right to 1,284,100,000 aggregate additional votes on all matters brought before the shareholders for a vote.

Each issuance of shares of Series A Preferred Stock to George J. Coates does not have any effect on the share of dividends or liquidation value of the holders of the Company's common stock. However, the voting rights of the holders of the Company's common stock are diluted with each issuance.

19. INVESTMENT AGREEMENTS WITH DUTCHESS OPPORTUNITY FUND II, LP

In June 2011, the Company entered into an investment agreement (the "Investment Agreement") with Dutchess Opportunity Fund II, LP, a Delaware limited partnership ("Dutchess"). Pursuant to the terms of the Investment Agreement, Dutchess committed to purchase, in a series of purchase transactions ("Puts") up to Twenty Million (\$20,000,000) Dollars of the Company's common stock over a period of up to thirty-six (36) months.

The amount that the Company is entitled to request with each Put delivered to Dutchess is equal to, at its option, either (i) two hundred percent (200%) of the average daily volume (U.S. market only) of its common stock for the three (3) Trading Days prior to the applicable Put Notice Date, multiplied by the average of the three (3) daily closing prices immediately preceding the Put Date or (ii) five hundred thousand dollars (\$500,000). The purchase price to be paid by Dutchess for the shares of common stock covered by each Put will be equal to ninety-four percent (94%) of the lowest daily volume weighted average prices of the common stock during the period beginning on the Put Notice Date and ending on and including the date that is five (5) trading days after such Put Notice Date (the "Pricing Period"). "Put Notice Date" is the trading day immediately following the day on which Dutchess receives a Put Notice from the Company.

In connection with the Investment Agreement, the Company also entered into a registration rights agreement (the "Registration Rights Agreement") with Dutchess. Pursuant to the Registration Rights Agreement, the Company filed a registration statement on Form S-1 with the Securities and Exchange Commission ("SEC"), covering 17,500,000 shares of the common stock underlying the Investment Agreement. In addition, during the term of the Registration Rights Agreement, the Company is obligated to maintain the effectiveness of such registration statement.

During the nine months ended September 30, 2013 and 2012, the Company sold 1,990,430 and 2,153,706 registered shares of its common stock, respectively, under this equity line of credit with Dutchess and received proceeds of \$72,000 and \$259,000, respectively, which were used for general working capital purposes. There were no offering costs related to the sales of these shares. At September 30, 2013, the unused portion of this equity line of credit was \$19,669,000 and the remaining number of registered shares underlying the Investment Agreement was 13,251,736.

20. INTENTION TO MERGE WITH CHINA-BASED MANUFACTURING AND CASTING COMPANY

In August 2013, the Company signed a letter of commitment with a China-based manufacturer and casting company. This company also owns coal mining operations in China. The parties agreed to enter into negotiations and undertake due diligence with a mutual goal of merging the two companies for the purpose of establishing large scale production in China of industrial CSRV electric power generators. An important element in ensuring success of this transaction is that the Company intends to undertake a public offering in the U.S. and Hong Kong to raise US\$300-500 million. As this transaction is at an early stage, there can be no assurance that it will be consummated.

21. LOSS PER SHARE

For the nine months ended September 30, 2013 and 2012, diluted net loss per share was based on the weighted average number of common shares outstanding without consideration of potentially dilutive shares of common stock because the Company incurred a net loss in those periods and the effect of including any of the potentially dilutive shares of common stock in the calculation would have been anti-dilutive.

The following presents the potentially issuable shares of common stock upon assumed conversion of:

Description	Exercise Price	Number of Underlying Shares of Common Stock at September 30,	
		2013	2012
Common stock options	\$ 0.0600	5,607,000	5,607,000
Common stock options	0.2400	1,800,000	1,800,000
Common stock options	0.2500	2,000,000	2,000,000
Common stock options	0.3900	50,000	50,000
Common stock options	0.4000	360,000	360,000
Common stock options	0.4300	100,000	100,000
Common stock options	0.4400	1,750,000	1,750,000
Common stock options	1.0000	30,000	30,000
Common stock warrants	0.0150	666,667	-
Common stock warrants	0.0200	500,000	-
Common stock warrants	0.0225	666,667	-
Common stock warrants	0.0250	1,000,000	-
Common stock warrants	0.0300	333,333	-
Common stock warrants	0.0350	2,000,001	-
Common stock warrants	0.0450	333,333	-
Common stock warrants	0.0500	400,000	-
Common stock warrants	0.0550	2,181,819	1,090,910
Common stock warrants	0.0600	2,000,000	1,500,000
Common stock warrants	0.0625	4,269,838	4,269,838
Common stock warrants	0.0700	571,429	571,429
Common stock warrants	0.0900	666,666	666,666
Common stock warrants	0.1200	416,667	416,667
Common stock warrants	0.2500	1,200,000	1,200,000
Common stock warrants	0.2700	833,333	833,333
Common stock warrants	0.3000	333,333	333,333
Common stock warrants	0.3250	153,846	153,846
Common stock warrants	0.3500	1,028,570	1,028,570
\$10,000, 10% Convertible promissory note	0.4500	22,222	22,222
8% Convertible promissory notes	(1)	4,435,615	4,583,622
12% Convertible promissory notes	(2)	4,756,056	-
Total		<u>40,466,395</u>	<u>\$ 28,367,436</u>

- (1) The principal amount of the 8% convertible promissory notes outstanding, which had not been converted at September 30, 2013, was \$128,000. The conversion rate is variable as it is equal to the average of the three lowest closing bid prices during the ten trading days prior to the date of conversion. The actual number of shares underlying these convertible instruments will likely vary from the number assumed above. The number of shares underlying these convertible notes was determined based on the three lowest closing bid prices during the ten trading days prior to September 30, 2013, the last trading day of the quarter.
- (2) The principal amount of the 12% convertible promissory note outstanding, which had not been converted at September 30, 2013, was \$123,000. The conversion rate is variable as it is equal to the lowest trading price during the twenty-five trading days prior to the date of conversion. The actual number of shares underlying these convertible instruments will likely vary from the number assumed above. The number of shares underlying these convertible notes was determined based on the lowest trading price during the twenty-five trading days prior to September 30, 2013, the last trading day of the quarter.

22. STOCK OPTIONS

The Company's 2006 Stock Option and Incentive Plan (the "Stock Plan") was adopted by the Company's board in October 2006. In September 2007, the Stock Plan, by consent of George J. Coates, majority shareholder, was adopted by our shareholders. The Stock Plan provides for the grant of stock-based awards to employees, officers and directors of, and consultants or advisors to, the Company and its subsidiaries, if any. Under the Stock Plan, the Company may grant options that are intended to qualify as incentive stock options ("incentive stock options") within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), options not intended to qualify as incentive stock options ("non-statutory options"), restricted stock and other stock-based awards. Incentive stock options may be granted only to employees of the Company. A total of 12,500,000 shares of common stock may be issued upon the exercise of options or other awards granted under the Stock Plan. The maximum number of shares with respect to which awards may be granted during any one year to any employee under the Stock Plan shall not exceed 25% of the 12,500,000 shares of common stock covered by the Stock Plan. At September 30, 2013, there remained 803,000 shares of common stock available for stock options or awards under the Stock Plan.

The Stock Plan is administered by the board and the Compensation Committee. Subject to the provisions of the Stock Plan, the board and the Compensation Committee each has the authority to select the persons to whom awards are granted and determine the terms of each award, including the number of shares of common stock subject to the award. Payment of the exercise price of an award may be made in cash, in a "cashless exercise" through a broker, or if the applicable stock option agreement permits, shares of common stock or by any other method approved by the board or Compensation Committee. Unless otherwise permitted by the Company, awards are not assignable or transferable except by will or the laws of descent and distribution.

Upon the consummation of an acquisition of the business of the Company, by merger or otherwise, the board shall, as to outstanding awards (on the same basis or on different bases as the board shall specify), make appropriate provision for the continuation of such awards by the Company or the assumption of such awards by the surviving or acquiring entity and by substituting on an equitable basis for the shares then subject to such awards either (a) the consideration payable with respect to the outstanding shares of common stock in connection with the acquisition, (b) shares of stock of the surviving or acquiring corporation, or (c) such other securities or other consideration as the board deems appropriate, the fair market value of which (as determined by the board in its sole discretion) shall not materially differ from the fair market value of the shares of common stock subject to such awards immediately preceding the acquisition. In addition to, or in lieu of the foregoing, with respect to outstanding stock options, the board may, on the same basis or on different bases as the board shall specify, upon written notice to the affected optionees, provide that one or more options then outstanding must be exercised, in whole or in part, within a specified number of days of the date of such notice, at the end of which period such options shall terminate, or provide that one or more options then outstanding, in whole or in part, shall be terminated in exchange for a cash payment equal to the excess of the fair market value (as determined by the board in its sole discretion) for the shares subject to such stock options over the exercise price thereof. Unless otherwise determined by the board (on the same basis or on different bases as the board shall specify), any repurchase rights or other rights of the Company that relate to a stock option or other award shall continue to apply to consideration, including cash, that has been substituted, assumed or amended for a stock option or other award pursuant to these provisions. The Company may hold in escrow all or any portion of any such consideration in order to effectuate any continuing restrictions.

The board may at any time provide that any stock options shall become immediately exercisable in full or in part, that any restricted stock awards shall be free of some or all restrictions, or that any other stock-based awards may become exercisable in full or in part or free of some or all restrictions or conditions, or otherwise realizable in full or in part, as the case may be.

The board or Compensation Committee may, in its sole discretion, amend, modify or terminate any award granted or made under the Stock Plan, so long as such amendment, modification or termination would not materially and adversely affect the participant.

During the nine months ended September 30, 2013 no employee stock options were granted. During the nine months ended September 30, 2012, employee stock options to purchase 5,607,000 shares of common stock at a price per share of \$0.06 per share were granted. These options fully vested in June 2013.

During the nine months ended September 30, 2013, employee stock options to purchase 5,607,000 shares of common stock at a price per share of \$0.06 per share became vested. During the nine months ended September 30, 2012, 200,000 stock options with an exercise price of \$0.25 per share became vested. There were no unvested stock options at September 30, 2013.

During the three months ended September 30, 2013 and 2012, the Company recorded non-cash stock-based compensation expense related to employee stock options amounting to \$-0- and \$163,000, respectively. For the three months ended September 30, 2013 and 2012, \$-0- and \$41,000, respectively, of this amount is included in research and development expenses and \$-0- and \$122,000, respectively, of this amount is included in general and administrative expenses in the accompanying statements of operations.

During the nine months ended September 30, 2013 and 2012, the Company recorded non-cash stock-based compensation expense related to employee stock options amounting to \$179,000 and \$624,000, respectively. For the nine months ended September 30, 2013 and 2012, \$15,000 and \$217,000, respectively, of this amount is included in research and development expenses and \$164,000 and \$407,000, respectively, of this amount is included in general and administrative expenses in the accompanying statements of operations.

Details of the common stock options outstanding under the Company's Stock Option Plan are as follows:

	Exercise Price Per Share	Number Outstanding	Weighted Average Remaining Contractual Life	Number Exercisable	Weighted Average Exercise Price	Weighted Average Fair Value Per Stock Option at Date of Grant
Balance, 1/1/13	\$ 0.06 -1.00	11,697,000	14	6,090,000	\$ 0.019	\$ 0.180
Vested	\$ 0.06		14	5,607,000	\$ 0.060	\$ 0.064
Balance, 9/30/13	\$ 0.06 -1.00	11,697,000	14	11,697,000	\$ 0.019	\$ 0.180

No stock options were exercised, forfeited or expired during the nine months ended September 30, 2013 and 2012.

The weighted average fair value of the Company's stock options was estimated using the Black-Scholes option pricing model which requires highly subjective assumptions including the expected stock price volatility. These assumptions were as follows:

● Historical stock price volatility	139-167%
● Risk-free interest rate	0.21%-4.64%
● Expected life (in years)	4
● Dividend yield	0.00%

The valuation assumptions were determined as follows:

- Historical stock price volatility: The Company initially obtained the volatility factor of other publicly traded engine manufacturers that were also in the research and development stage. Subsequently, once sufficient trading history became available, the volatility factor was calculated based on the historical daily closing prices of the Company's common stock on the OTCQB.
- Risk-free interest rate: The Company bases the risk-free interest rate on the interest rate payable on U.S. Treasury securities in effect at the time of the grant for a period that is commensurate with the assumed expected option life.
- Expected life: The expected life of the options represents the period of time options are expected to be outstanding. The Company has very limited historical data on which to base this estimate. Accordingly, the Company estimated the expected life based on its assumption that the executives will be subject to frequent black-out periods during the time that the stock options will be exercisable and based on the Company's expectation that it will complete its research and development phase and commence its initial production phase. The vesting period of these options was also considered in the determination of the expected life of each stock option grant.
- No expected dividends.

The same methodology and assumptions were utilized in estimating the fair value of non-employee stock options granted to the Company's general corporate counsel, as discussed above.

23. INCOME TAXES

Deferred income taxes are determined using the liability method for the temporary differences between the financial reporting basis and income tax basis of the Company's assets and liabilities. Deferred income taxes are measured based on the tax rates expected to be in effect when the temporary differences are included in the Company's tax return. Deferred tax assets and liabilities are recognized based on anticipated future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases.

Deferred tax assets increased by \$160,000 and \$395,000 for the three months ended September 30, 2013 and 2012, respectively. Deferred tax assets increased by \$659,000 and \$1,212,000 for the nine months ended September 30, 2013 and 2012, respectively. These amounts were fully offset by a corresponding decrease in the tax valuation allowance resulting in no net change in deferred tax assets, respectively, during these periods.

No liability for unrecognized tax benefits was required to be reported at September 30, 2013 and 2012. Based on the Company's evaluation, it has concluded that there are no significant uncertain tax positions requiring recognition in the Company's financial statements. The Company's evaluation was performed for tax years ended 2009 through 2012, the only periods subject to examination. The Company believes that its income tax positions and deductions will be sustained on audit and does not anticipate that adjustments, if any, will result in a material change to its financial position. For the nine months ended September 30, 2013 and 2012, there were no penalties or interest related to the Company's income tax returns.

24. RELATED PARTY TRANSACTIONS

Compensation and Benefits Paid

The approximate amount of base compensation and benefits paid to George J. Coates, Gregory Coates and Bernadette Coates is summarized as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012 (a)	2013	2012 (b)
George J. Coates (c), (d), (e), (f), (g)	\$ -	\$ 70,000	\$ 29,000	\$ 210,000
Gregory Coates (h)	38,000	43,000	125,000	129,000
Bernadette Coates (i)	-	19,000	13,000	56,000

- (a) Certain amounts previously reported for the three months ended September 30, 2012 were reclassified in order to make them comparable to the amounts for the three months ended September 30, 2013.
- (b) Certain amounts previously reported for the nine months ended September 30, 2012 were reclassified in order to make them comparable to the amounts for the nine months ended September 30, 2013.
- (c) For the three months ended September 30, 2013, George J. Coates earned additional base compensation of \$63,000, payment of which is being deferred until the Company has sufficient working capital. For the nine months ended September 30, 2013, George J. Coates earned additional base compensation of \$168,000, payment of which is being deferred until the Company has sufficient working capital. This amount is included in deferred compensation in the accompanying balance sheet at September 30, 2013.
- (d) During the three months ended September 30, 2013, George J. Coates was awarded 1,928,763 unregistered shares of the Company's common stock for anti-dilution protection related to new shares of common stock issued during the quarter. The estimated value of these shares, based on the closing trading price of the stock on the dates of issuance was \$98,000. During the nine months ended September 30, 2013, George J. Coates was awarded 14,142,085 unregistered shares of the Company's common stock for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares, based on the closing trading price of the stock on the dates of issuance was \$420,000. On August 30, 2013, these shares were voluntarily returned to the Company for cancellation, upon which the shares were restored to the authorized, but unissued status.
- (e) During the three months ended September 30, 2013, George J. Coates was awarded 6,830 unregistered shares of the Company's Series A Preferred Stock for anti-dilution protection related to new shares of common stock issued during the quarter. The estimated value of these shares was \$15,000. During the nine months ended September 30, 2013, George J. Coates was awarded 55,527 unregistered shares of the Company's Series A Preferred Stock for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares was \$127,000.
- (f) During the three months ended September 30, 2013 and 2012, the Company recorded stock-based compensation expense amounting to \$0- and \$66,000, respectively, in connection with employee stock options granted to George J. Coates during 2011 and 2012. During the nine months ended September 30, 2013 and 2012, the Company recorded stock-based compensation expense amounting to \$58,000 and \$291,000, respectively, in connection with employee stock options granted to George J. Coates during 2011 and 2012.
- (g) In January 2013, the Company issued 20,895,046 unregistered shares of its common stock to George J. Coates in satisfaction of a deferred compensation liability consisting of 20,275,046 shares for anti-dilution protection for the year ended December 31, 2012 and a 620,000 share stock award originally granted in 2011. The value of these shares, based on the closing trading price on the dates of the anti-dilution or the date of the stock award was \$1,761,000, of which \$1,674,000 and \$87,000 was charged to stock compensation expense during the years ended December 31, 2012 and 2011, respectively. On August 30, 2013, these shares were voluntarily returned to the Company for cancellation, upon which the shares were restored to the authorized, but unissued status.

- (h) During the three months ended September 30, 2012, the Company recorded stock-based compensation expense amounting to \$36,000 in connection with employee stock options granted to Gregory Coates during 2011. During the nine months ended September 30, 2012, the Company recorded stock-based compensation expense amounting to \$252,000 in connection with employee stock options granted to Gregory Coates during 2011.
- (i) For the three months ended September 30, 2013, Bernadette Coates earned additional base compensation of \$17,000, payment of which is being deferred until the Company has sufficient working capital. For the nine months ended September 30, 2013, Bernadette Coates earned additional base compensation of \$40,000, payment of which is being deferred until the Company has sufficient working capital. This amount is included in deferred compensation in the accompanying balance sheet at September 30, 2013.

Promissory Notes to Related Parties

Issuances of promissory notes to related parties during the nine months ended September 30, 2013 and 2012 are discussed in detail in Note 13. The promissory notes to related parties are payable on demand and bear interest at the rate of 17% per annum, compounded monthly.

Issuances of Common Stock and Warrants

Issuances of common stock and common stock warrants to related parties during the nine months ended September 30, 2013 are discussed in detail in Note 18. During the nine months ended September 30, 2012, the Company sold 190,185 restricted shares of its common stock in consideration for 185,185 tradable shares of its common stock received from the son of Dr. Richard W. Evans, director.

These transactions were private sales of unregistered, restricted securities pursuant to stock purchase agreements.

Personal Guaranty and Stock Pledge

George J. Coates has pledged certain of his shares of common stock of the Company to the extent required by the lender and provided a personal guaranty as additional collateral for a mortgage loan on the Company's headquarters facility.

Other

During the three months ended September 30, 2013 and 2012, Barry C. Kaye, Treasurer and Chief Financial Officer was paid compensation of \$15,000 and \$11,000, respectively. For the three months ended September 30, 2013, Mr. Kaye earned compensation of \$31,000, which was not paid and is being deferred until the Company has sufficient working capital to remit payment to him.

During the nine months ended September 30, 2013 and 2012, Barry C. Kaye, Treasurer and Chief Financial Officer was paid compensation of \$20,000 and \$46,000, respectively. For the nine months ended September 30, 2013, Mr. Kaye earned compensation of \$92,000, which was not paid and is being deferred until the Company has sufficient working capital to remit payment to him.

At September 30, 2013, the total unpaid deferred compensation owed to Mr. Kaye amounted to \$114,000. This amount is included in accounts payable and accrued liabilities in the accompanying balance sheet at September 30, 2013.

25. LITIGATION AND CONTINGENCIES

Mark D. Goldsmith, a former executive of the Company, filed a lawsuit against the Company in January 2008 in which he asserted that the Company was liable to him for breach of an employment contract. On August 30, 2013, the parties executed a settlement agreement. The settlement provides that the Company pay the plaintiff \$125,000 in five installments of \$40,000, \$25,000, \$25,000, \$25,000 and \$10,000 due on November 28, 2013 and the 15th day of March 2014, June 2014, September 2014 and February 2015, respectively. The parties also executed mutual releases. The \$125,000 amount of the settlement has been fully accrued for and is included in accounts payable and accrued liabilities on the accompanying balance sheet at September 30, 2013. In the event that the Company is delinquent in the payment of any installment, the total amount of the judgment may be increased to \$200,000.

The Company is not a party to any other litigation that is material to its business.

26. RECENTLY ISSUED ACCOUNTING STANDARD

In July 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-11, "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists". This update requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, unless the net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under applicable tax law or if the company does not intend to use the tax benefit towards the settlement of a disallowed tax position, if any.

This standard will become effective for interim periods and fiscal years beginning on or after December 15, 2013. Adoption of this standard is not expected to have a material effect on the Company's financial statements.

27. SUBSEQUENT EVENTS

Anti-dilution Shares issued to George J. Coates Related to New Shares of Common Stock Sold

Subsequent to September 30, 2013, the Company issued 5,590 shares of Series A Preferred Stock to Mr. Coates related to anti-dilution. The estimated fair value of these shares was \$14,000.

Issuance of 12% Convertible Note

In November 2013, the Company issued a \$28,000, 12% convertible note on the same terms and conditions as the other 12% convertible notes discussed in more detail in Note 14. The Company received cash proceeds of \$25,000, which was net of an approximately 10.5% original issue discount. This note matures in November 2014, if not converted prior thereto.

Issuance of Convertible Promissory Note

In October 2013, the Company entered into a securities purchase agreement with an investor and issued an 8% convertible promissory note which matures in July 2014 and received cash proceeds of \$45,000, net of financing costs of \$2,500. This note contains the same terms and conditions as the previous 8% convertible promissory notes more fully discussed in Note 14.

Conversion of 12% Convertible Note

Subsequent to September 30, 2013, \$25,000 principal amount of 12% convertible promissory notes were converted into 950,000 unregistered shares of the Company's common stock.

Conversion of 8% Convertible Note

Subsequent to September 30, 2013, a \$44,000 principal amount, 8% convertible promissory note, including accrued interest thereon of \$2,000, was converted into 1,263,426 unregistered shares of the Company's common stock.

Promissory Notes to Related Parties

Subsequent to September 30, 2013, the Company repaid \$15,000 of the 17% promissory notes due to George J. Coates.

Mr. and Mrs. Coates have made loans to the Company from time to time for working capital purposes but they are not obligated to continue to do so in the future.

Issuance of Common Stock under Equity Line of Credit

Subsequent to September 30, 2013, the Company issued 997,981 registered shares of its common stock under the equity line of credit with Dutchess Opportunity Fund II, LP and received net proceeds of \$58,000.

Deferred Compensation

Subsequent to September 30, 2013, George J. Coates, Barry C. Kaye and Bernadette Coates agreed to additional deferral of their compensation amounting to \$34,000, \$14,000 and \$9,000, respectively, bringing their total deferred compensation to \$202,000, \$113,000 and \$49,000, respectively.

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

Cautionary Notice Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q (this "Report") contains "forward-looking statements" within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act of 1934, as amended. Forward-looking statements discuss matters that are not historical facts. Because they discuss future events or conditions, forward-looking statements may include words such as "anticipate," "believe," "estimate," "intend," "could," "should," "would," "may," "seek," "plan," "might," "will," "expect," "predict," "project," "forecast," "potential," "continue" negatives thereof or similar expressions. These forward-looking statements are found at various places throughout this Report and include information concerning possible or assumed future results of our operations; business strategies; future cash flows; financing plans; plans and objectives of management; any other statements regarding future operations, future cash needs, business plans and future financial results, and any other statements that are not historical facts.

From time to time, forward-looking statements also are included in our other periodic reports on Forms 10-K and 8-K, in our press releases, in our presentations, on our website and in other materials released to the public. Any or all of the forward-looking statements included in this Report and in any other reports or public statements made by us are not guarantees of future performance and may turn out to be inaccurate. These forward-looking statements represent our intentions, plans, expectations, assumptions and beliefs about future events and are subject to risks, uncertainties and other factors. Many of those factors are outside of our control and could cause actual results to differ materially from the results expressed or implied by those forward-looking statements. In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Report. All subsequent written and oral forward-looking statements concerning other matters addressed in this Report and attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this Report.

For a discussion of factors that we believe could cause our actual results to differ materially from expected and historical results see "Item 1A - Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission.

Background

We have completed development of the Coates spherical rotary valve engine technology. This technology has been successfully applied to natural gas fueled industrial electric power generator engines, automobile engines, residential generators and high-performance racing car engines. We have been primarily investing our management time and resources in securing new working capital and developing plans for transitioning to large scale production in order to be properly positioned to take advantage of this technology as it achieves acceptance in the marketplace. This includes consideration of an optimal location, shipping logistics, manufacturing capacity and quality of the labor pool for such large scale manufacturing. In the second quarter of 2013, we also commenced research and development of a Hydrogen Reactor capable of generating Hydroxy Gas from an ordinary water supply, with a goal toward using the Hydroxy Gas to power our CSRV engines.

In the fourth quarter of 2011, we identified cracks on the lower engine heads that resulted from a defect in the manufacturing by one of our suppliers. Based on our testing of the Gen Sets to confirm our resolution of this problem, we believe we have determined the cause of this cracked head condition. As soon as the Company raises sufficient working capital, it will procure new cast-steel head castings to resolve the cracked head problems with the engines originally shipped to Almont Energy Inc. ("Almont") and undertake field testing of the generators, after which, it will begin larger scale production. We continue to be engaged in new research and development activities in connection with applying this technology to other commercially feasible internal combustion engine applications and intend to manufacture engines and/or license the CSRV system technology to third party Original Equipment Manufacturers ("OEM's") for multiple other applications and uses.

In July 2013, George J. Coates and his son Gregory Coates successfully completed research and development on a first generation Hydrogen Reactor, which is capable of splitting ordinary tap water molecules into Hydroxy Gas and Oxygen. The Hydroxy Gas is harvested from the tap water on demand by the hydrogen splitting reactor. It is our goal to power our Coates CSRV engines with the harvested Hydroxy Gas. The first generation Hydrogen Reactor is capable of powering a 14-horsepower CSRV engine.

CSRV engines operating on Hydroxy Gas do not produce any emissions, and the energy is sourced from an ordinary water supply, making this a relatively inexpensive and "green" source of power. Conventional engines designed with poppet valve assemblies would likely experience catastrophic failure in a very short time running on Hydroxy Gas because they are designed to run on gasoline or diesel fuel and there is no lubricity in Hydroxy Gas.

At this time, the Company is continuing with the development of this technology and is working on applying this technology to more powerful, higher capacity CSRV engines. George and Gregory Coates have agreed to grant us a license to the rights to this Hydrogen Reactor technology once it is applied to higher capacity engines. The consideration for this grant of license will be determined between the related parties. Once we obtain the licensing rights, we plan to commence production of CSRV products powered with this new technology. There can be no assurance that this technology can be successfully applied to such higher powered CSRV engines.

In July 2013, we announced our intention to spin off our manufacturing operations and grant a license to the rights to our intellectual property for the CSRV system technology to Coates Hi-Tech Engines, Ltd. ("Coates Hi-Tech"), a majority owned subsidiary. In August 2013, the Company announced that it had canceled its plans for this spin-off.

Plan of Operation

We are prepared to commence the production phase of our operations, but will first need to raise sufficient new working capital for this purpose. We intend to begin manufacturing and selling natural gas fueled industrial electric power generators powered by CSRV technology based engines ("Gen Sets") to Almont under (i) a license agreement covering the territory of Canada; and, (ii) certain rights to a license covering the territory of the United States. Almont is a privately held, independent third party entity based in Alberta, Canada.

We intend to take advantage of the fact that essentially all the components of the Gen Sets may be readily sourced and acquired from subcontractors and, accordingly, expect to manufacture the Gen Sets in the two following ways:

- Assembly – to develop assembly lines within our premises. We intend to initially commence production on a small scale. This will enable us to prove our concept for the CSRV system technology, and we expect this will dovetail with the existing substantial demand in the marketplace. We plan to address this demand by establishing large scale manufacturing operations in the United States. Transitioning to large-scale manufacturing is expected to require substantial working capital for inventory procurement, an increase in our work force and capital expenditures for additional production capacity and production equipment. To date, we have not been successful in securing the necessary working capital for this purpose.
- Licensing the CSRV system technology to OEM's – to take advantage of third party manufacturers' production capacity by signing OEM agreements.

Our ability to establish such manufacturing operations, recruit plant workers, finance initial manufacturing inventories and fund capital expenditures is highly dependent on our ability to successfully raise substantial new working capital in an amount and at a pace which matches our business plans. Possible sources of such new working capital include, sales of our common stock and warrants through private transactions, issuances of promissory notes to related parties, issuances of convertible promissory notes, sales of shares of our common stock through the equity line of credit arrangement with Dutchess Opportunity Fund II, LP, sales of CSRV products, sales of our equity and/or debt securities through private placement offerings and pursuing and entering into additional sublicensing agreements with OEM's and/or distributors. There can be no assurance that we will be successful in raising adequate new working capital or even any new working capital to carry out our business plans. The current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest funds and low investor confidence has introduced additional risk and difficulty to our challenge to secure such additional working capital.

Significant Estimates

The preparation of our financial statements in conformity with generally accepted accounting principles in the United States requires our management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. These significant estimates include determining the fair value of convertible promissory notes containing embedded derivatives as a result of variable conversion rate provisions, assigning useful lives to the Company's property, plant and equipment, determining an appropriate amount to reserve for obsolete and slow moving inventory, providing a valuation allowance for deferred tax assets, assigning expected lives to and estimating the rate of forfeitures of stock options granted and selecting a volatility factor for the Company's stock options in order to estimate the fair value of the Company's stock options on the date of grant. Actual results could differ from those estimates.

Recent Developments

Intention to Merge with China-Based Manufacturing and Casting Company

In August 2013, we signed a letter of commitment with a China-based manufacturer and casting company. This company also owns coal mining operations in China. The parties agreed to enter into negotiations and undertake due diligence with a mutual goal of merging the two companies for the purpose of establishing large scale production in China of industrial CSRV electric power generators. An important element in ensuring success of this transaction is that we intend to undertake a public offering in the U.S. and Hong Kong to raise US\$300 – 500 million. As this transaction is at an early stage, there can be no assurance that it will be consummated.

Results of Operations

Three Months Ended September 30, 2013 Compared to the Three Months Ended September 30, 2012

Our principal business activities and efforts for the three months ended September 30, 2013 and 2012 were devoted to (i) undertaking efforts to raise additional working capital in order to fund the start-up of large scale manufacturing operations, and (ii) developing plans for transitioning to large scale manufacturing. In addition, during the three months ended September 30, 2013, we conducted continued research and development to apply the aforementioned new Hydrogen Reactor technology to power a CSRV engine. During the three months ended September 30, 2012, we were also engaged, to a limited extent, in research and development activities related to applying the CSRV technology to industrial engines.

Although we incurred substantial net losses for the three months ended September 30, 2013 and 2012 of \$440,995 and \$804,235, respectively, it is important to consider that a substantial portion of these losses resulted from non-cash expenses required to be recorded for financial reporting purposes in accordance with GAAP. These net losses should be considered in view of the fact that actual cash used for operations was significantly less than these net losses. Cash used for operations amounted to (\$137,908) and (\$264,382) in the 2013 and 2012 comparable periods, respectively.

Revenues

There were no sales and no revenues from research and development for the three months ended September 30, 2013 and 2012.

Sublicensing fee revenue for the three months ended September 30, 2013 and 2012, amounted to \$4,800 and \$4,800, respectively. The Company is recognizing the license deposit of \$300,000 on the Canadian License with Almont as revenue over the approximately 16-year remaining life of the last CSRV technology patent in force at the date amortization began.

Operating Expenses

Research and Development Expenses

In the third quarter of 2013, the Company continued research and development of the Hydrogen Reactor. Research and development expenses in 2012 related to applying the CSRV technology to industrial engines. Research and development expenses for the three months ended September 30, 2013 and 2012 amounted to \$95,000 and \$94,000, respectively. Included in research and development expenses for the three months ended September 30, 2013 and 2012 was \$88,000 and \$51,000, respectively, of allocated compensation and benefits, \$-0- and \$41,000, respectively, of allocated stock-based compensation expense and \$7,000 and \$2,000, respectively, of parts and materials.

General and Administrative Expenses

General and administrative expenses decreased to \$383,664 for the three months ended September 30, 2013 from \$571,213 in the corresponding period in 2012. This net decrease of \$187,549 primarily resulted from the following: A decrease in non-cash stock-based compensation expense of \$188,933, a decrease in patent maintenance of \$35,609, a decrease in compensation and benefits of \$16,533, a decrease in travel and entertainment of \$5,665 and a decrease in insurance of \$5,200, partially offset by an increase in legal and professional fees and expenses of \$26,116, an increase in investor relations costs of \$10,172, an increase in printing expenses of \$6,125, an increase in miscellaneous expenses of \$5,685, an increase in postage of \$5,312, an increase in offering costs of \$4,667, an increase in marketing expenses of \$2,610, an increase in property taxes of \$2,578 and a net increase in other expenses of \$1,186.

Depreciation and Amortization

Depreciation and amortization decreased by \$5,551 to \$16,621 for the three months ended September 30, 2013 from \$22,172 for the three months ended September 30, 2012.

Other Income (Expense)

Other income (expense) for the three months ended September 30, 2013 and 2012, consisted of an decrease (increase) in the fair value of embedded derivative liabilities amounting to \$224,855 and (\$17,151), respectively, and interest expense of (\$175,468) and (\$104,477), respectively.

Provision for Income Taxes

The change in deferred tax assets for the three months ended September 30, 2013 and 2012 was fully offset by a valuation allowance, resulting in a \$-0- net income tax provision.

Net Loss

We incurred net losses of (\$440,955) and (\$804,235) for the three months ended September 30, 2013 and 2012, respectively.

Nine Months Ended September 30, 2013 Compared to the Nine Months Ended September 30, 2012

Our principal business activities and efforts for the nine months ended September 30, 2013 and 2012 were devoted to (i) undertaking efforts to raise additional working capital in order to fund the start-up of large scale manufacturing operations, (ii) preparing applications to, and negotiating with certain states, with the objective of securing a package of business, finance and tax incentives they may be offering to new businesses willing to relocate their operations in order to stimulate their economy and create new jobs within the state; and (iii) developing plans for transitioning to large scale manufacturing. In addition, during the nine months ended September 30, 2013, research and development was under way to develop and apply the aforementioned new Hydrogen Reactor technology to power a CSRV engine. During the nine months ended September 30, 2012, we were also engaged, to a limited extent, in research and development activities related to applying the CSRV technology to industrial engines.

Although we incurred substantial net losses for the nine months ended September 30, 2013 and 2012 of \$2,422,974 and \$3,692,077, respectively, it is important to consider that a substantial portion of these losses resulted from non-cash expenses required to be recorded for financial reporting purposes in accordance with GAAP. These net losses should be considered in view of the fact that actual cash used for operations was significantly less than these net losses. Cash used for operations amounted to (\$511,718) and (\$906,317) in the 2013 and 2012, respectively. Included in the net losses for financial reporting purposes for the nine months ended September 30, 2013 and 2012 was non-cash stock-based compensation expense of \$736,103 and \$2,080,275, respectively, \$258,074 and \$25,960 of non-cash expense from the change in the estimated fair value of embedded derivative liabilities related to convertible promissory notes, respectively, unpaid accrued interest expense of \$290,150 and \$298,125, respectively and \$208,354 and \$-0- of deferred compensation expense, respectively.

Revenues

There were no sales and no revenues from research and development for the nine months ended September 30, 2013 and 2012.

Sublicensing fee revenue for the nine months ended September 30, 2013 and 2012, amounted to \$14,400 and \$14,400, respectively. The Company is recognizing the license deposit of \$300,000 on the Canadian License with Almont as revenue over the approximately 16-year remaining life of the last CSRV technology patent in force at the date amortization began.

Operating Expenses

Research and Development Expenses

In the second quarter of 2013, the Company commenced research and development of the Hydrogen Reactor. There were no research and development activities in the first quarter of 2013. Research and development expenses in 2012 related to applying the CSRV technology to industrial engines. Research and development expenses for the nine months ended September 30, 2013 and 2012 amounted to \$174,220 and \$415,879, respectively. Included in research and development expenses for the nine months ended September 30, 2013 and 2012 was \$148,200 and \$151,300, respectively, of allocated compensation and benefits, \$14,500 and \$217,400, respectively, of allocated stock-based compensation expense and \$11,520 and \$47,179, respectively of parts and materials.

General and Administrative Expenses

General and administrative expenses decreased to \$1,577,612 for the nine months ended September 30, 2013 from \$2,835,691 in the corresponding period in 2012. This net decrease of \$1,258,079 primarily resulted from the following: A decrease in non-cash stock-based compensation expense of \$1,141,272, a decrease in legal and professional fees and expenses of \$49,099, a decrease in patent maintenance costs of \$48,067, a decrease in investor relations expenses of \$26,938, a decrease in insurance of \$18,411, a decrease in marketing expenses of \$4,610, a decrease in dues and subscriptions of \$4,320, a decrease in travel and entertainment of \$3,968, a decrease in tools expense of \$2,979, a decrease in building expenses of \$2,268 and a decrease in repairs and maintenance of \$2,038, partially offset by an increase in real estate taxes of \$16,249, an increase in costs to comply with S.E.C. rules and regulations for publicly reporting companies of \$10,489, an increase in utilities and communications expenses of \$6,357, an increase in offering costs of \$4,424, an increase in postage of \$3,092, an increase in miscellaneous expenses of \$2,643, an increase in printing expenses of \$2,101 and a net increase in other expenses of \$534.

Depreciation and Amortization

Depreciation and amortization increased by \$1,109 to \$49,863 for the nine months ended September 30, 2013 from \$48,754 for the nine months ended September 30, 2012.

Other Income (Expense)

Other income (expense) for the nine months ended September 30, 2013 and 2012, consisted of an (increase) in the fair value of embedded derivative liabilities amounting to (\$258,074) and (\$25,960), respectively, and interest expense of (\$377,605) and (\$380,193), respectively.

Provision for Income Taxes

The change in deferred tax assets for the nine months ended September 30, 2013 and 2012 was fully offset by a valuation allowance, resulting in a \$-0- net income tax provision.

Net Loss

We incurred net losses of (\$2,422,974) and (\$3,692,077) for the nine months ended September 30, 2013 and 2012, respectively.

Liquidity and Capital Resources (All amounts rounded to thousands of dollars)

Our cash position at September 30, 2013 was \$45,225, an increase of \$31,922 from the cash position of \$13,303 at December 31, 2012. We had negative working capital of (\$5,158,246) at September 30, 2013, which represents a \$734,787 improvement from the (\$5,893,033) of negative working capital at December 31, 2012. Current liabilities of \$5,329,572 at September 30, 2013, decreased by \$704,086 from the \$6,033,658 balance at December 31, 2012. Current liabilities were primarily comprised of accounts payable and accrued liabilities of \$2,199,106, a mortgage loan in the amount of \$1,528,284, promissory notes to related parties totaling \$638,081, embedded derivative liabilities related to convertible promissory notes of \$402,899, deferred compensation payable of \$358,954, net carrying value of convertible promissory notes of \$144,358 and unearned revenue of \$19,124.

Operating activities utilized cash of (\$511,718) during the nine months ended September 30, 2013, which primarily consisted of a net loss for the period of (\$2,422,974), decreased by non-cash stock-based compensation expense of \$736,103, a \$258,074 non-cash increase in the estimated fair value of embedded derivative liabilities related to convertible promissory notes, non-cash interest expense of \$290,150, an increase in deferred salaries of \$208,354, depreciation and amortization of \$49,864 and non-cash financing costs of \$7,684, partially offset by non-cash sublicensing revenues of (\$14,400). In addition, we realized net additional operating cash of \$414,193 consisting of a net increase in accounts payable and accrued liabilities of \$378,678, the current portion of a lease finance obligation of \$38,766 and a net decrease in deferred offering costs and other assets of \$3,251.

There were no investing activities for the nine months ended September 30, 2013.

Financing activities generated net cash of \$543,640 for the nine months ended September 30, 2013, consisting of proceeds from issuance of convertible notes amounting to \$160,000, net proceeds from the sale/leaseback of equipment of \$132,550, proceeds from issuance of promissory notes to related parties, net of repayments amounting to \$120,386, proceeds from issuance of common stock and warrants of \$105,000 and proceeds from issuance of common stock under an equity line of credit of \$72,420, offset by a \$46,716 partial repayment of the principal amount of a mortgage loan.

In the opinion of management, we will be required to raise additional working capital to fully achieve our objectives to enter the production phase of our operations. Various potential sources of such additional working capital are anticipated to come from one or more of the following: issuances of convertible promissory notes, issuances of promissory notes to related parties, private sales of common stock and common stock warrants and sales of shares of common stock to Dutchess Opportunity Fund II, LP under the equity line of credit.

Going Concern

We have incurred net recurring losses since inception, amounting to (\$33,650,095), as of September 30, 2013, primarily consisting of research and development expenses and had a stockholders' deficiency of (\$3,331,747). These research and development expenses which were incurred to develop the CSRV system technology could begin to create value if we are able to raise sufficient working capital and commence production of our CSRV engines. We will need to obtain additional working capital in order to continue to cover our ongoing cash expenses.

These factors raise substantial doubt about our ability to continue as a going concern. In addition, the current economic environment, which is characterized by tight credit markets, investor uncertainty about how to safely invest funds and low investor confidence, has introduced additional risk and difficulty to our challenge to secure needed additional working capital. Our Independent Registered Public Accountants have stated in their Auditor's Report dated April 15, 2013 with respect to our financial statements as of and for the year ended December 31, 2012 that these circumstances raise substantial doubt about our ability to continue as a going concern.

We have restricted variable costs to only those expenses that are necessary to perform activities related to efforts to raise working capital to enable us to commence production of our CSRV system technology products, research and development and general administrative costs in support of such activities.

During the nine months ended September 30, 2013, we raised additional working capital of \$590,356, consisting of proceeds, net of repayments, from issuances of promissory notes to George J. Coates and Bernadette Coates, spouse of George J. Coates amounting to \$62,973 and \$57,413, respectively, net proceeds from issuances of convertible promissory notes aggregating of \$160,000, net proceeds from sale/leaseback of equipment of \$132,550, proceeds from sales of common stock and warrants to the son of Dr. Richard W. Evans, a director, of \$105,000 and sales of common stock under an equity line of credit of \$72,420.

Our financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Additional Release Payments are currently due us amounting to \$5,847,000 under the Escrow Agreement with Almont. At this time, Almont is unable to pay the balance due us until it raises sufficient new working capital. As a result, we have needed to rely on other sources for raising new working capital for our operations. Almont, which has been assigned the Canadian License and rights to the US License, is required to remit to us 60% of the proceeds from any new working capital raised, with the exception of proceeds from equipment lease financing transactions. In addition, the annual minimum purchase requirements under both the United States and Canadian licensing agreements of 120 engine generators per year will also become effective upon the commencement of production of the Gen Sets for Almont. At this time, we do not anticipate receiving additional Release Payments until we raise sufficient new working capital to commence production and begin shipments to Almont.

New Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-11, "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists". This update requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, unless the net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under applicable tax law or if the company does not intend to use the tax benefit towards the settlement of a disallowed tax position, if any.

This standard will become effective for interim periods and fiscal years beginning on or after December 15, 2013. Adoption of this standard is not expected to have a material effect on our financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Smaller reporting companies are not required to provide such information.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the "Exchange Act"), we carried out an evaluation, with the participation of our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") (our principal financial and accounting officer), of the effectiveness of our disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are currently not involved in any litigation that we believe could have a material adverse effect on our financial condition or results of operations. There is no action, suit, proceeding, inquiry or investigation before or by any court, public board, government agency, self-regulatory organization or body pending or, to the knowledge of the executive officers of our company or any of our subsidiaries, threatened against or affecting our company, our common stock, any of our subsidiaries or of our companies or our subsidiaries' officers or directors in their capacities as such, in which an adverse decision could have a material adverse effect.

Item 1A. Risk Factors

We believe there are no changes that constitute material changes from the risk factors previously disclosed in the Company's 2012 Annual Report filed on Form 10-K.

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

The following issuances of securities (rounded to thousands of dollars) during the three months ended September 30, 2013 were exempt from registration pursuant to Section 4(2), and Regulation D promulgated under the Securities Act. We made this determination based on the representations of the Investors which included, in pertinent part, that such Investors were "accredited investors" within the meaning of Rule 501 of Regulation D promulgated under the Securities Act, and that such Investors were acquiring our common stock, for investment purposes for their own respective accounts and not as nominees or agents, and not with a view to the resale or distribution thereof, and that the Investors understood that the shares of our common stock may not be sold or otherwise disposed of without registration under the Securities Act or an applicable exemption therefrom.

In a series of transactions, we made private sales, pursuant to stock purchase agreements of 333,333 unregistered shares of our common stock and 333,333 five-year, common stock warrants to purchase one unregistered share of our common stock at an exercise price of \$0.03 per share in consideration for \$10,000 received from the son of Dr. Richard W. Evans, a director.

In a series of transactions, we issued 1,928,763 unregistered shares of our common stock to George J. Coates for anti-dilution protection related to new shares of common stock issued in 2013. The estimated value of these shares, based on the closing trading price of the stock on the dates of issuance was \$98,139. In August 2013, these shares were voluntarily returned by Mr. Coates for cancellation.

On August 8, 2013, we issued a \$53,000 principal amount, 8% convertible promissory note to an accredited investor and received cash proceeds of \$50,000, net of closing costs. The lender may convert the promissory notes into unregistered shares of the Company's common stock at any time beginning 180 days after the date of funding. The conversion rate is equal to 61% of the average of the three lowest closing bid prices of the stock during the ten trading days prior to the date of conversion.

On August 14, 2013, we issued a \$28,000 principal amount, 12% convertible promissory note to another accredited investor and received cash proceeds of \$25,000. The lender may convert the promissory notes into unregistered shares of the Company's common stock at any time beginning 180 days after the date of funding. The conversion rate shall be equal to the lesser of \$0.035 per share or 60% of the lowest trading price of the common stock in the 25 trading days prior to the date of conversion.

On September 20, 2013, the holder of a 12% convertible promissory note converted an \$8,700 portion of the convertible promissory note into, 400,000 unregistered shares of common stock.

Net proceeds from the above transactions were used for general working capital purposes.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

The information required to be contained in this Item is incorporated by reference to Part II, Item 1 of this Quarterly Report on Form 10-Q under the heading "Legal Proceedings."

Item 6. Exhibits

Exhibit Number	Description
10.1	Sale/leaseback Agreement with Paradigm Commercial Capital Group, dated August 15, 2013
31.1	Section 302 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Section 302 Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS *	XBRL Instance Document
101.SCH *	XBRL Taxonomy Schema
101.CAL *	XBRL Taxonomy Calculation Linkbase
101.DEF *	XBRL Taxonomy Definition Linkbase
101.LAB *	XBRL Taxonomy Label Linkbase
101.PRE *	XBRL Taxonomy Presentation Linkbase
101.DEF *	XBRL Taxonomy Extension Definition Linkbase Document

In accordance with SEC Release 33-8238, Exhibit 32.1 and 32.2 are being furnished and not filed.

* Furnished herewith. XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

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

COATES INTERNATIONAL, LTD.

Date: November 14, 2013

/s/ George J. Coates

George J. Coates
Duly Authorized Officer, President and Chief Executive Officer
(Principal Executive Officer)

Date: November 14, 2013

/s/ Barry C. Kaye

Barry C. Kaye
Duly Authorized Officer, Treasurer and Chief Financial Officer
(Principal Financial and Accounting Officer)

-35-

Exhibit 10.1

LEASE SCHEDULE NO. 001 TO MASTER LEASE AGREEMENT NO. PFE0019

This Lease Schedule No. 001 dated August 15, 2013 (the "Schedule") between PARADIGM COMMERCIAL CAPITAL GROUP CORP (the "Lessor") and COATES INTERNATIONAL, LTD. (the "Lessee") incorporates by reference the terms and conditions of Master Lease Agreement No. PFE0019 dated August 15, 2013 (the "Master Lease"), the Property invoice ("Property" Description) and the Schedule A ("Stipulated Loss Schedule"), and constitutes a separate lease between Lessor and Lessee and is referred to herein as the "Lease". Lessor shall have the right to replace this Schedule with multiple Schedules for the purpose of segregating the Property into separate Lease Schedules. All capitalized terms used herein but not defined herein shall have the same meanings ascribed to them in the Master Lease.

SECTION 1 **PROPERTY:** (Refer to attached Exhibit A - Property) and all other Property purchased or paid for by Lessor and any and all attachments, accessions, additions, enhancements, and replacements thereto.

SECTION 2 **PROPERTY LOCATION:** 2100 Highway 34, Wall Township, NJ 07719

SECTION 3 **BASE PERIOD:** Twenty-four (24) months with the first payment starting October 1, 2013 and all following payments due on the 1st of each month thereafter. The payment due October 1, 2013 will include an interim payment for the time reflecting the fund date August 16, 2013 to August 31, 2013 and first lease payment at regular rate.

SECTION 4 **TOTAL PROPERTY COST:** \$150,000.00

SECTION 5a **MONTHLY PAYMENT:** \$7,875.00, plus applicable sales/use tax (based on Lease Rate Factor of 0.0525)

SECTION 5b **INTERIM PAYMENT:** \$3,810.50, plus applicable sales/use tax (based on Lease Rate Factor of 0.0525)

SECTION 6 **RENTAL FREQUENCY:** Monthly in advance.

SECTION 7 **RESIDUAL:** Six (6) months extension payments. A partial residual advance of 10% is required. An early buy-out option to purchase the equipment is available upon the end of the base period. Refer to the Master Lease Agreement for details.

SECTION 8 **PAYMENT BY ELECTRONIC TRANSFER:** Lessee authorizes Lessor or its assigns to electronically transfer all rental payments and other monies due under this Schedule from Lessee's account maintained with its financial institution, and Lessee agrees to execute and deliver a written "Authorization for Electronic Transfer" form to Lessor to affect such transfers. Failure or refusal of Lessee to authorize such transfers or failure of Lessor or its assigns to receive such payments by electronic transfer shall constitute an additional Event of Default under Section 18 of the Master Lease. Upon the occurrence of the Event of Default specified above, Lessor shall be entitled to exercise its rights and remedies under the Lease.

SECTION 9 **REPRESENTATION OF LESSEE:** Lessor and Lessee agree that this Schedule is a "Finance Lease" as defined by the Uniform Commercial Code Article 2A, in that (i) Lessee has selected the Property in its sole discretion, (ii) Lessor has acquired the Property solely for the purpose of leasing such Property under this Schedule, and (iii) Lessee has received a copy of the contract evidencing Lessor's purchase of the Property.

LESSOR:

LESSEE:

PARADIGM COMMERCIAL CAPITAL GROUP CORP

COATES INTERNATIONAL LTD.

BY: /s/ Thomas Karren

BY: /s/ George J. Coates

TITLE: Operations Manager

TITLE: President and Chief Executive Officer

PARADIGM COMMERCIAL CAPITAL GROUP CORP
1246 W. Flint Meadow Dr. Suite 104
Kaysville, Utah 84037

MASTER LEASE AGREEMENT NO. PFE0019

THIS MASTER LEASE AGREEMENT is made on August 15, 2013, between PARADIGM COMMERCIAL CAPITAL GROUP

CORP with its principal office located at 1246 W. Flint Meadow Dr, Suite 104, Kaysville, Utah 84037, and its assign(s) (the 'Lessor') and COATES INTERNATIONAL, LTD. a corporation organized in the state of Delaware, with its principal office located at 2100 Highway 34, Wall Township, NJ 07719 (the 'Lessee').

SECTION 1. LEASE:

Lessor agrees to lease to Lessee, and Lessee agrees to lease from Lessor the Property described in any Schedule executed and delivered by Lessor and Lessee in connection with this Master Lease Agreement. Each Schedule shall incorporate by reference the terms and conditions of this Master Lease Agreement, and together with the Acceptance and Delivery Certificate and Master Progress Payment Agreement. If applicable, shall constitute a separate Lease.

SECTION 2. TERM OF LEASE:

The term of any Lease, as to all Property designated on the applicable Schedule, shall commence on the Date of Acceptance for such Property, and shall continue for a Base Period ending that number of months from the Lease Commencement Date as specified in the Schedule. Thereafter, Lessee shall have those options as provided in Section 20n of this Master Lease Agreement.

SECTION 3. RENT AND PAYMENT:

Lessee shall pay as rent for use of the Property, aggregate rentals equal to the sum of all the Monthly Rentals and other payments due under the Lease for the entire Base Period. The Monthly Rental shall begin on the Date of Acceptance and shall be due and payable by Lessee in advance on the first day of each month throughout the Base Period. If the Date of Acceptance does not fall on the first day of a calendar quarter, then the first rental payment shall be calculated by multiplying the number of days from and including the Date of Acceptance to the Lease Commencement Date by a daily rental equal to one-thirtieth (1/30) of the Monthly Rental, and shall be due and payable on the Date of Acceptance. Lessee shall pay to Lessor, or its assigns, all rentals as due when due, without notice or demand, to Lessor's address set forth above, or as otherwise directed in writing by Lessor, or its assigns. LESSEE SHALL NOT ABATE, SET OFF OR DEDUCT ANY AMOUNT OR DAMAGES FROM OR REDUCE ANY MONTHLY RENTAL OR

SECTION 5. NET LEASE:

This is a fully net, non-cancelable lease contract which may not be terminated for any reason except as otherwise specifically provided herein. Lessee has no right of prepayment unless agreed to in writing by Lessor. Lessor and Lessee agree that any Lease is a "Finance Lease" as defined by the Uniform Commercial Code Article 2A. Lessee shall be responsible for and shall indemnify Lessor against, all costs, expenses and claims of every nature whatsoever arising out of or in connection with or related to the Lease or the Property.

Lessee acknowledges and agrees that its obligations to pay all Monthly Rentals and other amounts due and owing and perform its obligations hereunder shall be primary, absolute, unconditional, independent and irrevocable and shall not be subject to or affected by (i) any circumstance whatsoever, including, without limitation, any setoff, counterclaim, recoupment, abatement, suspension, reduction, rescission, defense or other right otherwise available to Lessee; (ii) any defect in the title, merchantability, condition, design, operation or fitness for use of, or any damage to, removal, abandonment, requisition, taking condemnation or loss or theft or destruction of, the Property, or any interference, interruption, restriction, curtailment or cessation in or prohibition of the use or possession thereof by the Lessee or any other person for any reason whatsoever; or (iii) failure on the part of the manufacturer or the shipper of the Property to deliver the Property or any part thereof to Lessee. Lessor is not responsible to install, test, repair, service, or maintain any Property.

SECTION 6. CONDITIONS PRECEDENT:

Lessor's obligations under each Schedule, including its obligation to purchase and lease any Property to be leased thereunder, are conditioned upon Lessor's receipt of, in form or substance satisfactory to Lessor, and Lessor's determination that all of the following are satisfactory: (i) evidence as to due compliance with the insurance provisions hereof; (ii) Uniform Commercial Code financing statements and all other filings and recordings as required by Lessor; (iii) lien searches in the jurisdiction of Lessee's organization and in each jurisdiction in which the Property and/or Lessee's chief executive office are located; (iv) incumbency and signature of the officers of Lessee authorized to execute such documents; (v) resolutions of Lessee's Board of Directors and/or Members duly authorizing the leasing, or sale and leaseback, as the case may be, of the Property hereunder and the execution, delivery and performance of the Lease; (vi) if requested by Lessor, certificates of good

OTHER PAYMENT DUE FOR ANY REASON. THIS LEASE IS NON-CANCELABLE FOR THE ENTIRE TERM OF THE BASE PERIOD AND ANY RENEWAL PERIODS. standing from the jurisdiction of Lessee's organization, and (vii) if requested by Lessor, a copy of Lessee's organizational documents and evidence of Lessee's organizational number.

If any rental or other payment due under any Lease shall be unpaid ten (10) days after its due date, Lessee will pay on demand, as a late charge, but not as interest, the greater of twenty-five dollars (\$25.00) or ten percent (10%) of any such unpaid amount but in no event to exceed maximum lawful charges.

SECTION 4. TAXES AND FEES:

Lessee shall promptly pay to Lessor, and agrees to indemnify and hold Lessor harmless from all taxes, fees, assessments and charges paid, payable or required to be collected by Lessor (together with any penalties, fines or interest thereon), which are levied or based on the Monthly Rental or other payment due under the Lease, or on the delivery, acquisition, possession, use, operation, lease, rental, sale, purchase, control or value of the Property, including without limitation, registration and license fees and assessments, recycling fees, state and local privilege or excise taxes, documentary stamp taxes or assessments, sales and use taxes, personal and other property taxes, and taxes or charges based on gross revenue, but excluding taxes based on Lessor's net income, (collectively "taxes", whether the same be assessed to Lessor or Lessee. Lessee also agrees to pay to Lessor all servicing and administrative costs associated with processing and paying various fees and taxes. Lessor shall file all required reports and returns with all applicable governmental agencies relating to the taxes concerning the Property.

SECTION 7. MAINTENANCE AND REPAIRS: RETURN OF PROPERTY:

a. During the continuance of each Lease, Lessee shall, at its own expense, enter into and maintain in force a contract with the manufacturer or other qualified maintenance organization reasonably satisfactory to Lessor for maintenance of each item of Property that requires such a contract. Such contract as to each item shall commence upon the earlier of the Certificate date, if applicable, or the Date of Acceptance. Upon request Lessee shall furnish Lessor with a copy of such contract.

b. During the continuance of each Lease. Lessee shall, at its own cost and expense, and in accordance with all manufacturer maintenance specifications, (i) keep the Property in good repair, condition, operating order and appearance. (ii) make all necessary adjustments repairs and replacements, (iii) not use or permit the Property to be used for any purpose for which, In the opinion of the manufacturer, the Property is not designed or reasonably suitable, and (iv) furnish all required parts, mechanisms, devices, maintenance and servicing, so as to keep each item of Property and any part in good repair and operating order (ordinary wear and tear excepted) in the same condition and appearance as when delivered to the Lessee. Such parts, mechanisms and devices shall Immediately become a part of the Property for all purposes hereunder and title thereto shall vest in Lessor. If the manufacturer does not provide maintenance specifications, Lessee shall perform all maintenance in accordance with industry standards for like property.



- c. Lessee shall immediately notify Lessor in writing of all details concerning any damage or loss to the Property, including without limitation, any damage or loss arising from the alleged or apparent improper manufacture, functioning or operation of the Property.
- d. Lessee shall pay all shipping and delivery charges and other expenses incurred in connection with the Property. Upon default, or at the expiration or earlier termination of any Lease, Lessee shall, at its own expense, assemble, prepare for shipment and promptly return the Property to Lessor at the location within the continental United States designated by Lessor. Upon such return, the Property shall be in the same operating order, repair, condition and appearance as on the Date of Acceptance, except for reasonable wear and tear from proper use thereof, and shall include all engineering changes theretofore prescribed by the manufacturer. Lessee shall provide maintenance certificates or qualification letters and/or arrange for and pay all costs which are necessary for the manufacturer to accept the Property under contract maintenance at its then standard rates ("recertification"). The term of the Lease shall continue upon the same terms and conditions until such recertification has been obtained.
- e. With regard to Software, at the expiration or earlier termination of any Lease, or upon demand by Lessor upon the occurrence of an Event of Default (hereinafter defined) under the Lease, Lessee shall (i) destroy all copies or duplicates of the Software which were not returned to Lessor; (ii) delete from its systems all Software then installed; (iii) cease using the Software altogether or; iv) disable the computers, computer systems or other equipment which run and/or operate and or are controlled by the Software. Upon its receipt from Lessee, Lessor shall be responsible to return the Software to the owner/vendor/licensor so that Lessee shall not be in breach of any software license.
- e. Lessee shall comply with all applicable laws, regulations, requirements, rules and orders, all manufacturer's instructions and warranty requirements, and with the conditions and requirements of all policies of insurance with respect to the Property and the Lease.
- f. Lessee may not make alterations or attachments to the Property without first obtaining the written consent of Lessor. Any such alterations or attachments shall be made at Lessee's expense and shall not interfere with the normal and satisfactory operation or maintenance of the Property. The manufacturer may incorporate engineering changes or make temporary alterations to the Property upon request of Lessee. Unless Lessor shall otherwise agree in writing, all such alterations and attachments shall be and become the property of Lessor upon their attachment to the Property or, at the option of Lessor, shall be removed by Lessee at the termination of the Lease and the Property restored at Lessee's expense to its original condition, reasonable wear and tear only excepted.
- g. Lessee shall enforce that the Property be installed, used, operated and, at the termination of the Lease, if applicable, removed at Lessee's expense (i) in accordance with any applicable manufacturer's manuals or instructions; (ii) by competent and duly qualified personnel only; and (iii) in accordance with applicable governmental regulations.
- h. In the event the Property includes Software, the following shall apply: (i) Lessee shall possess and use the Software in accordance with the terms and conditions of any license agreement entered into with the owner/vendor/licensor of such Software ("license") (at Lessor's request, Lessee shall provide a complete copy of the License to Lessor) and shall not breach the License; (ii) Lessee agrees that Lessor has an interest in the License and Software due to its payment of the price thereof and is an assignee or third-party beneficiary of the License; (iii) as due consideration for Lessor's payment of the price of the License and Software and for providing the Software to Lessee at a lease rate (as opposed to a debt rate), Lessee agrees that Lessor is leasing (and not financing) the Software to Lessee; (iv) except for the original price paid by Lessor, Lessee shall, at its own expense, pay promptly when due all servicing fees, maintenance fees, update and upgrade costs, modification costs, and all other costs and expenses relating to the License and Software and maintain the License in effect during the term of the Lease; and (v) the Software shall be deemed Property for all purposes under the Lease.

SECTION 8. USE: ALTERATIONS AND ATTACHMENTS:

- a. Lessee shall at all times keep the Property in its sole possession and control. The Property shall not be moved from the location stated in the Schedule without the prior written consent of Lessor, which consent shall not be unreasonably withheld.
- b. The Property is leased solely for commercial or business purposes.
- c. After Lessee receives and inspects any Property and is satisfied that the Property is acceptable, Lessee shall execute and deliver to Lessor an Acceptance and Delivery Certificate in form provided by Lessor; provided, however, that Lessee's failure to execute and deliver an Acceptance

SECTION 9. OWNERSHIP AND INSPECTION:

- a. The Property shall at all times be the property of Lessor or its assigns, and Lessee shall have no right, title or interest therein except as to the use thereof subject to the terms and

and Delivery Certificate for any Property shall not affect the validity and enforceability of the Lease with respect to the Property. If Lessee has executed and delivered a Master Progress Payment Agreement, Lessor may, in its sole discretion, at any time by written notice to Lessee, declare all prior Certificates executed in connection with the Master Progress Payment Agreement to be and constitute the Acceptance and Delivery Certificate for all purposes under the Lease, and the Date of Acceptance of the Lease shall be the date determined by Lessor in its sole discretion which shall not be earlier than the date of the last Certificate.

- d. The Property is and shall remain personal property during the term of the Lease notwithstanding that any portion thereof may in any manner become affixed, attached to or located on real property or any building or improvement thereon. Lessee shall not affix or attach, or permit any of the Property to become affixed or attached to any real property in any manner which would change its nature from that of personal property to real property. Lessee shall not permit the Property to become an accession to other goods or a fixture to or part of any real property. Lessee will obtain and deliver to Lessor a lien waiver in a form satisfactory to Lessor, from all persons not a party hereto who might claim an interest, lien or other claim in the Property.

conditions of the Lease. For purposes of the foregoing, Lessee transfers to Lessor all of Lessee's right, title and interest (including all ownership interest) in and to the Property free and clear of all liens, security interests and encumbrances. Lessor may affix (or require Lessee to affix) tags, decals or plates to the Property indicating Lessor's ownership, and Lessee shall not permit their removal or concealment. Lessee shall not permit the name of any person or entity other than Lessor or its assigns to be placed on the Property as a designation that might be interpreted as a claim of ownership or security interest.

- b. Lessor, its assigns and their agents shall have free access to the Property at all reasonable times during normal business hours for the purpose of inspecting the Property and for any other purpose contemplated in the Lease. Lessee shall pay any and all costs uncured by Lessor in connection with any inspection performed by Lessor and/or its assigns.

- c. LESSEE SHALL KEEP THE PROPERTY AND LESSEE'S INTEREST UNDER ANY LEASE FREE AND CLEAR OF ALL LIENS AND ENCUMBRANCES, EXCEPT THOSE PERMITTED IN WRITING BY LESSOR OR ITS ASSIGNS.
- c. Lessor assigns to Lessee all assignable warranties on the Property, including without limitation any warranties described in Lessor's purchase contract, which assignment shall be effective only (i) during the Base Period and any renewal period thereof; and (ii) so long as no Event of Default exists.

SECTION 10. DISCLAIMER OF WARRANTIES:

- a. WITHOUT WAIVING ANY CLAIM THE LESSEE MAY HAVE AGAINST ANY MANUFACTURER, LESSEE ACKNOWLEDGES AND AGREES THAT i) LESSOR IS NOT A SELLER, SUPPLIER OR THE MANUFACTURER OF THE PROPERTY (AS SUCH TERMS ARE DEFINED OR USED, AS THE CASE MAY BE, IN THE UNIFORM COMMERCIAL CODE) OR DEALER, NOR A SELLERS OR A DEALER'S AGENT THEREIN, ii) THE PROPERTY IS OF A SIZE, DESIGN, CAPACITY AND MANUFACTURE SELECTED BY AND ACCEPTABLE TO THE LESSEE, iii) THE LESSEE HAS EXAMINED AND IS SATISFIED THAT EVERY ITEM OF PROPERTY IS SUITABLE FOR ITS PURPOSE, iv) THE LESSEE ACCEPTS THE PROPERTY AND EACH PART THEREOF "AS IS" AND "WHERE IS", v) THE LESSOR HAS NOT MADE AND DOES NOT MAKE, AND HEREBY DISCLAIMS LIABILITY FOR, AND LESSEE HEREBY WAIVES ALL RIGHTS AGAINST LESSOR RELATING TO, ANY AND ALL WARRANTIES, REPRESENTATIONS OR OBLIGATIONS WHATSOEVER, EXPRESS OR IMPLIED, ARISING BY APPLICABLE LAW OR OTHERWISE, RELATING TO THE PROPERTY, OR ANY PART THEREOF, INCLUDING, WITHOUT LIMITATION, ANY AND ALL WARRANTIES, REPRESENTATIONS OR OBLIGATIONS AS TO: (1) THE DESCRIPTION, CONDITION, DESIGN, QUALITY OR PERFORMANCE OF THE PROPERTY OR QUALITY OR CAPACITY OF MATERIALS OR WORKMANSHIP IN THE PROPERTY; (2) ITS MERCHANTABILITY OR FITNESS OR SUITABILITY FOR A PARTICULAR PURPOSE WHETHER OR NOT DISCLOSED TO LESSOR; (3) THE ABSENCE OF LATENT OR OTHER DEFECTS, WHETHER OR NOT DISCOVERABLE (4) THE ABSENCE OF ANY INFRINGEMENT OF ANY PATENT, TRADEMARK OR COPYRIGHT OR THE LIKE; AND (5) THE ABSENCE OF OBLIGATIONS BASED ON STRICT LIABILITY IN TORT. It is agreed that all such risks incident to the matters described in this Section 10a, as between the Lessor and the Lessee are to be borne by the Lessee. If the Property or Software is not properly installed, does not function as represented or warranted by original owner/seller/supplier/licensor, or is unsatisfactory for any reason, Lessee shall make any claim on account thereof solely against original owner/seller/supplier/licensor and shall nevertheless pay all sums payable under the Lease, Lessee hereby waiving the right to make any such claims against Lessor. Lessor shall not be liable to Lessee for any loss, damage or expense of any kind or nature caused, directly or indirectly, by the Property or the use, possession
- SECTION 11. ASSIGNMENT BY LESSOR:**
- Lessor may assign or transfer its rights and interests in the Lease and/or the Property to another party ("Lessor's Assignee") either outright or as security for loans (collectively the "Underwriting"). Upon notice of any such assignment and instructions from Lessor, Lessee shall pay its Monthly Rental and other payments and perform its other obligations under the Lease to the Lessor's Assignee (or to another party designated by Lessor's Assignee). Upon any such sale or assignment, LESSEE'S OBLIGATIONS TO LESSOR'S ASSIGNEE UNDER THE ASSIGNED LEASE SHALL BE ABSOLUTE AND UNCONDITIONAL AND LESSEE WILL NOT ASSERT AGAINST LESSOR'S ASSIGNEE ANY CLAIM, DEFENSE, OFFSET OR COUNTERCLAIM WHICH LESSEE MIGHT HAVE AGAINST LESSOR. Lessee waives and will not assert against any assignee of Lessor any claims, defenses, or set-offs which Lessee could assert against Lessor. Lessor's Assignee shall have all of the rights but none of the obligations of Lessor under the assigned Lease, and after such assignment Lessor shall continue to be responsible for all of Lessor's obligations under the Lease.
- Upon any such assignment, Lessee agrees to promptly execute or otherwise authenticate and deliver to Lessor estoppel certificates, acknowledgements of assignment, records and other documents requested by Lessor which acknowledge the assignment, affirmation of provisions of the Lease which may be required to effect the Underwriting. Lessee authorizes Lessor's assigns to file UCC-1 financing statements or precautionary filings as Lessor or its assigns deem necessary. Lessor's assigns are authorized to take any measures necessary to protect their interest in the Property, including placing a lien on titled vehicles.
- Only one executed counterpart of any Schedule shall be marked "Original"; any other executed counterparts shall be marked "Duplicate Original" or "Counterpart". No security interest in any Schedule may be created or perfected through the transfer or possession or control, as applicable, of any counterpart other than the document or record, as applicable, marked "Original".
- SECTION 12. ASSIGNMENT BY LESSEE:**
- LESSEE MAY NOT ASSIGN ANY LEASE OR ANY OF ITS RIGHTS HEREUNDER OR SUBLEASE THE PROPERTY WITHOUT THE PRIOR WRITTEN CONSENT OF LESSOR. NO PERMITTED ASSIGNMENT OR SUBLEASE SHALL RELIEVE

or maintenance thereof, or the repair, service or adjustment thereof, or by any delay or failure to provide any such maintenance, repair, service or adjustment, or by any interruption of service or loss of use thereof (including without limitation, Lessee's use of or right to use any Software) or for any loss of business howsoever caused.

LESSEE OF ANY OF ITS OBLIGATIONS HEREUNDER. Subject to the terms of this Lease, this Lease and each Schedule inure to the benefit of, and are binding upon, the successors and assigns of Lessee, and, without limiting the foregoing, shall bind all persons who become bound as a "new debtor" (as defined in the Uniform Commercial Code) to this Lease and any Schedule.

b. NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED IN THE LEASE, LESSOR SHALL NOT, UNDER ANY CIRCUMSTANCES, BE LIABLE TO LESSEE OR ANY THIRD PARTY, FOR CONSEQUENTIAL, INCIDENTAL, SPECIAL OR EXEMPLARY DAMAGES ARISING OUT OF OR RELATED TO THE TRANSACTION CONTEMPLATED HEREUNDER, WHETHER IN AN ACTION BASED ON CONTRACT, TORT (INCLUDING NEGLIGENCE OR STRICT LIABILITY) OR ANY OTHER LEGAL THEORY, INCLUDING WITHOUT LIMITATION, LOSS OF ANTICIPATED PROFITS, OR BENEFITS OF USE OR LOSS OF BUSINESS, EVEN IF LESSOR IS APPRISED OF THE LIKEHOOD OF SUCH DAMAGES OCCURRING.

IT IS EXPRESSLY UNDERSTOOD AND AGREED THAT EACH AND EVERY PROVISION OF ANY LEASE WHICH PROVIDES FOR A LIMITATION OF LIABILITY, DISCLAIMER OF WARRANTIES OR EXCLUSION OF DAMAGES, IS INTENDED BY THE PARTIES TO BE SEVERABLE FROM ANY OTHER PROVISION AND IS A SEPARABLE AND INDEPENDENT ELEMENT OF RISK ALLOCATION AND IS INTENDED TO BE ENFORCED AS SUCH.

SECTION 13. LESSEE'S REPRESENTATIONS AND WARRANTIES:

Lessee represents and warrants as follows:

a. If Lessee is a corporation, that it is duly organized and validly existing in good standing under the laws of the jurisdiction of its incorporation, that it is duly qualified to do business in each jurisdiction where any Property is, or is to be located, and has full corporate power and authority to hold property under lease and to enter into and perform its obligations under any Lease; that the execution, delivery and performance by Lessee of any Lease has been duly authorized by all necessary corporate action on the part of Lessee, and is not inconsistent with its articles of incorporation or by-laws or other governing instruments;

b. (i) Lessee's state of organization is the state listed in the introductory paragraph of this Lease; (ii) Lessee's principal office is located in the state listed in the introductory paragraph of this Lease; (iii) Lessee is the legal entity or organization indicated in the introductory paragraph of this Lease, which organization is duly organized, validly existing and in good standing under the laws of the state listed in the introductory paragraph of this Lease; and (iv) Lessee's full and exact legal name is the same as listed in the introductory paragraph of this Lease;

c. The execution, delivery and performance by Lessee of any Lease does not violate any law or governmental rule, regulation, or order applicable to Lessee, does not and will not contravene any provision of constitute a default under, or result in the creation of any lien on or in any property or assets of the Lessee, pursuant to any indenture, mortgage, contract, or other instrument to which it is bound and, upon execution and delivery of each Lease, will constitute a legal, valid and binding agreement of Lessee, enforceable in accordance with its terms;

d. If Lessee is a partnership, that it is duly organized by written partnership agreement and validly existing in accordance with the laws of the jurisdiction of its organization, that it is duly qualified to do business in each jurisdiction where the Property is, or is to be located, and has full power and authority to hold property under lease and to enter into and perform its obligations under any Lease; that the execution, delivery and performance by Lessee of any Lease has been duly authorized by all necessary action on the part of the Lessee, and is not inconsistent with its partnership agreement or other governing instruments. Upon request, Lessee will deliver to Lessor certified copies of its partnership agreement and other governing instruments and original certificate of partners and other instruments deemed necessary or desirable by Lessor. To the extent required by applicable law, Lessee has filed and published its fictitious business name certificate;

e. No action, including any permits or consents, in respect of or by any state, federal or other governmental authority or agency is required with respect to the execution, delivery and performance by Lessee of any Lease, and;

f. There are no actions, suits or proceedings pending or, to the knowledge of the Lessee, threatened against or affecting the Lessee in any court or before any governmental commission, board or authority which, if adversely determined, will have a material adverse effect on the ability of the Lessee to perform its obligations under any Lease.

SECTION 14. RISK OF LOSS ON LESSEE:

SECTION 16. INDEMNIFICATION:

Lessee shall indemnify and hold Lessor harmless from and against any and all claims, (including without limitation negligence, tort and strict liability), damages, judgments, suits and legal proceedings, and any and all costs and expenses in connection therewith (including attorney fees incurred by Lessor either in enforcing this indemnity or in defending against such claims), arising out of or in any manner connected with or resulting from the Lease or the Property, including, without limitation the manufacture, purchase, financing, ownership, rejection, non-delivery, transportation, delivery, possession, use, operation, maintenance, condition, lease, return, storage or disposition thereof; including without limitation (i) claims for injury to or death of persons and for damage to property; (ii) claims relating to latent or other defects in the Property whether or not discoverable by Lessor; (iii) claims relating to patent, copyright, or trademark infringement; and (iv) claims for wrongful, negligent or improper act or misuse by Lessor. Lessee agrees to give Lessor prompt notice of any such claim or liability. For purposes of this paragraph and any Lease, the term "Lessor" shall include Lessor, its successors and assigns, shareholders, members, owners, partners, directors, officers, representatives and agents, and the provisions of this paragraph shall survive expiration of any Lease with respect to events occurring prior thereto.

Upon request of Lessor, Lessee shall assume the defense of all demands, claims, or actions, suits and all proceedings against Lessor for which indemnity is provided and shall allow Lessor to participate in the defense thereof. Lessor shall be subrogated to all rights of Lessee for any matter which Lessor has assumed obligation hereunder, and may settle any such demand, claim, or action without Lessee's prior consent, and without prejudice to Lessor's right to indemnification hereunder.

SECTION 17. INSURANCE:

Lessee shall obtain and maintain for the entire time the Lease is in effect, at its own expense (as primary insurance for Lessor and Lessee), property damage and liability insurance and insurance against loss or damage to the Property including without limitation loss by fire (Including so-called extended coverage), theft, collision and such other risks of loss as are customarily insured against on the type of Property leased under any lease and by businesses in which Lessee is engaged, in such amounts, in such form and with such insurers as shall be satisfactory to Lessor, provided, however, that the amount of insurance against loss or damage to the Property shall be equal to or greater than the full replacement value or the Stipulated Loss Value (as defined herein) of such items of Property. Stipulated Loss Value means the product of the Property cost (as designated on the related Schedule) and the applicable percentage factor set forth on the Stipulated Loss Schedule attached to the Schedule ("Stipulated Loss Value"). Each

From the earlier of the date the supplier ships the Property to Lessee or the date Lessor confirms Lessee's purchase order or contract to supplier until the date the Property is returned to Lessor as provided in the Lease, Lessee hereby assumes and shall bear all risk of loss for theft, damage, non-delivery or destruction to the Property (hereafter, such loss, damage, non-delivery or destruction to the Property shall be referred to as the "Casualty"), howsoever caused. NO SUCH CASUALTY SHALL IMPAIR ANY OBLIGATION OF LESSEE UNDER THIS LEASE WHICH OBLIGATION, INCLUDING TIMELY RENTAL PAYMENTS, SHALL CONTINUE IN FULL FORCE AND EFFECT.

SECTION 15. LESSEE'S WAIVERS:

To the extent permitted by applicable law, Lessee hereby waives any and all rights and remedies conferred upon a Lessee by §§ 70A-2A-508 through 70A-2A-522 of the Utah Uniform Commercial Code, including but not limited to Lessee's rights to: (i) cancel the Lease; (ii) repudiate the Lease; (iii) reject the Property; (iv) revoke acceptance of the Property; (v) recover damages from Lessor for any breaches of warranty or for any other reason; (vi) claim, grant or permit a security interest in the Property In Lessee's possession or control for any reason; (vii) deduct all or any part of any claimed damages resulting from Lessor's default. If any, under the Lease; (viii) cover by making any purchase or lease of or contract to purchase or lease property in substitution for the Property due from Lessor; (ix) recover any general, special, incidental or consequential damages, for any reason whatsoever; and (x) commence legal action against Lessor for specific performance, replevin, detinue, sequestration, claim and delivery or the like for any Property identified in the Lease. To the extent permitted by applicable law, Lessee also hereby waives any rights now or hereafter conferred by statute or otherwise which may require Lessor to sell, lease or otherwise use any Property in mitigation of Lessors Damages as set forth in Section 19 hereof or which may otherwise limit or modify any of Lessor's rights or remedies in that section.

insurance policy will name Lessee as insured and Lessor and Its assignees as additional insureds and loss payees thereof, shall contain cross-liability endorsements and shall contain a clause requiring the insurer to give Lessor and its assignees at least thirty (30) days prior written notice of any material alteration in the terms of such policy or of the cancellation thereof. Lessee shall furnish to Lessor a certificate of insurance or other evidence satisfactory to Lessor that such insurance coverage is in effect; provided, however, that Lessor shall be under no duty either to ascertain the existence of or to examine such insurance policy or to advise Lessee in the event such insurance coverage shall not comply with the requirements hereof. All Insurance covering loss or damage to the Property shall contain a breach of warranty clause satisfactory to Lessor.

In the event of a Casualty to the Property (or any part thereof) and irrespective of payment from any insurance coverage maintained by Lessee, but applying full credit thereof, Lessee shall at the option of Lessor, (i) place the Property in good repair, condition and working order; or (ii) replace the Property (or any part thereof) with like property of equal or greater value, in good repair, condition and working order and transfer clear title to such replacement property to Lessor whereupon such replacement property shall be deemed the Property for all purposes under the Lease; or (iii) pay to Lessor the total rent due and owing at the time of such payment plus an amount calculated by Lessor which is equal to the Stipulated Loss Value (defined in the Stipulated Loss Schedule) specified in the Stipulated Loss Schedule attached to the Schedule.

Lessee shall notify Lessor within ten (10) days of the actual date of the Casualty; Lessor will notify Lessee of its election of either option (i), (ii), or (iii), as set forth above, within five (5) days of receipt of Lessee's notice. Lessee will then fully perform the repair, replacement or payment (as elected by Lessor) within sixty (60) days of the date of the Casualty.

SECTION 18. DEFAULT:

An "Event of Default" shall occur under any Lease if

- a. Lessee fails to pay any Monthly Rental or other payment required under the Lease when the same becomes due and payable and such failure continues for ten (10) days after its due date;
- b. Lessee fails to promptly execute or otherwise authenticate and deliver to Lessor or its assigns any document or record, as applicable, required under the terms of this Master Lease Agreement;
- c. Lessee attempts to or does, remove, sell, assign, transfer, encumber, sublet or part with possession of any one or more items of the Property or any interest under any Lease, except as expressly permitted herein, or permits a judgment or other claim to become a lien upon any or all of Lessee's assets or upon the Property;
- d. Lessee permits any item of Property to become subject to any levy, seizure, attachment, assignment or execution; or Lessee abandons any item of Property;
- e. Lessee fails to immediately (within ten (10) days) notify Lessor of any loss, damage, or destruction to the Property or fails to timely repair, replace, or make payment as required in Sections 7 and 17, herein;
- f. Lessee or any guarantor, shall (i) be adjudicated insolvent or bankrupt, or cease, be unable, or admit its inability, to pay its debts as they mature, or make a general assignment for the benefit of creditors or enter into any composition or arrangement with creditors; (ii) apply for or consent to the appointment of a receiver, trustee or liquidator of it or of a substantial part of its property, or authorize such application or consent, or proceedings seeking such appointment shall be instituted against it without such authorization, consent or application and shall continue undismissed for a period of sixty (60) days; (iii) authorize or file a voluntary petition in bankruptcy or apply for or consent to the application of any bankruptcy, reorganization in bankruptcy, arrangement, readjustment of debt, insolvency, dissolution, moratorium or other similar law of any jurisdiction, or authorize such application or consent or proceedings to such end shall be instituted against it without such authorization, application or consent

Lessee or any guarantor, shall suffer a material adverse change in its financial condition after the date hereof as determined by Lessor in its sole discretion, or there shall occur a substantial change in ownership of the outstanding stock of Lessee or a substantial change in control of its board of directors and/or members;

- k. Lessor in good faith believes the Property to be in danger of misuse, abuse or confiscation or to be in any other way threatened, or believes in good faith for any other reason that the prospect of payment or performance has become impaired, or if Lessee takes any action, makes any representation, or fails to do anything requested by Lessor, at any time before or after the execution of this Master Lease Agreement, the result of which causes Lessor, in good faith, to believe that the prospect of Lessee's payment or performance under the Lease is impaired, or otherwise causes Lessor to feel insecure in funding or continuing to fund the Lease or any Schedule;
- l. Lessee shall have terminated or changed its corporate existence, consolidated with, merged into, or conveyed or leased substantially all of its assets to any person or entity, unless: (i) such person or entity executes and delivers to Lessor an agreement satisfactory in form and substance to Lessor, in its sole discretion, containing such person's or entity's effective assumption, and its agreement to pay, perform, comply with and otherwise be liable for, in a due and punctual manner, all of Lessee's obligations having previously arisen, or then or thereafter arising, under the Lease, together with any and all documents, agreements, instruments, certificates, opinions and filings requested by Lessor; (ii) Lessor is satisfied as to the creditworthiness of such person's or entity's conformance to other standard criteria then used by Lessor for such purposes; and (iii) Lessee has provided no less than thirty (30) days prior written notice of such occurrence to Lessor or its assigns;
- m. Lessee breaches any License, maintenance or other agreement for Software or fails to pay when due all servicing fees, maintenance fees, update and upgrade costs, modification costs, and all other costs and expenses relating to the License and Software and fails to maintain the License in effect during the term of the Lease.

SECTION 19. REMEDIES:

Upon the occurrence of any Event of Default and at any time thereafter, Lessor may with or without giving notice to Lessee and with or without canceling the Lease, do any one or more of the following

- a. enforce this Master Lease Agreement according to its terms;

- and such proceeding instituted against it shall continue b. require additional collateral to secure the Lease;
undismissed for a period of sixty (60) days;
- g. Lessee is in default under any Lease or agreement executed with Lessor; or Lessee fails to sign or otherwise authenticate and deliver to Lessor any document or record requested by Lessor in connection with any Lease executed with Lessor; or Lessee fails to do anything whatsoever determined by Lessor to be necessary or desirable to effectuate the transaction contemplated by any Lease executed with Lessor, or Lessee fails to protect Lessor's rights and interests in any Lease and the Property; or Lessee fails to provide financial statements to Lessor as provided in Section 20k hereof; or Lessee is in default of any obligation or any agreement with any person or entity other than Lessor which obligation or agreement arises independently of any Lease;
- g. upon notice to Lessee, cancel this Master Lease Agreement and any or all Schedules executed pursuant thereto;
- d. advance funds on Lessee's behalf to cure the Event of Default, whereupon Lessee shall immediately reimburse Lessor therefore, together with late charges accrued thereon;
- e. upon notice to Lessee, refuse to fund any Schedule(s) pursuant to the Lease;
- f. declare any Lease or Leases immediately due and payable;
- g. refuse to deliver the Property to Lessee;
- h. Lessee or any guarantor, breaches any of its representations and warranties made under any Lease, or if any such representations or warranties shall be false or misleading in any material respect;
- h. declare immediately due and payable all amounts due or to become due hereunder for the full term of the Lease (including any renewal period or purchase options which Lessee has contracted to pay);
- i. Lessee or any guarantor, fails to observe or perform any of its covenants and obligations required to be observed or performed under the Lease and such failure continues uncured for ten (10) days after occurrence thereof, except that the ten (10) day cure period shall not apply and an Event of Default shall occur immediately upon Lessee's failure to maintain insurance;
- i. in its sole discretion, sell, re-lease or otherwise dispose of any or all of the Property covered under any Schedule, whether or not in Lessor's possession, in a commercially reasonable manner at public or private sale with notice to Lessee (the parties agreeing that ten (10) days' prior written notice shall constitute adequate notice of such sale), and apply the net proceeds of any such disposition, after deducting all costs incurred by Lessor in connection with such default, to the obligations of Lessee hereunder and under such Schedule, or proposed to retain any or all of the Property in full or partial satisfaction, as the case may be, with Lessee remaining liable for any deficiency. The sale, release, or other disposition may, at Lessor's sole option, be conducted at Lessee's premises. Lessor may at its sole discretion recover from Lessee liquidated damages for the loss of a bargain and not as a penalty an amount equal to Lessor's Damages;

- j. without notice to Lessee, repossess, disable or demand Lessee to disable the Property wherever found, with or without legal process, and for this purpose Lessor and/or its agents or assigns may enter upon any premises of or under the control or jurisdiction of Lessee or any agent of Lessee, without liability for suit, action or other proceeding by Lessee (any damages occasioned by such repossession or disablement being hereby expressly waived by Lessee) and remove or disable the Property therefrom; Lessee further agrees on demand, to assemble the Property and make it available to Lessor at a place to be designated by Lessor;
- k. exercise any other right or remedy which may be available to it under the Uniform Commercial Code or any other applicable law;
- l. if Lessee breaches any of its obligations under Section 7e of this Master Lease Agreement with regard to Software, Lessee shall be liable to Lessor for additional damages in an amount equal to the original price paid by Lessor for the Software, and in addition, at Lessor's option, Lessor shall be entitled to injunctive relief;
- m. if Lessor determines, in its sole discretion, not to take possession of the Property. Lessor shall continue to be the owner of the Property and may, but is not obligated to, dispose of the Property by sale or otherwise, all of which determinations may be made by Lessor in its sole discretion and for its own account;
- n. a cancellation hereunder shall occur only upon notice by Lessor and only as to such items of Property as Lessor specifically elects to cancel and this Lease shall continue in full force and effect as to the remaining items, if any;
- o. with or without terminating the Lease, and without waiving its right herein to repossess, recover, or sell the Property, recover the Stipulated Loss Value of the Property together with all accrued but unpaid late charges, interest, taxes, penalties, and any and all other sums due ending under the Schedule as of the rent payment date immediately preceding the date of default;
- p. With respect to any exercise by Lessor of its right to recover and/or dispose of any Property securing Lessee's obligations under any Schedule, Lessee acknowledges and agrees as follows: (i) Lessor shall have no obligation, subject to the requirements of commercial reasonableness, to clean-up or otherwise prepare the Property for disposition; (ii) Lessor may comply with any applicable State or Federal law requirements in connection with any disposition of the Property, and any actions taken in connection therewith shall not be deemed to have adversely affected the commercial reasonableness of any disposition
- Lessor may exercise any and all rights and remedies available at law or in equity. Including those available under the Uniform Commercial Code. The rights and remedies afforded Lessor hereunder shall not be deemed to be exclusive, but shall be in addition to any rights or remedies provided by law. Lessor's failure promptly to enforce any right or remedy hereunder shall not operate as a waiver of such right or remedy, and Lessor's waiver of any default shall not constitute a waiver of any subsequent or other default. Lessor may accept late payments or partial payments of amounts due under the Lease and may delay enforcing any of Lessor's rights or remedies hereunder without losing or waiving any of Lessor's rights or remedies under the Lease.
- In connection with Lessor's exercise of any or all of the above-listed remedies, Lessor shall be entitled to recover all costs and expenses incurred by Lessor in the repossession, recovery, storage, repair, sale, re-lease or other disposition of the Property, or the termination or disabling of Software, including without limitation, reasonable attorney fees and costs incurred in connection therewith or otherwise resulting or arising from Lessee's default, and any indemnity if then determinable, plus interest on all of the above until paid (before and after judgment) at the lesser of the rate of eighteen percent (18%) per annum or the highest rate permitted by law.
- SECTION 20. ADDITIONAL PROVISIONS:**
- a. Security interest. The parties acknowledge and agree that this is a "true lease" and title to the leased Property (or Lessee's interest in the Property if the Property is Software) is vested in the Lessor. In the event a court of competent jurisdiction or other governing authority shall determine that the Lease is not a "true lease" or is a lease intended as security or that Lessor (or its assigns) does not hold legal title to or is not the owner of the Property, the following shall apply:
- I Effective the execution date of the Lease, Lessee, as debtor, grants a security interest to Lessor, as secured party, in the Property (or Lessee's interest in the Property if the Property is Software), including but not limited to equipment and other personal property, general intangibles, Software and Lessee's license rights and other rights to use the Software, and accessions thereto, and any refunds, rebates, remittances, and all rights and services related thereto, and proceeds of any of the foregoing, to secure all duties and obligations of Lessee under any Lease or other agreement with Lessor. The Lease shall be deemed to be a security agreement with Lessee having granted to Lessor a security interest in the Property, and the Property shall secure all duties and obligations of Lessee under any Lease or other agreement with Lessor. With regard to any security interest created

of such Property; (iii) Lessor may specifically disclaim any warranties of title or the like with respect to the disposition of the Property; (iv) if Lessor purchases any of the Property, Lessor may pay for the same by crediting some or all of Lessee's obligations hereunder or under any Schedule; and (v) no right or remedy referred to in this Section is intended to be exclusive, but each shall be cumulative and shall be in addition to any other remedy referred to above or otherwise available at law or in equity, and may be exercised concurrently or separately from time to time;

- q. (i) by notice to Lessee, declare any license agreement with respect to Software terminated, in which event the right and license of Lessee to use the Software shall immediately terminate, and Lessee shall thereupon cease all use of the Software and return all copies thereof to Lessor or original licensor; (ii) have access to and disable, or demand Lessee to disable the Software by any means deemed necessary by Lessor, including but not limited to disabling the computers, computer systems or other equipment which run and/or operate and/or are controlled by the Software, for which purposes Lessee hereby expressly consents to such access and disablement, promises to take no action that would prevent or interfere with Lessor's ability to perform such access and disablement, and waives and releases any and all claims that it has or might otherwise have for any and all losses, damages, expenses, or other detriment that it might suffer as a result of such access and disablement; and (iii) Lessee agrees that the detriment which Lessor will suffer as a result of a breach by Lessee of the obligations contained in the Lease cannot be adequately compensated by monetary damages, and therefore Lessor shall be entitled to injunctive and other equitable relief to enforce the provisions of this Section 19q. LESSEE AGREES THAT LESSOR SHALL HAVE NO DUTY TO MITIGATE LESSOR'S DAMAGES UNDER ANY LEASE BY TAKING LEGAL ACTION TO RECOVER THE SOFTWARE FROM LESSEE OR ANY THIRD PARTY, OR TO DISPOSE OF THE SOFTWARE BY SALE, RE-LEASE OR OTHERWISE.

hereunder in any of the Property, Lessee consents and agrees that Lessor shall have all of the rights, privileges and remedies of a secured party under the Utah Uniform Commercial Code and all the rights of a lien holder on a titled vehicle under Utah state law.

- II Lessee authorizes Lessor to file financing statements and any records describing the Property and to take any and all actions necessary to perfect Lessor's interest in the Property. Lessee agrees to execute any further documents, and to take any further actions, reasonably requested by Lessor to evidence or perfect the security interest granted under this subpart of the Lease, to maintain the first priority of the security interests, or to effectuate the rights granted to Lessor under this subpart of Lease.

- b. Entire Agreement. Each Schedule shall incorporate the terms and conditions of this Master Lease Agreement and, together with the Acceptance and Delivery Certificate and Master Progress Payment Agreement (and Certificates thereunder), if applicable, and any amendments to any of the foregoing documents, shall supersede all prior communications, representations, agreements, and understandings, including but not limited to offer letters, proposal letters, comfort letters, commitment letters and the like, and constitute the entire understanding and agreement between the Lessor and Lessee with regard to the subject matter hereof and thereof, and there is no understanding or agreement, oral or written, which is not set forth herein or therein. In the event of conflict between the provisions of this Master Lease Agreement and any Schedule, the provisions of the Schedule shall govern.
- c. Time is of the Essence. Time is of the essence with respect to any Lease.
- d. Captions. Captions and section headings are inserted for reference and convenience only and in no way define, limit or describe the scope of this agreement or intent of any provision.
- e. Governing Law. THIS LEASE (AS DEFINED IN SECTION 22 HEREIN) SHALL IN ALL RESPECTS BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF UTAH, INCLUDING ALL MATTERS OF CONSTRUCTION, VALIDITY AND PERFORMANCE. THE PARTIES AGREE TO SUBMIT TO THE EXCLUSIVE JURISDICTION OF THE STATE OF UTAH; ANY SUIT OR OTHER PROCEEDING BROUGHT BY EITHER PARTY TO ENFORCE OR CONSTRUE THIS LEASE (AS DEFINED IN SECTION 22 HEREIN), OR TO DETERMINE MATTERS RELATING TO THE PROPERTY OR THE RELATIONSHIP BETWEEN THE PARTIES HERETO SHALL BE BROUGHT ONLY IN THE STATE OR FEDERAL COURTS IN THE STATE OF UTAH. THIS LEASE WAS EXECUTED IN THE STATE OF UTAH (BY THE LESSOR HAVING COUNTERSIGNED IT IN UTAH) AND IS TO BE PERFORMED IN THE STATE OF UTAH (BY REASON OF ONE OR MORE PAYMENTS REQUIRED TO BE MADE TO LESSOR IN UTAH).
- f. Waiver of Trial by Jury. Lessor and Lessee hereby waive the right to trial by jury of any matters arising out of the Lease or Property or the conduct of the relationship between Lessor and Lessee.
- g. Severability. Should any term or provision of this Agreement be declared invalid, illegal, void or unenforceable, all remaining terms and provisions hereof will remain in full force and effect and will in no way be invalidated or affected thereby.
- l. Acceptance and Delivery Certificate. If Lessee fails to sign and deliver an Acceptance and Delivery Certificate, then except as otherwise provided in Section 8c hereof, the Date of Acceptance shall be a date determined by Lessor which shall be no sooner than the date Lessee receives substantially all of the Property.
- m. Covenant of Quiet Possession. Lessor agrees that so long as no Event of Default has occurred and is continuing, Lessee shall be entitled to quietly possess the Property subject to and in accordance with the terms and conditions of this Master Lease Agreement.
- n. Lessee's Options at Maturity of Base Period. At the maturity of the Base Period of any Lease, Lessee shall, provided to Lessor \$1.00, after all payments, taxes and fees due under the lease have been paid, for the purchase of the equipment securing the Lease.
- o. Notices. Notices or demands required to be given herein shall be in writing and addressed to the other party at the address herein or such other address provided by written notice hereunder and shall be effective (i) upon the next business day if sent by guaranteed overnight express service; (ii) on the same day if personally delivered; or (iii) three days after mailing if sent by certified or registered U.S. mail, postage prepaid.
- p. Further Assurances: Financing Statements. Lessee will cooperate with Lessor in protecting Lessor's interests in the Property, the Lease and the amounts due under the Lease, including, without limitation, the execution (or other authentication), and delivery of Uniform Commercial Code statements, records and filings, patent and copyright registration documents with respect to proprietary Software (if applicable), and other documents requested by Lessor. Lessee will promptly execute, or otherwise authenticate, and deliver to Lessor such further documents, instruments, assurances and other records, and take such further action as Lessor may reasonably request in order to carry out the intent and purpose of this Lease and to establish and protect the rights and remedies created or intended to be created in favor of Lessor under this Lease. Lessee hereby authorizes Lessor to file UCC-1 financing statements, fixture filings, real property waivers, and all other filings and recordings, as may be deemed necessary by Lessor. Lessee hereby authorizes and/or ratifies the filing of any UCC-1 financing statements by Lessor before or after the execution of this Lease. Lessee shall pay all costs of filing any financing amendment, continuation and termination statements with respect to the Property and Lease, including without limitation, any intangibles tax, documentary stamp tax or other similar taxes or charges relating thereto and all costs of UCC or other lien searches and of obtaining and filing any full or partial third-party

- h. Binding Effect: Survivability. The provisions of each Lease shall inure to the benefit of and shall bind Lessor and Lessee and their respective permitted successors and assigns. All representations, warranties, covenants and indemnities of Lessee made or agreed to in the Lease or in any certificates delivered in connection therewith shall survive the expiration, termination or cancellation of the Lease for any reason.
- i. Waiver. A waiver by either Party of any term or condition of this agreement in any instance shall not be deemed or construed to be a waiver of such term or condition for the future, or any subsequent breach thereof.
- j. Limitations. No paragraph, clause or phrase of this agreement shall limit, infringe, deny, negate, refuse or render void any other paragraph, clause or phrase of this agreement.
- k. Financial Statements. Lessee, and any guarantor, shall provide to Lessor a copy of its annual audited financial statements within ninety (90) days after its fiscal year end, and a copy of its quarterly unaudited financial statements within forty-five (45) days after the end of each fiscal quarter.

releases deemed necessary or advisable by Lessor. Lessee will do whatever may be necessary or advisable to have a statement of the interest of Lessor in the Property noted on any certificate of title relating to the Property and will deposit said certificate with Lessor. Lessee will execute, or otherwise authenticate, and deliver to Lessor such other documents, records and written assurances and take such further action as Lessor may request to more fully carry out the implementation, effectuation, confirmation and perfection of the Lease and any rights of Lessor thereunder. Lessee grants to Lessor a security interest in all deposits and other property transferred or pledged to Lessor to secure the payment and performance of all of Lessee's obligations under the Lease. Lessor is authorized to take any measures necessary to protect its interest in the Property.

In the event the Property is in the possession of a third party, Lessee will join with Lessor in notifying the third party of Lessor's interest in the Property and obtaining art acknowledgment from the third party that the third party is holding the Property for the benefit of Lessor.

Lessor's Right to Perform for Lessee. If Lessee fails to perform or comply with any of its agreements contained herein, Lessor may perform or comply with such agreements and the amount of arty payments and expenses of Lessor incurred in connection with such performance or compliance (including attorney fees), together with interest thereon at the lesser of the rate of eighteen percent (18%) per annum, or the highest rate permitted by law shall be deemed additional rent payable by Lessee upon demand.

- r. Counterparts; Chattel Paper. This Lease may be executed in any number of counterparts and by different parties hereto or thereto on separate counterparts, each of which, when so executed or otherwise authenticated and delivered, shall be an original, but all such counterparts shall together consist of but one and the same instrument; provided, however, that to the extent that this Lease and/or the Schedule(s) would constitute chattel paper, as such term is defined in the Uniform Commercial Code as in effect in any applicable jurisdiction, no security interest herein or therein may be created or perfected through the transfer or possession of this Lease in and of itself without the transfer or possession or control, as applicable, of the original counterpart of such Schedule(s) identified as the document or record (as applicable) marked "Original", and all other counterparts shall be marked "Duplicate Original" or "Counterpart".
- s. Joint and Several Liability. In the event two or more parties execute this Master Lease Agreement as Lessee, each party shall be jointly and severally liable for all Lessee representations, warranties, and obligations (including without limitation, payment obligations) under this Master Lease Agreement or under any Schedule or other document executed in connection herewith. Any and all representations, agreements, or actions by one Lessee shall be binding on all other Lessees.
- t. Legal Fees and Other Costs. Lessee shall reimburse Lessor for all legal fees and additional charges, costs and expenses incurred by Lessor: (i) in review or preparation of any changes or amendments required by Lessee to Lessor's standard Lease documentation; (ii) in defending or protecting its interest in the Property; (iii) in the execution, delivery, administration, amendment and enforcement of the Lease or the collection of any rent or other payments due under the Lease, or the preparation of any amendments or settlement agreements prepared in connection with the Lease; and (iv) in any lawsuit or other legal or arbitration/mediation proceeding to which the Lease gives rise, including without limitation, actions in tort. Lessee shall pay applicable legal fees at the rate of \$250.00 per hour. Lessee shall pay a documentation fee calculated at .10% of the total cost of property with a minimum of \$250.00 and a maximum of \$3,000.00 for each Schedule.
- u. Amendment and Modification. The Lease may not be amended or modified except by a written amendment executed by a duly authorized representative of each party, but no such amendment or modification needs further consideration to be binding. Notwithstanding the foregoing, Lessee authorizes Lessor to amend any Schedule to identify more accurately the Property (including, without limitation, supplying serial numbers or other identifying data), and such amendment shall be binding on Lessor and Lessee unless Lessee objects thereto in writing within ten

SECTION 22. DEFINITIONS:

All capitalized terms not defined herein are defined in the Schedule.

a. "Acceptance and Delivery Certificate" means, any acceptance and delivery certificate, executed by the Lessee in connection with a Schedule, a Master Progress Payment Agreement, if any, and this Master Lease Agreement whereby the Lessee acknowledges that the items of Property to be leased have been delivered, received, installed, examined and tested and determined by Lessee to be satisfactory.

b. "Base Period" means, the period of any Lease referred to as such on the related Schedule under this Master Lease Agreement.

c. "Certificate" means, an Acceptance and Delivery and Approval for Progress Payment Certificate executed by the Lessee in connection with a Schedule, a Master Progress Payment Agreement and this Master Lease Agreement.

d. "Date of Acceptance" means, except as otherwise provided in Section 8c of this Master Lease Agreement, the date Lessee accepts the Property designated on any Schedule, as set forth in any Acceptance and Delivery Certificate executed by the Lessee in form provided by Lessor.

e. "Lease Commencement Date" means, as to the Property designated on any Schedule, where the Date of Acceptance for such Schedule falls on the first day of a calendar quarter, that date, and in any other case, the first day of the calendar quarter following the calendar quarter in which such Date of Acceptance falls.

f. "Lease" means, a Schedule incorporating the terms of this Master Lease Agreement, together with the related Master Progress Payment Agreement, if any, Stipulated Loss Schedule, Acceptance and Delivery Certificate, UCC financing statements and all other supporting documentation related thereto.

g. "Lessor's Damages" means, the Stipulated Loss Value together with costs, expenses, attorney's fees, interest, and any determinable indemnity owed by Lessee to Lessor.

h. "Master Progress Payment Agreement" means, an agreement under which (i) Lessee accepts items of Property by signing a Certificate, (ii) Lessor agrees to purchase said items or Property, and (iii) Lessee agrees to pay service charges, all prior to the Date of Acceptance of the Schedule.

i. "Monthly Rental" means, the monthly rental, together with sales tax and other amounts, if applicable, referred to as

(10) days after receiving notice of the amendment from Lessor.

- v. Unauthorized Distribution of lease Documents Prohibited. Lessee agrees that it will not, through any of its actions or omissions, cause any document or any portion of any document, associated with any Lease to be delivered, distributed, or otherwise fall into the possession of anyone not employed by Lessee on a full time basis, without the written consent of Lessor. Lessee further acknowledges that any such unauthorized delivery or distribution could cause Lessor to suffer irreparable economic harm.
- w. Change in Lessee's Name, Address and Jurisdiction. Lessee shall not change its name, chief executive office address, or jurisdiction of organization from that set forth above, unless it shall have given Lessor or its assigns no less than thirty (30) days prior written notice.

SECTION 21. POWER OF ATTORNEY:

LESSEE HEREBY AUTHORIZES AND APPOINTS LESSOR AND LESSOR'S AGENTS AND ASSIGNS AS LESSEE'S ATTORNEY-IN-FACT TO EXECUTE ACKNOWLEDGEMENT LETTERS AND OTHER DOCUMENTS REQUIRED TO BE EXECUTED BY LESSEE TO EFFECT ANY UNDERWRITING OR PERFECT ANY SECURITY INTEREST WITH REGARD TO A SCHEDULE.

such on the related Schedule under this Master Lease Agreement.

j. "Property" means, equipment and other property, together with all related software whether embedded therein or otherwise, with all attachments, replacements, parts, substitutions, additions, repairs, accessions and accessories, incorporated therein and/or affixed thereto described in any Lease Schedule to be executed and delivered by Lessor and Lessee in connection with this Master Lease Agreement.

k. "Schedule" means, any Lease Schedule to be executed and delivered by Lessor and Lessee under this Master Lease Agreement, which Schedule states the terms and other information associated with the Schedule and describes the leased Property.

l. "Software" means, any computer program and supporting data, including all documentation, later versions, updates, upgrades and modifications, provided and/or described in any Lease Schedule to be executed and delivered by Lessor and Lessee in connection with this Master Lease Agreement.

m. "Stipulated Loss Schedule" means, Schedule of Stipulated Loss Values relating to a specific Schedule under this Master Lease Agreement.

IN WITNESS WHEREOF, Lessor and Lessee have executed this Master Lease Agreement on the month, day and year first above written.

LESSOR:

PARADIGM COMMERCIAL CAPITAL GROUP CORP

BY: /s/ Thomas Karren

TITLE: Operations Manager

LESSEE:

COATES INTERNATIONAL LTD.

BY: /s/ George J. Coates

TITLE: President and Chief Executive Officer



**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002**

I, George J. Coates, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Coates International, Ltd. (the “registrant”):
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures; and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has

materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

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

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

Date: November 14, 2013

/s/ George J. Coates

George J. Coates
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

**CERTIFICATION OF PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002**

I, Barry C. Kaye, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Coates International, Ltd. (the "registrant"):

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

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

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

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

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

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

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

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

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

Date: November 14, 2013

/s/ Barry C. Kaye

Barry C. Kaye
Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit 32.1

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

In connection with the Quarterly Report of Coates International, Ltd. (the "Company") on Form 10-Q for the period ended September 30, 2013 (the "Report"), I, George J. Coates, Chief Executive Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Date: November 14, 2013

/s/ George J. Coates

George J. Coates
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 32.2

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

In connection with the Quarterly Report of Coates International, Ltd. (the "Company") on Form 10-Q for the period ended September 30, 2013 (the "Report"), I, Barry C. Kaye, Chief Financial Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Date: November 14, 2013

/s/ Barry C. Kaye

Barry C. Kaye
Treasurer and Chief Financial Officer
(Principal Accounting Officer)
