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

FORM 8-K

CURRENT REPORT

**Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934**

**Date of Report: July 10, 2012
(Date of earliest event reported)**

ENTEROMEDICS INC.

(Exact name of registrant as specified in its charter)

Commission File Number: 1-33818

Delaware
**(State or other jurisdiction
of incorporation)**

48-1293684
**(IRS Employer
Identification No.)**

2800 Patton Road, St. Paul, Minnesota 55113
(Address of principal executive offices, including zip code)

(651) 634-3003
(Registrant's telephone number, including area code)

Not Applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
 - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
 - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
 - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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Item 5.02. Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.

(e) On July 10, 2012, the Compensation Committee of the Board of Directors (the “Committee”) and the Board of Directors of EnteroMedics Inc. (the “Company”) approved an amendment to the 2003 Stock Incentive Plan (the “Plan”) to increase the number of shares authorized under the Plan by 8,000,000 shares (the “Amendment”), subject to stockholder approval at the next special or annual meeting of the stockholders of the Company.

On July 10, 2012, the Committee and the Board of Directors of the Company also approved the grant of non-incentive stock options to senior management. Pursuant to these grants, the Company’s named executive officers received non-incentive stock options to purchase the following number of shares: Mark Knudson, Ph.D., 1,292,225 shares; Greg Lea, 863,156 shares; Katherine Tweden, 291,638 shares and Adrianus (Jos) Donders, 355,063 shares. These options have an exercise price of \$3.35 per share, the closing price of the Company’s common stock on the NASDAQ Capital Market on July 10, 2012, and vest in increments of 1/48th per month beginning on July 10, 2012. Because these options were granted using shares authorized by the Amendment, they are subject to stockholder approval of the Amendment and may not be exercised unless and until such approval is obtained. These options also provide that the Company will make an excise tax only “gross-up” payment to the optionee in the event that payments made to the optionee in connection with a change in control of the Company are subject to the excise tax imposed by Section 4999 of the Internal Revenue Code.

On July 10, 2012, the Committee and the Board of Directors of the Company approved a new form of non-incentive stock option agreement pursuant to the Plan to be used for these options. A copy of the Form of 2012 Senior Management Non-Incentive Stock Option Agreement is attached as Exhibit 10.1 to this Current Report on Form 8-K and is incorporated herein by reference.

Item 9.01 Financial Statements and Exhibits.

(d) Exhibits

<u>Exhibit No.</u>	<u>Description</u>
10.1	Form of 2012 Senior Management Non-Incentive Stock Option Agreement pursuant to the 2003 Stock Incentive Plan

SIGNATURE

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 hereunto duly authorized.

ENTEROMEDICS INC.

By: /s/ Greg S. Lea

Greg S. Lea
Senior Vice President and
Chief Financial Officer

Date: July 13, 2012

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
10.1	Form of 2012 Senior Management Non-Incentive Stock Option Agreement pursuant to the 2003 Stock Incentive Plan

Grant ID XXXXX

**ENTEROMEDICS INC.
2012 SENIOR MANAGEMENT
NON-INCENTIVE STOCK OPTION AGREEMENT**

THIS AGREEMENT, made as of this day of , , by and between EnteroMedics Inc., a Delaware corporation (the "Company"), and ("Optionee").

WHEREAS, the Company, pursuant to the Amended and Restated EnteroMedics Inc. 2003 Stock Incentive Plan (the "Plan"), wishes to grant this stock option to Optionee;

NOW, THEREFORE, in consideration of the premises and of the mutual covenants herein contained, the parties hereto hereby agree as follows:

1. Grant of Option. The Company hereby grants to Optionee the right and option ("the Option") to purchase all or any part of an aggregate of shares (the "Shares") of the common stock, par value \$0.01 per share (the "Common Stock"), of the Company at the price of \$ per Share on the terms and conditions set forth herein. The Option is not intended to qualify as an incentive stock option within the meaning of Section 422A of the Internal Revenue Code of 1986, as amended (the "Code").

The Option is subject to the stockholders of the Company approving an amendment to the Plan to increase the number of shares authorized under the Plan by 8,000,000 from 4,300,000 to 12,300,000 (the "Amendment") at the next annual or special meeting of the stockholders of the Company. Notwithstanding any other provisions of this Agreement, in the event that the Amendment is not approved by the stockholders at such meeting, the Option will terminate effective as of the date of such meeting.

2. Duration and Exercisability. The Option may not be exercised by Optionee except as set forth herein, and the Option shall in all events terminate ten years from the date hereof. Subject to the other terms and conditions set forth herein, the Option shall vest as follows:

<u>On or after each of the following dates</u>	<u>Shares as to which the Option is vested</u>
XXXXX, XXXX	_____
Each subsequent month for months	_____
th subsequent month	_____

Although the Option shall vest as described above, the Option may not be exercised by Optionee unless and until the Company obtains stockholder approval of the Amendment. The Option will become exercisable with respect to any vested Shares immediately upon receipt of stockholder approval of the Amendment and will be exercisable thereafter as set forth herein. In the event that Optionee's relationship with the Company or its subsidiaries terminates prior to the receipt of stockholder approval of the Amendment, and stockholder approval of the Amendment is subsequently obtained, Optionee's right to exercise the Option shall not terminate earlier than thirty (30) days after the date on which stockholder approval of the Amendment is obtained.

During the lifetime of Optionee, the Option shall be exercisable only by Optionee. The Option shall not be assignable or transferable by Optionee, other than by will or the laws of descent and distribution. The vesting of the Option is subject to acceleration under the circumstances described in Section 4.

3. Effect of Termination of Relationship with the Company.

(a) In the event that Optionee's relationship with the Company or its subsidiaries shall terminate, for any reason other than Optionee's gross and willful misconduct or Optionee's death or disability, Optionee shall have the right to exercise the Option at any time within five years after such termination to the extent of the full number of Shares Optionee was entitled to purchase under the Option on the date of termination, subject to the condition that the Option shall not be exercisable after the expiration of its term.

(b) In the event that Optionee's relationship with the Company or its subsidiaries shall terminate by reason of Optionee's gross and willful misconduct during the course of his/her relationship with the Company (as reasonably determined by the Company), the Option shall terminate as of the date of the misconduct and shall not be exercisable thereafter.

(c) If Optionee shall die during its relationship with the Company or its subsidiaries, or within three months after termination of such relationship with the Company for any reason other than gross and willful misconduct, or if Optionee's relationship with the Company or its subsidiaries is terminated because the Optionee has become disabled within the meaning of Section 22(e)(3) of the Code, and Optionee shall not have fully exercised the Option, the Option may be exercised at any time within twelve months after the date of Optionee's death or termination of Optionee's relationship because of disability by the legal representative or, if applicable, guardian of Optionee or by any person to whom the Option is transferred by will or the applicable laws of descent and distribution to the extent of the full number of Shares Optionee was entitled to purchase under the Option on the date of death (or termination of Optionee's relationship with the Company, if earlier) or termination of Optionee's relationship because of disability and subject to the condition that the Option shall not be exercisable after the expiration of its term.

4. Change in Control.

(a) In the event that a "Change in Control" (as hereinafter defined) occurs, (i) all outstanding Options shall be subject to the agreement pursuant to which such Change in Control is consummated and (ii) the vesting schedule of the Options held by Optionee shall accelerate such that on the date the Change in Control is completed, 50% of any then-unvested shares subject to the Options held by Optionee shall immediately vest, irrespective of which of the provisions described in clauses (i) through (v) below are set forth in the agreement pursuant to which such Change in Control is consummated (except in the case of clause (iv), in which case 100% of the Options would become vested). Such agreement shall provide for one or more of the following:

(i) The continuation of such outstanding Options by the Company (if the Company is the surviving corporation).

(ii) The assumption of such outstanding Options by the surviving corporation or its parent in a manner that complies with Section 424(a) of the Code (whether or not such Options are ISOs).

(iii) The substitution by the surviving corporation or its parent of new options for such outstanding Options in a manner that complies with Section 424(a) of the Code (whether or not such Options are ISOs).

(iv) Full exercisability of such outstanding Options and full vesting of the Shares subject to such Options, followed by the cancellation of such Options. The full exercisability of such Options and full vesting of the Shares subject to such Options may be contingent on the closing of such Change in Control. The Optionees shall be able to exercise such Options during a period of not less than five full business days preceding the closing date of such Change in Control, unless (A) a shorter period is required to permit a timely closing of such Change in Control and (B) such shorter period still offers the Optionee a reasonable opportunity to exercise such Options. Any exercise of such Options during such period may be contingent on the closing of such Change in Control.

(v) The cancellation of such outstanding Options and a payment to the Optionee equal to the excess of (A) the Fair Market Value (as defined in the Plan) of the Shares subject to such Options (whether or not such Options are then exercisable or such Shares are then vested) as of the closing date of such Change in Control over (B) their aggregate exercise price. Such payment shall be made in the form of cash, cash equivalents, or securities of the surviving corporation or its parent with a Fair Market Value equal to the required amount. Such payment may be made in installments and may be deferred until the date or dates when such Options would have become exercisable or such Shares would have vested. Such payment may be subject to vesting based on the Optionee's continuing service to the Company or its affiliates, provided that the vesting schedule shall not be less favorable to the Optionee than the schedule under which such Options would have become exercisable or such Shares would have vested. If the aggregate exercise price of the Shares subject to such Options exceeds the Fair Market Value of such Shares by greater than ten percent (10%) of the Fair Market Value of such Shares, then such Options may be cancelled without making a payment to the Optionee. For purposes of this Section 4(a)(v), the Fair Market Value of any security shall be determined without regard to any vesting conditions that may apply to such security.

(b) A "Change in Control" of the Company shall be deemed to have occurred if:

(i) Any "person" (as such term is used in Sections 13(d) and 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) who did not own shares of the capital stock of the Company on the date of grant of the Option shall, together with his, her or its "Affiliates" and "Associates" (as such terms are defined in Rule 12b-2 promulgated under the Exchange Act), become the "Beneficial Owner" (as such term is defined in Rule 13d-3 promulgated under the Exchange Act), directly or indirectly, of securities of the Company representing 50% or more of the combined voting power of the Company's then outstanding securities (any such person being hereinafter referred to as an "Acquiring Person");

(ii) The "Continuing Directors" (as hereinafter defined) shall cease to constitute a majority of the Company's Board of Directors;

(iii) There should occur (A) any consolidation or merger involving the Company and the Company shall not be the continuing or surviving corporation or the shares of the Company's capital stock shall be converted into cash, securities or other property; provided, however, that this subclause (A) shall not apply to a merger or consolidation in which (i) the Company is the surviving corporation and (ii) the stockholders of the Company immediately prior to the transaction have the same proportionate ownership of the capital stock of the surviving corporation immediately after the transaction; (B) any sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all or substantially all of the assets of the Company; or (C) any liquidation or dissolution of the Company; or

(iv) The majority of the Continuing Directors determine, in their sole and absolute discretion, that there has been a Change in Control.

(c) "Continuing Director" shall mean any person who is a member of the Board of Directors of the Company, while such person is a member of the Board of Directors, who is not an Acquiring Person, an Affiliate or Associate of an Acquiring Person or a representative of an Acquiring Person or of any such Affiliate or Associate and who (i) was a member of the Company's Board of Directors on the date of grant of the Option or (ii) subsequently became a member of the Board of Directors, upon the nomination or recommendation, or with the approval of, a majority of the Continuing Directors.

5. Manner of Exercise.

(a) The Option may only be exercised by Optionee or other proper party within the option period by delivering written notice of exercise to the Company at its principal executive office. The notice shall state the number of Shares as to which the Option is being exercised and shall be accompanied by payment in full of the option price for all of the Shares designated in the notice.

(b) Optionee may, at the Company's election, pay the option price in cash, by check (bank check, certified check or personal check) or by any other means approved by the Committee (as such term is defined in the Plan) in its discretion, or in accordance with the terms set forth in the Plan.

(c) The exercise of the Option is contingent upon receipt from Optionee (or other proper person exercising the Option) of a representation that, at the time of such exercise, it is Optionee's intention to acquire the Shares being purchased for investment and not with a view to the distribution or sale thereof within the meaning of the Securities Act of 1933, as amended (the "Securities Act"); provided, however, that the receipt of such representation shall not be required upon exercise of the Option if, at the time of such exercise, the issuance of the Shares subject to the Option shall have been properly registered under the Securities Act and all applicable state securities laws. Such representation shall be in writing and in such form as the Company may reasonably request. The certificate representing the Shares so issued for investment shall be imprinted with an appropriate legend setting forth all applicable restrictions on their transferability.

6. Right of First Refusal.

(a) **Right of First Refusal.** In the event that the Optionee proposes to sell, pledge or otherwise transfer to a third party any Shares acquired under this Agreement, or any interest in such Shares, the Company shall have the Right of First Refusal with respect to all (and not less than all) of such Shares. If

the Optionee desires to transfer Shares acquired under this Agreement, the Optionee shall give a written transfer notice (a "Transfer Notice") to the Company describing fully the proposed transfer, including the number of Shares proposed to be transferred, the proposed transfer price, the name and address of the proposed transferee (the "Transferee") and proof satisfactory to the Company that the proposed sale or transfer will not violate any applicable federal or state securities laws. The Transfer Notice shall be signed both by the Optionee and by the proposed Transferee and must constitute a binding commitment of both parties to the transfer of the Shares. The Company shall have the right to purchase all, and not less than all, of the Shares on the terms of the proposal described in the Transfer Notice (subject, however, to any change in such terms permitted under Subsection (b) below) by delivery of a notice of exercise of the Right of First Refusal within 30 days after the date when the Transfer Notice was received by the Company.

(b) **Transfer of Shares.** If the Company fails to exercise its Right of First Refusal within 30 days after the date when it received the Transfer Notice, the Optionee may, not later than 90 days following receipt of the Transfer Notice by the Company, conclude a transfer of the Shares subject to the Transfer Notice on the terms and conditions described in the Transfer Notice, provided that any such sale is made in compliance with applicable federal and state securities laws and not in violation of any other contractual restrictions to which the Optionee is bound. Any proposed transfer on terms and conditions different from those described in the Transfer Notice, as well as any subsequent proposed transfer by the Optionee, shall again be subject to the Right of First Refusal and shall require compliance with the procedure described in Subsection (a) above. If the Company exercises its Right of First Refusal, the parties shall consummate the sale of the Shares on the terms set forth in the Transfer Notice within 60 days after the date when the Company received the Transfer Notice (or within such longer period as may have been specified in the Transfer Notice); provided, however, that in the event the Transfer Notice provided that payment for the Shares was to be made in a form other than cash or cash equivalents paid at the time of transfer, the Company shall have the option of paying for the Shares with cash or cash equivalents equal to the present value of the consideration described in the Transfer Notice.

(c) **Additional or Exchanged Securities and Property.** In the event of a merger or consolidation of the Company with or into another entity, any other corporate reorganization, a stock split, the declaration of a stock dividend, the declaration of an extraordinary dividend payable in a form other than stock, a spin-off, an adjustment in conversion ratio, a recapitalization or a similar transaction affecting the Company's outstanding securities, any securities or other property (including cash or cash equivalents) that are by reason of such transaction exchanged for, or distributed with respect to, any Shares subject to this Section 6 shall immediately be subject to the Right of First Refusal. Appropriate adjustments to reflect the exchange or distribution of such securities or property shall be made to the number and/or class of the Shares subject to this Section 6.

(d) **Termination of Right of First Refusal.** Any other provision of this Section 6 notwithstanding, in the event that the Common Stock is readily tradable on an established securities market when the Optionee desires to transfer Shares, the Company shall have no Right of First Refusal, and the Optionee shall have no obligation to comply with the procedures prescribed by Subsections (a) and (b) above.

(e) **Permitted Transfers.** This Section 6 shall not apply to (i) a transfer by beneficiary designation, will or intestate succession or (ii) a transfer to one or more members of the Optionee's Immediate Family or to a trust established by the Optionee for the benefit of the Optionee and/or one or more members of the Optionee's Immediate Family, provided in either case that the Transferee agrees in writing on a form prescribed by the Company to be bound by all provisions of this Agreement. If the

Optionee transfers any Shares acquired under this Agreement, either under this Subsection (e) or after the Company has failed to exercise the Right of First Refusal, then this Agreement shall apply to the Transferee to the same extent as to the Optionee. For purposes of this Agreement, "Immediate Family" shall include the ancestors, descendants, siblings and spouse of the Optionee.

(f) **Termination of Rights as Stockholder.** If the Company makes available, at the time and place and in the amount and form provided in this Agreement, the consideration for the Shares to be purchased in accordance with this Section 6, then after such time the person from whom such Shares are to be purchased shall no longer have any rights as a holder of such Shares (other than the right to receive payment of such consideration in accordance with this Agreement). Such Shares shall be deemed to have been purchased in accordance with the applicable provisions hereof, whether or not the certificate(s) therefor have been delivered as required by this Agreement.

(g) **Assignment of Right of First Refusal.** The Board of Directors may freely assign the Company's Right of First Refusal, in whole or in part. Any person who accepts an assignment of the Right of First Refusal from the Company shall assume all of the Company's rights and obligations under this Section 6.

7. **Market Stand-Off.** In connection with any underwritten public offering by the Company of its equity securities pursuant to an effective registration statement filed under the Securities Act, including the Company's initial public offering, the Optionee or a Transferee shall not directly or indirectly sell, make any short sale of, loan, hypothecate, pledge, offer, grant or sell any option or other contract for the purchase of, purchase any option or other contract for the sale of, or otherwise dispose of or transfer, or agree to engage in any of the foregoing transactions with respect to, any Shares acquired under this Agreement without the prior written consent of the Company or its underwriters. Such restriction (the "Market Stand-Off") shall be in effect for such period of time following the date of the final prospectus for the offering as may be requested by the Company or such underwriters. In no event, however, shall such period exceed 180 days. The Market Stand-Off shall in any event terminate two years after the date of the Company's initial public offering. In the event of the declaration of a stock dividend, a spin-off, a stock split, an adjustment in conversion ratio, a recapitalization or a similar transaction affecting the Company's outstanding securities without receipt of consideration, any new, substituted or additional securities which are by reason of such transaction distributed with respect to any Shares subject to the Market Stand-Off, or into which such Shares thereby become convertible, shall immediately be subject to the Market Stand-Off. In order to enforce the Market Stand-Off, the Company may impose stop-transfer instructions with respect to the Shares acquired under this Agreement until the end of the applicable stand-off period. The Company's underwriters shall be beneficiaries of the agreement set forth in this Section 7. This Section 7 shall not apply to Shares registered in the public offering under the Securities Act, and the Optionee or a Transferee shall be subject to this Section 7 only if the directors and officers of the Company are subject to similar arrangements.

8. **Adjustments.** In the event that there is any change in the Common Stock or corporate structure of the Company as a result of any dividend or other distribution (whether in the form of cash, Common Stock, other securities or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase or exchange of Common Stock or other securities of the Company, issuance of warrants or other rights to purchase Common Stock or other securities of the Company or other similar corporate transaction or event, and all or any portion of the Option shall then be unexercised and not yet expired, then appropriate adjustments in the outstanding Option shall be made as determined by the Committee in accordance with the provisions of Section 4(c) of the Plan in order to prevent dilution or enlargement of Option rights.

9. Tax Gross-Up Payment.

(a) In the event it shall be determined that any payments, benefits or distributions by the Company, any person or entity whose actions result in a Change in Control or any person or entity affiliated with the Company or such person or entity, to or for Optionee's benefit (whether paid or payable or distributed or distributable pursuant to the terms of this Agreement, any other agreement or otherwise, but determined without regard to any payments required under this Section 9) (collectively, the "Payments") would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code (the "Code") or Optionee incurs any interest or penalties with respect to such excise tax (such excise tax, together with any such interest and penalties, are hereinafter collectively referred to as the "Excise Tax"), then Optionee shall be entitled to receive an additional payment (a "Gross-Up Payment") in an amount such that, after payment of all taxes (and any interest or penalties imposed with respect to such taxes), including any income taxes and Excise Tax imposed upon the Gross-Up Payment, Optionee retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments.

(b) Subject to the provisions of Subsection (d), below, all determinations required to be made under this Section 9, including whether and when a Gross-Up Payment is required and the amount such Gross-Up Payment and the assumptions to be utilized in arriving at such determination, shall be made by an accounting firm of national reputation selected by the Company (the "Accounting Firm"), which shall provide detailed supporting calculations both to Optionee and to the Company within fifteen (15) business days of the receipt of notice from Optionee that there has been a Payment, or such earlier time as is requested by the Company. In the event that the Accounting Firm is serving as accountant or auditor for the individual, entity or group effecting the Change in Control, the Company shall appoint another nationally recognized accounting firm to make the determinations required hereunder (which accounting firm shall then be referred to as the "Accounting Firm" hereunder). All fees and expenses of the Accounting Firm shall be borne solely by the Company. Any Gross-Up Payment, as determined pursuant to this Section 9, shall be paid by the Company on Optionee's behalf within five days of the receipt of the Accounting Firm's determination. If the Accounting Firm determines that no Excise Tax is payable, it shall furnish evidence of its determination that failure to report the Excise Tax on Optionee's applicable federal income tax return would not result in the imposition of a penalty. Any determination by the Accounting Firm shall be binding upon Optionee and the Company.

(c) As a result of uncertainty in the application of Section 4999 of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that Gross-Up Payments which should have been made by the Company will not have been made ("Underpayment"), consistent with the calculations required to be made hereunder. In the event that the Company exhausts its remedies pursuant to Subsection (d) below and Optionee thereafter is required to make a payment of any additional Excise Tax, the Accounting Firm shall determine the amount of the Underpayment that has occurred and any such Underpayment shall be promptly paid by the Company to or for Optionee's benefit.

(d) Optionee shall notify the Company in writing of any claim by the Internal Revenue Service or any other taxing authority that, if successful, would require the payment by the Company of any Gross-Up Payment. Such notification shall be given as soon as practicable but no later than ten (10) business days after Optionee knows of such claim and shall apprise the Company of the nature of such claim and the date on which such claim is requested to be paid. Optionee shall not pay such claim prior to the expiration of the thirty (30)-day period following the date on which Optionee gives such notice to the Company (or such shorter period ending on the date that any payment of taxes with respect to such claim is due). If the Company notifies Optionee in writing prior to the expiration of such period that it desires to contest such claim, Optionee shall:

- (i) give the Company any information reasonably requested by the Company relating to such claim;
- (ii) take such action in connection with contesting such claim as the Company shall reasonably request in writing from time to time, including accepting legal representation with respect to such claim by an attorney reasonably selected by the Company;
- (iii) cooperate with the Company in good faith in order to effectively contest such claim; and
- (iv) permit the Company to participate in any proceedings relating to such claim;

provided, however, that the Company shall bear and pay directly all costs and expenses (including additional interest and penalties) incurred in connection with such contest and shall indemnify and hold Optionee harmless, on an after-tax basis, for any Excise Tax or income tax (including interest and penalties with respect thereto) imposed as a result of such representation and payment of costs and expenses. Without limitation on the foregoing provisions of this Subsection (d), the Company shall control all proceedings taken in connection with such contest and, at its sole option, may pursue or forego any and all administrative appeals, proceedings, hearings and conferences with the taxing authority in respect of such claim and may, at its sole option, either direct Optionee to pay the tax claimed and sue for a refund or contest the claim in any permissible manner, and Optionee agrees to prosecute such contest to a determination before any administrative tribunal, in a court of initial jurisdiction and in one or more appellate courts, as the Company shall determine. If the Company directs Optionee to pay such claim and sue for a refund, the Company shall: (i) to the extent not prohibited by law, rule or regulation, advance the amount of such payment on an interest-free basis; or (ii) to the extent any such advance is so prohibited, pay such amount directly; and, in either case, shall indemnify and hold Optionee harmless, on an after-tax basis, from any Excise Tax or income tax (including interest or penalties with respect thereto) imposed with respect to such payment or advance or with respect to any imputed income with respect to such payment or advance; and provided further that any extension of the statute of limitations relating to payment of taxes for Optionee's taxable year with respect to which such contested amount is claimed to be due is limited solely to such contested amount. Furthermore, the Company's control of the contest shall be limited to issues with respect to which a Gross-Up Payment would be payable hereunder and Optionee shall be entitled to settle or contest, as the case may be, any other issue raised by the Internal Revenue Service or any other taxing authority.

(e) If, after Optionee's receipt of an amount advanced by the Company pursuant to Subsection (d), above, Optionee becomes entitled to receive any refund with respect to such claim, Optionee shall (subject to the Company's complying with the requirements of Subsection (d)) promptly pay to the Company the amount of such refund (together with any interest paid or credited thereon after taxes applicable thereto). If, after Optionee's receipt of an amount advanced by the Company pursuant to Subsection (d), above, a determination is made that Optionee shall not be entitled to any refund with respect to such claim and the Company does not notify Optionee in writing of its intent to contest such denial of refund prior to the expiration of thirty (30) days after such determination, then such advance shall be forgiven and shall not be required to be repaid and the amount of such advance shall offset, to the extent thereof, the amount of Gross-Up Payment required to be paid.

(f) The parties acknowledge and agree that, to the extent applicable, this Section 9 shall be interpreted in accordance with, and the parties agree to use their best efforts to achieve timely compliance with, Section 409A of the Code and the Department of Treasury regulations and other interpretive guidance issued thereunder.

10. Miscellaneous.

(a) The Option is issued pursuant to the Plan and is subject to its terms. In the event any of the terms of this Option conflict or are inconsistent in any respect with terms of the Plan, the Plan terms shall control. Optionee hereby acknowledges receipt of a copy of the Plan. The Plan is also available for inspection during business hours at the principal office of the Company.

(b) This Agreement shall not confer on Optionee any right with respect to continuance of employment by or continuance of the relationship with the Company or any of its subsidiaries, nor will it interfere in any way with the right of the Company to terminate such employment at any time. Optionee shall have none of the rights of a stockholder with respect to the Shares until such Shares shall have been issued to him or her upon exercise of the Option.

(c) The Company shall at all times during the term of the Option reserve and keep available such number of Shares as will be sufficient to satisfy the requirements thereof. The exercise of all or any part of the Option shall only be effective at, and may be deferred until, such time as the sale of the Shares pursuant to such exercise will not violate any federal or state securities laws, it being understood that the Company shall have no obligation to register the issuance or sale of the Shares for such purpose.

[The remainder of this page is intentionally left blank; signature page follows]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed on the day and year first above written.

ENTEROMEDICS, INC.

By _____

Name: Mark B. Knudson, Ph.D.

Title: President and CEO

Optionee