As filed with the Securities and Exchange Commission on May 25, 2007

Registration No. 333-

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

Form S-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

EnteroMedics Inc.
(Exact name of registrant as specified in its charter)

Delaware	**3845**	**48-1293684**
(State or other jurisdiction of incorporation or organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification No.)*

2800 Patton Road
St. Paul, Minnesota 55113
(651) 634-3003
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Mark B. Knudson, Ph.D.
Chief Executive Officer
EnteroMedics Inc.
2800 Patton Road
St. Paul, Minnesota 55113
(651) 634-3003
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Kenneth L. Cutler
Ted S. Hollifield
Dorsey & Whitney LLP
50 South Sixth Street
Minneapolis, Minnesota 55402
(612) 340-2600
Fax: (612) 340-2868

Charles K. Ruck
B. Shayne Kennedy
Latham & Watkins LLP
650 Town Center Drive
Costa Mesa, California 92626
(714) 540-1235
Fax: (714) 755-8290

Approximate date of commencement of proposed sale to the public: As soon as practicable after this registration statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box: ☐

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Proposed Maximum Aggregate Offering Price(1)	Amount of Registration Fee(2)
Common stock, $0.01 par value per share	$86,250,000	$2,648

(1) Estimated solely for the purpose of calculating the amount of the registration fee in accordance with Rule 457(o) under the Securities Act of 1933, as amended. Includes $11,250,000 of shares that the underwriters have the option to purchase to cover over-allotments.

(2) Calculated pursuant to Rule 457(o) based on an estimate of the proposed maximum aggregate offering price.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Table of Contents

Subject to Completion, Dated May 25, 2007

Shares

EnteroMedics™
ORCHESTRATING OBESITY SOLUTIONS

Common Stock

EnteroMedics Inc. is offering shares of its common stock. This is our initial public offering and no public market currently exists for our shares. We anticipate that the initial public offering price will be between $ and $ per share.

We intend to apply to have our common stock quoted on the NASDAQ Global Market under the symbol "ETRM."

Investing in our common stock involves risks. See "Risk Factors" beginning on page 8 of this prospectus.

	Per Share	Total
Initial public offering price	$	$
Underwriting discounts	$	$
Proceeds, before expenses, to EnteroMedics Inc.	$	$

We have granted the underwriters the right to purchase up to an additional shares of common stock to cover over-allotments.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the shares to purchasers on , 2007.

JPMorgan **Morgan Stanley**

Cowen and Company

Leerink Swann & Company

, 2007

[Table of Contents](#)

OUTSIDE FRONT GATE

1. *In the center of the page, there is a graphic depicting an obese person showing the digestive system and the vagus nerve running from the brain down to the stomach and other gastrointestinal organs. The graphic is entitled "The Vagus Nerve and the Digestive System." The following caption appears beneath the picture:*

The vagus nerve controls much of the activity of the stomach, intestine and pancreas and plays a role in food processing, including:

- Expansion of the stomach as food enters
- Contractions of the stomach to break food into smaller particles
- Release of gastric acid required for food processing
- Emptying of the stomach contents into the small intestine
- Secretion of digestive pancreative enzymes that enable absorption of calories
- Controlling sensations of hunger, satisfaction and fullness

INSIDE FRONT GATE

1. On the left side of the page there is a graphic depicting an obese person showing the digestive tract, the vagus nerve and a diagram of an implanted Maestro neuroregulator scaled to the approximate size of the person with the lead system connected to the vagus nerve. The following caption appears on the right side of the page:

VBLOC Therapy is designed to block the gastrointestinal effects of the vagus nerve by using high-frequency, low-energy electrical impulses to intermittently interrupt naturally occurring neural impulses on the vagus nerve between the brain and the digestive system.

We have designed our *Maestro*™ System to address a significant market opportunity that we believe exists for a safe, effective and less-invasive therapy that is intended to address the underlying causes of hunger and obesity. Our Maestro System is designed to offer each of the following benefits, which we believe could lead to the adoption of VBLOC therapy as the treatment of choice for obesity.

2. The VBLOC therapy logo appears at the top right side of the page.

INSIDE FRONT COVER

1. In the center of the page there is a picture of the Maestro System, including the RF neuroregulator, the RC neuroregulator, the controller and the lead system. The following caption appears above the picture:

VBLOC therapy, delivered via our Maestro System, is intended to offer patients an effective, safe, outpatient solution that minimizes complications. We believe that if approved, it could enable patients to lose weight and maintain long-term weight loss while enjoying a normal, healthy diet.

2. The following cautionary language also appears in proximity to the picture:

CAUTION: Investigational device. Limited by Federal law to investigational use and not approved for commercial sale. The Maestro System has not been approved for sale by any regulatory authority.

3. The following caption appears beneath the picture:

- Preserves normal anatomy
- Allows continued ingestion and digestion of foods found in a typical, healthy diet
- May be implanted on an outpatient basis and adjusted non-invasively
- Offers favorable safety profile
- Targets multiple factors that contribute to hunger and obesity

Table of Contents

TABLE OF CONTENTS

You should rely only on the information contained in this prospectus and any free-writing prospectus that we authorize to be distributed to you. We have not, and the underwriters have not, authorized anyone to provide you with information different from or in addition to that contained in this prospectus or any related free-writing prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. We are offering to sell, and are seeking offers to buy, shares of common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of the common stock. Our business, financial conditions, results of operations and prospects may have changed since that date.

EnteroMedics™, Maestro™, VBLOC™ vagal blocking therapy and the EnteroMedics logo are trademarks of EnteroMedics Inc. and we have applied to register these trademarks in the United States. This prospectus contains other trade names and service marks of EnteroMedics and of other companies.

PROSPECTUS SUMMARY

This summary highlights selected information contained in greater detail elsewhere in this prospectus. This summary may not contain all of the information that you should consider before investing in our common stock. You should carefully read the entire prospectus, including "Risk Factors" beginning on page 8 and the financial statements and related notes, before making an investment decision. As used in this prospectus, references to "we," "our," "us" and "EnteroMedics" refer to EnteroMedics Inc. and its subsidiary unless the context requires otherwise.

Our Business

We are a development stage medical device company focused on the design and development of devices that use neuroblocking technology to treat obesity and other gastrointestinal disorders. Our proprietary neuroblocking technology, which we refer to as VBLOC therapy, is designed to intermittently block the vagus nerve using high-frequency, low-energy, electrical impulses. The vagus nerve controls much of the activity of the stomach, intestines and pancreas and plays a role in food processing. Our initial product under development is the Maestro System, which uses VBLOC therapy to limit the expansion of the stomach, reduce the frequency and intensity of stomach contractions and produce a feeling of early and prolonged fullness. Based on our preclinical studies and initial clinical trials, we believe the Maestro System has the potential to offer obese patients a minimally-invasive treatment alternative that can result in significant and sustained weight loss.

We are currently evaluating the Maestro System in human clinical trials conducted internationally. As of April 30, 2007, we have implanted the Maestro System in 63 subjects. To date, we have not observed any mortality or any medically serious device-related complications that have required surgical attention in these subjects.

We recently received a conditional investigational device exemption, or IDE, for our U.S. pivotal trial of the Maestro System, the EMPOWER trial. We plan to commence enrollment in this 220 subject, randomized, double-blind, placebo-controlled, prospective, multi-center trial in the third quarter of 2007. We plan to use data from our EMPOWER trial to support our premarket approval, or PMA, application for the Maestro System, which we expect to submit in the first half of 2009. If the U.S. Food and Drug Administration, or FDA, grants us approval, we anticipate we will be able to commercialize the Maestro System in the United States in 2010.

The Obesity Epidemic

Obesity has been identified by the U.S. Surgeon General as the fastest growing cause of disease and death in the United States. In 1980, approximately 15% of the adult population in the United States was obese according to National Health and Nutrition Examination Survey. By 2004, the incidence of obesity had more than doubled to 32%. Currently, the Centers for Disease Control and Prevention, or CDC, estimates that there are 65 million obese adults in the United States, with 42 million having a Body Mass Index, or BMI, of 30 to 35 and 23 million having a BMI greater than 35. BMI is calculated by dividing a person's weight in kilograms by the square of their height in meters. Obesity is also a significant health problem outside of the United States, with as many as 400 million people worldwide estimated to be obese, according to the World Health Organization.

The CDC has identified obesity as a leading public health threat in the United States. In 2005, it was estimated that there are approximately 112,000 obesity-related deaths each year in the United States. According to data from the CDC, 76% of people with a BMI above 35 have an obesity-related disease or disorder, also called a co-morbidity. According to the North American Association for the Study of Obesity and the CDC, obesity is associated with many significant weight-related co-morbidities including Type 2 diabetes, high blood-pressure, sleep apnea, certain cancers, high cholesterol, coronary artery disease, osteoarthritis and stroke. In addition, a number of disorders involving the central nervous system may also be complicated by obesity, such as anxiety, bipolar disorder, agoraphobia, depression and insomnia. As of 2000, the Department of Health and Human Services estimated the overall economic costs of obesity in the United States to be $117 billion per year.

We believe that the obesity epidemic will continue to grow worldwide given dietary trends in developed nations that favor highly processed sugars, larger meals and fattier foods, as well as increasingly sedentary lifestyles. Despite the growing obesity rate, increasing public interest in the obesity epidemic and significant medical repercussions and economic costs associated with obesity, there continues to be a significant unmet need for more effective treatments. We believe existing options for the treatment of obesity have seen limited adoption to date due to a range of efficacy and potential side effects including morbidity. The principal treatment alternatives available today for obesity include:

- ***Behavioral modification*.** Behavioral modification, which includes diet and exercise, is an important component in the treatment of obesity; however, most obese patients find it difficult to achieve and maintain significant weight loss with a regimen of diet and exercise alone.
- ***Pharmaceutical therapy*.** Pharmaceutical therapies often represent a first option in the treatment of obese patients within lower BMI ranges but carry significant safety risks and may present troublesome side effects.
- ***Bariatric surgery*.** In more severe cases of obesity, patients may pursue more aggressive surgical treatment options such as gastric bypass and gastric banding. These procedures promote weight loss by surgically restricting the stomach’s capacity and outlet size. While largely effective, they may present substantial side effects and carry short- and long-term safety risks that have limited their adoption.

Given the limitations of behavioral modification, pharmaceutical therapy and bariatric surgical approaches, we believe there is a substantial need for a safer and more effective solution that:

- preserves normal anatomy;
- allows continued ingestion and digestion of foods found in a typical, healthy diet;
- enables non-invasive adjustability while reducing the need for frequent clinic visits;
- minimizes the risks of re-operations, malnutrition and mortality; and
- reduces the natural hunger drive of patients.

EnteroMedics’ Solution

We believe our Maestro System addresses a significant market opportunity that exists for a safe, effective and less-invasive therapy that is intended to address the underlying causes of hunger and obesity. Our VBLOC therapy is designed to limit the expansion of the stomach and to reduce the frequency and intensity of stomach contractions by intermittently blocking, or interrupting, naturally occurring neural impulses on the vagus nerve. In addition, we believe VBLOC therapy also reduces the absorption of calories by decreasing the secretion of digestive enzymes. We believe that the physiologic effects of VBLOC therapy produce a feeling of early and prolonged fullness following smaller meal portions and a subsequent reduction in hunger.

Our Maestro System delivers VBLOC therapy via two small electrodes that are laparoscopically implanted and placed in contact with the trunks of the vagus nerve just above the junction between the esophagus and the stomach, near the diaphragm. The electrodes receive electrical impulses from a neuroregulator implanted under the skin in the abdominal region. The major components of the Maestro System include:

- ***Neuroregulator*.** The neuroregulator is an implanted device that delivers VBLOC therapy by emitting electrical pulses through the lead system.
- ***Lead system*.** The lead system is connected to the neuroregulator and delivers electrical pulses to the vagus nerve via the electrodes, which are implanted in contact with the vagus nerve.
- ***Controller*.** The controller regulates the rate and intensity of the electrical pulses delivered by the neuroregulator and maintains a log of device and treatment changes.
- ***Transmit coil*.** The transmit coil delivers radiofrequency energy and therapy control information across the skin into the neuroregulator.
- ***Clinician programmer*.** The clinician programmer connects to the controller to enable clinicians to customize therapy settings as necessary and download reports stored in system components.

Our Maestro System is expected to be implanted by a bariatric surgeon in approximately one hour during an outpatient procedure that is typically performed using a short-acting general anesthetic. The physician activates the Maestro System in a follow-up visit approximately two weeks following implantation. VBLOC therapy is then delivered intermittently each day during the patient's waking hours.

Our Strategy

Our goal is to establish VBLOC therapy, delivered via our Maestro System, as the leading obesity management solution. The key business strategies by which we intend to achieve these objectives include:

- achieve regulatory approval for VBLOC therapy using our Maestro System;
- drive the adoption and endorsement of VBLOC therapy through key opinion leaders;
- commercialize our products using a direct sales and marketing effort;
- procure appropriate coding, coverage and payment for the Maestro System;
- expand and protect our intellectual property position; and
- leverage our VBLOC technology for other disease states.

Risks Associated with Our Business

Our business is subject to numerous risks discussed more fully in the section entitled "*Risk Factors*" immediately following this prospectus summary. We are a development stage company with a limited history of operations and no commercially approved products, and we cannot assure you that we will ever have a commercialized product. We have incurred losses since inception and we anticipate that we will continue to incur increasing losses for the foreseeable future. We have not received, and may never receive, approval from the FDA or the relevant regulatory body in any other country to market our Maestro System for the treatment of obesity. In addition, we may be unable to complete our EMPOWER or other trials, or we may experience significant delays in completing our trials, which could prevent or delay regulatory approval of our Maestro System and impair our financial position. Even if we obtain regulatory approval for our Maestro System, our efforts to commercialize our product may not succeed or may encounter delays that could significantly harm our ability to generate revenue.

Our Corporate Information

We were incorporated in Minnesota in December 2002 under the name Beta Medical, Inc. In 2003, we changed our name to EnteroMedics Inc. and in 2004 we reincorporated in Delaware. Our principal executive offices are located at 2800 Patton Road, St. Paul, Minnesota 55113, and our telephone number is (651) 634-3003. Our website address is www.enteromedics.com. The information on, or that may be accessed through, our website is not incorporated by reference into this prospectus and should not be considered a part of this prospectus.

The Offering

Common stock offered by us	shares
Common stock to be outstanding after this offering	shares
Over-allotment option	shares
Use of proceeds	We intend to use the net proceeds of this offering for achieving regulatory approval for our product, initiating sales and marketing efforts, research and product development activities and other working capital and general corporate purposes. See "Use of Proceeds" for additional information.
Proposed Nasdaq Global Market symbol	ETRM

The number of shares of our common stock that will be outstanding immediately after this offering is based on 102,808,327 shares outstanding as of March 31, 2007 and assumes the issuance by us of our shares to Mayo Foundation for Medical Education and Research. The number of outstanding shares excludes:

- 15,772,968 shares of common stock issuable upon the exercise of options outstanding as of March 31, 2007, at a weighted average exercise price of $0.23 per share;
- 4,980,362 shares of common stock issuable upon the exercise of warrants outstanding as of March 31, 2007, on an as-converted basis and at a weighted average exercise price of $0.44 per share; and
- 18,451,382 shares of common stock expected to be available for future issuance under our stock incentive plans upon completion of this offering.

Except where we state otherwise, the information we present in this prospectus reflects:

- a -for- reverse split of our common stock;
- the conversion of all of the outstanding shares of our preferred stock into 95,442,677 shares common stock upon completion of this offering;
- the issuance of 1,875,000 shares of our common stock to Mayo Foundation for Medical Education and Research pursuant to a license agreement;
- amendments to our certificate of incorporation and bylaws to be effective upon completion of this offering; and
- no exercise by the underwriters of their over-allotment option.

Table of Contents

Summary Financial Data

The following tables summarize our financial data for the periods presented. The summary statement of operations data for each of the years ended December 31, 2004, 2005 and 2006, except for the pro forma net loss per share and pro forma weighted average number of shares data, are derived from our audited consolidated financial statements included elsewhere in this prospectus. The summary statement of operations data for the three months ended March 31, 2006 and 2007, except for the pro forma net loss per share and pro forma weighted average number of shares data, the statement of operations data for the period from December 19, 2002 (inception) through March 31, 2007 and the summary balance sheet data as of March 31, 2007 have been derived from our unaudited consolidated financial statements, which are included elsewhere in this prospectus. The historical results are not necessarily indicative of the results to be expected for any future periods. You should read this data together with the consolidated financial statements and related notes appearing elsewhere in this prospectus, as well as “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the other financial information included elsewhere in this prospectus.

	Years Ended December 31,			Three Months Ended March 31,		Period from December 19, 2002 (inception) to March 31, 2007
	2004	2005	2006	2006	2007	
	(In thousands, except per share data)					
Statement of Operations Data:						
Operating expenses:						
Research and development	$ 1,755	$ 8,833	$ 14,361	$ 3,645	$ 4,078	$ 31,380
Selling, general and administrative	1,491	2,319	3,761	846	1,348	9,054
Total operating expenses	3,246	11,152	18,122	4,491	5,426	40,434
Other income (expense):						
Interest income	35	110	1,136	87	415	1,696
Interest expense	(238)	(181)	(710)	(169)	(137)	(1,282)
Change in value of the convertible preferred stock warrant liability	—	—	7	—	(244)	(237)
Other, net	—	8	(1)	(7)	(6)	1
Net loss	$(3,449)	$(11,215)	$ (17,690)	$ (4,580)	$ (5,398)	$ (40,256)
Net loss per share – basic and diluted(1)	$ (2.68)	$ (3.17)	$ (3.76)	$ (1.11)	$ (1.01)	
Weighted average number of shares used in per share calculations – basic and diluted(1)	1,288	3,541	4,709	4,118	5,362	
Pro forma net loss per common share (unaudited) – basic and diluted			$ (0.24)		$ (0.05)	
Weighted average number of shares used in pro forma per share calculations – basic and diluted			73,188		100,804	

(1) Please see Note 2 to our consolidated financial statements for an explanation of the method used to calculate basic and diluted net loss per common share.

Table of Contents

	As of March 31, 2007	
	Actual	Pro Forma As Adjusted(1)
	(In thousands)	
Balance Sheet Data:		
Cash, cash equivalents and short-term investments	$ 28,547	$
Working capital (current assets less current liabilities)	24,000	
Total assets	30,369	
Long-term debt, net of current portion and discounts	915	
Convertible preferred stock	939	
Deficit accumulated during development stage	(40,256)	(2)
Total stockholders' equity	23,431	(2)

(1) On a pro forma as adjusted basis to give effect to the conversion of all of the outstanding shares of our preferred stock into 95,442,677 shares of our common stock upon the completion of this offering, our sale of shares of common stock in this offering at an assumed initial public offering price of $ per share, the mid-point of the range set forth on the cover page of this prospectus, after deducting estimated underwriting discounts and commissions and offering expenses, and the application of the net proceeds from those shares. Each $1.00 increase (decrease) in the assumed public offering price of $ per share would increase (decrease) each of cash, cash equivalents and short-term investments, working capital, total assets and total stockholders' equity by approximately $ million, assuming that the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same, and after deducting estimated underwriting discounts and commissions and estimated offering expenses payable by us. We may also increase or decrease the number of shares we are offering. Each increase of 1.0 million shares in the number of shares offered by us, together with a $1.00 increase in the assumed offering price of $ per share, would increase each of cash, cash equivalents and short-term investments, working capital, total assets and total stockholders' equity by approximately $ million. Similarly, each decrease of 1.0 million shares in the number of shares offered by us, together with a $1.00 decrease in the assumed offering price of $ per share, would decrease each of cash, cash equivalents and short-term investments, working capital, total assets and total stockholders' equity by approximately $ million. The pro forma information discussed above is illustrative only and will adjust based on the actual public offering price and other terms of this offering determined at pricing.

(2) On a pro forma as adjusted basis to give effect to the issuance of 1,875,000 shares of our common stock to Mayo Foundation for Medical Education and Research pursuant to a license agreement upon the completion of this offering. In connection with the issuance of these shares, we will record a one-time stock-based compensation expense of $, which amount has been computed using the mid-point of the range listed on the cover page of this prospectus.

RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the following risk factors and all other information contained in this prospectus before purchasing our common stock. If any of the following risks were to occur, our business, financial condition or results of operations could be materially and adversely affected. In these circumstances, the market price of our common stock could decline, and you may lose some or all of your investment.

Risks Related to Our Business and Industry

We are a development stage company with a limited history of operations and no approved products, and we cannot assure you that we will ever have a commercialized product.

We are a development stage company with a limited operating history upon which you can evaluate our business. We currently do not have any products cleared or approved for commercialization or any other source of revenue, and we do not expect to have a commercialized product until at least 2010. We have been engaged in research and development since our inception in 2002 and have invested substantially all of our time and resources in developing our VBLOC therapy, which we intend to commercialize initially in the form of our Maestro System. The success of our business will depend on our ability to obtain regulatory approval to market our Maestro System and any products we may develop in the future and our ability to create product sales, successfully introduce new products, establish our sales force and control costs, all of which we may be unable to do. If we are unable to successfully develop, receive regulatory clearance for and commercialize our Maestro System for its indicated use, we may never generate revenue or be profitable and we may have to cease operations. Our lack of a significant operating history also limits your ability to make a comparative evaluation of us, our products and our prospects.

We have incurred losses since inception and we anticipate that we will continue to incur increasing losses for the foreseeable future.

We have incurred losses in each year since our formation in 2002. As of March 31, 2007, we had a deficit accumulated during the development stage of $40.3 million. Our net losses applicable to common stockholders for the fiscal years ended December 31, 2004, 2005 and 2006 were $2.68, $3.17 and $3.76 per share, respectively. We have funded our operations to date principally from the sale of our securities and through the issuance of indebtedness. Development of a new medical device, including conducting clinical trials and seeking regulatory approvals, is a long, expensive and uncertain process. We expect our research and development expenses to increase in connection with our currently ongoing clinical trials, upcoming EMPOWER pivotal trial and trials that we may initiate in the future. We also expect our research and development expenses to increase in connection with our ongoing and future product development initiatives. In addition, if our Maestro System is approved for marketing by the U.S. Food and Drug Administration, or FDA, we expect to incur significant sales and marketing expenses prior to recording sufficient revenue to offset these expenses. We also expect our general and administrative expenses to increase following this offering as we implement the infrastructure to operate as a public company. For these reasons, we expect to continue to incur significant and increasing operating losses for the next several years. These losses, among other things, have had and will continue to have an adverse effect on our stockholders' equity and working capital. Because of the numerous risks and uncertainties associated with developing new medical devices, we are unable to predict the extent of any future losses or when we will become profitable, if ever.

We have not received, and may never receive, approval from the FDA or the regulatory body in any other country to market our Maestro System for the treatment of obesity.

We do not have the necessary regulatory approvals to market our Maestro System in the United States or in any foreign market. We plan initially to launch our product, if approved, in the United States, but ultimately will also seek to commercialize our Maestro System in countries outside the United States, such as obtaining a CE Mark for marketing in the European Community.

We cannot market our product in the United States unless it has been approved by the FDA. The FDA approval process involves, among other things, successfully completing clinical trials and obtaining a premarket approval, or PMA. The PMA process requires us to prove the safety and efficacy of our Maestro System to the FDA's satisfaction. This process can be expensive and uncertain, requires detailed and comprehensive scientific and human clinical data, generally takes one to three years after a PMA application is filed, and notwithstanding the effort and expense incurred, may never result in the FDA granting a PMA. Because VBLOC therapy represents a novel way to effect weight loss in the treatment of obesity, and because there is a large population of obese patients who might be eligible for treatment, it is possible that the FDA and other regulatory bodies will review an application for approval of our Maestro System with greater scrutiny, which could cause that process to be lengthier and more involved than that for products without such characteristics. The FDA can delay, limit or deny approval of a PMA application for many reasons, including:

- our inability to demonstrate safety or effectiveness to the FDA's satisfaction;
- the data from our preclinical studies and clinical trials may be insufficient to support approval;
- the facilities of our third-party manufacturers or suppliers may not meet applicable requirements;
- our compliance with preclinical, clinical or other regulations;
- our inability to meet the FDA's statistical requirements or changes in statistical tests or significance level the FDA requires for approval of a medical device, including ours; and
- changes in the FDA approval policies, expectations with regard to the type or amount of scientific data required or adoption of new regulations may require additional data or additional clinical studies.

In order to market our Maestro System outside of the United States, we will need to establish and comply with the numerous and varying regulatory requirements of other countries regarding safety and efficacy. Approval procedures vary among countries and can involve additional product testing and additional administrative review periods. The time required to obtain approval in other countries may differ from that required to obtain FDA approval. The regulatory approval process in other countries may also include all of the risks detailed above regarding FDA approval in the United States. Regulatory approval in one country does not ensure regulatory approval in another, but a failure or delay in obtaining regulatory approval in one country may negatively impact the regulatory process in others. We cannot assure you when, or if, we will be able to obtain approval to market our Maestro System in countries outside the United States.

We may not obtain the necessary regulatory approvals to market our Maestro System in the United States or anywhere else. Even if we obtain approval, the FDA or other regulatory authorities may require expensive or burdensome post-market testing or controls. Any delay in, failure to receive or maintain, or significant limitation on approval for our Maestro System could prevent us from generating revenue or achieving profitability and we may be forced to cease operations.

We may be unable to complete our EMPOWER pivotal trial or other trials, or we may experience significant delays in completing our clinical trials, which could prevent or delay regulatory approval of our Maestro System and impair our financial position.

Our application for an investigational device exemption, or IDE, for the EMPOWER pivotal trial, a randomized, prospective, placebo-controlled multi-center trial of our Maestro System in the United States, has been conditionally approved by the FDA, allowing us to start the EMPOWER trial. We expect to commence the trial in the third quarter of 2007 upon receipt of approval from the relevant institutional review boards at the various sites at which we will be conducting the trial, and expect to complete enrollment in the first half of 2008. Conducting a clinical trial of this size, which involves screening, assessing, testing, treating and monitoring patients at up to 15 sites across the country, and coordinating with patients and clinical institutions, is a complex and uncertain process.

The commencement of our EMPOWER trial could be delayed for a variety of reasons, including:

- reaching agreement on acceptable terms with prospective clinical trial sites;
- manufacturing sufficient quantities of our Maestro System;
- obtaining institutional review board approval to conduct the trial at a prospective site; and
- obtaining sufficient patient enrollment, which is a function of many factors, including the size of the patient population, the nature of the protocol, the proximity of patients to clinical sites and the eligibility criteria for the trial.

Once our EMPOWER trial has begun, the completion of the EMPOWER trial, and our other ongoing clinical trials, could be delayed, suspended or terminated for several reasons, including:

- ongoing discussions with regulatory authorities regarding the scope or design of our preclinical results or clinical trial or requests for supplemental information with respect to our preclinical results or clinical trial results;
- our failure or inability to conduct the clinical trials in accordance with regulatory requirements;
- sites currently participating in the trial may drop out of the trial, which may require us to engage new sites or petition the FDA for an expansion of the number of sites that are permitted to be involved in the trial;
- patients may not enroll in, remain in or complete, clinical trials at the rates we expect;
- patients may experience serious adverse events or side effects during the trial, which, whether or not related to our product, could cause the FDA or other regulatory authorities to place the clinical trial on hold;
- clinical investigators may not perform our clinical trials on our anticipated schedule or consistent with the clinical trial protocol and good clinical practices;
- we may be unable to obtain a sufficient supply of our Maestro System necessary for the timely conduct of the clinical trials; and
- Maestro RC requires approval of an IDE supplement by the FDA and institutional review boards, which we may not be able to secure.

If our clinical trials are delayed it will take us longer to ultimately commercialize a product and generate revenue or the delay could result in our being unable to do so. Moreover, our development costs will increase if we have material delays in our clinical trials or if we need to perform more or larger clinical trials than planned.

Even if we complete our EMPOWER trial and our other clinical trials, these trials may not produce results that are sufficient to support approval of a PMA application.

We will consider our Maestro System to be effective if the EMPOWER trial demonstrates at least a 10 percentage point greater excess weight loss, or EWL, than a control group at 12 months. The FDA has indicated to us that they believe that a 20 to 25 percentage point greater EWL than a control group is the appropriate efficacy criterion for the EMPOWER trial. Thus, there is a risk that, even if we achieve our endpoint of a 10 percentage point greater EWL than the control group at 12 months, the FDA may not approve our Maestro System. To date, we have limited clinical data regarding the efficacy of our therapy at 12 months upon which to evaluate our ability to meet either our or the FDA's proposed efficacy endpoint. Our results and our ability to obtain approval from the FDA for our Maestro System may also depend on the measurement standards we use to evaluate the excess weight loss data. In addition, there is a risk that the FDA may require us to conduct a longer clinical trial, submit additional follow-up data, or engage in other costly and time consuming activities that may delay the FDA's approval of the Maestro System. If our clinical trials fail to produce sufficient data to support a PMA application, it will take us longer to ultimately commercialize a product and generate revenue or the delay could result in our being unable to do so. Moreover, our development costs will increase if, to achieve efficient data to support PMA, we need to perform more or larger clinical trials than planned.

Even if we obtain the necessary regulatory approvals, our efforts to commercialize our Maestro System may not succeed or may encounter delays which could significantly harm our ability to generate revenue.

If we obtain regulatory approval to market our Maestro System, our ability to generate revenue will depend upon the successful commercialization of this product. Our efforts to commercialize our Maestro System may not succeed for a number of reasons, including:

- our Maestro System may not be accepted in the marketplace by physicians, patients and third-party payors;
- the price of our Maestro System, associated costs of the surgical procedure and treatment and the availability of sufficient third-party reimbursement for the procedure and therapy implantation and follow-up procedures;
- appropriate reimbursement coding options may not exist to enable billing for the system implantation and follow-up procedures;
- we may not be able to sell our Maestro System at a price that allows us to meet the revenue targets necessary to generate revenue for profitability;
- the frequency and severity of any side effects of our VBLOC therapy;
- physicians and potential patients may not be aware of the perceived effectiveness and sustainability of the results of VBLOC therapy provided by our Maestro System;
- we, or the investigators of our product, may not be able to have information on the outcome of the trials published in medical journals;
- the availability and perceived advantages and disadvantages of alternative treatments;
- patient noncompliance with wearing the external components of the Maestro RF System may render VBLOC therapy less effective in achieving long-term weight loss;
- any rapid technological change may make our product obsolete;
- we may not be able to have our Maestro System manufactured in commercial quantities or at an acceptable cost;
- we may not have adequate financial or other resources to complete the development and commercialization of our Maestro System; and
- we may be sued for infringement of intellectual property rights and could be enjoined from manufacturing or selling our products.

Besides requiring physician adoption, market acceptance of our Maestro System will depend on successfully communicating the benefits of our VBLOC therapy to three additional constituencies involved in deciding whether to treat a particular patient using such therapy: (1) the potential patients themselves; (2) institutions such as hospitals, where the procedure would be performed and opinion leaders in these institutions; and (3) third- party payors, such as private healthcare insurers and Medicare, which would ultimately bear most of the costs of the various providers and equipment involved in our VBLOC therapy. Marketing to each of these constituencies requires a different marketing approach, and we must convince each of these groups of the efficacy and utility of our VBLOC therapy to be successful.

If our VBLOC therapy, or any other neuroblocking therapy for other gastrointestinal diseases and disorders that we may develop, does not achieve an adequate level of acceptance by the relevant constituencies, we may not generate significant product revenue and may not become profitable. The earliest we expect to be able to commercialize our Maestro System is 2010, if at all. If we are not successful in the commercialization of our Maestro System for the treatment of obesity we may never generate any revenue and may be forced to cease operations.

We depend on clinical investigators and clinical sites to enroll patients in our clinical trials, and on other third parties to manage the trials and to perform related data collection and analysis, and, as a result, we may face costs and delays that are outside of our control.

We rely on clinical investigators and clinical sites to enroll patients in our clinical trials, including EMPOWER, and other third parties to manage the trials and to perform related data collection and analysis. However, we may not be able to control the amount and timing of resources that clinical sites may devote to our clinical trials. If these clinical investigators and clinical sites fail to enroll a sufficient number of patients in our clinical trials, to ensure compliance by patients with clinical protocols or comply with regulatory requirements, we will be unable to complete these trials, which could prevent us from obtaining regulatory approvals for our product. Our agreements with clinical investigators and clinical trial sites for clinical testing place substantial responsibilities on these parties and, if these parties fail to perform as expected, our trials could be delayed or terminated. If these clinical investigators, clinical sites or other third parties do not carry out their contractual duties or obligations or fail to meet expected deadlines, or if the quality or accuracy of the clinical data they obtain is compromised due to their failure to adhere to our clinical protocols, regulatory requirements or for other reasons, our clinical trials may be extended, delayed or terminated, or the clinical data may be rejected by the FDA, and we may be unable to obtain regulatory approval for, or successfully commercialize, our product.

Assuming we receive regulatory approval for the Maestro System, modifications to the Maestro System may require additional approval from the FDA, which may not be obtained or may delay our commercialization efforts.

The FDA requires medical device companies to initially make and document a determination of whether or not a modification requires a new approval, supplement or clearance; however, the FDA can review a company's decision. Any modifications to an FDA-approved device that could significantly affect its safety or efficacy, or that would constitute a major change in its intended use would require a supplemental IDE and possibly additional clinical studies and a separate PMA application. Product changes or revisions will require all the regulatory steps and associated risks discussed above including testing, an IDE supplement and clinical study. We may not be able to obtain approval of supplemental IDEs or PMAs for product modifications, new indications for our product or new products. Delays in obtaining future clearances would adversely affect our ability to introduce new or enhanced products in a timely manner, which in turn would harm our commercialization efforts and future growth.

Physicians may not widely adopt our Maestro System and VBLOC therapy unless they determine, based on experience, long-term clinical data and published peer reviewed journal articles, that VBLOC therapy provides a safe and effective alternative to other existing treatments for obesity.

Physicians tend to be slow to change their medical treatment practices because of the time and skill required to learn a new procedure and the perceived liability risks arising from the use of new products and procedures, and the uncertainty of third-party coverage and reimbursement. Physicians may not widely adopt our Maestro System and VBLOC therapy unless they determine, based on experience, long-term clinical data and published peer reviewed journal articles, that the use of our VBLOC therapy provides a safe and effective alternative to other existing treatments for obesity, including pharmaceutical solutions and bariatric surgical procedures.

We cannot provide any assurance that the data collected from our current and planned clinical trials will be sufficient to demonstrate that our VBLOC therapy is an attractive alternative to other obesity treatment procedures. We rely on experienced and highly trained surgeons to perform the procedures in our clinical trials and both short- and long-term results reported in our clinical trials may be significantly more favorable than typical results of practicing physicians, which could negatively impact rates of adoption of our Maestro System and VBLOC therapy. We believe that published peer-reviewed journal articles and recommendations and support by influential physicians regarding our Maestro System and VBLOC therapy will be important for market acceptance and adoption, and we cannot assure you that we will receive these recommendations and support, or that supportive articles will be published.

If we fail to obtain adequate coding, coverage or payment levels for our product by governmental healthcare programs and other third-party payors, there may be no commercially viable markets for our Maestro System or other products we may develop or our target markets may be much smaller than expected.

Healthcare providers generally rely on third-party payors, including governmental payors, such as Medicare and Medicaid, and private healthcare insurers, to adequately cover and reimburse the cost of medical devices. Importantly, third-party payors are increasingly challenging the price of medical products and services and instituting cost containment measures to control or significantly influence the purchase of medical products and services. We expect that third-party payors will continue to attempt to contain or reduce the costs of healthcare by challenging the prices charged for healthcare products and services. If reimbursement for our Maestro System and the related surgery and facility costs is unavailable or limited in scope or amount, or if pricing is set at unsatisfactory levels, market acceptance of our Maestro System will be impaired and our future revenue, if any, would be adversely affected. As such, even if we obtain FDA clearance or approval for our Maestro System and begin to market it, the availability and level of third-party coverage and reimbursement could substantially affect our ability to commercialize our Maestro System and other products we may develop.

The efficacy, safety, ease of use and cost-effectiveness of our Maestro System and of any competing products will, in part, determine the availability and level of coverage and payment. In particular, we expect that securing coding, coverage and payment for our Maestro System will be more difficult if our EMPOWER trial does not demonstrate a percentage of excess weight loss from a pre-implementation baseline that healthcare providers and obese individuals consider clinically meaningful, whether or not regulatory agencies consider the improvement of patients treated in clinical trials to have been clinically meaningful.

In some international markets, pricing of medical devices is subject to government control. In the United States and international markets, we expect that both government and third-party payors will continue to attempt to contain or reduce the costs of healthcare by challenging the prices charged for healthcare products and services. If payment for our Maestro System and the related surgery and facility costs is unavailable or limited in scope or amount, or if pricing is set at unsatisfactory levels, market acceptance of our Maestro System will be impaired and our future revenue, if any, would be adversely affected.

We cannot predict the likelihood or pace of any significant regulatory or legislative action in any of these areas, nor can we predict whether or in what form healthcare legislation being formulated by various governments will be passed. We also cannot predict with precision what effect such governmental measures would have if they were ultimately enacted into law. However, in general, we believe that such legislative activity will likely continue. If adopted, such measures can be expected to have an impact on our business.

Even if our Maestro System is approved by regulatory authorities, if we or our suppliers fail to comply with ongoing regulatory requirements, or if we experience unanticipated product problems, our Maestro System could be subject to restrictions or withdrawal from the market.

Completion of our clinical trials and commercialization of our Maestro System will require access to manufacturing facilities that meet applicable regulatory standards to manufacture a sufficient supply of our product. We rely solely on third parties to manufacture and assemble our Maestro System, and do not currently plan to manufacture or assemble our Maestro System ourselves in the future.

Any product for which we obtain marketing approval, along with the manufacturing processes, post-approval clinical data and promotional activities for such product, will be subject to continual review and periodic inspections by the FDA and other regulatory bodies. In particular we and our manufacturers and suppliers are required to comply with Good Manufacturing Practices, or GMP, which for medical devices is called the Quality System Regulation, or QSR, and other regulations which cover the methods and documentation of the design, testing, production, control, quality assurance, labeling, packaging, storage and shipping of any product for which we obtain marketing approval. The FDA enforces the QSR through unannounced inspections. We and our third-party manufacturers and suppliers have not yet been inspected by the FDA and will have to successfully complete such inspections before we receive regulatory approvals for our Maestro System. Failure by us or one of our manufacturers or suppliers to comply with statutes and regulations administered by the FDA and other regulatory bodies, or failure to adequately respond to any observations, could result in enforcement actions against us or our manufacturers or suppliers, including, restrictions on our product or manufacturing processes, withdrawal of the product from the market, voluntary or mandatory recall, fines, suspension of regulatory approvals, product seizures, injunctions or the imposition of civil or criminal penalties.

If any of these actions were to occur it would harm our reputation and cause our product sales to suffer. Furthermore, our key component suppliers may not currently be or may not continue to be in compliance with applicable regulatory requirements. If the FDA or any other regulatory body finds their compliance status to be unsatisfactory, our commercialization efforts could be delayed, which would harm our business and our results of operations.

Even if regulatory approval of a product is granted, the approval may be subject to limitations on the indicated uses for which the product may be marketed. If the FDA determines that our promotional materials, training or other activities constitute promotion of an unapproved use, we could be subject to significant liability, the FDA could request that we cease, correct or modify our training or promotional materials or subject us to regulatory enforcement actions. It is also possible that other federal, state or foreign enforcement authorities might take action if they consider our training or other promotional materials to constitute promotion of an unapproved use, which could result in significant fines or penalties under other statutory authorities, such as laws prohibiting false claims for reimbursement.

We are subject to medical device reporting, or MDR, regulations that require us to report to the FDA or governmental authorities in other countries if our products cause or contribute to a death or serious injury or malfunction in a way that would be reasonably likely to contribute to death or serious injury if the malfunction were to recur. The FDA and similar governmental authorities in other countries have the authority to require the recall of our products in the event of material deficiencies or defects in design or manufacturing. A government mandated, or voluntary, recall by us could occur as a result of component failures, manufacturing errors or design defects, including defects in labeling. Any recall would divert managerial and financial resources and could harm our reputation with customers. There can be no assurance that there will not be product recalls in the future or that such recalls would not have a material adverse effect on our business. Furthermore, we may later discover previously unknown problems with our products, including unanticipated adverse events. For example, we do not have long-term data on the safety of the Maestro System. Thus, there is a risk that long-term use of our Maestro System could cause injuries or harm, including possible damage to the vagus nerve. Any discovery of previously unknown problems with our product, including unanticipated adverse events, may result in restrictions on such products, withdrawal of the products from the market, voluntary or mandatory recalls, fines, suspension of regulatory approvals, product seizures, injunctions or the imposition of civil or criminal penalties.

We depend on a limited number of manufacturers and suppliers of various critical components for our Maestro System. The loss of any of these manufacturer or supplier relationships could delay our clinical trials or prevent or delay commercialization of our Maestro System.

We rely entirely on third parties to manufacture our Maestro System and to supply us with all of the critical components of our Maestro System, including our leads, implantable batteries, neuroregulators and controllers. We have entered into two long-term supply arrangements that are exclusive and we are in the process of solidifying additional supply agreements. If any of our existing suppliers was unable or unwilling to meet our demand for product components, or if the components or finished products that they supply do not meet quality and other specifications, our EMPOWER trial or commercialization of our product could be delayed. Alternatively, if we have to switch to a replacement manufacturer or replacement supplier for any of our product components, we may face additional regulatory delays, and the manufacture and delivery of our Maestro System could be interrupted for an extended period of time, which could delay completion of our clinical trials or commercialization of our Maestro System. In addition, we may be required to obtain regulatory clearance from the FDA to use different suppliers or components.

If our device manufacturers or our suppliers are unable to provide an adequate supply of our product following the start of commercialization, our growth could be limited and our business could be harmed.

In order to produce our Maestro System in the quantities that we anticipate will be required to meet anticipated market demand, we will need our manufacturers to increase, or scale-up, the production process by a significant factor over our current level of production. There are technical challenges to scaling-up manufacturing capacity and developing commercial-scale manufacturing facilities that may require the investment of substantial additional funds by our manufacturers and hiring and retaining additional management and technical personnel who have the necessary manufacturing experience. If our manufacturers are unable to do so, we may not be able to meet the requirements for the launch of the product or to meet future demand, if at all. We may also represent only a small portion of our supplier's or manufacturer's business and if they become capacity constrained they may choose to allocate their available resources to other customers that represent a larger portion of their business. We currently anticipate that we will continue to rely on third-party manufacturers and suppliers for the production of the Maestro System following commercialization. If we develop and obtain regulatory approval for our product and are unable to obtain a sufficient supply of our product, our revenue, business and financial prospects would be adversely affected.

If we are unable to establish sales and marketing capabilities or enter into and maintain arrangements with third parties to market and sell our Maestro System, our business may be harmed.

We do not have a sales organization and have no experience as a company in sales, marketing and distribution of our product. To generate sales we will need to develop a sales and marketing infrastructure or contract with third parties to perform that function. Developing a sales force is expensive and time consuming and could delay or limit the success of any product launch. Even if we obtain approval from the FDA to market our Maestro System, we may be unable to develop an effective sales and marketing organization on a timely basis, if at all. If we develop our own sales and marketing capabilities, our sales force will be competing with the experienced and well-funded marketing and sales organizations of our more established competitors. If we are unable to establish our own sales and marketing capabilities, we will need to contract with third parties to market and sell our product. In this event, our profit margins would likely be lower than if we performed these functions ourselves. In addition, we would necessarily be relying on the skills and efforts of others for the successful marketing of our product. If we are unable to establish and maintain effective sales and marketing capabilities, independently or with others, we may not be able to generate product revenue and may not become profitable.

We may need substantial additional funding and may be unable to raise capital when needed, which would force us to delay, reduce or eliminate our product development programs or commercialization efforts.

Our operations have consumed substantial amounts of cash since inception. We expect to continue to spend substantial amounts on research and development, including conducting clinical trials for our Maestro System. Even before we receive regulatory approval to market our Maestro System, we expect to spend significant funds commercializing the product, including development of a direct sales force. In 2006, our cash used in operations was $16.2 million. We expect cash used in operations will increase significantly in each of the next several years, and we may need additional funds to complete the development and commercialization of our Maestro System. We believe that the estimated net proceeds from this offering of approximately $ million, based on the assumed initial public offering price of $ per share, the mid-point of the range on the cover of this prospectus, after deducting underwriting discounts and commissions and estimated offering expenses, together with our cash resources and amounts available to us under a loan agreement, will be sufficient to meet our cash needs for at least the next 36 months. After, and possibly prior to, such time we may need to raise substantial additional capital to: continue our research and development programs; commercialize our Maestro System, if approved by the FDA; and fund our operations in general.

Our future funding requirements will depend on many factors, including:

- the scope, rate of progress, results and cost of our clinical trials and other research and development activities;
- the cost and timing of regulatory approvals;
- the cost and timing of establishing sales, marketing and distribution capabilities;
- the cost of establishing clinical and commercial supplies of our Maestro System and any products that we may develop;
- the rate of market acceptance of our Maestro System and VBLOC therapy and any other product candidates;
- the cost of filing and prosecuting patent applications and defending and enforcing our patent and other intellectual property rights;
- the cost of defending, in litigation or otherwise, any claims that we infringe third-party patent or other intellectual property rights;

- the effect of competing products and market developments;
- the cost of explanting clinical devices;
- the terms and timing of any collaborative, licensing or other arrangements that we may establish;
- any revenue generated by sales of our future products; and
- the extent to which we acquire or invest in businesses, products and technologies, although we currently have no commitments or agreements relating to any of these types of transactions.

Until the time, if ever, when we can generate a sufficient amount of product revenue, we expect to finance our future cash needs through public or private equity offerings, debt financings or corporate collaboration, licensing arrangements and grants, as well as through interest income earned on cash balances.

Additional capital may not be available on terms favorable to us, or at all. If we raise additional funds by issuing equity securities, our stockholders may experience dilution. Debt financing, if available, may involve restrictive covenants or additional security interests in our assets. Any additional debt or equity financing that we complete may contain terms that are not favorable to us or our stockholders. If we raise additional funds through collaboration and licensing arrangements with third parties, it may be necessary to relinquish some rights to our technologies or products, or grant licenses on terms that are not favorable to us. If we are unable to raise adequate funds, we may have to delay, reduce the scope of, or eliminate some or all of, our development programs or liquidate some or all of our assets.

We may be unable to attract and retain management and other personnel we need to succeed.

Our success depends on the services of our senior management and other key research and development employees. The loss of the services of one or more of our officers or key research and development employees could delay or prevent the successful completion of our clinical trials and the commercialization of our Maestro System. Upon receiving regulatory approval for our product, we expect to rapidly expand our operations and grow our research and development, product development and administrative operations. Our growth will require hiring a significant number of qualified clinical, scientific, commercial and administrative personnel. Accordingly, recruiting and retaining such personnel in the future will be critical to our success. There is intense competition from other companies and research and academic institutions for qualified personnel in the areas of our activities. If we fail to identify, attract, retain and motivate these highly skilled personnel, we may be unable to continue our development and commercialization activities.

We may be unable to manage our growth effectively.

Our business strategy entails significant future growth. For example, we will have to expand existing operations in order to conduct additional clinical trials, increase our contract manufacturing capabilities, hire and train new personnel to handle the marketing and sales of our product, assist patients in obtaining reimbursement for the use of our product and create and develop new applications for our technology. This growth may place significant strain on our management and financial and operational resources. Successful growth is also dependent upon our ability to implement appropriate financial and management controls, systems and procedures. Our ability to effectively manage growth depends on our success in attracting and retaining highly qualified personnel, for which the competition may be intense. If we fail to manage these challenges effectively, our business could be harmed.

We face the risk of product liability claims that could be expensive, divert management's attention and harm our reputation and business. We may not be able to obtain adequate product liability insurance.

Our business exposes us to a risk of product liability claims that is inherent in the testing, manufacturing and marketing of medical devices. The medical device industry has historically been subject to extensive litigation over product liability claims. We may be subject to product liability claims if our Maestro System, or any other products we may sell, causes, or appears to have caused, an injury. Claims may be made by consumers, healthcare providers, third-party strategic collaborators or others selling our products.

We have $5 million of product liability insurance, which covers the use of our Maestro System and VBLOC therapy in our clinical trials, which amount we believe is appropriate. Our current product liability insurance may not continue to be available to us on acceptable terms, if at all, and, if available, the coverage may not be adequate to protect us against any future product liability claims. If we are unable to obtain insurance at an acceptable cost and on acceptable terms for an adequate coverage amount, or otherwise to protect against potential product liability claims, we could be exposed to significant liabilities, which may harm our business. A product liability claim, recall or other claim with respect to uninsured liabilities or for amounts in excess of insured liabilities could have a material adverse effect on our business, financial condition and results of operations. These liabilities could prevent or interfere with our product commercialization efforts. Defending a suit, regardless of merit, could be costly, could divert management attention and might result in adverse publicity, which could result in the withdrawal of, or inability to recruit, clinical trial volunteers or result in reduced acceptance of our Maestro System and VBLOC therapy in the market.

We may be subject to product liability claims even if it appears that the claimed injury is due to the actions of others. For example, we rely on the expertise of surgeons and other associated medical personnel to perform the medical procedure to implant and remove our Maestro System and to perform the related VBLOC therapy. If these medical personnel are not properly trained or are negligent, the therapeutic effect of our Maestro System and VBLOC therapy may be diminished or the patient may suffer critical injury, which may subject us to liability. In addition, an injury that is caused by the negligence of one of our suppliers in supplying us with a defective component that injures a patient could be the basis for a claim against us. A product liability claim, regardless of its merit or eventual outcome, could result in decreased demand for our products; injury to our reputation; diversion of management's attention; withdrawal of clinical trial participants; significant costs of related litigation; substantial monetary awards to patients; product recalls or market withdrawals; loss of revenue; and the inability to commercialize our products under development.

We may be subject, directly or indirectly, to federal and state healthcare fraud and abuse and false claims laws and regulations. Prosecutions under such laws have increased in recent years and we may become subject to such litigation. If we are unable to, or have not fully complied with such laws, we could face substantial penalties.

If we are successful in achieving regulatory approval to market our Maestro System, our operations will be directly, or indirectly through our customers, subject to various state and federal fraud and abuse laws, including, without limitation, the federal Anti-Kickback Statute and federal False Claims Act. These laws may impact, among other things, our proposed sales, marketing and education programs.

The federal Anti-Kickback Statute prohibits persons from knowingly and willfully soliciting, offering, receiving or providing remuneration, directly or indirectly, in exchange for or to induce either the referral of an individual, or the furnishing or arranging for a good or service, for which payment may be made under a federal healthcare program such as the Medicare and Medicaid programs. Several courts have interpreted the statute's intent requirement to mean that if any one purpose of an arrangement involving remuneration is to induce referrals of federal healthcare covered business, the statute has been violated. The Anti-Kickback Statute is broad and, despite a series of narrow safe harbors, prohibits many arrangements and practices that are lawful in businesses outside of the healthcare industry. Penalties for violations of the federal Anti-Kickback Statute include criminal penalties and civil sanctions such as fines, imprisonment and possible exclusion from Medicare, Medicaid and other federal healthcare programs. Many states have also adopted laws similar to the federal Anti-Kickback Statute, some of which apply to the referral of patients for healthcare items or services reimbursed by any source, not only the Medicare and Medicaid programs.

The federal False Claims Act prohibits persons from knowingly filing, or causing to be filed, a false claim to, or the knowing use of false statements to obtain payment from the federal government. Suits filed under the False Claims Act, known as “qui tam” actions, can be brought by any individual on behalf of the government and such individuals, commonly known as “whistleblowers,” may share in any amounts paid by the entity to the government in fines or settlement. The frequency of filing qui tam actions has increased significantly in recent years, causing greater numbers of medical device, pharmaceutical and healthcare companies to have to defend a False Claim Act action. When an entity is determined to have violated the federal False Claims Act, it may be required to pay up to three times the actual damages sustained by the government, plus civil penalties for each separate false claim. Various states have also enacted laws modeled after the federal False Claims Act.

We are unable to predict whether we could be subject to actions under any of these laws, or the impact of such actions. If we are found to be in violation of any of the laws described above and other applicable state and federal fraud and abuse laws, we may be subject to penalties, including civil and criminal penalties, damages, fines, exclusion from government healthcare reimbursement programs and the curtailment or restructuring of our operations.

Provisions of federal securities laws and regulations are likely to increase our costs.

The Sarbanes-Oxley Act of 2002 has required us to adopt new corporate governance, securities disclosure and compliance practices. In response to the requirements of that act, the Securities Exchange Commission and The Nasdaq Stock Market, Inc. have enacted new rules. Compliance with these new rules has increased our legal, financial and accounting costs in connection with this offering, and we expect these increased costs to continue indefinitely. These laws and regulations may also make it more difficult for us to attract and retain qualified members of our board of directors or members of senior management.

The financial reporting obligations of being a public company place significant demands on our management. In addition, if we are unable to satisfy regulatory requirements relating to internal control over financial reporting, or if our internal control is not effective, our business and financial results may suffer.

Prior to the consummation of this offering, we have never operated as a public company. The obligations of being a public company, including substantial public reporting and auditing obligations, will require significant additional expenditures, place additional demands on our management and require the hiring of additional personnel. Section 404 of the Sarbanes-Oxley Act of 2002 and the SEC rules and regulations implementing such act will require us to conduct an annual evaluation of our internal control over financial reporting and auditor attestation of internal control. This process will increase our legal and financial compliance costs, and make some activities more difficult, time consuming or costly. If we fail to have an effectively designed and operating system of internal control, we may be unable to comply with the requirements of Section 404 in a timely manner. As a result of our required compliance with Section 404, we may need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge to ensure such compliance.

We operate in a highly competitive industry that is subject to rapid change. If our competitors are able to develop and market products that are safer or more effective than our products, our commercial opportunities will be reduced or eliminated.

The health care industry is highly competitive, subject to rapid change and significantly affected by new product introductions and other market activities of industry participants. The obesity treatment market in which we operate has grown significantly in recent years and is expected to continue to expand as technology continues to evolve and awareness of the need to treat the obesity epidemic grows. Although we are not aware of any competitors in the neuroblocking market, we face potential competition from pharmaceutical and surgical obesity treatments. Many of our competitors in the obesity treatment field have significantly greater financial resources and expertise in research and development, manufacturing, preclinical testing, clinical trials, obtaining regulatory approvals and marketing approved products than we do. Smaller or early-stage companies may also prove to be significant competitors, particularly if they pursue competing solutions through collaborative arrangements with large and established companies, such as Allergan, Cyberonics, Johnson & Johnson, Medtronic or St. Jude Medical. Our competitors may develop and patent processes or products earlier than us, obtain regulatory approvals for competing products more rapidly than we are able to and develop more effective, safer and less expensive products or technologies that would render our products non-competitive or obsolete.

We may not be successful in our efforts to utilize our VBLOC therapy to treat other gastrointestinal diseases and disorders.

As part of our long-term business strategy, we plan to research the application of our VBLOC therapy to treat other gastrointestinal diseases and disorders. Research to identify new target applications requires substantial technical, financial and human resources, whether or not any new applications for our VBLOC therapy are ultimately identified. We may be unable to identify or pursue other applications of our technology. Even if we identify potential new applications for our VBLOC therapy, investigating the safety and efficacy of our therapy requires extensive clinical testing, which is expensive and time-consuming. If we terminate a clinical trial in which we have invested significant resources, our prospects will suffer, as we will have expended resources on a program that will not provide a return on our investment and missed the opportunity to allocate those resources to potentially more productive uses. We will also need to obtain regulatory approval for these new applications, as well as achieve market acceptance and an acceptable level of reimbursement.

Risks Related to Intellectual Property

If we are unable to obtain or maintain intellectual property rights relating to our technology and neuroblocking therapy, the commercial value of our technology and any future products will be adversely affected and our competitive position will be harmed.

Our commercial success depends in part on our ability to obtain protection in the United States and other countries for our Maestro System and VBLOC therapy by establishing and maintaining intellectual property rights relating to or incorporated into our technology and products. As of May 20, 2007, we owned four issued U.S. patents, two of which pertain to treating gastrointestinal disorders, and 20 U.S. patent applications and three national stage patent applications, including two European applications, in foreign jurisdictions. Our pending and future patent applications may not issue as patents or, if issued, may not issue in a form that will provide us any competitive advantage. We expect to incur substantial costs in obtaining patents and, if necessary, defending our proprietary rights. The patent positions of medical device companies, including ours, can be highly uncertain and involve complex and evolving legal and factual questions. We do not know whether we will obtain the patent protection we seek, or that the protection we do obtain will be found valid and enforceable if challenged. If we fail to obtain adequate protection of our intellectual property, or if any protection we obtain is reduced or eliminated, others could use our intellectual property without compensating us, resulting in harm to our business. We may also determine that it is in our best interests to voluntarily challenge a third party’s products or patents in litigation or administrative proceedings, including patent interferences or re-examinations. In the event that we seek to enforce any of our owned or exclusively licensed patents against an infringing party, it is likely that the party defending the claim will seek to invalidate the patents we assert, which, if successful could result in the loss of the entire patent or the relevant portion of our patent, which would not be limited to any particular party. Any litigation to enforce or defend our patent rights, even if we were to prevail, could be costly and time-consuming and could divert the attention of our management and key personnel from our business operations. Even if we were to prevail in any litigation, we cannot assure you that we can obtain an injunction that prevents our competitors from practicing our patented technology. Our competitors may independently develop similar or alternative technologies or products without infringing any of our patent or other intellectual property rights, or may design around our proprietary technologies.

We cannot assure you that we will obtain any patent protection that we seek, that any protection we do obtain will be found valid and enforceable if challenged or that it will confer any significant commercial advantage. U.S. patents and patent applications may also be subject to interference proceedings and U.S. patents may be subject to re-examination proceedings in the U.S. Patent and Trademark Office, and foreign patents may be subject to opposition or comparable proceedings in the corresponding foreign patent offices, which proceedings could result in either loss of the patent or denial of the patent application, or loss or reduction in the scope of one or more of the claims of, the patent or patent application. In addition, such interference, re-examination and opposition proceedings may be costly. Moreover, the U.S. patent laws may change, possibly making it easier to challenge patents. Some of our technology was, and continues to be, developed in conjunction with third parties, and thus there is a risk that such third parties may claim rights in our intellectual property. Thus, any patents that we own or license from others may provide limited or no protection against competitors. Our pending patent applications, those we may file in the future, or those we may license from third parties, may not result in patents being issued. If issued, they may not provide us with proprietary protection or competitive advantages against competitors with similar technology.

Non-payment or delay in payment of patent fees or annuities, whether intentional or unintentional, may result in loss of patents or patent rights important to our business. Many countries, including certain countries in Europe, have compulsory licensing laws under which a patent owner may be compelled to grant licenses to third parties. In addition, many countries limit the enforceability of patents against third parties, including government agencies or government contractors. In these countries, the patent owner may have limited remedies, which could materially diminish the value of the patent. In addition, the laws of some foreign countries do not protect intellectual property rights to the same extent as do the laws of the United States, particularly in the field of medical products and procedures.

Many of our competitors have significant resources and incentives to apply for and obtain intellectual property rights that could limit or prevent our ability to commercialize our current or future products in the United States or abroad.

Many of our competitors who have significant resources and have made substantial investments in competing technologies may seek to apply for and obtain patents that will prevent, limit or interfere with our ability to make, use or sell our products either in the United States or in international markets. Our current or future U.S. or foreign patents may be challenged, circumvented by competitors or others or may be found to be invalid, unenforceable or insufficient. Since patent applications are confidential until patents are issued in the United States, or in most cases, until after 18 months from filing of the application, or corresponding applications are published in other countries, and since publication of discoveries in the scientific or patent literature often lags behind actual discoveries, we cannot be certain that we were the first to make the inventions covered by each of our pending patent applications, or that we were the first to file patent applications for such inventions.

If we are unable to protect the confidentiality of our proprietary information and know-how, the value of our technology and products could be adversely affected.

In addition to patented technology, we rely on our unpatented proprietary technology, trade secrets, processes and know-how. We generally seek to protect this information by confidentiality agreements with our employees, consultants, scientific advisors and third parties. These agreements may be breached, and we may not have adequate remedies for any such breach. In addition, our trade secrets may otherwise become known or be independently developed by competitors. To the extent that our employees, consultants or contractors use intellectual property owned by others in their work for us, disputes may arise as to the rights in related or resulting know-how and inventions.

Intellectual property litigation is a common tactic in the medical device industry to gain competitive advantage. If we become subject to a lawsuit, we may be required to expend significant financial and other resources and our management's attention may be diverted from our business.

There has been a history of frequent and extensive litigation regarding patent and other intellectual property rights in the medical device industry, and companies in the medical device industry have employed intellectual property litigation to gain a competitive advantage. Accordingly, we may become subject to patent infringement claims or litigation in a court of law, or interference proceedings declared by the United States Patent and Trademarks Office, or USPTO, to determine the priority of inventions or an opposition to a patent grant in a foreign jurisdiction. The defense and prosecution of intellectual property suits, USPTO interference or opposition proceedings and related legal and administrative proceedings, are both costly and time consuming and could result in substantial uncertainty to us. Litigation or regulatory proceedings may also be necessary to enforce patent or other intellectual property rights of ours or to determine the scope and validity of other parties' proprietary rights. Any litigation, opposition or interference proceedings, with or without merit, may result in substantial expense to us, cause significant strain on our financial resources, divert the attention of our technical and management personnel and harm our reputation. We may not have the financial resources to defend our patents from infringement or claims of invalidity. An adverse determination in any litigation could subject us to significant liabilities to third parties, require us to seek licenses from or pay royalties to third parties or prevent us from manufacturing, selling or using our proposed products, any of which could have a material adverse effect on our business and prospects. We are not currently a party to any patent or other litigation.

Our VBLOC therapy or Maestro System may infringe or be claimed to infringe patents that we do not own or license, including patents that may issue in the future based on patent applications of which we are currently aware, as well as applications of which we are unaware. For example, we are aware of other companies that are investigating neurostimulation, including neuroblocking, and of patents and published patent applications held by companies in those fields. While we believe that none of such patents and patent applications are applicable to our products and technologies under development, third parties who own or control these patents and patent applications in the United States and abroad could bring claims against us that would cause us to incur substantial expenses and, if such claims are successfully asserted against us, they could cause us to pay substantial damages, could result in an injunction preventing us from selling, manufacturing or using our proposed products and would divert management's attention. Because patent applications in many countries such as the United States are maintained under conditions of confidentiality and can take many years to issue, there may be applications now pending of which we are unaware and which may later result in issued patents that our products infringe. If a patent infringement suit were brought against us, we could be forced to stop our ongoing or planned clinical trials, or delay or abandon commercialization of the product that is subject of the suit.

As a result of patent infringement claims, or to avoid potential claims, we may choose or be required to seek a license from a third party and be required to pay license fees or royalties, or both. A license may not be available at all or on commercially reasonable terms, and we may not be able to redesign our products to avoid infringement. Modification of our products or development of new products could require us to conduct additional clinical trials and to revise our filings with the FDA and other regulatory bodies, which would be time-consuming and expensive. Even if we were able to obtain a license, the rights may be nonexclusive, which could result in our competitors gaining access to the same intellectual property. Ultimately, we could be forced to cease some aspect of our business operations if, as a result of actual or threatened patent infringement claims, we are unable to enter into licenses on acceptable terms. This could harm our business significantly.

Risks Relating to This Offering and Ownership of Our Common Stock

Because there has not been a public market for our common stock and our stock price may be volatile, you may not be able to resell your shares at or above the initial offering price.

Prior to this offering, you could not buy or sell our common stock publicly. An active trading market for our common stock may not develop after completion of this offering or, if developed, may not be sustained. The price of the common stock sold in this offering will not necessarily reflect the market price of our common stock after this offering. The market for medical device stocks has been volatile. The following factors, most of which are outside of our control, could cause the market price of our common stock to decrease significantly from the price you pay in this offering:

- the denial or delay of regulatory clearances or approvals of our product or receipt of regulatory approval of competing products;
- changes in policies affecting third-party coverage and reimbursement in the United States and other countries;
- changes in government regulations and standards affecting the medical device industry and our product;
- ability of our product, if it receives regulatory clearance, to achieve market success;
- the performance of third-party contract manufacturers and component suppliers;
- our ability to develop sales and marketing capabilities;
- actual or anticipated variations in our results of operations or those of our competitors;
- announcements of new products, technological innovations or product advancements by us or our competitors;
- developments with respect to patents and other intellectual property rights;
- sales of common stock or other securities by us or our stockholders in the future;
- additions or departures of key scientific or management personnel;
- disputes or other developments relating to proprietary rights, including patents, litigation matters and our ability to obtain patent protection for our technologies;
- trading volume of our common stock;
- changes in earnings estimates or recommendations by securities analysts, failure to obtain analyst coverage of our common stock or our failure to achieve analyst earnings estimates;
- decreases in market valuations of medical device companies; and
- general market conditions and other factors unrelated to our operating performance or the operating performance of our competitors.

In the past, securities class action litigation often has been initiated against a company following a period of volatility in the market price of the company's securities. If class action litigation is initiated against us, we may incur substantial costs and our management's attention may be diverted from our operations. All of these factors could cause the market price of our stock to decline, and you may lose some or all of your investment.

If we do not achieve our projected business goals in the time frames we announce and expect, our stock price may decline.

From time to time, we estimate and publicly announce, including in this prospectus, the anticipated timing of the accomplishment of various clinical, regulatory and other product development goals. These statements, which are forward-looking statements, include our estimates regarding enrolling patients in our clinical trials, when we will complete our EMPOWER trial or our other clinical trials, when we will submit requests for and obtain FDA approval for our product and when we will begin to receive revenue. These estimates are and must necessarily be based on a variety of assumptions. The timing of the actual achievement of these milestones may vary dramatically compared to our estimates, in some cases for reasons beyond our control. Our failure to meet any publicly-announced goals may be perceived negatively by the public markets and, as a result, our stock price may decline. Please refer to our discussion under the caption "Special Note Regarding Forward-Looking Statements."

If equity research analysts do not publish research or reports about our business, or if they issue unfavorable commentary or downgrade our common stock, the price of our common stock could decline.

The trading market for our common stock will rely in part on the research and reports that equity research analysts publish about us and our business. We do not control these analysts or the content and opinions included in their reports. Securities analysts may elect not to provide research coverage of our common stock after the completion of this offering, and such lack of research coverage may adversely affect the market price of our common stock. The price of our stock could decline if one or more equity research analysts downgrade our stock or if those analysts issue other unfavorable commentary or cease publishing reports about us or our business. If one or more equity research analysts ceases coverage of our company, we could lose visibility in the market, which in turn could cause our stock price to decline.

Future sales of our common stock by existing stockholders could cause our stock price to decline.

If our existing stockholders sell substantial amounts of our common stock in the public market, the market price of our common stock could decrease significantly. The perception in the public market that our stockholders might sell shares of common stock could also depress the market price of our common stock. Substantially all of our existing stockholders prior to this offering are subject to lock-up agreements with the underwriters that restrict their ability to transfer their stock for at least 180 days after the date of this prospectus, with an extension in limited circumstances. Upon expiration of the lock-up agreements, 99,808,847 shares of our common stock will be eligible for sale in the public market pursuant to Rule 144 or Rule 701, and the volume, manner of sale and other limitations under those rules. The market price of our common stock may drop significantly when the restrictions on resale of these shares lapse and our existing stockholders are able to sell shares of our common stock into the market.

Following the offering, we also intend to increase the number of our registered shares of common stock by filing registration statements with the SEC covering all of the shares of our common stock subject to options outstanding, but not exercised, at the close of the offering and all of the shares available for future issuance under our stock incentive plan. In addition, upon completion of this offering, the holders of our preferred stock, including shares issuable upon exercise of outstanding warrants to purchase common stock and preferred stock, will hold an aggregate of 98,999,040 shares of common stock with rights, subject to some conditions, to require us to file registration statements covering their shares or to include their shares in registration statements that we may file for ourselves or other stockholders. If we were to include in a company-initiated registration statement shares held by those holders pursuant to the exercise of their registration rights, the sale of those shares could impair our ability to raise needed capital by depressing the price at which we could sell our common stock.

A decline in the price of shares of our common stock might impede our ability to raise capital through the issuance of additional shares of our common stock or other equity securities, and may cause you to lose part or all of your investment.

We have broad discretion in the use of the proceeds of this offering and may apply the proceeds in ways with which you do not agree.

Substantially all of our net proceeds from this offering will be used, as determined by management in its sole discretion, for achieving regulatory approval of our product, for initiating sales and marketing efforts, for research and development activities and for working capital and other general corporate purposes. Our management will have broad discretion over the use and investment of the net proceeds of this offering. The failure of our management to apply these funds effectively could harm our business. You will not have the opportunity, as part of your investment decision, to assess whether our proceeds are being used appropriately. Pending application of our proceeds, they may be placed in investments that do not produce income or that lose value.

Our directors and executive officers will continue to have substantial control over us after this offering and could limit your ability to influence the outcome of key transactions, including changes of control.

We anticipate that our executive officers and directors and entities affiliated with them will, in the aggregate, beneficially own % of our outstanding common stock following the completion of this offering, assuming the underwriters do not exercise their over-allotment option. Our executive officers, directors and affiliated entities, if acting together, would be able to control or influence significantly all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other significant corporate transactions. These stockholders may have interests that differ from yours, and they may vote in a way with which you disagree and that may be adverse to your interests. The concentration of ownership of our common stock may have the effect of delaying, preventing or deterring a change of control of our company, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company and may affect the market price of our common stock. This significant concentration of stock ownership may adversely affect the trading price of our common stock due to investors' perception that conflicts of interest may exist or arise.

Our organizational documents and Delaware law make a takeover of our company more difficult, which may prevent certain changes in control and limit the market price of our common stock.

Our certificate of incorporation and bylaws and Section 203 of the Delaware General Corporation Law contain provisions that may have the effect of deterring or delaying attempts by our stockholders to remove or replace management, engage in proxy contests and effect changes in control. These provisions include:

- our board of directors will be authorized, without prior stockholder approval, to create and issue preferred stock which could be used to implement anti-takeover devices;

- advance notice will be required for director nominations or for proposals that can be acted upon at stockholder meetings;

- our board of directors will be classified such that not all members of our board are elected at one time, which may make it more difficult for a person who acquires control of a majority of our outstanding voting stock to replace all or a majority of our directors;

- stockholder action by written consent will be prohibited;

- special meetings of the stockholders will be permitted to be called only by the chairman of our board of directors or by a majority of our board of directors; and

- stockholders will not be permitted to accumulate their votes for the election of directors; and stockholders will be permitted to amend our bylaws only upon receiving a majority of the votes entitled to be cast by holders of all outstanding shares then entitled to vote generally in the election of directors, voting together as a single class.

In addition, as a Delaware corporation, we are subject to Delaware law, including Section 203 of the Delaware General Corporation Law. In general, Section 203 prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the date that the stockholder became an interested stockholder unless certain specific requirements are met as set forth in Section 203. These provisions, alone or together, could have the effect of deterring or delaying changes in incumbent management, proxy contests or changes in control.

These provisions also could discourage proxy contests and make it more difficult for you and other stockholders to elect directors and take other corporate actions. The existence of these provisions could limit the price that investors might be willing to pay in the future for shares of our common stock. Some provisions in our certificate of incorporation and bylaws may deter third parties from acquiring us, which may limit the market price of our common stock.

You will experience immediate and substantial dilution in the net tangible book value of the common stock you purchase in this offering.

If you purchase shares of our common stock in this offering, you will experience immediate dilution of $ per share based on the mid-point of the range on the cover page of this prospectus because the price that you pay will be substantially greater than the adjusted pro forma net tangible book value per share of common stock that you acquire. This dilution is due in large part to the fact that our earlier investors paid substantially less than the price of the shares being sold in this offering when they purchased their shares of our capital stock. If outstanding options to purchase our common stock are exercised, you will experience additional dilution. See the section entitled “Dilution” in this prospectus for a more detailed description of this dilution.

We have not paid dividends in the past and do not expect to pay dividends in the future, and any return on investment may be limited to the value of our common stock.

We have never paid dividends on our common stock and do not anticipate paying dividends on our common stock in the foreseeable future. The payment of dividends on our common stock will depend on our earnings, financial condition and other business and economic factors affecting us at such time as our board of directors may consider relevant. If we do not pay dividends, our common stock may be less valuable because a return on your investment will only occur if our stock price increases.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “potential” or “continue” or the negative of these terms or other similar words, although not all forward-looking statements contain these words. These statements are only predictions. Although we believe that we have a reasonable basis for each forward-looking statement contained in this prospectus, we caution you that these statements are based on our projections of the future that are subject to risks and uncertainties. The outcome of the events described in these forward-looking statements is subject to known and unknown risks, uncertainties and other factors that may cause our, our customers’ or our industry’s actual results, levels of activity, performance or achievements expressed or implied by these forward-looking statements, to differ. “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business,” as well as other sections in this prospectus, discuss some of the factors that could contribute to these differences.

The forward-looking statements made in this prospectus relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

This prospectus also contains market data related to our business and industry. These market data include projections that are based on a number of assumptions. While we believe these assumptions to be reasonable and sound as of the date of this prospectus, if these assumptions turn out to be incorrect, actual results may differ from the projections based on these assumptions. As a result, our markets may not grow at the rates projected by these data, or at all. The failure of these markets to grow at these projected rates may have a material adverse effect on our business, results of operations, financial condition and the market price of our common stock.

USE OF PROCEEDS

We estimate that the net proceeds from our sale of shares of common stock in this offering will be approximately $ million, or approximately $ million if the underwriters exercise their over-allotment option in full, assuming an initial public offering price of $ per share, the mid-point of the range on the cover page of this prospectus, and after deducting the estimated underwriting discounts and commissions and offering expenses payable by us. A $1.00 increase (decrease) in the assumed initial public offering price of $ per share would increase (decrease) the net proceeds to us from this offering by $ million, assuming that the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting the estimated underwriting discounts and commissions and estimated offering expenses payable by us. We may also increase or decrease the number of shares we are offering. Each increase of 1.0 million shares in the number of shares offered by us, together with a $1.00 increase in the assumed offering price of $ per share, would increase the net proceeds to us from this offering by $ million. Similarly, each decrease of 1.0 million shares in the number of shares offered by us, together with a $1.00 decrease in the assumed offering price of $ per share, would decrease the net proceeds to us from this offering by $ million.

We currently expect to use our net proceeds from this offering as follows:

- approximately $23.0 million for achieving regulatory approval of our product;
- approximately $20.0 million for initiating sales and marketing efforts;
- approximately $13.0 million for research and product development activities; and
- the remainder for working capital and other general corporate purposes.

This expected use of net proceeds of this offering represents our current intentions based upon our present plans and business conditions. The amounts we actually expend in these areas may vary significantly from our current intentions and will depend upon a number of factors, including FDA clearance for our product, future sales growth, success of research and product development efforts, cash generated from future operations and actual expenses to operate our business.

As of the date of this prospectus, we cannot specify with certainty all of the particular uses for the net proceeds to be received upon the completion of this offering. Accordingly, our management will have broad discretion in the application of the net proceeds, and investors will be relying on the judgment of our management regarding the application of the proceeds of this offering. The amounts and timing of these expenditures will vary depending upon a number of factors, including FDA clearance for our products, future sales growth, success of research and product development efforts, cash generated from future operations and actual expenses to operate our business.

Pending the uses described above, we intend to invest the net proceeds in United States government securities and other short-term, investment-grade, interest-bearing instruments.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our common stock and do not anticipate paying cash dividends on our common stock. We anticipate that we will retain all of our future earnings, if any, for use in the development and expansion of our business and for general corporate purposes. Any determination to pay dividends in the future will be at the discretion of our board of directors and will depend upon our financial condition and operating results.

Table of Contents

CAPITALIZATION

The following table describes our capitalization as of March 31, 2007 on an actual basis and on a pro forma as adjusted basis to reflect:

- the conversion of all of the outstanding shares of our preferred stock into 95,442,677 shares of common stock upon completion of this offering;
- the conversion of all outstanding preferred stock warrants to common stock warrants;
- the issuance upon the completion of this offering of 1,875,000 shares of our common stock to Mayo Foundation for Medical Education and Research pursuant to a license;
- the filing of amendments to our certificate of incorporation effective upon completion of this offering; and
- our sale of shares of common stock in this offering at an assumed initial public offering price of $ per share, the mid-point of the range on the cover page of this prospectus, after deducting estimated underwriting discounts and commissions and offering expenses.

You should read this capitalization table together with the financial statements and related notes appearing elsewhere in this prospectus, as well as "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the other financial information included elsewhere in this prospectus.

	As of March 31, 2007	
	Actual	Pro Forma as Adjusted(1)
	(In thousands, except share and per share data)	
Current liabilities	$ 5,049	$
Notes payable, less current portion and discounts	915	
Convertible preferred stock warrant liability	973	
Total liabilities	6,937	
Stockholders' equity:		
Series C convertible preferred stock, $0.01 par value: 53,000,000 shares authorized, actual; 51,957,735 shares issued and outstanding, actual; no shares authorized, issued and outstanding, pro forma as adjusted	520	—
Series B convertible preferred stock, $0.01 par value: 41,089,088 shares authorized, actual; 39,002,196 shares issued and outstanding, actual; no shares authorized, issued and outstanding, pro forma as adjusted	390	—
Series A convertible preferred stock, $0.01 par value: 2,896,249 shares authorized, actual; 2,896,249 shares issued and outstanding, actual; no shares authorized, issued and outstanding, pro forma as adjusted	29	—
Preferred stock, $0.01 par value: no shares authorized, issued or outstanding, actual; 5,000,000 shares authorized and no shares issued and outstanding, pro forma as adjusted	—	—
Common stock, $0.01 par value: 130,000,000 shares authorized, actual; 5,490,650 shares issued and outstanding, actual; 50,000,000 shares authorized and shares issued and outstanding, pro forma as adjusted	55	
Additional paid-in capital	62,754	
Deferred compensation	(60)	
Deficit accumulated during development stage	(40,256)	
Total stockholders' equity	23,432	
Total liabilities and stockholders' equity	$ 30,369	$

(1) A $1.00 increase (decrease) in the assumed initial public offering price of $ per share would increase (decrease) additional paid-in capital, total stockholders' equity and total liabilities and stockholders' equity by $ million, assuming that the number of shares offered by us, as set forth on the cover page of this

prospectus, remains the same and after deducting underwriting discounts and commissions. We may also increase or decrease the number of shares we are offering. Each increase of 1.0 million shares in the number of shares offered by us, together with a $1.00 increase in the assumed offering price of $ per share, would increase additional paid-in capital, total stockholders' equity and total liabilities and stockholders' equity by approximately $ million. Similarly, each decrease of 1.0 million shares in the number of shares offered by us, together with a $1.00 decrease in the assumed offering price of $ per share, would decrease additional paid-in capital, total stockholders' equity and total liabilities and stockholders' equity by approximately $ million. The pro forma information discussed above is illustrative only and will adjust based on the actual public offering price and terms of this offering determined at pricing.

The preceding table excludes:

- 4,980,362 shares of common stock issuable upon the exercise of warrants outstanding as of March 31, 2007, on an as-converted basis and at a weighted average exercise price of $0.44 per share;
- 15,772,968 shares of common stock issuable upon the exercise of options outstanding as of March 31, 2007, at a weighted average exercise price of $0.23 per share; and
- 18,451,382 shares of common stock expected to be available for future issuance under our stock incentive plans upon completion of this offering.

We expect to complete a -for- reverse split of our common stock before the closing of this offering. All share amounts have been adjusted retroactively to give effect to this stock split.

DILUTION

If you invest in our common stock, your ownership interest will be diluted to the extent of the difference between the initial public offering price per share of common stock and the pro forma as adjusted net tangible book value per share of our common stock immediately after this offering. Our historical net tangible book value as of March 31, 2007 was $23.4 million, or $4.27 per share of common stock. Net tangible book value per share is determined by dividing our total tangible assets less our total liabilities by the number of shares of common stock outstanding. The pro forma net tangible book value of our common stock as of March 31, 2007 was approximately $24.4 million, or approximately $0.24 per share based on the number of shares outstanding as of March 31, 2007 after giving effect to the conversion of all outstanding preferred stock into common stock, the reclassification of convertible preferred stock warrants from liabilities to stockholders' equity and the issuance of 1,875,000 shares of common stock to the Mayo Foundation for Medical Education and Research upon closing of this offering.

After giving effect to our sale of shares of common stock at an assumed initial public offering price of $ per share, the mid-point of the range on the cover of this prospectus, and after deducting estimated underwriting discounts and commissions and offering expenses, our pro forma as adjusted net tangible book value as of March 31, 2007 would have been $ million, or $ per share. This amount represents an immediate increase in net tangible book value to our existing stockholders of $ per share and an immediate dilution to new investors of $ per share. The following table illustrates this per share dilution:

Assumed initial public offering price per share		$
Historical net tangible book value per share as of March 31, 2007	$	
Effect of reclassification of convertible preferred stock warrants from liabilities to stockholders' equity	$	
Pro forma net tangible book value per share before this offering	$	
Pro forma increase in net tangible book value per share attributable to investors participating in this offering	$	
Pro forma as adjusted net tangible book value per share after this offering		
Pro forma dilution per share to investors participating in this offering		$

Each $1.00 increase (decrease) in the assumed public offering price of $ per share would increase (decrease) our pro forma as adjusted net tangible book value by approximately $ million, or approximately $ per share, and the pro forma dilution per share to investors in this offering by approximately $ per share, assuming that the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same and after deducting underwriting discounts and commissions. We may also increase or decrease the number of shares we are offering. An increase of 1.0 million shares in the number of shares offered by us, together with a $1.00 increase in the assumed offering price of $ per share, would result in a pro forma as adjusted net tangible book value of approximately $ million, or $ per share, and the pro forma dilution per share to investors in this offering would be $ per share. Similarly, a decrease of 1.0 million shares in the number of shares offered by us, together with a $1.00 decrease in the assumed public offering price of $ per share, would result in an pro forma as adjusted net tangible book value of approximately $ million, or $ per share, and the pro forma dilution per share to investors in this offering would be $ per share. The pro forma as adjusted information discussed above is illustrative only and will adjust based on the actual public offering price and other terms of this offering determined at pricing.

If the underwriters exercise their over-allotment option to purchase additional shares in this offering, our pro forma as adjusted net tangible book value at March 31, 2007 would be $ million, or $ per share, representing an immediate increase in pro forma as adjusted net tangible book value to our existing stockholders of $ per share and an immediate dilution to investors participating in this offering of $ per share.

The following table summarizes as of , 2007, on a pro forma as adjusted basis, the number of shares of common stock purchased from us, the total consideration paid to us and the average price per share paid by our existing stockholders and by investors participating in this offering, based upon an assumed initial public offering price of $ per share, the mid-point of the range on the cover of this prospectus, and before deducting estimated underwriting discounts and commissions and offering expenses payable by us.

	Shares Purchased		Total Consideration		Weighted Average Price Per Share
	Number	Percent	Amount	Percent	
Existing stockholders		%	$	%	$
Investors participating in this offering					
Total		100%	$	100%	

The above discussion and tables also assume no exercise of any outstanding stock options or warrants except as set forth above. As of March 31, 2007, there were:

- 15,772,968 shares of common stock issuable upon the exercise of outstanding options with a weighted average exercise price of $0.23 per share;
- 4,980,362 shares of common stock issuable upon the exercise of warrants outstanding with a weighted average exercise price of $0.44 per share; and
- 18,451,382 shares of common stock reserved for future issuance under our stock incentive plans upon completion of this offering.

To the extent any of the foregoing options or warrants are exercised, there will be further dilution to investors participating in this offering.

SELECTED FINANCIAL DATA

The following selected financial data should be read together with our consolidated financial statements and accompanying notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this prospectus. The selected financial data in this section is not intended to replace our consolidated financial statements and the accompanying notes. Our historical results are not necessarily indicative of our future results.

Except for the pro forma net loss per share and pro forma weighted average number of shares data, we derived the statements of operations data for the years ended December 31, 2004, 2005 and 2006, and the balance sheet data as of December 31, 2005 and 2006 from our audited consolidated financial statements appearing elsewhere in this prospectus. Except for the pro forma net loss per share and pro forma weighted average number of shares data, the statement of operations data for the three months ended March 31, 2006 and 2007 and for the period from December 19, 2002 (inception) through March 31, 2007 and the balance sheet data as of March 31, 2007 have been derived from our unaudited consolidated financial statements included elsewhere in this prospectus. The statements of operations data for the year ended December 31, 2003 and for the period from December 19, 2002 (inception) through December 31, 2002 and the balance sheet data as of December 31, 2002, 2003 and 2004 are derived from our unaudited consolidated financial statements not included in this prospectus.

	Period from December 19, 2002 (inception) to December 31, 2002	Years Ended December 31,				Three Months Ended March 31,		Period from December 19, 2002 (inception) to March 31, 2007
		2003	2004	2005	2006	2006	2007	
Statements of Operations Data:	(In thousands, except per share data)							
Operating expenses:								
Research and development	$ 603	$ 1,750	$ 1,755	$ 8,833	$ 14,361	$ 3,645	$ 4,078	$ 31,380
Selling, general and administrative	—	135	1,491	2,319	3,761	846	1,348	9,054
Total operating expenses	603	1,885	3,246	11,152	18,122	4,491	5,426	40,434
Other income (expense):								
Interest income	—	—	35	110	1,136	87	415	1,696
Interest expense	—	(16)	(238)	(181)	(710)	(169)	(137)	(1,282)
Change in value of the convertible preferred stock warrant liability	—	—	—	—	7	—	(244)	(237)
Other, net	—	—	—	8	(1)	(7)	(6)	1
Net loss	$ (603)	$(1,901)	$(3,449)	$(11,215)	$(17,690)	$(4,580)	$ (5,398)	$ (40,256)
Net loss per share—basic and diluted(1)	$ (0.30)	$ (1.31)	$ (2.68)	$ (3.17)	$ (3.76)	$ (1.11)	$ (1.01)	
Weighted average number of shares used in per share calculations—basic and diluted(1)	2,000	1,446	1,288	3,541	4,709	4,118	5,362	
Pro forma net loss per common share (unaudited)—basic and diluted					$ (0.24)		$ (0.05)	
Weighted average number of shares used in pro forma per share calculations—basic and diluted					73,188		100,804	

(1) Please see Note 2 to our consolidated financial statements for an explanation of the method used to calculate basic and diluted net loss per common share attributable to common stockholders.

	As of December 31,					As of March 31,
	2002	2003	2004	2005	2006	2007
	(In thousands)					
Balance Sheet Data:						
Cash, cash equivalents and short-term investments	$ —	$ 664	$ 5,332	$ 10,719	$ 34,732	$ 28,547
Working capital (current assets less current liabilities)	20	448	5,025	8,640	29,921	24,000
Total assets	20	717	5,699	11,561	36,064	30,369
Long-term debt, net of current portion and discounts	—	1,155	—	7,344	1,727	915
Convertible preferred stock	6	18	240	419	939	939
Deficit accumulated during development stage	(603)	(2,504)	(5,952)	(17,168)	(34,858)	(40,256)
Total stockholders' equity (deficit)	20	(670)	5,327	1,975	28,574	23,431

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read together with our consolidated financial statements and related notes and the other financial information appearing elsewhere in this prospectus. This discussion and analysis contains forward-looking statements that involve risk, uncertainties and assumptions. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of many factors, including those discussed in "Risk Factors" and elsewhere in this prospectus.

Overview

We are a development stage medical device company focused on the design and development of devices that use neuroblocking technology to treat obesity and other gastrointestinal disorders. Our proprietary neuroblocking technology, which we refer to as VBLOC therapy, is designed to intermittently block the vagus nerve using high frequency, low energy, electrical impulses. We have a limited operating history and we currently have no products approved for sale. Our initial product under development is the Maestro System, which uses VBLOC therapy to limit the expansion of the stomach, reduce the frequency and intensity of stomach contractions and produce a feeling of early and prolonged fullness. We were formerly known as Beta Medical, Inc. and were incorporated in Minnesota on December 19, 2002. We later changed our state of incorporation to Delaware on July 22, 2004. Since inception, we have devoted substantially all of our resources to the development and commercialization of our Maestro System.

Based on our preclinical studies and initial clinical trials, we believe the Maestro System has the potential to offer obese patients a minimally invasive treatment alternative that can result in significant and sustained weight loss. We believe that our Maestro System will allow bariatric surgeons to help obese patients who are concerned about the risks and complications associated with gastric banding and gastric bypass surgery. We are continuing to evaluate the Maestro System in human clinical trials conducted internationally and plan to commence enrollment in our first U.S. pivotal trial, the EMPOWER trial, in the third quarter of 2007. We plan to use data from our EMPOWER trial to support our premarket approval, or PMA, application for the Maestro System, which we expect to submit in the first half of 2009. We anticipate commercialization in the United States beginning in 2010 if and when the FDA grants us PMA. We have implanted the Maestro System in 63 subjects as of April 30, 2007.

If and when we obtain FDA clearance of our Maestro System we intend to market our products in the United States through a direct sales force supported by field technical and marketing managers who provide training, technical and other support services to our customers. Outside the United States we intend to use direct, dealer and distributor sales models as the targeted geography best dictates. To date, we have relied on third-party manufacturers and suppliers for the production of our Maestro System. We currently anticipate that we will continue to rely on third-party manufacturers and suppliers for the production of the Maestro System following commercialization.

To date, we have generated no revenue from the sale of products, and we have incurred net losses in each year since our inception. As of March 31, 2007, we had a deficit accumulated during the development stage of $40.3 million. We expect our losses to continue and to increase as we continue our development activities and expand our commercialization activities. We have financed our operations primarily through private placement of our equity securities and issuance of debt.

Critical Accounting Policies and Significant Judgments and Estimates

Our management's discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported expenses during the reporting periods. We evaluate our estimates and judgments on an ongoing basis. Actual results may differ materially from these estimates under different assumptions or conditions.

While our significant accounting policies are more fully described in Note 2 to our consolidated financial statements included elsewhere in this prospectus, we believe that the following accounting policies and estimates are most critical to a full understanding and evaluation of our reported financial results.

Stock-Based Compensation

Through December 31, 2005, we have accounted for stock-based employee compensation arrangements using the intrinsic value method in accordance with the recognition and measurement provisions of Accounting Principles Board Opinion, or APB, No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, including the Financial Accounting Standards Board, or FASB, Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No. 25*. For periods prior to December 31, 2005, we have complied with the disclosure-only provisions required by Statement of Financial Accounting Standards, or SFAS, No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*, an amendment to SFAS No. 123.

Under APB No. 25, we were not required to recognize stock-based compensation expense for employee stock options granted from inception through 2005 as the exercise prices, for financial reporting purposes, were determined to be at or above the deemed fair value of the underlying common stock on the date of grant. The fair value of our common stock was assessed and approved by our board of directors, the members of which have extensive experience in the life sciences industry and all but one of whom are non-employee directors. In determining the appropriateness of the fair value of our common stock, the board of directors considered several factors, such as our life cycle, results of research and development, recent financings and financial projections.

While our consolidated financial statements through December 31, 2005 account for stock option grants pursuant to APB No. 25, in accordance with SFAS No. 123, we disclose in the notes to our consolidated financial statements the pro forma impact on our net loss had we accounted for stock option grants using the minimum value method of accounting. We account for stock-based compensation arrangements with non-employees in accordance with SFAS No. 123, as amended by SFAS No. 148, and Emerging Issues Task Force, or EITF, No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, using a fair value approach. For stock options granted to non-employees, the fair value of the stock options is estimated using the Black-Scholes valuation model. This model utilizes the estimated fair value of common stock and requires that, at the date of grant and each subsequent reporting period until the services are completed or a significant disincentive for nonperformance occurs, we make assumptions with respect to the expected term of the option, the volatility of the fair value of our common stock, risk free interest rates and expected dividend yields of our common stock. Different estimates of volatility and expected life of the option could materially change the value of an option and the resulting expense.

Adoption of SFAS No. 123R

Effective January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, or SFAS No. 123R, which requires compensation costs related to share-based transactions, including employee stock options, to be recognized in the financial statements based on fair value. SFAS No. 123R revises SFAS No. 123, as amended, and supersedes APB No. 25. We adopted SFAS No. 123R using the prospective transition method. Under this method, compensation cost is recognized for all share-based payments granted or modified subsequent to December 31, 2005. Prior to January 1, 2006, we used the minimum value method to determine values for our pro forma stock-based compensation disclosures. We have not utilized the minimum value method subsequent to our adoption of SFAS No. 123R on January 1, 2006, and the fair value of our options will be higher as a result. Our net loss for the three months ended March 31, 2007 and for the year ended December 31, 2006, was higher than if we had continued to account for employee stock-based compensation under APB No. 25 by $81,821 and $47,479, respectively.

We selected the Black-Scholes pricing model to determine the fair value of stock options. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model will be affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our estimated common stock fair value, expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rates, forfeitures and expected dividends.

The fair value of our common stock was assessed and approved by our board of directors. In determining the appropriateness of the fair value of our common stock, the board of directors considered several factors, including valuations performed by an unrelated valuation specialist, our life cycle, results of research and development, recent financings and financial projections. The expected term represents the weighted-average period that our stock options are expected to be outstanding. The expected term is currently based on the “simplified” method described in the SEC Staff Accounting Bulletin, Topic 14: Share-Based Payment. As we have been operating as a private company since inception, we are unable to use actual price volatility data. Therefore, we estimate the volatility of our common stock based on volatility of similar publicly-held entities. We base the risk-free interest rate that we use in the option pricing model on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options. We do not anticipate paying any cash dividends in the foreseeable future and therefore use an expected dividend yield of zero in the option pricing model. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. We had a choice of two attribution methods for allocating compensation costs under SFAS No. 123R: the “straight-line method,” which allocates expense on a straight-line basis over the requisite service period of the last separately vesting portion of an award, or the “graded vesting attribution method,” which allocates expense on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards. We chose the former method and amortized the fair value of each option on a straight-line basis over the requisite service period.

Calculating stock-based compensation expense requires the input of highly subjective assumptions, which represent our best estimates and involve inherent uncertainties and the application of management’s judgment. Estimates of stock-based compensation expenses are significant to our consolidated financial statements, but these expenses are non-cash expenses.

The guidance in SFAS No. 123R and Staff Accounting Bulletin No. 107 is relatively new, and best practices are not well established. The application of these principles may be subject to further interpretation and refinement over time. There are significant differences among option valuation models, and this may result in a lack of comparability with other companies that use different models, methods and assumptions. If factors change and we employ different assumptions in the application of SFAS No. 123R in future periods, or if we decide to use a different valuation model, the compensation expense that we record in the future under SFAS No. 123R may differ significantly from what we have recorded in the current period and could materially affect our operating loss, net loss and net loss per common share.

Net Operating Losses and Tax Credit Carryforwards

At December 31, 2006, we had federal and state net operating loss carryforwards of approximately $17.9 million each. These net operating loss carryforwards will expire in varying amounts from 2022 through

2026, if not utilized. Under the provisions of Section 382 of the Internal Revenue Code, substantial changes in our ownership may limit the amount of net operating loss carryforwards and certain tax credits that can be utilized annually in the future to offset taxable income. A valuation allowance has been established to reserve the potential benefits of these carryforwards and tax credits in our consolidated financial statements to reflect the uncertainty of future taxable income required to utilize available tax loss carryforwards and other deferred tax assets. If a change in our ownership is deemed to have occurred or occurs in the future, our ability to use our net operating loss carryforwards and tax credits in any fiscal year may be significantly limited.

Financial Overview

Revenue

To date, we have not generated any revenue. We do not expect to generate revenue until at least the second quarter of 2010 and only if we receive FDA clearance of our Maestro System. Any revenue from initial sales of a new product is difficult to predict and in any event will only modestly reduce our continued and increasing losses resulting from our research and development and other activities.

Research and Development Expenses

Our research and development expenses primarily consist of engineering, product development and clinical and regulatory expenses, incurred in the development of our Maestro System. Research and development expenses also include employee compensation, including stock-based compensation, consulting services, outside services, materials, supplies, depreciation and travel. We expense research and development costs as they are incurred. From inception through March 31, 2007, we have incurred a total of $31.4 million in research and development expenses.

Selling, General and Administrative Expenses

Our selling, general and administrative expenses consist primarily of compensation for executive, finance, market development and administrative personnel, including stock-based compensation. Other significant expenses include costs associated with attending medical conferences, professional fees for legal, including legal services associated with our efforts to obtain and maintain broad protection for the intellectual property related to our products, and accounting services, cash management fees, consulting fees and travel expenses. From inception through March 31, 2007, we have incurred $9.1 million in selling, general and administrative expenses.

Results of Operations

Comparison of the Three-Month Periods Ended March 31, 2006 and 2007

Research and Development Expenses. Research and development expenses were $4.1 million for the three months ended March 31, 2007, compared to $3.6 million for the three months ended March 31, 2006. The increase of $433,000, or 11.9%, is primarily due to a $266,000 increase in compensation expense associated with increased headcount and a $311,000 increase in professional services primarily associated with additional resources needed to complete development of the Maestro RC System. The increase was partially offset by reduced supplies, travel and other information technology expenses of $279,000. Included in research and development expenses during the first quarter of 2007 was $133,000 of stock-based compensation due to the adoption of SFAS No. 123R and non-employee stock compensation charges compared to $14,000 in the first quarter of 2006. The increase of $119,000 is the result of adopting the prospective method prescribed in SFAS No. 123R and an increase in the fair value of our common stock from January 1, 2006 through March 31, 2007. We expect our research and development expenses to increase as we continue development and clinical trials of our Maestro RC System for the obesity market and other future applications. We also expect a significant increase to occur in the quarter in which this offering is completed as a result of the issuance of 1,875,000 shares of common stock to the Mayo Foundation for Medical Education and Research, resulting in a one-time stock-based compensation expense of $, which amount has been computed using the mid-point of the range listed on the cover page of this prospectus.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $1.3 million for the three months ended March 31, 2007, compared to $846,000 for the three months ended March 31, 2006. The increase of $502,000, or 59.3%, is primarily due to a $234,000 increase in professional services expense related to patent filing fees and general patent support, audit fees associated with our initial public offering, public relations and reimbursement activities, and employee recruiting fees. Additional components of the increase include a $72,000 increase in compensation expense associated with increased headcount and a $98,000 increase in facility and other administrative costs. Included in selling, general and administrative expenses during the first quarter of 2007 was $112,000 of stock-based compensation due to the adoption of SFAS No. 123R and non-employee stock compensation charges compared to $1,000 in the first quarter of 2006. The increase of $111,000 is the result of adopting the prospective method prescribed in SFAS No. 123R and an increase in the fair value of our common stock from January 1, 2006 through March 31, 2007. We expect our selling, general and administrative expenses to increase substantially due to increased headcount necessary to support our continued growth in operations, the costs associated with operating as a publicly-traded company and the cost associated with the expected commercial launch of our Maestro System.

Interest Income. Interest income was $415,000 for the three months ended March 31, 2007, compared to $87,000 for the three months ended March 31, 2006. The increase of $329,000 was primarily due to higher cash, cash equivalents and short-term investment balances during the first quarter of 2007 as a result of the closing of our $46.2 million Series C preferred stock financing, debt funding and higher interest rates. We expect our interest income to increase as a result of the proceeds of this offering.

Interest Expense. Interest expense was $137,000 for the three months ended March 31, 2007, compared to $169,000 for the three months ended March 31, 2006. The decrease of $32,000 was primarily due to a decrease in the principal balance outstanding on loan agreements entered into during 2005 and 2006.

Change in Value of the Convertible Preferred Stock Warrant Liability. Change in value of the convertible preferred stock warrant liability was $244,000 for the three months ended March 31, 2007, compared to none for the three months ended March 31, 2006. This is the result of a convertible preferred stock warrant liability being recorded on December 11, 2006 when we sold an additional 1,124,480 shares of Series C convertible preferred stock. Upon closing the sale, we had insufficient authorized and unissued shares of Series C convertible preferred stock available to share settle outstanding warrants to purchase Series C convertible preferred stock, resulting in the warrants being reclassified as a liability at the estimated fair value of $735,000 on December 11, 2006 and subsequently remeasured as of December 31, 2006 and March 31, 2007. The fair market value of the warrants as of March 31, 2007 and December 31, 2006 was $973,000 and $729,000, respectively.

Comparison of the Years Ended December 31, 2005 and 2006

Research and Development Expenses. Research and development expenses were $14.4 million for the year ended December 31, 2006, compared to $8.8 million for the year ended December 31, 2005. The increase of $5.6 million, or 62.6%, was primarily due to a $1.5 million increase in compensation related expenses associated with increased headcount and a $3.9 million increase in professional services expenses associated with the continued development of our Maestro RF System and the beginning of our international clinical trials. Included in research and development expenses during 2006 was $121,000 of stock-based compensation due to the adoption of SFAS No. 123R and non-employee stock compensation charges compared to $0 in 2005.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $3.8 million for the year ended December 31, 2006, compared to $2.3 million for the year ended December 31, 2005. The increase of $1.5 million, or 62.1%, was primarily due to a $405,000 increase in compensation related expenses associated with increased headcount, a $511,000 increase in professional services and a $161,000 increase in facility expenses as a result of increased rent costs. Included in selling, general and administrative expenses during 2006 was $43,000 of stock-based compensation due to the adoption of SFAS No. 123R and non-employee stock compensation charges compared to $25,000 in 2005.

Interest Income. Interest income was $1.1 million for the year ended December 31, 2006, compared to $110,000 for the year ended December 31, 2005. The increase of $1.0 million was primarily due to higher cash, cash equivalents and short-term investment balances during 2006 as a result of the closing of our $46.2 million Series C preferred stock financing and higher interest rates.

Interest Expense. Interest expense was $710,000 for the year ended December 31, 2006, compared to $181,000 for the year ended December 31, 2005. The increase of $529,000 was primarily due to 2006 having a full year of interest on loan agreements entered into during the last half of 2005 and additional loan agreements entered into in the first half of 2006.

Comparison of the Years Ended December 31, 2004 and 2005

Research and Development Expenses. Research and development expenses were $8.8 million for the year ended December 31, 2005, compared to $1.8 million for the year ended December 31, 2004. The increase of $7.0 million was primarily the result of product development activities associated with our Maestro RF System and increased activity in preparation of launching our international clinical trials. Specifically, compensation related expenses increased $1.3 million as a result of increased headcount, consulting related expenses increased $1.7 million and travel expenses increased $215,000. There was also an increase of $3.4 million in product development costs.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $2.3 million for the year ended December 31, 2005, compared to $1.5 million for the year ended December 31, 2004. The increase of $828,000, or 55.5%, was primarily due to a $265,000 increase in compensation related expenses associated with increased headcount, a $233,000 increase in office supply related purchases, a $180,000 increase in professional services due mainly to audit and legal fees and a $71,000 increase in market development expenses.

Liquidity and Capital Resources

We have incurred losses since our inception in December 2002 and, as of March 31, 2007 we had a deficit accumulated during the development stage of $40.3 million. We have financed our operations to date principally through sale of capital stock, debt financing and interest earned on investments. Through March 31, 2007, we have received net proceeds of $63.2 million from the sale of common stock and preferred stock and $5.8 million in debt financing from a lender that provides $746,000 to finance equipment purchases and $5.0 million to finance working capital. As of March 31, 2007, we had $28.5 million in cash, cash equivalents and short-term investments. Our cash and investment balances are held in a variety of interest bearing instruments, including obligations of U.S. government agencies, corporate bonds, commercial paper, variable rate demand notes and money market funds. Cash in excess of immediate requirements is invested in accordance with our investment policy, primarily with a view to liquidity and capital preservation.

Net Cash Used in Operating Activities

Net cash used in operating activities was $16.2 million, $10.3 million and $3.1 million for the years ended December 31, 2006, 2005 and 2004, respectively. Net cash used in operating activities was $5.3 million and $4.3 million for the three months ended March 31, 2007 and 2006, respectively. Net cash used in operating activities primarily reflects the net loss for those periods, which was partially offset by depreciation and amortization, stock-based compensation and changes in operating assets and liabilities.

Net Cash Provided by or Used in Investing Activities

Net cash used in investing activities was $17.7 million, $450,000 and $242,000 for the years ended December 31, 2006, 2005 and 2004, respectively. Net cash used in investing activities for the year ended

December 31, 2006 was primarily related to the purchase of short-term investments and, to a lesser extent, purchase of property and equipment offset somewhat by the proceeds from the maturity of short-term investments. Net cash used in investing activities for the years ended December 31, 2005 and 2004 was related to the purchase of property and equipment. Net cash provided by investing activities was $2.9 million for the three months ended March 31, 2007 compared to net cash used in investing activities of $62,000 for the three months ended March 31, 2006. Net cash provided by investing activities for the three months ended March 31, 2007 was primarily related to the proceeds from the maturity of short-term investments partially offset by the purchase of short-term investments and, to a lesser extent, the purchase of property and equipment.

Net Cash Provided by or Used in Financing Activities

Net cash provided by financing activities was $40.7 million, $16.1 million and $8.0 million for the years ended December 31, 2006, 2005 and 2004, respectively. Net cash used in financing activities was $630,000 for the three months ended March 31, 2007 compared to net cash provided by financing activities of $2.5 million for the three months ended March 31, 2006. Net cash provided by financing activities was primarily attributable to the issuance of Series B preferred stock in the years ended December 31, 2005 and 2004, the issuance of Series C preferred stock in the year ended December 31, 2006 and proceeds from debt financing in the years ended December 31, 2006 and 2005. Net cash used in financing activities for the three months ended March 31, 2007 was primarily related to repayments made on outstanding loan amounts, partially offset by proceeds from the exercise of common stock options. Net cash provided by financing activities for the three months ended March 31, 2006 was primarily related to proceeds from debt financing and proceeds from the exercise of common stock options, partially offset by repayments made on outstanding loan amounts.

Operating Capital and Capital Expenditure Requirements

To date, we have not commercialized any products and we have not earned any operating revenues. We anticipate that we will continue to incur substantial net losses for the next several years as we develop our products, prepare for the potential commercial launch of our Maestro System, develop the corporate infrastructure required to sell our products and operate as a publicly-traded company as well as pursue additional applications for our technology platform.

We do not expect to generate significant product revenue until 2010. We do not anticipate generating any product revenue in the United States unless and until we successfully obtain FDA clearance for our Maestro System. We believe the net proceeds from this offering, together with our cash, cash equivalents and short-term investment balances and interest income we earn on these balances will be sufficient to meet our anticipated cash requirements through at least the next 36 months. If our available cash, cash equivalents and investment balances and net proceeds from this offering are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities or enter into a credit facility. The sale of additional equity and debt securities may result in dilution to our stockholders. If we raise additional funds through the issuance of debt securities, these securities could have rights senior to those of our common stock and could contain covenants that would restrict our operations. We may require additional capital beyond our currently forecasted amounts. Any such required additional capital may not be available on reasonable terms, if at all. If we are unable to obtain additional financing, we may be required to reduce the scope of, delay, or eliminate some or all of, our planned research, development and commercialization activities, which could materially harm our business.

Our forecast of the period of time through which our financial resources will be adequate to support our operations, the costs to complete development of products and the cost to commercialize our products are forward-looking statements and involve risks and uncertainties, and actual results could vary materially and negatively as a result of a number of factors, including the factors discussed in the “Risk Factors” section of this prospectus. We have based these estimates on assumptions that may prove to be wrong, and we could utilize our available capital resources sooner than we currently expect.

Because of the numerous risks and uncertainties associated with the development of medical devices, such as our Maestro System, we are unable to estimate the exact amounts of capital outlays and operating expenditures necessary to complete the development of the products and successfully deliver a commercial product to the market. Our future capital requirements will depend on many factors, including but not limited to the following:

- the scope, rate of progress, results and cost of our clinical trials and other research and development activities;
- the cost and timing of regulatory approvals;
- the cost and timing of establishing sales, marketing and distribution capabilities;
- the cost of establishing clinical and commercial supplies of our Maestro System and any products that we may develop;
- the rate of market acceptance of our Maestro System and VBLOC therapy and any other product candidates;
- the cost of filing and prosecuting patent applications and defending and enforcing our patent and other intellectual property rights;
- the cost of defending, in litigation or otherwise, any claims that we infringe third-party patent or other intellectual property rights;
- the effect of competing products and market developments;
- the cost of explanting clinical devices;
- the terms and timing of any collaborative, licensing or other arrangements that we may establish;
- any revenue generated by sales of our future products; and
- the extent to which we acquire or invest in businesses, products and technologies, although we currently have no commitments or agreements relating to any of these types of transactions.

Contractual Obligations

The following table summarizes our contractual obligations as of December 31, 2006 and the effect those obligations are expected to have on our financial condition and liquidity position in future periods:

	Payments Due By Period				
Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Operating lease	$ 242,440	$ 138,076	$ 104,364	$ 0	$ 0
Long-term debt	4,996,410	3,054,028	1,942,382	0	0
Other long-term liabilities	750,000	250,000	500,000	0	0
Total contractual cash obligations	$5,988,850	$3,442,104	$2,546,746	$ 0	$ 0

Our commitments for operating lease relate to the lease for our corporate headquarters in St. Paul, Minnesota. There has been no material change in these obligations other than scheduled payments through March 31, 2007. Other long-term liabilities consist of obligations required under the terms of our license agreement with the Mayo Foundation for Medical Education and Research, or Mayo Foundation.

We are also obligated to issue up to 1,875,000 shares of common stock to the Mayo Foundation as consideration if future Mayo Foundation patents are issued or if the FDA approves a product patented by the Mayo Foundation or jointly patented by the Mayo Foundation and us. Upon the completion of this offering, the 1,875,000 shares of common stock become immediately issuable to the Mayo Foundation and we will record a one-time stock-based compensation expense of $, which amount has been computed using the mid-point of the range listed on the cover page of this prospectus.

Off-balance-sheet Arrangements

Since our inception, we have not engaged in any off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K of the SEC.

Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk is confined to our cash, cash equivalents and short-term investments which have maturities of less than one year. The goals of our investment policy are preservation of capital, fulfillment of liquidity needs and fiduciary control of cash and investments. We also seek to maximize income from our investments without assuming significant risk. To achieve our goals, we maintain a portfolio of cash equivalents and investments in a variety of securities of high credit quality. The securities in our investment portfolio are not leveraged, are classified as either available for sale or held-to-maturity and are, due to their very short-term nature, subject to minimal interest rate risk. We currently do not hedge interest rate exposure. Because of the short-term maturities of our investments, we do not believe that an increase in market rates would have any material negative impact on the value of our investment portfolio.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize in our financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year, with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to opening retained earnings. The adoption of FIN 48 had no impact on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (SFAS 157), *Fair Value Measurements*, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided we have not yet issued financial statements, including for interim periods, for that fiscal year. We are currently evaluating the impact of SFAS 157.

In September 2006, the United Stated Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 (SAB 108), *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements*, which provides interpretive guidance on how registrants should quantify financial statement misstatements. Under SAB 108, registrants are required to consider both a “rollover” method which focuses primarily on the income statement impact of misstatements and the “iron curtain” method which focuses primarily on the balance sheet impact of misstatements. The adoption of SAB 108 had no impact on our consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The amendment to SFAS 115 applies to all entities with investments in available-for-sale or trading securities. The statement is effective for fiscal years beginning after November 15, 2007. We have not yet determined the effect SFAS 159 will have on our consolidated financial statements.

BUSINESS

Overview

We are a development stage medical device company focused on the design and development of devices that use neuroblocking technology to treat obesity and other gastrointestinal disorders. Our proprietary neuroblocking technology, which we refer to as VBLOC therapy, is designed to intermittently block the vagus nerve using high-frequency, low-energy, electrical impulses. The vagus nerve controls much of the activity of the stomach, intestines and pancreas and plays a role in food processing. Our initial product under development is the Maestro System, which uses VBLOC therapy to limit the expansion of the stomach, reduce the frequency and intensity of stomach contractions and produce a feeling of early and prolonged fullness. Based on our preclinical studies and initial clinical trials, we believe the Maestro System has the potential to offer obese patients a minimally-invasive treatment alternative that can result in significant and sustained weight loss.

We believe that our Maestro System will allow bariatric surgeons to help obese patients who are concerned about the risks and complications associated with gastric banding and gastric bypass surgery. We are continuing to evaluate the Maestro System in human clinical trials conducted internationally. We recently received a conditional investigational device exemption, or IDE, for our first U.S. pivotal trial, the EMPOWER trial, and plan to commence enrollment in the third quarter of 2007. We plan to use data from our EMPOWER trial to support our application for premarket approval, or PMA, for the Maestro System, which we expect to submit in the first half of 2009. If the U.S. Food and Drug Administration, or FDA, grants us approval, we anticipate we will be able to commercialize the Maestro System in the United States in 2010. We have implanted the Maestro System in 63 subjects as of April 30, 2007. To date, we have not observed any mortality or any medically serious device-related complications that have required surgical attention in the 63 subjects we have implanted with the Maestro System.

Our Maestro System delivers VBLOC therapy via two small electrodes that are laparoscopically implanted and placed in contact with the trunks of the vagus nerve just above the junction between the esophagus and the stomach, near the diaphragm. The electrodes deliver the appropriate VBLOC therapy algorithm as programmed by a neuroregulator implanted under the skin in the abdominal region. Our Maestro System is designed to be implanted by a bariatric surgeon in approximately one hour during an outpatient procedure that is typically performed using a short-acting general anesthetic. The physician activates the Maestro System after an approximate two-week healing period following implantation. VBLOC therapy is then delivered intermittently each day during the patient’s waking hours.

If and when we obtain FDA clearance of our Maestro System we intend to market our products in the United States through a direct sales force supported by field technical and marketing managers who provide training, technical and other support services to our customers. Initially, we anticipate that our sales representatives will exclusively target selected bariatric surgery Centers of Excellence and nationally recognized bariatric surgery centers. Outside the United States we currently intend to use direct, dealer and distributor sales models as the targeted geography best dictates.

We believe we are the only company applying neuroblocking therapy to the vagus nerve for the treatment of obesity. We believe that two of our issued patents and our patent applications broadly cover the use of neuroblocking therapy for obesity and other disorders and we intend to continue to pursue further intellectual property protection through U.S. and foreign patent applications.

The Obesity Epidemic

Obesity has been identified by the U.S. Surgeon General as the fastest growing cause of disease and death in the United States. In 1980, approximately 15% of the adult population in the United States was obese, according to the National Health and Nutrition Examination Survey. By 2004, the incidence of obesity had more than doubled to 32%. Currently, the Centers for Disease Control and Prevention, or CDC, estimates that there are 65 million obese adults in the United States, with 42 million having a Body Mass Index, or BMI, of 30 to 35 and 23 million having a BMI greater than 35. BMI is calculated by dividing a person's weight in kilograms by the square of their height in meters. Obesity is also a significant health problem outside of the United States, with as many as 400 million people worldwide estimated to be obese according to the World Health Organization.

The CDC has identified obesity as a leading public health threat in the United States and estimated that there are approximately 112,000 obesity-related deaths each year in the United States. According to data from the CDC, 76% of people with a BMI above 35 have an obesity-related disease or disorder, also called a co-morbidity. According to the North American Association for the Study of Obesity and the CDC, obesity is associated with many significant weight-related co-morbidities including Type 2 diabetes, high blood-pressure, sleep apnea, certain cancers, high cholesterol, coronary artery disease, osteoarthritis and stroke. In addition, a number of disorders involving the central nervous system may also be complicated by obesity, such as anxiety, bipolar disorder, agoraphobia, depression and insomnia. As of 2000, the Department of Health and Human Services estimated the overall economic costs of obesity in the United States to be $117 billion per year.

We believe that the obesity epidemic will continue to grow worldwide given dietary trends in developed nations that favor highly processed sugars, larger meals and fattier foods, as well as increasingly sedentary lifestyles. Despite the growing obesity rate, increasing public interest in the obesity epidemic and significant medical repercussions and economic costs associated with obesity, there continues to be a significant unmet need for more effective treatments.

Existing Obesity Treatments and Limitations

Existing options for the treatment of obesity include behavioral modification, pharmaceutical therapy and bariatric surgery. While behavioral modification, including nutritional and exercise counseling, is an important component in the treatment of obesity, most patients find it difficult to achieve and maintain significant weight loss with a regimen of diet and exercise alone. Studies have shown that behavioral modification alone is an ineffective treatment for obesity in 95% of patients. As a result, there is a significant need for other treatments such as pharmaceutical therapy or bariatric surgery. However, we believe these alternatives have seen limited adoption to date as physicians and patients remain dissatisfied with the tradeoffs between efficacy and safety of existing treatment options.

Pharmaceutical therapy. Several pharmaceutical products have been approved by the FDA for obesity therapy in the United States. These drug therapies often represent a first option in the treatment of obese patients within lower BMI ranges, but may carry significant safety risks or troublesome side-effects, such as high blood pressure, increased heart rate or diarrhea. In addition, patients using pharmaceutical therapy often experience a weight loss plateau after six months. We believe these side-effects and shortcomings have led to limited adoption of pharmaceutical therapy, as reflected in a September 2006 Frost & Sullivan report, which states that in 2005 less than two percent of the obese population in the United States was treated with pharmaceuticals.

Bariatric surgery. In the more severe cases of obesity, patients may pursue more aggressive surgical treatment options. Gastric bypass and gastric banding, the most commonly employed bariatric surgeries, promote weight loss by surgically restricting the stomach's capacity and its outlet size. Gastric bypass also affects weight loss by restricting the body's ability to absorb nutrients. However, according to American Society for Bariatric Surgery estimates in 2006, less than two percent of the 15 million surgically-eligible obese population underwent a bariatric surgical procedure. We believe this low adoption rate is largely due to the numerous short and long-term safety risks presented by these procedures.

The most common form of gastric bypass accounts for approximately 70% of all bariatric surgeries in the United States. Gastric bypass typically involves the surgical division of the stomach and small intestine. The surgeon creates a small walnut-sized pouch out of the upper segment of the stomach, which is connected to the severed downstream section of the small intestine, thereby bypassing the lower part of the stomach and much of the front end of the small intestine. Gastric bypass is a highly invasive, anatomy-altering surgery and patients may face many of the following:

- potentially fatal post-surgical complications including pulmonary embolism, or blood clots that travel to the lungs, as well as leaks that may lead to post-surgical infection, which occur at the juncture between newly-joined or repaired sections of the digestive system;
- re-operations to repair sections of the digestive system and to dilate or further reduce the surgically-created passageway between the stomach and the intestine;
- nutrient deficiency resulting from the reduced capacity to absorb vitamins and minerals in the bypassed section of the small intestine;
- intolerance to common foods; and
- extended hospitalization.

Gastric bypass is performed as an open surgical procedure or a laparoscopic procedure. Length of stay averaged 3.7 days for open bariatric surgical procedures and 2.5 days for laparoscopic bariatric procedures. Although laparoscopic surgery can reduce the risks associated with gastric bypass surgery, it does not eliminate them entirely. These risks may include: breathing problems, irregular heart rhythm, bleeding, injury of abdominal organs including the lower esophagus, blood clots in legs and lungs, infection, temporary abdominal discomfort and loss of appetite and, in rare cases, death. The 30-day mortality rates in patients with gastric bypass range from 0.3% to over one percent. A study of 16,155 Medicare patients who underwent bariatric surgery from 1997 to 2002 showed 12-month mortality rates to be over twice as high as the 30-day rates. We believe that the perceived risk presented by these mortality rates represents a substantial barrier to adoption.

Gastric banding typically involves implantation of a silicone band around the upper portion of the stomach to restrict stomach capacity and stomach outlet size, usually to less than one centimeter. The silicone band can be adjusted by a surgeon through a needle-accessible port to restrict the diameter of the stomach pouch outlet. Although less invasive than gastric bypass, with gastric banding, patients and surgeons may face many of the following:

- re-operations to correct slippage of the stomach through the band or to correct erosions of the band through the wall of the stomach. Bands that are too loose or that slip become ineffective, while those that are too tight tend to cause nausea and vomiting. Recent European research indicates that band-related complications and re-operations may occur throughout the life of the gastric band at a rate of nearly five percent per year;
- intolerance to common foods such as meats and certain breads that can obstruct the restricted passageway and require patients to vomit to clear the obstruction;
- ongoing clinical visits to receive physician-controlled, sometimes uncomfortable, band adjustments that require significant time for the patient and the surgeon and increase surgical staffing requirements;
- complications generally associated with laparoscopic procedures as well as device failure or malfunction with possible need for additional surgery; and
- an in-patient hospital stay.

We believe that gastric banding has not been more widely accepted because of the high rate of re-operation, the frequent nausea and vomiting experienced by patients, the restrictive post-operative diet and the post-operative burden placed on both the patient and physician for frequent follow-up visits.

Neurostimulation as a Treatment for Obesity: Because of the side effects and limitations involved with bariatric surgery, efforts have been made to develop alternative treatments for obesity. One alternative treatment that has been explored is neurostimulation, which uses low-frequency, electrical stimulation of either the vagus nerve or the smooth muscles and nerves of the stomach to slow the emptying of the stomach or induce a feeling of fullness. However, reports of two recent clinical studies have not shown neurostimulation to be effective in treating obesity:

- In 2003, researchers using Cyberonics' VNS system reported inconclusive results of a pilot study using bilateral vagal nerve stimulation in a small human series following earlier promising results in canines.
- In December 2005, Medtronic announced that it did not meet the efficacy endpoint in the U.S. pivotal clinical trial for its gastric stimulation device.

We believe that these results suggest that stimulation therapies have limited application in the treatment of obesity.

Given the limitations of pharmaceutical therapy, bariatric surgery and neurostimulation, we believe there is a substantial need among physicians and obese individuals for a safe and effective solution that:

- preserves normal anatomy;
- allows continued ingestion and digestion of foods found in a typical, healthy diet;
- enables non-invasive adjustability while reducing the need for frequent clinic visits;
- minimizes the risks of re-operation, malnutrition and mortality; and
- reduces the natural hunger drive of patients.

EnteroMedics' Solution

We believe that our Maestro System addresses many of the unmet needs of physicians and patients for an effective long-term obesity treatment that minimizes the complications presented by existing alternatives. The Maestro System delivers VBLOC therapy, which we believe is the first therapy of its kind for the treatment of obesity using neuroblocking. VBLOC therapy interrupts nerve signals along the vagus nerve to selectively block the gastrointestinal effects of the vagus nerve, unlike neurostimulation, which attempts to increase neural activity through stimulation to impact the digestive system.

The Vagus Nerve and the Digestive System

Beginning in the brain, the vagus nerve travels down alongside the esophagus to the stomach and other gastrointestinal organs and is primarily responsible for autonomic regulation involved in heart, lung and gastrointestinal function. The vagus nerve controls much of the activity of the stomach, intestine and pancreas and plays a role in food processing, including:

- expansion of the stomach as food enters;
- contractions of the stomach to break food into smaller particles;

- release of gastric acid required for food processing;
- emptying of the stomach contents into the small intestine;
- secretion of digestive pancreatic enzymes that enable absorption of calories; and
- controlling sensations of hunger, satisfaction and fullness.

VBLOC Therapy

Several studies of the vagus nerve and its effect on the digestive system have focused on the effects of surgical vagotomy, the permanent severing of the vagus nerve at the level of the junction between the esophagus and the stomach. Given the role of the vagus nerve in regulating the release of gastric acid, early researchers originally used vagotomy as a treatment for peptic ulcers. They discovered that their patients often experienced weight loss or, at a minimum, failure to gain weight following vagotomy. However, weight loss after vagotomy alone has been disappointing, particularly over the long-term and likely dissipates as the body compensates for the anatomical disruption by partial restoration of nervous system function.

VBLOC therapy is designed to block the gastrointestinal effects of the vagus nerve by using high-frequency, low-energy electrical impulses to intermittently interrupt naturally occurring neural impulses on the vagus nerve between the brain and the digestive system. Our therapy is designed to limit the expansion of the stomach and to reduce the frequency and intensity of stomach contractions. In addition, we believe VBLOC therapy also reduces the absorption of calories by decreasing the secretion of digestive enzymes. The resulting physiologic effects of VBLOC therapy are intended to produce a feeling of early and prolonged fullness following smaller meal portions and a subsequent reduction in hunger. By intermittently blocking the vagus nerve and allowing it to return to full function between therapeutic episodes, we believe we have limited the body's natural tendency to circumvent the therapy, which can result in long-term weight loss.

We have designed our Maestro System to address a significant market opportunity that exists for a safe, effective and less-invasive therapy that is intended to address the underlying causes of hunger and obesity. Our Maestro System is designed to offer each of the following benefits, which we believe could lead to the adoption of VBLOC as the therapy of choice for obesity:

- ***Preserves Normal Anatomy.*** Our system is designed to block the neural signals that influence a patient's hunger and sense of fullness without altering digestive system anatomy. Accordingly, patients should experience fewer and less severe side effects compared to treatments that incorporate anatomical alterations.
- ***Allows Continued Ingestion and Digestion of Foods Found in a Typical, Healthy Diet.*** Because our therapy leaves the digestive anatomy unaltered, we believe that patients will be able to maintain a more consistent nutritional balance compared to existing surgical approaches.
- ***May be Implanted on an Outpatient Basis and Adjusted Non-Invasively.*** The Maestro System is designed to be laparoscopically implanted in approximately one hour, allowing patients to leave the hospital or clinic on the same day. The implantable system is designed to be turned off and left in place for patients who reach their target weight. When desired, the follow-up physician can simply and non-invasively turn the therapy back on. Alternatively, the implantable system can be removed in a laparoscopic procedure.
- ***Offers Favorable Safety Profile.*** We have designed our EMPOWER clinical trial to demonstrate the safety of the Maestro System. In our clinical trials to date, we have not observed any mortality or any medically serious device-related complications that have required surgical attention in the 63 patients we

have implanted with the Maestro System. We have also not observed any long-term problematic clinical side effects in any patients, including in the nine patients who have been using the Maestro System for more than 10 months.

- ***Targets Multiple Factors that Contribute to Hunger and Obesity***. We designed VBLOC therapy to target the multiple digestive functions of the vagus nerve and to affect the perception of hunger and fullness, which together contribute to obesity.

VBLOC therapy, delivered via our Maestro System, is intended to offer patients an effective, safe, outpatient solution that minimizes complications. We believe that if approved it could enable patients to lose weight and maintain long-term weight loss while enjoying a normal, healthy diet. We also believe that the Maestro System, if approved, will appeal to physicians based on the inherent physiological approach of VBLOC therapy and its anticipated favorable safety profile.

Our Business Strategy

Our goal is to establish VBLOC therapy, delivered via our Maestro System, as the leading obesity management solution. The key business strategies by which we intend to achieve these objectives include:

Achieve Regulatory Approval for VBLOC Therapy Using Our Maestro System. We have received a conditional Investigational Device Exemption, or IDE, from the FDA for use of the Maestro System in the United States in our EMPOWER pivotal trial, but have yet to receive regulatory approval to market the Maestro System. We plan to commence our EMPOWER pivotal trial in the United States and Australia in the third quarter of 2007. If we achieve favorable results from the EMPOWER pivotal trial, we plan to use the data from this trial to obtain a PMA from the FDA to allow us to commence sales in the United States in 2010. We also plan to complete the regulatory submissions required to enable the eventual sale of our systems internationally.

Drive the Adoption and Endorsement of VBLOC Therapy Through Key Opinion Leaders. Our clinical development strategy is to collaborate closely with regulatory bodies, physician opinion leaders and scientific experts. We have established credible and open relationships with physician opinion leaders and scientific experts and we believe these key opinion leaders and scientific experts will be important in promoting patient awareness and gaining widespread adoption once the Maestro System is approved and commercialized.

Commercialize Our Products using a Direct Sales and Marketing Effort. We plan to build a sales force to call directly on key opinion leaders and bariatric surgeons, primarily within bariatric Centers of Excellence. We believe this currently represents approximately 230 facilities within the United States, which we believe will enable us to target them effectively with a small sales force. We expect that our direct sales force will promote the Maestro System to physicians and patients who have concerns with current bariatric surgical procedures. We also plan to call on physicians, weight-management specialists and nurses who influence patient adoption.

Procure Appropriate Coding, Coverage and Payment for the Maestro System. While payors are not our direct customers, their coverage and reimbursement policies influence patient and physician selection of obesity treatment. We plan to employ a focused campaign to obtain payor support for VBLOC therapy. We plan to seek specific and appropriate coding, coverage and payment for our Maestro System from the Centers for Medicare and Medicaid Services, or CMS, and from private insurers.

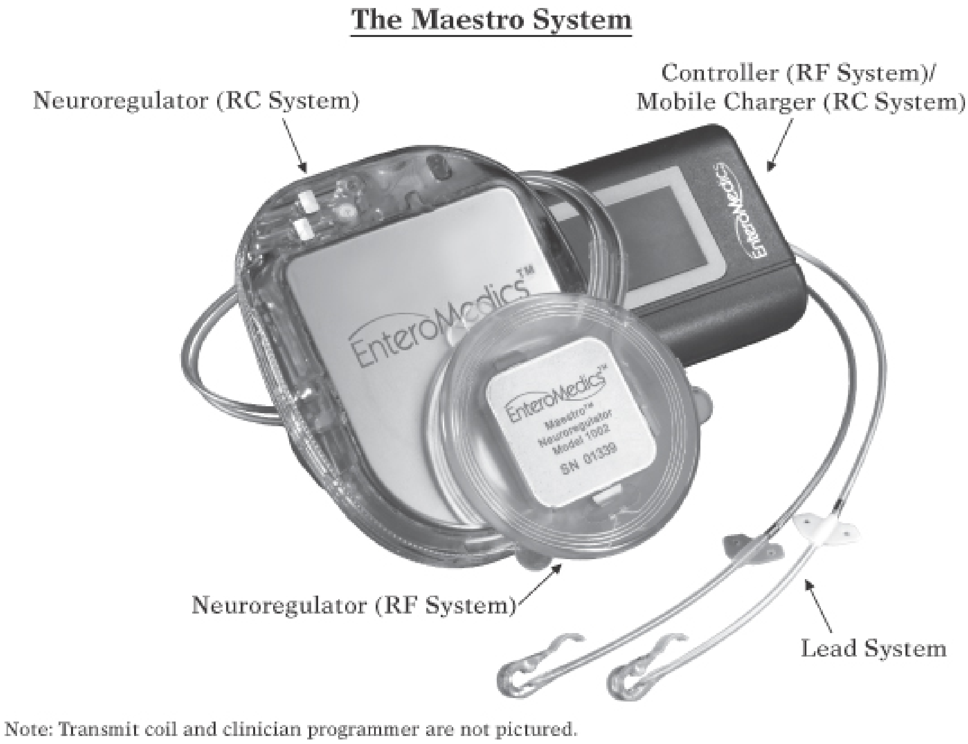
Expand and Protect Our Intellectual Property Position. We believe that our issued patents and our patent applications encompass a broad platform of neuromodulation therapies, including vagal blocking and combination therapy focused on obesity and other gastrointestinal disorders. We intend to continue to pursue further intellectual property protection through U.S. and foreign patent applications.

Table of Contents

Leverage our VBLOC Technology for Other Disease States. We intend to continue to conduct research and development for other potential applications for our VBLOC therapy and believe we have a broad technology platform that will support the development of additional clinical applications and therapies for other gastrointestinal disorders in addition to obesity.

The Maestro System, Implantation Procedure and Usage

The Maestro System. Our Maestro System delivers VBLOC therapy via two small electrodes that are laparoscopically implanted and placed in contact with the trunks of the vagus nerve just above the junction between the esophagus and the stomach, near the diaphragm. We are developing the Maestro System in two different energy configurations, the Maestro RF System and the Maestro RC System.



The major components of the Maestro System include:

- ***Neuroregulator.*** The neuroregulator is an implanted device that controls the delivery of VBLOC therapy to the vagus nerve. It is surgically implanted just below, and parallel to, the skin, typically on the side of the body over the ribs. The neuroregulator emits short, charge-balanced electrical pulses at a high pulse rate that travel down the leads to the electrodes and intermittently block natural nerve signals on the vagus nerve.
- ***Lead system.*** Our neuroblocking leads are powered by the neuroregulator and deliver electrical pulses to the vagus nerve via the electrodes. The leads and electrodes are similar to those used in traditional neurostimulation products, are intended to be implanted and may be removed laparoscopically.
- ***Controller/Mobile charger.*** Our controller regulates the rate and intensity of the electrical pulses delivered by the neuroregulator and maintains a log of device and treatment changes. In the Maestro RF System, the controller is an external unit. In the Maestro RC System, the external controller is replaced by an external mobile charger designed to be worn approximately three hours once per week and the control logic is contained within the implanted neuroregulator.

- ***Transmit coil.*** The transmit coil is positioned over the implanted neuroregulator and delivers radiofrequency energy and therapy control information across the skin into the device. The coil is held in position over the neuroregulator using either an adhesive or an adjustable elastic belt worn around the torso.

- ***Clinician programmer.*** The clinician programmer connects to the controller to enable clinicians to customize therapy settings as necessary and download reports stored in system components. The reports include patient use and system performance information used to manage therapy. The clinician programmer incorporates our proprietary software and is operated with a commercially available laptop computer.

The Maestro RF System and the Maestro RC System differ in the following ways:

- The neuroregulator within the Maestro RF System is powered by a battery in the externally-worn controller, which is connected to the external transmit coil. The transmit coil needs to be properly positioned over the approximately 20 cubic centimeter neuroregulator and worn daily during the patient’s waking hours to deliver therapy. The controller is recharged nightly using AC wall power.

- The neuroregulator in the Maestro RC System is powered by an internal rechargeable battery. The RC neuroregulator is approximately 70 cubic centimeters in volume to accommodate its internal battery. An external mobile charger is connected to the external transmit coil to recharge the battery and needs to be worn approximately three hours once per week in order to recharge the internal battery. The mobile charger is recharged using AC wall power.

We intend to evaluate each system as part of our clinical trial plan.

Implantation Procedure. The Maestro System is designed to be implanted by a bariatric surgeon in approximately one hour during an outpatient procedure that will be typically performed using a short-acting general anesthetic. During the procedure, the surgeon laparoscopically implants the electrodes in contact with the vagal nerve trunks and then connects the lead wires to the neuroregulator. After the electrodes have been attached adjacent to the vagal trunks and connected to the neuroregulator, the surgeon confirms final system operation by sending electrical pulses to the leads by the neuroregulator. Once system operation has been confirmed, the surgeon implants the neuroregulator under the skin and closes all incisions. We believe that patients who are implanted with the Maestro System will be able to return home from the hospital or clinic on the same day. The implantation procedure and usage of the Maestro System carry some risks, such as the risks generally associated with laparoscopic procedure described above as well as the possibility of device malfunction. In addition, in rare circumstances during implantation, the vagus nerve or esophagus may be damaged causing problems such as difficulty in swallowing, vomiting, heartburn, belching, abdominal fullness or discomfort, diarrhea, or decreased appetite. We expect that any of these problems would be temporary without lasting effects, although there is the risk of permanent injury to the vagus nerve. Some post-operative effects that may occur after implantation of our Maestro System include movement of the leads or neuroregulator from their original positions, erosion or wire breakage and potential allergic reaction with internal or external device contacts.

Usage of the Maestro System. The physician activates the Maestro System after an approximate two-week healing period following implantation. VBLOC therapy is then delivered intermittently each day during the patient’s waking hours through the neuroregulator. The scheduled delivery of the intermittent electrical pulses blocking the vagus nerve is customized for each patient by the physician using the clinician programmer and when necessary, therapy can also be easily and non-invasively modified by the physician. The physician determines the duration of the therapy in consultation with the patient based on the patient’s weight loss and overall treatment objectives. Patients using the Maestro RF System can elect to suspend or circumvent therapy at any time by simply not carrying the controller. Without the controller, the RF neuroregulator receives no power and cannot provide therapy. Patients using the Maestro RC System are more limited in their ability to suspend or circumvent therapy because the control logic is embedded in the implanted neuroregulator, which is generally recharged approximately once a week.

The physician is able to download reports to monitor patient use and system performance information. This information is particularly useful to physicians to ensure that patients are properly using the system. Although usage of our Maestro System generally proceeds without complications, as part of the therapy or intentional weight loss, subjects in our clinical trials have observed side-effects such as heartburn, bloating, diarrhea, sweating, nausea, constipation, greasy bowel movements, tiredness and excessive feelings of fullness, especially after meals. In addition, patient noncompliance with wearing the external components of the Maestro RF System may render VBLOC therapy less effective in achieving long-term weight loss.

Maestro Clinical Development

We are developing our Maestro System to deliver VBLOC therapy for the long-term treatment of obesity. Based on our preliminary preclinical and clinical findings, we believe that our Maestro System has the potential to offer a compelling combination of efficacy and safety. We are continuing to evaluate the Maestro System in human clinical studies conducted internationally and plan to commence enrollment in our first U.S. pivotal trial, the EMPOWER trial, in the third quarter of 2007. We plan to use data from our EMPOWER trial to obtain FDA approval and anticipate filing our PMA application by the first half of 2009.

Preclinical Experience

We have completed several preclinical animal studies, primarily in pigs and rats, to evaluate the safety of our Maestro System and to refine our implantation procedure. These studies have also shown that VBLOC therapy could completely block activated nerve signals, with the nerve regaining normal function within minutes after each intermittent application of therapy. Over a 12-week period of VBLOC therapy, over 93% of all nerve fibers showed normal histology and the animals demonstrated unimpaired heart rate, respiration, blood pressure and glucose regulation. Additionally, we observed that VBLOC therapy resulted in a greater than 80% reduction in pancreatic exocrine secretions, which are composed of digestive enzymes, water and bicarbonate that facilitate food digestion and caloric intake.

As a result of the findings of our preclinical studies, we were able to refine the implant technique, demonstrate the biocompatibility of our Maestro System in animals and collect the data necessary to begin human clinical trials. Several publications resulting from these preclinical studies were peer-reviewed and accepted for podium presentation at the Digestive Disease Week meeting in May 2006, the American Society for Bariatric Surgery meeting in June 2006, and the International Federation for Surgery of Obesity meeting in August 2006.

Clinical Experience

We began evaluating VBLOC therapy with our initial Maestro System, the RF1 system, in a clinical trial in February 2006 and have now implanted the Maestro System, including the next generation RF2 system, in a total of 63 subjects as of April 30, 2007. The RF2 system is distinguished from the RF1 system by an improved user interface, improvements in the energy management within the neuroregulator and a more robust transmission link for delivering energy from the coil to the neuroregulator in the RF2 system. Our early clinical experience has shown that VBLOC therapy using the Maestro System offers physicians a programmable method to selectively and reversibly block the vagus nerve and results in clinically and statistically significant excess weight loss. Excess weight represents the difference between a subject’s actual weight and the subject’s weight assuming a BMI of 25, which is considered healthy. Excess weight loss, or EWL, is reported as the percentage of excess weight that is lost by the subject.

We have not observed any mortality or any medically serious device-related complications that have required surgical attention in any of our completed or ongoing studies. Reported effects include those associated with laparoscopic surgery or any implantable electronic device. The effects of VBLOC therapy include changes in appetite, and, in some subjects, effects that may be expected with decreased intra-abdominal vagus nerve activity, such as temporary abdominal discomfort and short episodes of belching, bloating, cramping or nausea.

[Table of Contents](#)

We expect to initiate our pivotal clinical study, the EMPOWER trial, in the third quarter of 2007 upon receipt of approval from the relevant institutional review boards. The EMPOWER trial is a multi-center, randomized, double-blind, prospective, placebo-controlled pivotal study and will be conducted in the United States and selected international centers. Upon receipt of all enrolled patients' one-year endpoint data, we intend to use the data from this study to support our PMA application for the Maestro System for the treatment of obesity in the United States. In addition, we expect to use our clinical studies in a submission to our Notified Body for a CE Mark that would allow us to commercialize our Maestro System in the European Union.

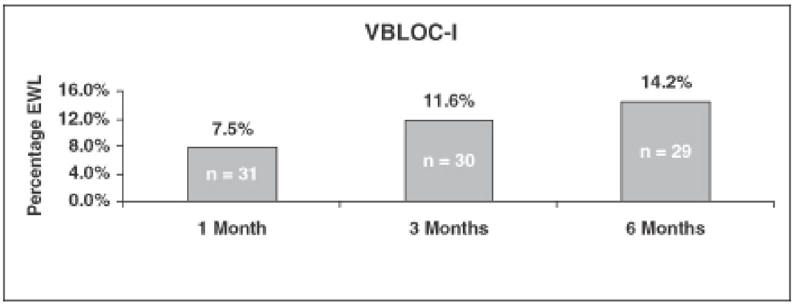
The following table is a summary of our planned, ongoing and completed clinical studies:

Clinical Study	Maestro System	Description	Sites	Number of Subjects	Status
VBLOC-I	RF1	Initial safety and efficacy trial VBLOC therapy with six month follow-up	3	31	Complete
VBLOC-EC	RF1, RF2	Continuation of VBLOC-I for 18 months	3	11	In follow-up
VBLOC-GF	RF2	Assessment of VBLOC therapy on gastric function	1	12	In follow-up
VBLOC-RF2	RF2	Assessment of Maestro System intended for use in pivotal trial	4	Up to 33	Enrolling
VBLOC-RC	RC	Initial trial of Maestro RC System	Up to 5	Up to 20	Enrollment beginning Q3 2007
EMPOWER	RF2, RC	Trial focused on obtaining safety and efficacy clinical data for PMA application	10 to 15	Minimum 220	Enrollment beginning Q3 2007

VBLOC-I

The VBLOC-I trial was our initial clinical trial and was designed to evaluate the safety and efficacy of the Maestro System in treating patients with obesity. We also gathered data for guidance in selection of the appropriate parameters for VBLOC therapy delivery. The trial was an international, open-label, prospective, multi-center study, involving 31 subjects with a mean BMI of 41. Of the 31 subjects, five were men and 26 were women. Additionally, none of these subjects were enrolled in any diet, behavior modification, or exercise programs so that we could focus on and isolate the impact of VBLOC therapy on weight reduction. We evaluated the efficacy of VBLOC therapy by measuring the average percentage EWL at one, three and six months. We completed our VBLOC-I trial with six months of follow-up in December 2006.

We believe the VBLOC-I trial demonstrated the feasibility of the Maestro System in treating subjects with obesity. The table below shows the average percentage EWL at follow-up months one, three and six.



In addition to its demonstrated clinical benefits, we also believe that VBLOC-I demonstrated the safety of the Maestro System in this subject population. No deaths or unanticipated adverse device-related effects were reported during the study. Two subjects were excluded from the data for non-compliance due to lack of system use. Two readily reversible serious events related to the implant procedure occurred. One subject contracted a post-operative lower respiratory tract infection and one subject contracted a localized, subcutaneous infection at the neuroregulator site not requiring system removal. These events required a single day's hospitalization. A third and unrelated serious adverse event occurred in one subject who experienced severe diarrhea from bacterial infection. Other nonserious adverse events were adequately resolved without permanent effects and these patients remained in the trial.

Because of the investigational stage of our Maestro System, we were required to provide subjects the opportunity to transition from VBLOC therapy to a surgical alternative once they had undergone a minimum of six months of VBLOC therapy. Of the 31 subjects in this trial, five elected to convert to an alternative procedure. Two subjects were successfully converted to an adjustable gastric band and three subjects were successfully converted to gastric bypass after six months. We believe the therapy conversions of these subjects demonstrate that the neuroregulator and the implanted leads of the Maestro System can be removed in a short laparoscopic procedure.

As part of the VBLOC-I study, we also conducted two sub-studies to evaluate secondary endpoints among subsets of the subjects enrolled in the trial.

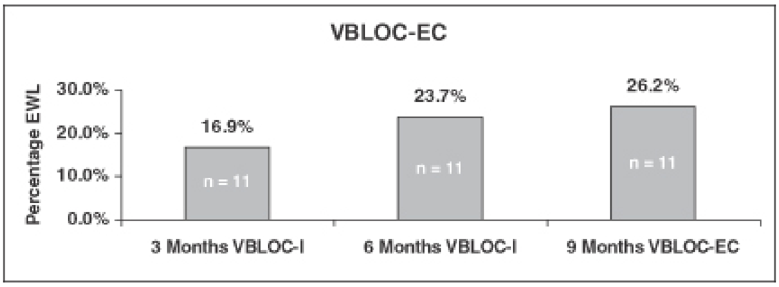
- ***Sub-Study 1: Weight Loss, Calorie Intake, Hunger and Fullness.*** This sub-study assessed the impact of VBLOC therapy on calorie intake, hunger and fullness at one site in a population of ten female subjects with an age range of 31 to 60 years and a BMI range of 33 to 48. This sub-study analyzed a series of seven-day diet diaries, computerized calorie calculations, hunger and fullness visual analogue scales and weight before and during VBLOC therapy. Participants in this sub-study had an average percentage EWL in excess of 20% after six months of treatment with a reduction in calorie intake determined from detailed dietary analysis. Subjects reported reduced hunger, earlier fullness and reduced food intake using validated visual analogue scales. We believe that the results of this sub-study indicate that VBLOC therapy may be effective in reducing calorie intake even though no diet, exercise or behavior modification programs of any kind were provided. VBLOC therapy may also be effective in reducing hunger and increasing feelings of fullness during a period of reduced calorie intake and sustained weight loss.

- ***Sub-Study 2: Pancreatic Polypeptide Response***. This sub-study assessed the impact of VBLOC therapy on pancreatic function, which is a test often used to evaluate vagal nerve function, in a population of 20 women and five men at two sites with an age range of 30 to 58 years and a BMI range of 33 to 48. The exocrine pancreas is responsible for production and secretion of digestive enzymes in the small intestine that are responsible for food digestion, resulting in food absorption. This sub-study showed at the three month follow-up that implantation of the Maestro System and the use of VBLOC therapy blunted the pancreatic polypeptide response, an indicator of successful vagal blocking.

VBLOC-EC Trial

VBLOC-EC is an efficacy continuation of VBLOC-I. Twenty-six of the 31 VBLOC-I subjects were assigned to a long-term safety evaluation and two sites and 11 subjects met the criteria for inclusion in the efficacy continuation arm. To participate in the VBLOC-EC trial, subjects were required to consent to long-term follow-up, to be compliant in their use of the system and to be enrolled in sites that had implemented a formal bariatric patient follow-up program. These EC subjects started receiving diet, behavior modification and exercise advice after the first six months of VBLOC therapy. We anticipate the completion of our VBLOC-EC study in December 2008. To date, no deaths or unanticipated adverse device effects have been reported during the VBLOC-EC study and the safety profile is similar to VBLOC-I. Other nonserious adverse events have been as expected.

The table below shows the average percentage EWL for the 11 subjects enrolled in VBLOC-I who continued on into the VBLOC-EC trial. The follow-up periods for the VBLOC-EC trial are at nine, 12 and 24 months after implantation in the VBLOC-I trial.



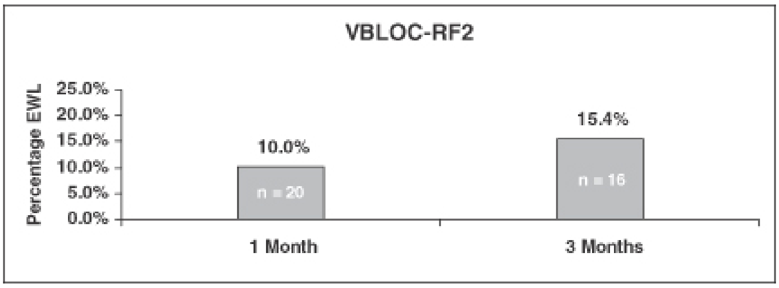
VBLOC-GF Trial

We initiated the VBLOC-GF trial to study the effects of VBLOC therapy on gastric function in 12 subjects who consented to gastric function testing prior to system implantation and at least two times after implant. Gastric function in response to interrupted VBLOC therapy will be assessed at several points throughout the trial. The gastric function testing uses a nutrient drink test to measure the amount of food required to feel full at meals and a trace radio-labeled standard solid meal protocol to measure gastric emptying. We anticipate completion of VBLOC-GF in the second half of 2009. To date, no deaths or unanticipated adverse device effects have been reported during the VBLOC-GF trial. Other nonserious adverse events have been as expected.

VBLOC-RF2 Trial

Enrollment of the VBLOC-RF2 trial began in November 2006 and is designed to evaluate the safety and efficacy of the Maestro RF2 System in treating patients with obesity over a period of 24 months. The trial is an international, open-label, prospective, multi-center study, involving up to 33 patients. Of the 21 subjects currently enrolled, four are men and 17 are women, with a mean BMI of 40. One subject was excluded from the data for noncompliance due to lack of system use. We are implementing medical weight management programs and plan to evaluate the efficacy of the VBLOC therapy by measuring average percentage EWL at one month, three, six, 12 and 24 months. We also plan to use results from this trial to further optimize selection of VBLOC therapy parameters. Preliminary data indicate that the RF2 system improvements have resulted in improved therapy delivery and more consistent weight loss. To date, no deaths or unanticipated adverse device effects have been reported during the VBLOC-RF2 trial and the safety profile is similar to VBLOC-I.

The following table summarizes current average percentage EWL data from this ongoing trial. We anticipate completion of VBLOC-RF2 in the second half of 2008 and will be periodically reporting safety and EWL data during the trial. The follow-up periods for the VBLOC-RF2 trial are at follow-up months one, three, six, 12 and 24.



VBLOC-RC Trial

VBLOC-RC is intended to demonstrate that the clinical performance of the Maestro RC is similar to that of the RF2 System. It is also intended to demonstrate that the subject can effectively recharge the implanted RC device on a weekly basis and the physician and staff can perform device programming and operation. The trial will study up to 20 subjects at sites outside the United States. Medical weight management programs such as diet, behavior modification, or exercise programs will be implemented. We plan to evaluate system performance and efficacy by measuring average percentage EWL at one, three and six months. We anticipate beginning enrollment in the third quarter of 2007 and completion of the first follow-up period at six months in the first half of 2008 and will be periodically reporting safety and weight loss data during the trial. Subjects will also be enrolled for long-term follow-up out to 24 months after completion.

EMPOWER Trial

We have received conditional IDE approval from the FDA for use of the Maestro System in our pivotal EMPOWER clinical trial. We submitted a supplement to our IDE application to the FDA in response to the FDA's March 14, 2007 letter and, on May 11, 2007, we received a response from the FDA to our IDE supplement, informing us that our IDE application remains conditionally approved. The EMPOWER trial is designed as a randomized, double-blind, placebo-controlled, prospective, multi-center study including a minimum of 220 subjects at 10 to 15 U.S. and international sites. We are in discussions with the FDA in response to several questions raised as part of the conditional approval. We are in the process of submitting the trial protocol to the institutional review boards at our anticipated trial sites. Upon approval from the institutional review boards, which we expect in the third quarter of 2007, we will commence enrollment of the trial. All EMPOWER subjects will be implanted with the Maestro System and randomized on a 2:1 basis to an active group, where therapy is turned on, or a control group, where therapy is turned off. A limited number of diabetic subjects will also be included in the trial and randomized 1:1. We intend to submit an IDE supplement to the FDA for the Maestro RC as part of the EMPOWER trial in the fourth quarter of 2007.

The purpose of the EMPOWER trial is to measure the safety and efficacy of our Maestro System in obese subjects after 12 months of VBLOC therapy. The EMPOWER trial is designed to evaluate the following objectives:

- The primary efficacy objective is to demonstrate a significantly greater percentage EWL with the Maestro System after 12 months of VBLOC therapy in the active group as compared to the control group. The trial is designed to demonstrate, with greater than 80% power, that the lower 97.5% confidence bound on the difference between the active and control groups is at least 10 percentage points. The underlying assumptions for the study are based on an EWL of 25% or more at 12 months for the active group versus an EWL of 8% or less for the control group, with an actual difference between groups of at least seventeen percentage points.

- A secondary efficacy objective is to compare the proportion of subjects in the active group versus the control group who achieve an EWL of 25% or more. The power associated with this evaluation exceeds 95%.

- The primary safety objectives are to estimate the rate of serious system and procedure-related adverse events associated with the Maestro System and to estimate the rate of serious, therapy-related adverse events.

The EMPOWER clinical data required for the PMA application is expected to be completed in the first half of 2009. Assuming these data are favorable, we intend to prepare and file our PMA application with the FDA. If approved, we would expect to commercially launch our Maestro System in the United States in 2010. Because the EMPOWER trial will be blinded, we will not be routinely reporting safety and EWL data until after the first year of the trial. After the first year, the trial will be unblinded and all subjects, including those in the control group, will have the option to receive ongoing VBLOC therapy. Subjects will continue to be followed out to 60 months as part of the trial and we will continue to monitor and report on average percentage EWL and safety during this extended period.

Even if we complete the EMPOWER trial it may not produce results that are sufficient to support approval of a PMA application, or the FDA may require higher efficacy endpoints to approve our Maestro System. For example, the FDA has indicated to us that they believe that a 20 to 25 percentage point greater EWL than a control group is the appropriate efficacy criterion for the EMPOWER trial. Thus, there is a risk that, even if we achieve our endpoint of a 10 percentage point greater EWL than the control group at 12 months, the FDA may not approve our Maestro System. To date, we have limited clinical data regarding the efficacy of our therapy at 12 months upon which to evaluate our ability to meet either our or the FDA's proposed efficacy endpoint. Our results and our ability to obtain approval from the FDA for our Maestro System may also depend on the measurement standards we use to evaluate the EWL data. In addition, there is a risk that the FDA may require us to conduct a longer clinical trial, submit additional follow-up data, or engage in other costly and time consuming activities that may delay the FDA's approval of the Maestro System.

Research and Development

We have an experienced, 40-person research and development team, including clinical, regulatory affairs and quality, comprised of scientists, electrical engineers, software engineers and mechanical engineers with significant clinical knowledge and expertise. Our research and development efforts are focused in the following major areas:

- identifying the effect of vagal blocking on nerve and organ function;

- developing the Maestro System; and

- investigating the Maestro platform for gastrointestinal disorders in addition to obesity.

We have spent a significant portion of our capital resources on research and development. Our research and development expenses were $14.4 million in 2006, $8.8 million in 2005 and $1.8 million in 2004. We expect our research and development expenditures to increase as we continue to commit resources to developing our vagal neuroblocking technology.

Other Diseases and Disorders

We believe that our VBLOC therapy may be used to treat a number of additional gastrointestinal disorders, including the following:

- ***Metabolic Syndrome.*** Metabolic syndrome refers to a group of risk factors for cardiovascular disease and Type 2 diabetes mellitus and affects an estimated 50 million people in the United States. We believe that VBLOC therapy has significant potential in treating metabolic syndrome as there appeared to be a beneficial relationship between EWL and diabetic control in our VBLOC-I trial. We plan to enroll a larger subset of diabetic patients in our EMPOWER trial to further explore the efficacy of VBLOC therapy in this patient population.

- ***Pancreatitis.*** Primary and recurrent cases of acute pancreatitis are estimated to number from 150,000 to 200,000 annually, resulting in approximately 80,000 hospital admissions each year in the United States. In animal and human studies, we have shown that VBLOC therapy suppresses pancreatic exocrine secretion, suggesting its potential efficacy in treating pancreatitis.

- ***Other Gastrointestinal Disorders.*** We believe that VBLOC therapy may have potential in a number of other gastrointestinal disorders, including irritable bowel syndrome and inflammatory bowel disease.

We are considering, but have not yet initiated, studies of VBLOC therapy in these indications.

Mayo Clinic Relationship

Our research and development team works with clinicians from Mayo Clinic Rochester, Minnesota pursuant to an exclusive know-how, license, and consulting agreement. Mayo clinicians with multiple specialties such as bariatric surgery, gastroenterology and laparoscopic surgery consult exclusively with our research and development team to advise us as we develop our devices for vagal blocking therapy to treat obesity. The agreement with Mayo Clinic also includes a similar collaboration for the development of products to address a wide variety of disorders susceptible to treatment by electrically blocking neural impulses on the vagus nerve. We retain the exclusive rights to obesity-related device inventions developed through this collaboration. We have also licensed-in four obesity-related patent applications from Mayo Clinic. These patent applications cover a number of novel medical device concepts for treating obesity. At any time after February 3, 2008, Mayo can terminate the license agreement without cause and upon such termination, the licenses granted to us by Mayo will become non-exclusive.

Medical Advisors

In addition to our collaboration with Mayo Clinic, we also have medical advisors who provide strategic guidance to our development programs, consult with us on clinical investigational plans and individual study protocols, and advise on clinical investigational site selection. Members of our medical advisory group also:

- serve on our Safety Monitoring Board and our Therapy Algorithm Panel;

- meet with governmental regulatory authorities;

- provide consultation on professional meeting presentations and journal manuscript submissions; and

- develop and participate in clinical site training programs, including study surgical technique training and study subject follow-up training.

As of May 21, 2007, our medical advisory group consisted of the following individuals:

Name	Specialty	Institution
Mehran Anvari, M.D., Ph.D.	Laparoscopic surgery	McMaster University
Charles J. Billington, M.D.	Bariatrics, endocrinology	University of Minnesota
Michael Camilleri, M.D.	Gastroenterology, neurogastroenterology	Mayo Clinic Rochester
James W. Freston, M.D., Ph.D.	Gastroenterology, pharmacology	University of Connecticut
Miguel Herrera, M.D.	Bariatric surgery	Instituto Nacional de la Nutricion, SZ (Mexico)
Samuel Klein, M.D.	Bariatrics, gastroenterology/nutrition	Washington University
David E. Larson, M.D.	Gastroenterology	Mayo Clinic Rochester
Frank G. Moody, M.D.	Bariatric surgery	University of Texas Health Science Center

Sales and Marketing

We currently do not have a sales organization and have no experience as a company in the marketing, sale or distribution of our proposed products. We plan to develop a direct sales force to market our Maestro System and to sell it in the United States when it receives FDA approval. Initially, we anticipate that our sales representatives will exclusively target selected bariatric surgery Centers of Excellence and nationally recognized bariatric surgery centers. To be approved as a bariatric surgery Center of Excellence, a surgery center needs to perform a minimum of 125 bariatric surgical procedures per year. As of May 2007, there were approximately 235 bariatric surgery Centers of Excellence approved by the Surgical Review Corporation. As of May 2007, there were 34 Level I Centers of Excellence approved by the American College of Surgeons. In addition we expect to market our products to a small number of nationally-recognized hospitals that do not intend to pursue the Center of Excellence certification.

We plan to support our sales representatives with field clinical experts who will be responsible for training and support at various implant centers. We also expect that our sales representatives will spend time implementing joint consumer marketing programs with surgical centers and implanting surgeons. We also intend to market to potential referral source clinicians such as general practitioners, internists, endocrinologists and nurses.

The primary focus of our sales efforts will be in the United States. Outside of the United States, we plan to sell and support our products either through direct sales or medical device distributors. We plan to target countries with reasonable regulatory and reimbursement barriers and a population interested in managing their obesity. Each country we target will require specific regulatory approval from the local government or agency. In some situations, we may be able to rely on FDA approval, European CE Mark or ISO quality certificates to satisfy local regulatory requirements.

To achieve commercial success for any product that receives regulatory approval, we must either develop a sales organization or enter into arrangements with others to sell our products. Developing a direct sales force can be expensive and time consuming and can delay the success of any product launch. Any sales force we develop will likely be competing against the experienced and well-funded sales and marketing operations of our competitors.

Competition

We compete primarily in the market for obesity treatment with surgical obesity procedures and various devices used to implement neurostimulation and gastric stimulation systems. We also compete with pharmaceutical therapies. The market for obesity treatments is intensely competitive, subject to rapid technological change and significantly affected by new product development. Although we expect to compete in the market for gastric stimulation systems and other neurotechnology devices that treat obesity, there are currently no FDA-approved neuromodulation or neuroblocking therapies for the treatment of obesity. We believe we are the first and only company currently pursuing neuroblocking therapy for the treatment of obesity.

We also compete against the manufacturers of pharmaceuticals that are directed at treating obesity. We are aware of two drugs that are approved for long-term treatment of obesity in the United States: Sibutramine, marketed by Abbott Labs, Inc. as Meridia, and Orlistat, marketed by Roche as Xenical. In addition, numerous pharmaceutical companies are working on additional drug therapies that may prove effective in addressing obesity.

We compete with several private early-stage companies developing neurostimulation devices for application to the gastric region and related nerves for the treatment of obesity. These companies may prove to be significant competitors, particularly through collaborative arrangements with large and established companies. They also compete with us in recruiting and retaining qualified scientific and management personnel, establishing clinical trial sites and subject registration for clinical trials, as well as in acquiring technologies and technology licenses complementary to our programs or advantageous to our business.

In addition, there are many larger potential competitors experimenting in the field of neurostimulation to treat various diseases and disorders. For example, Medtronic, which develops deep brain stimulators and spinal cord stimulators, acquired TransNeuronix, which sought to treat obesity by stimulating the smooth muscle of the stomach wall and nearby tissue. St. Jude Medical, through its acquisition of Advanced Neuromodulation Systems, is developing spinal cord stimulators. Cyberonics is developing vagus nerve stimulators to modulate epileptic seizures and other neurological disorders. Boston Scientific, through its Advanced Bionics division, is developing neurostimulation devices such as spinal cord stimulators and cochlear implants.

In addition to competition from developers of neurostimulation and gastric modulation systems, we expect our Maestro System will also compete with surgical obesity procedures, including gastric bypass, gastric banding, vertical-banded gastroplasty and biliopancreatic diversion. The leader in the field of gastric banding is Allergan, whose Lap-Band received FDA approval for marketing in 2001. Allergan also recently acquired EndoArt, a European band company that has developed the EasyBand, which uses RF telemetry to adjust the gastric band. Additionally, we are aware that Johnson & Johnson has filed for FDA approval of their gastric band product known as the Swedish Adjustable Gastric Band.

We believe that the principal competitive factors in our market include:

- acceptance by healthcare professionals, patients and payors;
- published rates of safety and efficacy;
- reliability and high quality performance;
- invasiveness and the inherent reversibility of the procedure or device;
- cost and average selling price of products and relative rates of reimbursement;
- effective marketing, education, sales and distribution;

- regulatory and reimbursement expertise;
- technological leadership and superiority; and
- speed of product innovation and time to market.

Many of our competitors are either publicly-traded or are divisions of publicly-traded companies, and they enjoy several competitive advantages over us, including:

- significantly greater name recognition;
- established relations with healthcare professionals, customers and third-party payors;
- established distribution networks;
- greater experience in research and development, manufacturing, preclinical testing, clinical trials, obtaining regulatory approvals, obtaining reimbursement and marketing approved products; and
- greater financial and human resources.

As a result, we cannot assure you that we will be able to compete effectively against these companies or their products.

Third-party Coverage and Reimbursement

We plan to set a market price for the Maestro System in the United States that is comparable to other high-end, active implantable devices such as implantable cardioverter defibrillators, or ICDs, neurostimulation devices for chronic pain, and cochlear implant systems. We expect that the procedure will be performed in the outpatient setting.

We believe that establishing appropriate third-party coverage for the therapy should be relatively straight-forward as important structural elements are already in place. Physician claims for payment use Current Procedural Terminology, Fourth Edition, or CPT, billing codes to describe procedures and services performed. Currently, there are established CPT codes for the implantation of cranial nerve pulse generators and related leads, and we expect providers may seek payment for our therapy based on these codes. With respect to possible usage of our product in the hospital inpatient setting, hospital inpatient billing is referenced by International Classifications of Diseases, 9th Revision, Clinical Modification, or ICD-9-CM procedure codes. There is an existing ICD-9-CM diagnosis code for morbid obesity and our studies are intended to provide the necessary outcomes data to link appropriate billing codes with the ICD-9 diagnosis code for morbid obesity. Our clinical trial data substantiating VBLOC therapy will also be used to seek coverage of VBLOC therapy for patients with morbid obesity and appropriate reimbursement for surgeons and hospitals under the codes already in place.

CMS, the federal agency that administers the Medicare program, has issued a national coverage determination for several specific types of bariatric surgery, which we view as positive, potential precedent and guidance to factors that CMS might use in deciding to cover our therapy. The policy indicates that Medicare will cover these bariatric surgical procedures when they are performed in an approved Bariatric Center of Excellence by a bariatric surgeon who also meets established requirements. Subjects with a BMI greater than or equal to 35, at least one obesity-related disease or disorder and who were previously unsuccessful with medical treatment for obesity are considered eligible. However, the policy reiterates that treatments for obesity alone are not covered, because such treatments are not considered reasonable and necessary. Although Medicare policies are often emulated or adopted by other third-party payors, other governmental and private insurance coverage currently varies by carrier and geographic location. We intend to actively work with major insurance carriers as well as CMS to obtain coverage for procedures using our product.

Other manufacturers of neurostimulator devices for a variety of indications have been successful in securing third-party coverage and reimbursement for use of their devices after early commercialization. We will actively pursue all similar opportunities to secure appropriate payment for our device.

Intellectual Property

Our success will depend in part on our ability to obtain and defend patent protection for our products and processes, to preserve our trade secrets and to operate without infringing or violating the proprietary rights of third parties. To date, we have four issued U.S. patents, two of which pertain to treating gastrointestinal disorders and we believe provide us with broad intellectual property protection covering electrically-induced vagal blocking and for treating obesity. We also have 20 U.S. patent applications and three national stage patent applications (including 2 European applications) in foreign jurisdictions. These applications primarily pertain to our vagal blocking technology and its application to obesity as well as other gastrointestinal disorders. In addition to our patents and applications, we have a license agreement with Mayo Foundation for Medical Education and Research for four pending U.S. patent applications on medical device obesity treatments.

We also register the trademarks and trade names through which we conduct our business. To date, we have applied to register the trademarks “EnteroMedics”, “Maestro” and “VBLOC” vagal blocking therapy in the United States. Those applications have been published by the U.S. Patent and Trademark Office. In addition, we have trademark registrations or pending applications for our name and mark in Australia, China, Mexico, and the European Community. We may file additional trademark applications from time to time as deemed appropriate by management.

Our technology is the subject of several international patent applications we have filed in addition to our U.S. patents and applications. We are dedicated to continuing our patent activity to ensure that our patent portfolio remains reflective of our intellectual property development. New developments and modifications of prior developments are periodically reviewed to identify necessary additions and modifications to our patent portfolio.

In addition to our patents, we rely on confidentiality and proprietary information agreements to protect our trade secrets and proprietary knowledge. These confidentiality and proprietary information agreements generally provide that all confidential information developed or made known to individuals by us during the course of their relationship with us is to be kept confidential and not disclosed to third parties, except in specific circumstances. The agreements also provide for ownership of inventions conceived during the course of such agreements. If our proprietary information is shared or our confidentiality agreements are breached, we may not have adequate remedies, or our trade secrets may otherwise become known to or independently developed by competitors.

Manufacturers and Suppliers

We have designed and developed all of the elements of our Maestro System, except for the clinician programmer hardware, which uses a commercially available laptop computer. To date, all of the materials and components of the system used in our clinical trials are procured from qualified suppliers and contract manufacturers in accordance with our proprietary specifications. We use third parties to manufacture our Maestro System to minimize our capital investment, help control costs and take advantage of the expertise these third parties have in the large-scale production of medical devices. We do not currently plan to manufacture our Maestro System ourselves. All of our key manufacturers and suppliers for our Maestro RF System, which is the only system we have manufactured to date, have experience working with commercial implantable device systems, are ISO certified and are regularly audited by us. Our key manufacturers and suppliers have a demonstrated record of compliance with international regulatory requirements.

Atrotech, located in Finland, currently manufactures our Maestro RF neuroregulators and coils under a supply agreement that extends through September 2010. Atrotech is contractually obligated to manufacture our products according to our purchase forecasts and to provide us with a one-year notice of any significant changes in its business that may negatively impact our supply of product, in which case we would receive an option to make a one-time purchase of devices in sufficient quantity to continue business with uninterrupted product supply for three years. We may solicit bids for the manufacture of our neuroregulators and coils at any time and are not required to notify Atrotech of the relevant terms of a superior bid. If we use Atrotech for commercial release of our device, Atrotech must be registered with the FDA and subject to related FDA factory inspection.

Our FDA approval process requires us to name and obtain approval for the suppliers of key components of our Maestro System. Many of our parts are custom designed and in certain instances, are obtained through long-term supply arrangements that are exclusive. Due to these factors, we may not be able to quickly qualify and establish additional or replacement suppliers for the components of our Maestro System. We plan to address potential future supply interruptions by ordering sufficient inventory stock to complete our pivotal EMPOWER trial. A delay in the approval process with the FDA for our Maestro System or a delay in our EMPOWER trial as a result of the need to qualify or obtain alternate vendors for any of our components would delay our ability to sell and market the Maestro System and could have a material adverse effect on our business.

We believe that our current manufacturing and supply arrangements will be adequate to complete our EMPOWER trial. In order to produce the Maestro System in the quantities we anticipate to meet future market demand, we will need our manufacturers and suppliers to increase, or scale up, manufacturing production and supply arrangements by a significant factor over the current level of production. There are technical challenges to scaling up manufacturing capacity and developing commercial-scale manufacturing facilities that may require the investment of substantial additional funds by our manufacturers and suppliers and hiring and retaining additional management and technical personnel who have the necessary experience. If our manufacturers or suppliers are unable to do so, we may not be able to meet the requirements for the launch of the product or to meet future demand, if at all. We may also represent only a small portion of our suppliers’ or manufacturers’ business and if they become capacity constrained they may choose to allocate their available resources to other customers that represent a larger portion of their business. We currently anticipate that we will continue to rely on third-party manufacturers and suppliers for the production of the Maestro System following commercialization. If we develop and obtain regulatory approval for our product and are unable to obtain a sufficient supply of our product, our revenue, business and financial prospects would be adversely affected.

Government Regulations

United States

Our Maestro System is regulated by the FDA as a medical device under the Federal Food, Drug, and Cosmetic Act, or FFDCA, and the regulations promulgated under the FFDCA. Pursuant to the FFDCA, the FDA regulates the research, design, testing, manufacture, safety, labeling, storage, record keeping, advertising, sales and distribution, post-market adverse event reporting, production and advertising and promotion of medical devices in the United States. Noncompliance with applicable requirements can result in warning letters, fines, injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, failure of the government to grant premarket approval for devices and criminal prosecution.

Medical devices are classified into one of three classes, Class I, II or III, on the basis of the amount of risk and the controls deemed by the FDA to be necessary to reasonably ensure their safety and effectiveness. Class I, low risk, devices are subject to general controls (e.g., labeling and adherence to good manufacturing practices, or GMPs). Class II, intermediate risk, devices are subject to general controls and to special controls (e.g., performance standards, and premarket notification). Generally, Class III devices are those which must receive premarket approval by the FDA to ensure their safety and effectiveness (e.g., life-sustaining, life-supporting and implantable devices, or new devices which have not been found substantially equivalent to legally marketed devices), and require clinical testing to ensure safety and effectiveness and FDA approval prior to marketing and distribution. The FDA also has the authority to require clinical testing of Class II devices. In both the United States and certain international markets, there have been a number of legislative and regulatory initiatives and changes, such as the Modernization Act, which could and have altered the healthcare system in ways that could impact our ability to sell our medical devices profitably. Recent, widely-publicized events concerning the safety of certain drug, food and medical device products have raised concerns among members of Congress, medical professionals, and the public regarding the FDA's handling of these events and its perceived lack of oversight over regulated products. The increased attention to safety and oversight issues could result in a more cautious approach by the FDA to device clearance sand approvals, as well as post- market compliance, which could prevent, delay clearance or approval of our new products or product modifications, or require us to expend additional resources on post-market studies and controls.

The FFCDA provides two basic review procedures for medical devices. Certain products may qualify for a submission authorized by Section 510(k) of the FFCDA, where the manufacturer submits to the FDA a premarket notification of the manufacturer's intention to commence marketing the product. The manufacturer must, among other things, establish that the product to be marketed is substantially equivalent to another legally marketed product. Marketing may commence when the FDA issues a letter finding substantial equivalence. If a medical device does not qualify for the 510(k) procedure, the manufacturer must file a premarket approval, or PMA, application with the FDA. This procedure requires more extensive pre-filing clinical and preclinical testing than the 510(k) procedure and involves a significantly longer FDA review process.

Premarket Approval

Our product will require prior premarket approval from the FDA. Because our Maestro System is an implanted device, it is deemed to pose a significant risk. To market the Maestro System in the United States, the FDA must approve the device after submission of a PMA. The FDA can also impose restrictions on the sale, distribution or use of devices at the time of their clearance or approval, or subsequent to marketing. The process of obtaining premarket approval is costly, lengthy and uncertain. A PMA must be supported by extensive data including, but not limited to, technical, pre-clinical and clinical trials to demonstrate to the FDA's satisfaction the safety and effectiveness of the device. Among other information, the PMA must also contain a full description of the device and its components, a full description of the methods, facilities and controls used for manufacturing, and proposed device labeling.

If the FDA determines that a PMA is complete, the FDA accepts the application and begins an in-depth review of the submitted information. The FDA, by statute and regulation, has 180 days to review an accepted PMA application, although the review and response activities generally occur over a significantly longer period of time, typically one year, and can take up to several years. During this review period, the FDA may request additional information or clarification of information already provided. Also during the review period, an advisory panel of experts from outside the FDA may be convened to review and evaluate the application and provide recommendations to the FDA as to the approvability of the device. In addition, the FDA will conduct a pre-approval inspection of our and our manufacturers' facilities to evaluate compliance with the quality system regulation. Under the Medical Device User Fee and Modernization Act of 2002, the fee to submit a PMA can be up to $259,600 per PMA, but certain companies, like EnteroMedics, may qualify for a small business exemption. If the FDA's evaluation of the PMA is favorable, the PMA is approved, and the device may be marketed in the United States. The FDA may approve the PMA with post-approval conditions intended to ensure the safety and effectiveness of the device. Failure to comply with the conditions or approval can result in material adverse enforcement action, including the loss or withdrawal of the approval. Even after approval of a PMA, new PMAs or supplemental PMAs are required for significant modifications to the manufacturing process, labeling, use and design of a device that is approved through the premarket approval process. Premarket approval supplements often require submission of the same type of information as a PMA except that the supplement is limited to information needed to support any changes from the device covered by the original PMA.

Clinical Trials

A clinical trial is almost always required to support a PMA. Clinical trials for a "significant risk" device such as ours require submission of an application for an IDE, to the FDA. The IDE application must be supported by appropriate data, such as animal and laboratory testing results, showing that it is safe to test the device in humans and that the testing protocol is scientifically sound. Clinical trials for a significant risk device may begin once the IDE application is allowed to proceed by the FDA and the institutional review boards overseeing the clinical trial at the various investigational sites. We have received conditional IDE approval from the FDA for use of the Maestro System in our pivotal EMPOWER clinical trial. We submitted a supplement to our IDE application to the FDA in response to the FDA's March 14, 2007 letter and, on May 11, 2007, we received a response from the FDA to our IDE supplement informing us that our IDE application remains conditionally approved.

Clinical trials require extensive recordkeeping and detailed reporting requirements. Our clinical trials must be conducted under the oversight of an institutional review board at the relevant clinical trial site and in accordance with applicable regulations and policies including, but not limited to, the FDA's good clinical practice, or GCP, requirements. We, the trial data safety monitoring board, the FDA or the institutional review board at each site at which a clinical trial is being performed may suspend a clinical trial at any time for various reasons, including a belief that the risks to study subjects outweigh the anticipated benefits.

Pervasive and Continuing FDA Regulation

Both before and after FDA approval, numerous regulatory requirements apply. These include:

- quality system regulation, which requires manufacturers to follow design, testing, control, documentation, complaint handling and other quality assurance procedures during the design and manufacturing processes;
- regulations which govern product labels and labeling, prohibit the promotion of products for unapproved or "off-label" uses and impose other restrictions on labeling and promotional activities;
- medical device reporting regulations, which require that manufacturers report to the FDA if their device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if it were to recur; and
- notices of correction or removal and recall regulations.

Advertising and promotion of medical devices are also regulated by the Federal Trade Commission and by state regulatory and enforcement authorities. Recently, some promotional activities for FDA-regulated products have resulted in enforcement actions brought under healthcare reimbursement laws and consumer protection statutes. In addition, under the federal Lanham Act, competitors and others can initiate litigation relating to advertising claims.

Compliance with regulatory requirements is enforced through periodic, unannounced facility inspections by the FDA. Failure to comply with applicable regulatory requirements can result in enforcement action by the FDA, which may include any of the following sanctions:

- warning letters or untitled letters;
- fines, injunction and civil penalties;
- recall or seizure of our products;
- customer notification, or orders for repair, replacement or refund;
- operating restrictions, partial suspension or total shutdown of production or clinical trials;
- refusing our request for premarket approval of new products;
- withdrawing premarket approvals that are already granted; and

- criminal prosecution.

International

International sales of medical devices are subject to foreign government regulations, which vary substantially from country to country. The time required to obtain approval by a foreign country may be longer or shorter than that required for FDA approval, and the requirements may differ. The primary regulatory environment in Europe is that of the European Economic Community, or EEC, which consists of 25 countries encompassing nearly all the major countries in Europe. Other countries that are not part of the EEC, such as Switzerland, have voluntarily adopted laws and regulations that mirror those of the EEC with respect to medical devices. The EEC has adopted Directive 90/385/EEC for implantable medical devices and numerous standards that govern and harmonize the national laws and standards regulating the design, manufacture, clinical trials, labeling and adverse event reporting for medical devices that are marketed in member states. Medical devices that comply with the requirements of the national law of the member state in which they are first marketed will be entitled to bear CE marking, indicating that the device conforms to applicable regulatory requirements, and, accordingly, can be commercially marketed within EEC states and other countries that recognize this mark for regulatory purposes.

We intend to apply for CE marking approval for sale of the Maestro System and expect to have final CE marking approval during 2008. The method of assessing conformity with applicable regulatory requirements varies depending on the class of the device, but for our Maestro System (which falls into Class III), the method involves a combination of self-assessment by the manufacturer of the safety and performance of the device, and a third-party assessment by a Notified Body, usually of the design of the device and of the manufacturer’s quality system. A Notified Body is a private commercial entity that is designated by the national government of a member state as being competent to make independent judgments about whether a product complies with applicable regulatory requirements. The manufacturer’s assessment will include a clinical evaluation of the conformity of the device with applicable regulatory requirements. We intend to use KEMA in the Netherlands as the Notified Body for our CE marking approval process.

Employees

As of May 24, 2007, we had a total of 53 employees, consisting of 2 employees in reimbursement and marketing, 40 employees in research and development, including clinical, regulatory affairs and quality, and 11 employees in general and administrative functions. All of these employees are located in the United States.

From time to time we also employ independent contractors, consultants and temporary employees to support our operations. None of our employees are subject to collective bargaining agreements. We have never experienced a work stoppage and believe that our relations with our employees are good.

Properties

Our headquarters in St. Paul, Minnesota comprise approximately 11,130 square feet of leased space, which we sublease from Restore Medical, Inc. In addition, we share an additional 8,517 square feet of common space with Restore Medical, Inc. The leased space includes furnished office space and various research and development labs. The sublease agreement for our St. Paul facility expires on September 30, 2008.

Legal Proceedings

We are not currently a party to any litigation and we are not aware of any pending or threatened litigation against us that could have a material adverse effect on our business, operating results or financial condition. The medical device industry in which we operate is characterized by frequent claims and litigation, including claims regarding patent and other intellectual property rights as well as improper hiring practices. As a result, we may be involved in various legal proceedings from time to time.

MANAGEMENT

Executive Officers and Directors

The following table sets forth information regarding our executive officers and directors, including their ages, as of May 24, 2007:

Name	Age	Position
Mark B. Knudson, Ph.D.(1)	58	President, Chief Executive Officer, Chairman and Director
Greg S. Lea	54	Senior Vice President and Chief Financial Officer
Adrianus (Jos) Donders	53	Senior Vice President of Operations
Russ Felkey	57	Senior Vice President of Clinical, Quality and Regulatory Affairs
Katherine S. Tweden, Ph.D.	46	Vice President of Research
Mark R. Stultz	47	Vice President of Market Development and Reimbursement
Luke Evnin, Ph.D.(1)(2)	43	Director
Catherine Friedman(3)	46	Director
Carl Goldfischer, M.D.(2)(3)	48	Director
Bobby I. Griffin(2)	69	Director
Donald C. Harrison, M.D.(1)	73	Director
Paul H. Klingenstein(2)(3)	51	Director
Ellen Koskinas(1)	40	Director
Nicholas L. Teti, Jr.(1)	54	Director

(1) Member or observer of compensation committee. Dr. Knudson and Dr. Harrison are observers.

(2) Member or observer of nominating and governance committee. Mr. Griffin is an observer.

(3) Member of audit committee.

Mark B. Knudson, Ph.D. has served as our President, Chief Executive Officer and Chairman of the board since December 2002. Dr. Knudson also serves as President and Chief Executive Officer of Venturi Group LLC and Venturi Development Inc., positions he has held since 1999 and 2001, respectively. From 1999 to the present, Dr. Knudson has also served as Chairman of the board of Restore Medical, Inc., a publicly-held medical device company focused on the treatment of sleep disordered breathing. Dr. Knudson is also a member of the audit committee of Restore Medical. Dr. Knudson received a Bachelor of Science in biology from Pacific Lutheran University and a Ph.D. in physiology from Washington State University.

Greg S. Lea has accepted an offer to serve as our Senior Vice President and Chief Financial Officer effective May 21, 2007. Prior to joining us, Mr. Lea served as Chief Financial Officer of Pemstar Inc. from July 2002 through January 2007 when it was acquired by Benchmark Electronics, Inc. Mr. Lea also served as a director of Pemstar from April 2001 through January 2007 and held the position of Corporate Controller from April 2002 through July 2002. From 1993 to April 2002, Mr. Lea served as a corporate Vice President for Jostens Corporation, a commemorative and affiliation products manufacturer, serving most recently as corporate Vice President-Business Ventures. Prior to that, Mr. Lea held several financial management and administrative positions at IBM Corporation from 1974 to 1993 and was President and a director of the Ability Building Center, Inc. from 1981 to 1993. Mr. Lea holds a B.S. in Accounting/Business Management from Minnesota State University, Mankato.

Adrianus (Jos) Donders has served as our Senior Vice President of Operations since April 2005. From September 2003 to April 2005, Mr. Donders was Director Communication Systems Engineering for Medtronic USA. From June 2000 to August 2003, Mr. Donders served as Director Clinical Study Management and Research and Development Europe for Medtronic Europe. Mr. Donders received a degree equivalent to a Masters of Electrical Engineering from the Institute of Technology Eindhoven Netherlands.

Russ Felkey has served as our Senior Vice President of Clinical, Quality and Regulatory Affairs since April 2007 and our Vice President of Clinical, Quality and Regulatory Affairs since January 2005. From 2003 to 2005, Mr. Felkey was Group Vice President, Cardiovascular Regulatory Affairs for Boston Scientific Corporation. From 2002 to 2003, Mr. Felkey was Senior Director of Quality Assurance and Regulatory Affairs for Medtronic Inc. Mr. Felkey also served as Executive Vice President, Secretary to the board of directors for ATS Medical from 1991 to 2002. Prior to that Mr. Felkey held regulatory positions at Cardiovascular Imaging Systems, Inc., GV Medical, Inc. and Medtronic, Inc. Mr. Felkey received a Bachelor of Science in chemistry from the University of Iowa.

Katherine S. Tweden, Ph.D. has served as our Vice President of Research since January 2003. From November 2002 to January 2003, Dr. Tweden was a consultant to Venturi Group, a medical device incubator company. From January 2003 through August 2004, Dr. Tweden worked for Venturi Development Inc. as a consultant to us. From July 1997 to October 2002, Dr. Tweden held positions including Director of Research and Vice President of Research for HeartStent Corporation. Dr. Tweden received a Bachelor of Arts in chemistry from Gustavus Adolphus College and a Masters degree and Ph.D. in biomedical engineering from Iowa State University.

Mark R. Stultz has served as our Vice President of Market Development and Reimbursement since April 2006 and as a consultant from July 2005 to April 2006. From April 2004 to July 2005, he served as Director of the Women's Health Business Unit at Gyrus Medical and from December 2001 to January 2004 he served as Director of Marketing for Female Pelvic Health at American Medical Systems. Prior to 2002, Mr. Stultz served in various management positions at Medtronic and at Advanced Bionics where he was involved in the marketing and development of multiple active implantable technologies including spinal cord stimulation, deep brain stimulation and cochlear stimulation. Mr. Stultz received a Bachelor of Science in physical therapy and a Masters degree in human factors engineering and ergonomics from the University of Wisconsin, Madison.

Luke Evnin, Ph.D. has served as one of our directors since inception in 1999. Dr. Evnin has served as a General Partner at MPM Capital since he joined as a co-founder in 1998. Prior to joining MPM, Dr. Evnin was at Accel Partners from 1991 to 1997 serving as a General Partner from 1994 to 1997. Dr. Evnin is also a director of Metabasis Therapeutics, Inc., a publicly-held biopharmaceutical company and Restore Medical, Inc., a publicly-held medical device company focused on the treatment of sleep disordered breathing. Dr. Evnin has served as director of other public companies, including Epix Medical, Inc., Sonic Innovations, Inc., and Signal Pharmaceuticals, Inc. and is currently a director of several private healthcare companies.

Catherine Friedman has served as one of our directors since May 2007. Ms. Friedman currently is an independent financial consultant serving private and public companies in the lifesciences. Prior to that, Ms. Friedman held numerous positions over a 24 year investment banking career with Morgan Stanley. Most recently, Ms. Friedman was Managing Director at Morgan Stanley from 1997 to 2006 and Head of West Coast Healthcare and Co-Head of the Biotechnology Practice at Morgan Stanley from 1993 to 2006.

Carl Goldfischer, M.D. has served as one of our directors since July 2004. Dr. Goldfischer is currently an Investment Partner and Managing Director of Bay City Capital, serving as a member of the board of directors and executive committee, and has been with the firm since December 2000. His background includes extensive public and private investment and transaction work, as well as clinical trial development knowledge. Prior to joining Bay City Capital, Dr. Goldfischer was Chief Financial Officer of ImClone Systems Incorporated, a public-held biotechnology company focused on developing therapeutic oncology products. Dr. Goldfischer is a member of the board of directors of Poniard Pharmaceuticals, Inc., a publicly-held biopharmaceutical company focused on commercializing innovative oncology products, and also serves on the boards and audit committees of several private companies.

Bobby I. Griffin has served as one of our directors since September 2006. In 1998, Mr. Griffin retired from a 25 year career with Medtronic Corporation, where he held various positions, including Executive Vice President from 1985 to 1998 and President of Medtronic's Pacemaker Business from 1991 to 1998. Since his retirement, Mr. Griffin has been a private investor, managing his own fund of companies as well as serving on the advisory boards of Affinity Capital Management Fund III and IV and Sapient Capital Management Fund, in which he also invests. In addition, Mr. Griffin has served on the board of directors of several public companies, including MTS Systems Corporation and Urologix, Inc. and is currently a director of several private companies.

Donald C. Harrison, M.D. has served as one of our directors since September 2003. He is currently Managing Partner of Charter Life Sciences, a venture capital firm, where he has served since 2003. From 1986 to 2003, Dr. Harrison was Chief Executive Officer of the University of Cincinnati Medical Center. Dr. Harrison is a member of the board of Kendle International Inc., a publicly-held global clinical research organization, and AtriCure, Inc., a publicly-held company that develops innovative products for tissue ablation during surgical procedures, and also serves on the audit committees of both of these companies.

Paul H. Klingenstein has served as one of our directors since July 2006. He has served as Managing Partner of Aberdare Ventures since its formation in 1999. Formerly, he served as a General Partner of Accel Partners, as a Consultant to the Rockefeller Foundation, and as an employee of E.M. Warburg, Pincus & Co. Mr. Klingenstein serves on the boards and audit committees of several private companies.

Ellen Koskinas has served as one of our directors since July 2006. Ms. Koskinas currently serves as a Partner with InterWest Partners, a venture capital firm focused on early stage investments in the medical technology sector. She joined InterWest in May 2002. Prior to joining InterWest, Ms. Koskinas was a Managing Director of a private equity firm in San Francisco and also started a new business in minimally invasive cardiac surgery for Guidant Corporation. Earlier in her career, she was an Engagement Manager for McKinsey & Company, managing consulting projects for a range of health care clients. Ms. Koskinas serves on the boards of several private companies.

Nicholas L. Teti, Jr. has served as one of our directors since May 2007. Mr. Teti is currently Chairman of the Board and Chief Executive Officer of Isolagen, Inc., a biotechnology company which develops emergent, novel skin and tissue rejuvenation technologies, positions he has held since June 2006. From 2001 to 2006, Mr. Teti was President and Chief Executive Officer of Inamed Corporation, primarily an aesthetics based company with business in saline and silicone breast implants, collagen and hyaluronic-based wrinkle correcting devices and the LAP-BAND® Adjustable Gastric Banding System, a surgically implantable device for obesity treatment. Mr. Teti also served as a member of the board of Inamed during 2001 and was Chairman of the Board from 2002 to 2006. Prior to that, Mr. Teti spent 25 years at DuPont and DuPont Merck where he held a number of senior management positions including President and CEO of DuPont Pharmaceuticals.

There are no family relationships among any of our directors or our executive officers. Each executive officer is elected or appointed by, and serves at the discretion of, our board of directors.

Board of Directors

Our board of directors currently consists of nine directors, all of whom were elected as directors pursuant to a voting agreement among the Company and its stockholders that is contained within the Company's investors rights agreement. The provisions of the voting agreement will terminate upon the completion of the offering made by this prospectus. We have not yet adopted procedures by which security holders may elect nominees to our board of directors, but plan to do so upon the completion of this offering. Dr. Knudson is currently Chairman of our board.

Upon completion of this offering, our bylaws will be amended and restated to provide that the authorized number of directors may be changed only by resolution of the board of directors. Upon the closing of this offering, our board of directors will be divided into three classes with staggered three-year terms. At each annual meeting of stockholders, the successors to directors whose terms then expire will be elected to serve from the time of election and qualification until the third annual meeting following election or until their earlier death, resignation or removal. Our directors have been divided among the three classes as follows:

- Class I directors will be Drs. Goldfischer and Harrison and Ms. Koskinas, and their terms will expire at the annual meeting of stockholders to be held in 2008;
- Class II directors will be Messrs. Griffin and Klingenstein and Dr. Evnin, and their terms will expire at the annual meeting of stockholders to be held in 2009; and
- Class III directors will be Dr. Knudson, Ms. Friedman and Mr. Teti, and their terms will expire at the annual meeting of stockholders to be held in 2010.

This classification of the board of directors, together with the ability of the stockholders to remove our directors only for cause and the inability of stockholders to call special meetings, may have the effect of delaying or preventing a change in control or management. See “Description of Capital Stock—Anti-takeover Provisions” for a discussion of other anti-takeover provisions found in our certificate of incorporation.

Commencing in fiscal year 2007, our board of directors will review at least annually the independence of each director. During these reviews, the board will consider transactions and relationships between each director (and his or her immediate family and affiliates) and our company and its management to determine whether any such transactions or relationships are inconsistent with a determination that the director is independent. This review will be based primarily on responses of the directors to questions in a directors’ and officers’ questionnaire regarding employment, business, familial, compensation and other relationships with EnteroMedics and our management. In June 2007, our board will meet to formally assess the independence of each of our directors.

We believe that the composition of our board of directors meets the requirements for independence under the current requirements of the Nasdaq Global Market. As required by the Nasdaq Global Market, we anticipate that our independent directors will meet in regularly scheduled executive sessions at which only independent directors are present. We intend to comply with future governance requirements to the extent they become applicable to us.

Corporate Governance

We believe that good corporate governance is important to ensure that, as a public company, we will be managed for the long-term benefit of our stockholders. In preparation for the offering being made by this prospectus, we and our board of directors have been reviewing the corporate governance policies and practices of other public companies, as well as those suggested by various authorities in corporate governance. We have also considered the provisions of the Sarbanes-Oxley Act and the rules of the SEC and the Nasdaq Global Market.

Based on this review, our board of directors has taken steps to implement many of these provisions and rules. In particular, we have established and adopted charters for the audit committee, compensation committee and nominating and corporate governance committee, as well as a code of business conduct and ethics applicable to all of our directors, officers and employees.

Board Committees

Our board of directors has established a standing audit committee, a compensation committee, and a nominating and governance committee. In June 2007, our board will meet to formally assess the independence of the members of each of these standing committees as defined under the rules of the Nasdaq Global Market and, in the case of the audit committee, the independence requirements contemplated by Rule 10A-3 under the Securities Exchange Act of 1934, as amended.

Audit Committee. Ms. Friedman, Dr. Goldfischer and Mr. Klingenstein serve on our audit committee. Ms. Friedman serves as chair of the audit committee and Ms. Friedman and Dr. Goldfischer are the audit committee's financial experts within the meaning of the regulations of the SEC. In June 2007, our board will meet to formally assess whether all members of the audit committee meet the composition requirements of the Nasdaq Global Market, including the requirements regarding financial literacy and financial sophistication. We believe they will find that these requirements have been met. The audit committee's primary responsibilities include:

- appointing, approving the compensation of, and assessing the qualifications and independence of our independent registered public accounting firm, which currently is Deloitte & Touche LLP;
- overseeing the work of our independent registered public accounting firm, including the receipt and assessment of reports from the independent registered public accounting firm;
- reviewing and discussing with management and our independent registered public accounting firm our annual and quarterly financial statements and related disclosures;
- preparing the audit committee report required by SEC rules to be included in our annual proxy statements;
- monitoring our internal control over financial reporting, disclosure controls and procedures;
- reviewing our risk management status;
- establishing policies regarding hiring employees from our independent registered public accounting firm and procedures for the receipt and retention of accounting related complaints and concerns;
- meeting independently with our independent registered public accounting firm and management; and
- monitoring compliance with the code of ethics for financial management.

All audit and non-audit services must be approved in advance by the audit committee. Our board of directors has adopted a written charter for the audit committee which will be available on our website at www.enteromedics.com upon the completion of this offering.

Compensation Committee. Ms. Koskinas, Mr. Teti and Dr. Evnin serve on our compensation committee. Dr. Evnin is the chair and Drs. Harrison and Knudson are observers. The compensation committee's responsibilities include:

- annually reviewing and approving corporate goals and objectives relevant to compensation of our chief executive officer;
- determining the compensation of our chief executive officer;
- reviewing and approving, or making recommendations to our board of directors with respect to, the compensation of our other executive officers;
- overseeing an evaluation of our senior executives; and
- overseeing and administering our cash and equity incentive plans.

The Chief Executive Officer makes compensation recommendations for our other executive officers and initially proposes the corporate and departmental performance objectives under our Management Incentive Plan to the compensation committee. From time to time, the compensation committee may use outside compensation consultants to assist it in analyzing our compensation programs and in determining appropriate levels of compensation and benefits, although the compensation committee has not used the services of a compensation consultant to date. For more information on the processes and procedures followed by the compensation committee for the consideration and determination of executive compensation see the section entitled "Compensation Discussion and Analysis." Our board of directors has adopted a written charter for the compensation committee which will be available on our website at www.enteromedics.com upon the completion of this offering.

Nominating and Governance Committee. Drs. Goldfischer and Evnin and Mr. Klingenstein serve on our nominating and governance committee. Dr. Goldfischer is the chair and Mr. Griffin is an observer. The nominating and governance committee's responsibilities include:

- identifying individuals qualified to become members of our board of directors;
- recommending to our board the persons to be nominated for election as directors and to each of our board's committees;
- reviewing and making recommendations to our board with respect to management succession planning;
- developing, updating and recommending to our board corporate governance principles and policies;
- overseeing the evaluation of our board; and
- reviewing and making recommendations to our board with respect to director compensation.

Our board of directors has adopted a written charter for the nominating and governance committee which will be available on our website at www.enteromedics.com upon the completion of this offering.

Compensation Committee Interlocks and Insider Participation

None of our executive officers serves as a member of the board of directors or compensation committee, or other committee serving an equivalent function, of any other entity that has one or more of its executive officers serving as a member of our board of directors or its compensation committee. None of the current members of the compensation committee of our board has ever been one of our employees.

Director Compensation

Prior to this offering, non-employee members of our board of directors did not receive any cash compensation for service on our board, including attending board meetings. However, we did reimburse our non-employee directors for travel, lodging and other reasonable expenses incurred in attending board and committee meetings. In addition, from time to time we have granted stock options to some of our directors. In fiscal year 2006, Bobby I. Griffin was the only non-employee director who received compensation in the form of equity in connection with his service as a non-employee director. We granted Mr. Griffin an option to purchase 1,000,000 shares of our common stock at $0.21 per share in September 2006 pursuant to our 2003 Stock Incentive Plan. Mr. Griffin's stock option vests twenty-five percent on the first anniversary of the grant with the remainder vesting monthly thereafter in 36 equal monthly installments.

Upon the effectiveness of this offering, each of our non-employee directors who has been a member of our board of directors for at least one year prior to completion of this offering will receive an option to purchase 25,000 shares of our common stock at an exercise price equal to the offering price to the public of our common stock. Twenty-five percent of these options will vest immediately with the remainder to vest in 36 equal monthly installments following the effectiveness of the registration statement of which this prospectus is a part. Following this offering, each non-employee director will receive an annual retainer of $7,500. In addition, each non-employee director will receive $2,500 per meeting of the board of directors attended in person or $1,000 per meeting attended telephonically, and each committee member will receive $750 per meeting attended of their respective committees.

Each non-employee director who serves on the audit committee, other than the chairperson of the audit committee, will receive an additional annual retainer of $1,500. The chairpersons of the audit committee, the compensation committee and the nominating and corporate governance committee will also receive additional annual retainers of $10,000, $4,000 and $4,000, respectively.

Each non-employee director who first becomes a member of our board of directors after the completion of this offering will be granted an option to purchase 25,000 shares of our common stock. Twenty-five percent of these options will vest immediately with the remainder to vest in 36 equal monthly installments following the offering. After the completion of this offering, each non-employee director that continues as a non-employee director will be entitled to receive an annual option grant to purchase 10,000 shares of our common stock. Twenty-five percent of these options will vest immediately with the remainder to vest in 36 equal monthly installments following the offering. Each such option will have an exercise price equal to the price of the last trade of our common stock on the date of grant and will have a ten-year term subject to earlier termination in connection with a termination of directorship.

The following table sets forth a summary of the compensation received by our only non-employee director who received compensation during our fiscal year ended December 31, 2006:

Director Compensation

Name	Option Awards ($) (1)	Total ($)
Bobby I. Griffin	$ 7,949	$7,949

(1) The amount in this column is the compensation cost recognized by us in fiscal year 2006 related to grants of stock options, as prescribed under the SFAS 123R and based on the financial statement compensation expense as reported in our consolidated statements of operations for the fiscal year ended December 31, 2006, excluding the impact of forfeitures. For a discussion of valuation assumptions, see Note 13 (Stock Options) to our audited consolidated financial statements for the fiscal year ended December 31, 2006 included as part of this prospectus. Mr. Griffin received a stock option grant in 2006 of 1,000,000 shares with a SFAS 123R grant date fair value based on the Black-Scholes model of option valuation of $0.127 per share. This option vests over a four-year period with 25% vesting on the one-year anniversary and the remainder vesting monthly thereafter for three years. As of December 31, 2006, Mr. Griffin was our only non-employee director with outstanding options. He held 1,500,000 options as of that date.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

This Compensation Discussion and Analysis describes the compensation policies and programs for our named executive officers, which consist of our Chief Executive Officer, our Controller, who served as our principal financial and accounting officer during fiscal year 2006, our three next most highly paid executive officers as determined under the rules of the SEC, and Virginia M. Kirby, our former Vice President of Clinical and Reimbursement, and Richard R. Wilson, our former Vice President of Clinical and Chief Medical Officer, who would have been one of our three most highly paid executive officers as of December 31, 2006, but whose employment ended effective April 14, 2006 and July 15, 2006, respectively.

From July 2006 to April 2007, the compensation committee, acting together with the board of directors, determined the compensation programs for our executive officers. Commencing April 27, 2007, our board of directors appointed independent directors to the compensation committee and formally adopted a charter outlining the responsibilities of the committee. This new compensation committee discharges the responsibilities of our board of directors with respect to all forms of compensation of our executive officers and oversees our compensation plans. The compensation committee is responsible for developing and recommending to the board our executive compensation program for Mark B. Knudson, our President and Chief Executive Officer, and our other named executive officers.

Compensation Philosophy

We are committed to attracting, hiring and retaining an experienced management team. Our fundamental executive compensation philosophy is to provide our executive officers with competitive compensation opportunities based upon their contributions to the development of our business, including the company's financial success and long-term interests of our stockholders, as well as the officers' personal performance. Each executive officer's total compensation is contingent upon both our overall company performance and each executive officer's individual performance. Accordingly, the compensation package for each executive officer is comprised of three elements: (i) a base salary that reflects individual experience and performance and is intended to be competitive in the context of applicable market factors; (ii) cash incentive payments that are contingent upon our achievement of specific pre-determined performance objectives; and (iii) stock-based incentive awards, which reward long-term performance and align the mutuality of interests between our executive officers and our stockholders. The mix of base pay, annual cash incentive compensation and long-term incentive compensation is designed to reflect a bias towards pay for performance by placing a significant percentage of target compensation at risk.

Compensation Determination Process and Components

During 2006 and prior years, compensation was based generally on programs and compensation levels that were historically in place. Thus, 2006 salaries reflect salaries in place in 2005 and prior years. Historically, the board of directors established the performance objectives of the annual cash incentive Management Incentive Plan during the first half of the year. Commencing in 2007, the compensation committee adopted a practice of reviewing each element of total compensation on an annual basis in the first half of the year in connection with the review or our annual performance. For the 2007 compensation review process, the compensation committee began by reviewing third-party survey information concerning base salaries paid by comparably sized, private and publicly-traded medical device companies with annual revenues less than $100 million to benchmark our competitive position. We believe the overall salary structure for our company is generally at the mid-point compared to such companies. Our policy for determining the allocation between long-term and currently-paid compensation is to ensure adequate base compensation to attract and retain our executive officers, while providing incentives to maximize long-term value for the company and our stockholders. We provide cash compensation in the form of base salary to meet competitive salary norms and provide cash bonus compensation to reward performance against specific short-term goals. In determining the long-term incentive component of compensation, the compensation committee considers our performance, the awards given in past years and any other relevant factors.

In particular, with respect to our Chief Executive Officer, the compensation committee reviews and approves corporate goals and objectives relevant to the Chief Executive Officer's compensation, evaluates the Chief Executive Officer's performance in light of those goals and objectives and determines and approves the Chief Executive Officer's compensation based on this evaluation.

The Chief Executive Officer participates in the compensation committee's meetings at the committee's request. Management does not participate in the final determination or recommendation of the amount or form of executive compensation, except that the Chief Executive Officer makes compensation recommendations for the other executive officers, which the compensation committee may, but is not required, to consider. The Chief Executive Officer does not make an initial recommendation on his own compensation.

The compensation committee has the authority to use outside compensation consultants to assist it in analyzing our compensation programs and determining appropriate levels of compensation and benefits or to retain outside counsel and other advisors to assist it in the performance of its functions. The decision to retain consultants and, if so, which consultants to retain, is made solely by the compensation committee. The compensation committee has not used the services of a compensation consultant to date; however, it will continue to consider the need to retain a compensation consultant following this offering.

Base Salary

Base salaries are designed to provide recurring compensation for the fulfillment of the duties and responsibilities associated with job roles, and are paid in cash on a semi-monthly basis. The base salaries for our executive officers are structured to be market-competitive and to attract and retain these key employees. An executive's base salary is also determined by reviewing the executive's other compensation to ensure that the executive's total compensation is in line with our overall compensation philosophy. The base salaries for each of our named executive officers for 2006, except Dr. Tweden and Mr. Brooks, were determined by the board of directors at the time of hire and were unchanged in 2006. Our Chief Executive Officer set the amount of base compensation received in 2006 by Dr. Tweden and Mr. Brooks. The agreement with our Chief Executive Officer, which was entered into in June 2005, provides for a minimum base salary of $300,000. In 2007, the compensation committee reviewed each individual's experience, each individual's performance during the prior year, market factors including the salary levels of comparable positions in the medical device industry using third-party survey information, and other publicly available data of comparable companies. For 2007, the compensation committee approved an across the board salary increase of four percent for all named executive officers, except for Mr. Brooks who received a $5,000 market-based compensation adjustment and a five percent increase of his adjusted salary.

The compensation committee has adopted a practice of reviewing base salaries annually. Additionally, we may adjust base salaries as warranted throughout the year for promotions or other changes in the scope or breadth of an executive's role or responsibilities.

Annual Cash Incentives

Our Management Incentive Plan, which commenced with our 2005 fiscal year, is designed to provide executive officers with annual incentive compensation based on the achievement of certain pre-established corporate and departmental performance objectives. This program blends objective and subjective performance factors critical to our success. At the beginning of each year, the objectives are initially proposed by our Chief Executive Officer. In 2005 and 2006, the objectives were then reviewed, revised and approved by the board of directors. Beginning in 2007, the objectives were recommended by the compensation committee and approved by the board of directors. “Target” objectives are assigned to each performance measure to determine payouts. If targets are not met, the board of directors has the discretion to consider the extent to which the targets were met in awarding bonuses, if any. As necessary, the compensation committee may modify or re-weight the objectives during the course of the fiscal year to reflect changes in our business plan. No modifications were made during 2006.

For fiscal year 2006, our performance objectives consisted of the corporate goals of completing certain milestones in our VBLOC-I clinical trial and the financial goal of closing our Series C financing. The financial goal was weighted to represent 33% of the total bonus, and the corporate goals were weighted to represent an aggregate 67% of the total bonus. If these objectives were met, the named executive officers were entitled to receive a bonus equal to a certain percentage of their base salary for the year set forth in the table below:

Mark B. Knudson	30%
Adrianus (Jos) Donders	25%
Russ Felkey	20%
Katherine S. Tweden	20%
David Brooks	15%

At its February 6, 2007 meeting, the compensation committee reviewed the achievement of the financial and corporate objectives in awarding bonuses under the Management Incentive Plan, and concluded that 100% of the 2006 performance objectives had been met. The board of directors, upon the recommendation of the compensation committee, approved the bonus awards for FY 2006 performance on February 6, 2007. As a result, bonus awards of $90,000, $17,081, $58,750, $46,000 and $40,000 were awarded to Dr. Knudson, Mr. Brooks, Mr. Donders, Mr. Felkey and Dr. Tweden during the first quarter of fiscal year 2007. Ms. Kirby and Dr. Wilson did not receive bonus awards under the 2006 Management Incentive Plan because their employment with us was terminated on April 14, 2006 and July 15, 2006, respectively.

In the first half of 2006, the board, after review of the company’s accomplishments and performance, established an employee bonus pool and awarded bonuses to persons who were not participants in the Management Incentive Plan for fiscal 2005. As a result, Mr. Brooks and Dr. Tweden were awarded bonuses out of the employee pool of $700, and $2,500, respectively.

In the first quarter of 2007, the compensation committee established the performance objectives under the Management Incentive Plan for 2007 and included an individual performance component for certain executive officers, weighted as follows:

Title	Corporate Objective Weighting	Individual Objective Weighting
President and CEO	100%	0%
Senior Vice President	90%	10%
Vice President	75%	25%
Controller	40%	60%

In addition, the compensation committee established corporate performance objectives for 2007 consisting of the completion of certain milestones related to our VBLOC clinical trials, including our EMPOWER pivotal trial, expanding our management team and meeting financial budgetary goals.

Long-Term Incentives

Our 2003 Stock Incentive Plan allows us the opportunity to grant stock options, restricted stock and other equity-based awards. Currently, long-term incentives are awarded to our executive officers through the grant of stock options. In 2003, we also sold shares of restricted stock to our executive officers and other employees for $0.01 per share, the then fair market value of the common stock, which shares were subject to a Share Restriction Agreement, that gives us the option to repurchase all unvested shares when the executive ceases to provide services to us. The shares vest 1/48th per month.

Our stock option grants are designed to align the long-term interests of each executive officer with those of our stockholders by providing executive officers with an incentive to manage our business from the perspective of an owner with an equity stake in the business. The compensation committee has used stock options, rather than other forms of long-term incentives, because they create value for the executive only if stockholder value is increased through an increased share price. In general, we view stock option grants as incentives for future performance and not as compensation for past accomplishments. We also believe that equity awards reward continued employment by an executive officer, with an associated benefit to us of employee continuity and retention.

Executive officers are granted stock options at the time they commence their employment with us. New hire grants occur at regularly scheduled board meetings. Executive officers are also eligible for annual grants thereafter, which are expected to occur at the first regularly scheduled board meeting of each fiscal year. Stock options granted to our executive officers generally vest twenty-five (25%) percent on the first anniversary of the date of grant, or the date of hire if it is associated with a new hire grant, and then 1/36th per month for 36 months thereafter and expire ten years after the date of grant subject to earlier termination in the event of a termination of employment. The vesting of some stock options issued to our executive officers may be tied to specified performance milestones. Stock option grants are made with an exercise price equal to the fair market value of our common stock on the date of grant. Prior to May 1, 2006, the grant date was the same as an employee's hire date, the date an agreement was entered into with a consultant or the date the board of directors approved the option grant. Since May 1, 2006, the stock option grant date has consistently been the day the board of directors approves the option grant.

The board of directors does not award stock options according to a prescribed formula or target. In determining the number of stock options granted to individuals and to the officers as a group, individual experience, contributions and achievements are considered, as well as the recommendations of the Chief Executive Officer. Beginning in 2007, a review of each component of the executive's compensation is conducted when determining annual equity awards to ensure that an executive's total compensation is in line with our overall compensation philosophy.

In 2006, the named executive officers, were awarded stock options in the amounts indicated in the "Grants of Plan-Based Awards" table. This includes grants to Dr. Knudson, Mr. Brooks, Mr. Donders, Mr. Felkey and Dr. Tweden in April 2006 and a grant to Mr. Brooks in December 2006.

Other Compensation

We provide our executive officers with benefits, including health insurance, life and disability insurance and dental insurance, that we believe are reasonable, competitive and consistent with our overall executive compensation program in order to attract and retain talented executives. Specifically, we fund the executive's Flex Spending Accounts and we pay 100% of the health and dental insurance premium costs for the families of our executive officers. The compensation committee periodically reviews the levels of benefits provided to executive officers.

We provide a 401(k) retirement savings plan in which all full-time employees, including the executive officers, may participate. Eligible employees may elect to reduce their current compensation by an amount no greater than the statutorily prescribed annual limit and may have that amount contributed to the 401(k) plan. Participation of the executive officers is on the same terms as any other participant in the plan. Matching contributions may be made by us to the 401(k) plan at the discretion of our board of directors. To date, we have not made any matching contributions to the 401(k) plan.

Executive Employment Agreements and Severance Benefits

We have entered into executive employment agreements with Dr. Knudson and Messrs. Lea, Donders and Felkey. These agreements establish a specified minimum base compensation and a maximum percentage of annual incentive compensation that may be earned by the each of these executive officers in a given year. In addition, these agreements provide for the payment of severance benefits upon certain termination events with Dr. Knudson and Messrs. Lea, Donders and Felkey and for the right to certain benefits upon a change in control of EnteroMedics. The purpose of these agreements is to attract and retain high caliber executive officers, recognizing that termination and change in control protections are commonly provided at comparable companies with which we compete for executive talent. In addition, the compensation committee believes change in control protections enhance the impartiality and objectivity of the executive officers in the event of a change in control transaction and better ensure that stockholder interests are protected. A more complete description of the executive employment agreements is found in the sections entitled "Employment Agreements" and "Potential Payments Upon Termination or Change in Control."

Compliance with Internal Revenue Code Section 162(m)

As a result of Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), we will not be allowed a federal income tax deduction for compensation paid to certain executive officers to the extent that compensation exceeds $1 million per officer in any one year. This limitation will apply to all compensation paid to the covered executive officers which is not considered to be performance-based. Compensation which does qualify as performance-based compensation will not have to be taken into account for purposes of this limitation.

Section 162(m) of the Code did not affect the deductibility of compensation paid to our executive officers in 2006 and it is anticipated it will not affect the deductibility of such compensation expected to be paid in the foreseeable future. The compensation committee will continue to monitor this matter and may propose additional changes to the executive compensation program if warranted.

Table of Contents

Summary Compensation Table

The following table sets forth information regarding compensation earned by our named executive officers during our fiscal year ended December 31, 2006.

Summary Compensation Table

Name and Principal Position	Year	Salary ($)	Bonus ($)(1)	Option Awards ($)(2)	Non-equity Incentive Plan Compensation ($)(3)	All Other Compensation ($)(4)	Total ($)
Mark B. Knudson *President and Chief Executive Officer*	2006	$300,000	$ —	$ 1,911	$90,000	$ 5,073	$396,984
David C. Brooks(5) *Controller*	2006	109,417	700	862	17,081	—	128,060
Adrianus (Jos) Donders *Senior Vice President of Operations*	2006	235,000	—	1,627	58,750	5,546	300,923
Russ Felkey *Senior Vice President of Clinical, Quality and Regulatory Affairs*	2006	230,000	—	1,162	46,000	5,627	282,789
Katherine S. Tweden *Vice President of Research*	2006	191,875	2,500	749	40,000	5,546	240,670
Virginia M. Kirby(6) *Former Vice President of Clinical and Reimbursement*	2006	63,461	—	1,224	—	86,145(7)	150,830
Richard R. Wilson(8) *Former Vice President of Clinical and Chief Medical Officer*	2006	123,933	—	10,922	—	101,602(9)	236,457

(1) Under current reporting rules, only discretionary or guaranteed bonuses are disclosed in this column. Mr. Brooks and Dr. Tweden received bonus payments in 2006 related to the employee bonus pool. Employee bonuses are paid at the discretion of the board.

(2) The amount in this column is based on the compensation cost we recognized for financial statement reporting purposes with respect to the year ended December 31, 2006 in accordance with SFAS 123R, excluding the impact of forfeitures and assuming that we used the minimum value method prescribed by APB 25 for reporting awards granted prior to January 1, 2006. The assumptions we used for calculating the compensation cost are disclosed in Note 13 (Stock Options) to our consolidated financial statements for the fiscal year ended December 31, 2006 included as part of this prospectus. The amounts in this column reported for Ms. Kirby and Dr. Wilson are the compensation costs related to options that were revalued during fiscal year 2006 in accordance with SFAS 123R as a result of modifications to the original stock option grants. See footnotes (6) and (7) to the "Grants of Plan-Based Awards" table for more details regarding these revaluations.

(3) Represents bonuses earned in 2006 under our Management Incentive Plan. All of our executive officers participate in the Management Incentive Plan. The details of the Management Incentive Plan are discussed further above under the heading "Compensation Discussion and Analysis."

(4) The amounts in this column include company contributions to each executive officer's Flex Spending Account (FSA) and premiums paid by the company for health care and dental coverage for the dependents

of each of our executive officers. With respect to the FSA spending contribution, the maximum contribution amount is included regardless of actual amounts used by the executives in 2006. With respect to the dependent health care and dental coverage, the amounts only include the 20% additional coverage paid by the company for executive officers as the company covers 80% of this expense for all employees.

(5) Mr. Brooks served as our principal financial and accounting officer during fiscal year 2006. On May 17, 2007, Gregory S. Lea accepted our offer as Senior Vice President and Chief Financial Officer and commenced his employment with us effective May 21, 2007.

(6) Ms. Kirby's employment with the company was terminated effective April 14, 2006.

(7) Includes $11,583 for paid time off (PTO) that was cashed out upon Ms. Kirby's termination and $71,375 paid to Ms. Kirby pursuant to a consulting agreement she entered into with the company to provide three-months of transition services following her departure. Ms. Kirby did not receive any severance payments in connection with her termination.

(8) Mr. Wilson's employment with the company was terminated effective July 15, 2006.

(9) Includes $26,400 for paid time off (PTO) that was cashed out upon Dr. Wilson's termination and $71,500 paid to Dr. Wilson pursuant to a consulting agreement he entered into with the company following his termination. Dr. Wilson continues to provide services to us pursuant to this agreement. Dr. Wilson did not receive any severance payments in connection with his termination.

Grants of Plan-Based Awards

The table below sets forth information regarding all plan-based awards granted to our named executive officers during fiscal year 2006.

Grants of Plan-Based Awards

Name	Grant Date	Estimated future payouts under non-equity incentive plan awards(1) Threshold ($)	Target ($)	Maximum ($)	All other option awards: number of securities underlying options (#)	Exercise or base price of option awards ($/Sh)	Grant date fair value of option awards ($)(2)
Mark B. Knudson	2/16/06	$ —	$90,000	$ —	—	$ —	$ —
	4/20/06	—	—	—	370,000(3)	0.05	11,467
David C. Brooks	2/16/06	—	17,081	—	—	—	—
	4/20/06	—	—	—	5,000(4)	0.05	132
	4/20/06	—	—	—	15,000(3)	0.05	465
	12/7/06	—	—	—	247,100(5)	0.21	31,311
Adrianus (Jos) Donders	2/16/06	—	58,750	—	—	—	—
	4/20/06	—	—	—	315,000(3)	0.05	9,762
Russ Felkey	2/16/06	—	46,000	—	—	—	—
	4/20/06	—	—	—	225,000(3)	0.05	6,973
Katherine S. Tweden	2/16/06	—	40,000	—	—	—	—
	4/20/06	—	—	—	145,000(3)	0.05	4,494
Virginia M. Kirby	2/16/06	—	44,000	—	—	—	—
	—	—	—	—	—	—	1,224(6)
Richard R. Wilson	2/16/06	—	45,760	—	—	—	—
	—	—	—	—	—	—	10,922(7)

(1) Represents the potential value of bonuses that could have been earned under our Management Incentive Plan. The target bonus for each executive officer will be a percentage of the respective base salary for the executive officer. Under the Management Incentive Plan for 2006, Dr. Knudson could have earned a bonus

up to 30% of his base salary, Mr. Donders could have earned a bonus of 25% of his base salary, Mr. Felkey and Drs. Wilson and Tweden and Ms. Kirby could have earned a bonus of 20% of each of their respective base salaries and Mr. Brooks could have earned a bonus of 15% of his base salary. Under the Management Incentive Plan, the board of directors establishes certain target financial and corporate objectives for each fiscal year. If these objectives are met, then the target bonus is payable. If any of the objectives are not met, or if they are exceeded, the board of directors has the discretion to make appropriate adjustments, but the plan does not provide for any formulaic adjustments or payments to be made in those circumstances. Commencing in 2007, the bonuses are reviewed by the compensation committee and, upon the recommendation of the compensation committee, approved by the board of directors. The actual awards earned by the executive officers in 2006 are reported in the Non-Equity Incentive Plan Compensation column in the Summary Compensation Table and are discussed further above under the heading "Compensation Discussion and Analysis."

(2) The amounts shown represent the grant date fair value based on the Black-Scholes model of option valuation, as prescribed under SFAS 123R. The assumptions used to arrive at the Black-Scholes value are disclosed in Note 13 (Stock Options) to our consolidated financial statements for the fiscal year ended December 31, 2006 included as part of this prospectus, excluding the impact of forfeitures.

(3) These stock options were granted under our 2003 Stock Incentive Plan and vest 25% on the first anniversary of the date of grant, and 1/36th per month for 36 months thereafter.

(4) This stock option was granted under our 2003 Stock Incentive Plan and vests 100% upon the date of grant.

(5) This stock option was granted under our 2003 Stock Incentive Plan and vests 25% on December 1, 2007, and 1/36th per month for 36 months thereafter.

(6) In connection with Ms. Kirby's termination, the board of directors approved a modification to her stock options on April 20, 2006, which eliminated the cliff vesting to give her the right to exercise the six months worth of options she had vested through her termination date. The amount in the table above represents the incremental fair value for this modification to the original stock option grant computed as of April 20, 2006 in accordance with SFAS 123R.

(7) Following his termination, Dr. Wilson entered into a consulting agreement pursuant to which his remaining outstanding options continued to vest in accordance with our standard vesting terms. As a non-employee, these options are remeasured at the end of each reporting period under SFAS 123R and pursuant to the guidance of EITF 96-18. The amount in the table above represents the incremental fair value for the remeasurements on September 30, 2006 and December 31, 2006, which was $5,484 and $5,438, respectively.

Employment Agreements

Executive Employment Agreement With Mark B. Knudson

On June 22, 2005, we entered into an executive employment agreement with Dr. Knudson, our Chief Executive Officer and President. The agreement has an initial term of two years and automatically renews for successive one year terms unless either party delivers written notice 90 days prior to the expiration of the current term or unless it is earlier terminated as described below. Pursuant to the agreement, Dr. Knudson is entitled to a base salary of not less than $300,000, or a higher annual rate if approved by the board of directors, and to cash and equity awards pursuant to our incentive compensation plan, contingent on Dr. Knudson meeting certain annual objectives agreed to by him and the compensation committee. The agreement establishes that the target amount of Dr. Knudson's annual incentive compensation may not exceed 30% of his base salary for that year. Dr. Knudson's executive employment agreements also provides for the receipt of certain benefits upon the occurrence of particular termination events or a change in control. See the section entitled "Potential Payments Upon Termination or Change in Control" for a more detailed discussion of these benefits. In addition, Dr. Knudson's agreement includes a non-disclosure and assignment provision and non-competition, non-solicitation and no recruitment commitments each lasting for a period of one year following termination.

Executive Employment Agreements With Greg S. Lea, Adrianus (Jos) Donders and Russ Felkey

In 2007, we also entered into executive employment agreements with Mr. Lea, our Senior Vice President and Chief Financial Officer, Mr. Donders, our Senior Vice President of Operations, and Mr. Felkey, our Senior Vice President of Clinical, Quality and Regulatory Affairs. These agreements have an initial term of one year and

Table of Contents

automatically renew for successive one year terms unless either party delivers written notice 90 days prior to the expiration of the current term or unless it is earlier terminated as described below. Pursuant to these agreements, these executive officers are entitled to a base salary, as set forth in the table below, or a higher annual rate if approved by the board of directors, and to cash and equity awards pursuant to our incentive compensation plan, contingent on the executive officers meeting certain annual objectives agreed to by them and the Chief Executive Officer. The agreements establish that the target amount of these executives' annual incentive compensation may not exceed 25% of their respective base salary for that year.

Greg S. Lea	$ 245,000
Adrianus (Jos) Donders	235,000
Russ Felkey	230,000

These agreements also provide for the receipt of certain benefits upon the occurrence of particular termination events or a change in control. See the section entitled "Potential Payments Upon Termination or Change in Control" for a more detailed discussion of these benefits. In addition, these agreements include non-disclosure and assignment provisions and non-competition, non-solicitation and no recruitment commitments each lasting for a period of one year following termination.

Outstanding Equity Awards at Fiscal Year-End

The following table summarizes the outstanding equity award holdings held by our named executive officers at December 31, 2006. Virginia M. Kirby did not hold any outstanding equity awards on December 31, 2006, due to the termination of her employment on April 14, 2006.

Outstanding Equity Awards at Fiscal Year-End

	Option awards				Stock awards	
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock Held That Have Not Vested (#)(1)	Market Value of Shares or Units of Stock That Have Not Vested ($)(2)
Mark B. Knudson	493,672	138,328(3)	$ 0.05	8/16/14	—	$—
	432,200	—(4)	0.05	4/27/15	37,500(7)	—
	—	370,000(5)	0.05	4/20/16	—	
David C. Brooks	29,115	78,385(8)	0.05	11/21/15	—	—
	5,000	—(9)	0.05	4/20/16	—	—
	—	15,000(5)	0.05	4/20/16	—	—
	—	247,100(6)	0.21	12/7/16	—	—
Adrianus (Jos) Donders	333,336	466,664(8)	0.05	4/11/15	—	—
	200,000	—(4)	0.05	4/27/15	—	—
	—	315,000(5)	0.05	4/20/16	—	—
Russ Felkey	69,381	192,701(8)	0.05	1/1/15	—	—
	—	225,000(5)	0.05	4/20/16	—	—
Katherine S. Tweden	402,129	154,371(10)	0.05	8/16/14	3,334(7)	—
	10,000	—(4)	0.05	4/27/15	4,011(11)	
	—	145,000(5)	0.05	4/20/16	—	
Richard R. Wilson(12)	—	191,656(13)	0.05	8/16/14	—	—

(1) Represents shares purchased by the executive in 2003 and currently unvested pursuant to Share Restriction Agreements. The unvested shares are subject to a right of repurchase that lapses as to 1/48th of the shares on the last day of each month beginning on a date specified in the agreements. See footnotes (6) and (10)

below. The repurchase right allows us to purchase the unvested shares from the named executive officer at the original purchase price from such officer in the event that he or she no longer provides services to us as either an employee or consultant. Such repurchase right also lapses in full in the event of a change in control and such officer's employment is involuntary or constructively terminated.

(2) The market value of the shares of stock that have not vested has been calculated by multiplying the number of shares times $, which is the mid-point of the range listed on the cover page of this prospectus.

(3) Stock options vest 300,000 shares immediately upon the date of grant, which was August 16, 2004, and then 25% on the first anniversary of the date of grant and 1/36th per month for 36 months thereafter.

(4) Stock options vest 100% upon the achievement of a milestone, which was defined for purposes of these grants as the implant of the Maestro RF System in 12 patients. These grants did not provide for any time restrictions with respect to the milestone, besides the ten-year term of the option. The milestone was achieved in March 2006.

(5) Stock options vest 25% on the first anniversary of the date of grant and 1/36th per month for 36 months thereafter.

(6) Stock options vest 25% on December 1, 2007, and 1/36th per month for 36 months thereafter.

(7) The right to repurchase with respect to these shares lapses, as described in footnote (1) above, beginning on April 30, 2003.

(8) Stock options vest 25% on the first anniversary of the date of grant and 1/36th per month for 36 months thereafter. Since these grants were made prior to May 1, 2006, the date of grant for these options is the hire date, rather than the board approval date. See the "Compensation Discussion and Analysis" for further detail. The hire dates related to these options are November 21, 2005, April 11, 2005 and January 1, 2005 for Messrs. Brooks, Donders and Felkey, respectively.

(9) Stock options vest 100% immediately upon the date of grant.

(10) Stock options vest 186,000 shares immediately upon the date of grant, which was August 16, 2004, and then 25% on the first anniversary of the date of grant and 1/36th per month for 36 months thereafter.

(11) The right to repurchase with respect to these shares lapses, as described in footnote (2) above, beginning on November 30, 2003.

(12) Dr. Wilson's employment with the company was terminated effective July 14, 2006. Dr. Wilson subsequently entered into a consulting agreement with the company pursuant to which his remaining outstanding options continued to vest in accordance with our standard vesting terms.

(13) Stock options continue to vest at 1/36th per month.

Option Exercises and Stock Vested

The following table summarizes the option exercises by our named executive officers and the vesting of stock options held by such officers during our fiscal year ended December 31, 2006:

Option Exercises and Stock Vested

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)(1)	Number of Shares Acquired on Vesting (#)(2)	Value Realized on Vesting ($)(3)
Mark B. Knudson	—	$ —	112,500	$
David C. Brooks	—	—	—	—
Adrianus (Jos) Donders	—	—	—	—
Russ Felkey	157,918		—	—
Katherine S. Tweden	—	—	14,375	
Virginia M. Kirby	46,250		—	—
Richard R. Wilson	163,344		—	—

(1) The value realized is determined by multiplying the number of shares acquired on exercise by $, which is the mid-point of the range listed on the cover page of this prospectus, net of the exercise price for acquiring the shares.

(2) Vesting relates to shares purchased by the executives in 2003 and subject to Share Restriction Agreements dated October 3, 2003 and October 20, 2003. The shares are subject to a right of repurchase by the company that lapses as to 1/48th of the shares on the last day of each month beginning on April 30, 2003 or November 30, 2003 as specified in the agreements. The right of repurchase fully lapsed with respect to Dr. Knudson's 450,000 shares and Dr. Tweden's 40,000 shares as of April 30, 2007. The right of repurchase will fully lapse with respect to Dr. Tweden's additional 17,500 shares as of November 30, 2007.

(3) The value realized is determined by multiplying the number of shares vested by $, which is the mid-point of the range listed on the cover page of this prospectus.

Pension Benefits

None of our named executive officers participate in or have account balances in qualified or non-qualified defined benefit plans sponsored by us.

Non-Qualified Deferred Compensation

We currently do not have any non-qualified defined contribution plans or other deferred compensation plans.

Potential Payments and Benefits Upon Termination or Change in Control

We have entered into Executive Employment Agreements with Mark B. Knudson, Greg S. Lea, Adrianus (Jos) Donders and Russ Felkey providing for the receipt of certain payments and benefits upon particular termination events or change in control.

These agreements may be terminated prior to the expiration of the term by mutual written agreement of the parties, in the event of death or disability, by us for cause (*i.e.*, for uncured willful breach of duties or this agreement, conviction of any felony or crime involving fraud, dishonesty or moral turpitude or participation in any fraud against or affecting us or any of our subsidiaries, affiliates, suppliers, clients, agents or employees or an act of personal dishonesty intended to result in personal enrichment at our expense or any other act we determine constitutes gross or willful misconduct) or by these executives for good reason (*i.e.*, a significant change and substantial reduction in their responsibilities or a relocation to more than 25 miles from our current facility). In addition, either party may terminate the executive's employment at any time for any reason or no reason, including after a change in control, with 30 days written notice. For purposes of these agreements, a change in control includes: (1) a change in beneficial ownership of our securities after the date of the agreement resulting in a new beneficial owner holding 50% or more of the combined voting power of our securities; (2) a majority of the board ceases to be composed of continuing directors (as defined in the agreement); (3) any consolidation or merger involving the company where the company is not the surviving corporation or the shares of the company's capital stock are converted into cash, securities or other property, except if the company is the surviving corporation and its stockholders immediately prior to the transaction maintain a proportionate ownership in the company's stock following the transaction, (4) 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; (5) any liquidation or dissolution of the company; or (6) a majority of the continuing directors determine, in their sole and absolute discretion, that there has been a change in control.

Payments Made Upon Termination Due to Death or Disability.

In the event that Dr. Knudson's employment is terminated due to death or disability (as defined in the agreement), he, or in the event of his death, his then spouse, is entitled to 12 months of continued health benefits. In the event that Messrs. Donders or Felkey's employment is terminated due to death or disability, each of them, or in the event of their death, their then spouses, are entitled to six months of continued health benefits.

Payments Made Upon Termination Without Cause or Resignation for Good Reason.

In the event that Dr. Knudson resigns for good reason or his employment is terminated without cause prior to the end of the term of his agreement, he is entitled to (1) receive base salary at the rate then currently in effect for a period of 12 months following the termination date, (2) exercise all vested options and those that would have vested within one year of the termination date for a period of five years following his termination, and (3) receive continued health benefits for a period of 12 months following the termination date. In the event that Messrs. Lea, Donders or Felkey resigns for good reason or is terminated without cause prior to the end of the term of their agreements, they are entitled to (1) receive base salary at the rate then currently in effect for a period of six months following the termination date, (2) exercise all vested options and those that would have vested within one year of the termination date for a period of five years following their termination and (3) receive continued health benefits for a period of six months following the termination date. Dr. Knudson and Messrs. Lea, Donders and Felkey's severance pay is subject to signing, and not rescinding, a general release of all claims against the company.

Benefits Upon Change in Control.

In the event of a change in control in which the employment of these executive officers is not terminated, the agreement provides that 50% of the remaining unvested portion of their stock options will automatically vest and be exercisable for a period of five years following termination of employment. In the event of a change in control in which the employment of these executive officers is terminated, 100% of the remaining unvested portion of their options will immediately vest and be exercisable for a period of five years following termination of employment. However, with respect to either of these provisions, if these executive officers receive a cash payment for their options in connection with the change in control equal to the difference between the per share amount paid to the common stockholders in the transaction and the exercise price of the option, their options will be cancelled in exchange for the cash payment.

In addition, in the event of a change in control and termination of employment, our right to repurchase shares of restricted stock subject to the Share Restriction Agreements will immediately and fully lapse. The only named executive officers holding such shares are Drs. Knudson and Tweden. At December 31, 2006, the value of the shares held by Drs. Knudson and Tweden for which this repurchase right had not lapsed is provided above in the "Outstanding Equity Awards at Fiscal Year-End" table. On April 30, 2007, the repurchase right fully lapsed with respect to Dr. Knudson's 37,500 shares and Dr. Tweden's 3,334 shares and on November 30, 2007, it will fully lapse with respect to Dr. Tweden's other 4,011 shares.

Potential Payments Upon Termination or Change in Control

The table below shows our reasonable estimates of potential payments and benefits payable to the named executive officers and Mr. Lea upon termination without cause, resignation for good reason and change in control of EnteroMedics, with or without termination, based on the mid-point of the range listed on the cover of this prospectus. The amounts shown assume that termination or change in control was effective as of December 29, 2006, the last business day of the fiscal year, assuming that each executive's employment agreement was effective as of such date and are estimates of the amounts that would be paid to the executive officer in addition to the base salary and bonus earned by the executives during 2006. Also excluded are benefits payable to all employees, such as accrued vacation and life insurance premiums. The actual amounts to be paid can only be determined at the actual time of an executive officer's termination.

Name(1)	Type of Payment	Payments Upon Change in Control With Termination ($)(2)	Payments Upon Change in Control Without Termination ($)(2)	Payments Upon Termination Without Cause or Resignation for Good Reason ($)
Mark B. Knudson	Severance Pay	$ —	$ —	$ 300,000
	Value of Stock Options Accelerated(3)			
	Health Care Benefits(4)	—	—	17,110
	Total			
Greg S. Lea	Severance Pay	$ —	$ —	$ 122,500
	Value of Stock Options Accelerated(3)			
	Health Care Benefits(4)	—	—	
	Total			
Adrianus (Jos) Donders	Severance Pay	$ —	$ —	$ 117,500
	Value of Stock Options Accelerated(3)			
	Health Care Benefits(4)	—	—	9,527
	Total			
Russ Felkey	Severance Pay	$ —	$ —	$ 115,000
	Value of Stock Options Accelerated(3)			
	Health Care Benefits(4)	—	—	9,929
	Total			

(1) We entered into executive employment agreements with Messrs. Lea, Donders and Felkey on May 21, 2007, February 9, 2007 and May 16, 2007, respectively, however, we have included in this table the benefits that would have been paid to them under these agreements assuming these agreements were in effect as of the assumed termination or change in control date of December 29, 2006.

(2) Assumes that options were not cashed out in connection with change in control. Additional amounts may be payable if the termination is without cause or is a resignation for good reason, as specified in the third column.

(3) Value computed based on the difference between $, which is the mid-point of the range listed on the front cover of this prospectus and the exercise price for each option accelerated.

(4) Amount represents the estimated full premiums to be paid by the company for health and dental coverage for the executive officer and his family for the duration of the 12 or six month severance period, as applicable, based on current premiums paid.

Other Termination Arrangements

Effective as of April 14, 2006, Virginia M. Kirby terminated her employment and entered into a three-month consulting agreement under which she agreed to provide us with certain transition-related services for a total payment of $71,375. Ms. Kirby was not entitled to any severance benefits under this agreement or any other agreement with the company; however, pursuant to her departure, on April 20, 2006, the board approved a modification to her stock options, which eliminated the cliff vesting to give her the right to exercise the six months worth of options she had vested through her termination date.

Effective as of July 15, 2006, Richard R. Wilson terminated his employment and entered into a consulting agreement with us, which provides fee payments of $3,000 per week, based on 20 hours per week. Dr. Wilson continues to provide services to us in connection with this agreement. In addition, pursuant to his entering this consulting agreement, Dr. Wilson’s outstanding options were reclassified as non-qualified stock options and continue to vest in accordance with the terms of his stock option agreement.

Employee Benefit Plans

2003 Stock Incentive Plan

Our 2003 Stock Incentive Plan, which we refer to as our 2003 plan, was adopted in October 2003. Our stockholders have approved an amendment to the 2003 plan to be effective upon the completion of this offering, whereby the number of shares of common stock authorized for issuance under the 2003 plan will be 35,500,000 shares. As of May 15, 2007, options to purchase an aggregate of 16,707,968 shares of common stock were outstanding under the 2003 plan and an aggregate of 1,275,650 shares of common stock had been issued upon the exercise of stock options under the 2003 plan. Any options granted under the 2003 plan that expire or are terminated prior to exercise and any shares of common stock that were purchased by exercise of options granted under the 2003 plan and that we repurchase will be eligible for issuance under the 2003 plan.

The 2003 plan provides for the grant of incentive stock options and nonstatutory stock options. Our officers, employees, directors, consultants, independent directors and affiliates are eligible to receive options under the 2003 plan; however, incentive stock options may only be granted to our employees.

Our compensation committee administers the 2003 plan. Our board of directors, or a committee to which it has delegated its authority, may select the recipients of options and determine, subject to any limitations in the 2003 plan:

- the number of shares of common stock covered by options and the dates upon which those options become exercisable;
- the exercise prices of options;
- the duration of options; and
- the method of payment of the exercise price.

Option agreements issued pursuant to the 2003 plan provide that upon the occurrence of a change in control event (as defined in the option agreements under the 2003 plan), 50% of the unvested options outstanding as of the date of the change of control will become immediately exercisable unless the options are to be cancelled within 5 days of the change in control in which case 100% of the unvested options will be immediately exercisable. We have also entered into executive employment agreements with certain of our executive officers that provide that 100% of the unvested options outstanding will become immediately exercisable upon the occurrence of a change in control event in which the executive officer is terminated. See “Potential Payments Upon Termination or Change in Control” for a more detailed description of the vesting provisions of these agreements.

Our compensation committee may amend, modify or terminate any outstanding award, only with the consent of the holder, unless the compensation committee or our board of directors determines that the amendment, modification or termination would not adversely affect the holder. Our board of directors may at any time suspend or terminate the 2003 plan, except that, to the extent determined by our board, no amendment requiring stockholder approval under any applicable legal, regulatory or listing requirement will become effective until the requisite stockholder approval is obtained.

Management Incentive Plan

For our fiscal year ending December 31, 2007, we adopted a management incentive plan for our executive and senior officers, including our senior vice presidents, vice presidents and controller, that provides an annual bonus payout in cash based on certain metrics set forth in the plan. In the first quarter of 2007, our compensation committee recommended and the board of directors approved the performance objectives for the 2007 Management Incentive Plan and the percentage of the bonus attributable to the achievement of corporate and individual performance objectives. For fiscal year 2007, the corporate performance objectives consist of the completion of certain milestones related to our VBLOC clinical trials, including our EMPOWER pivotal trial, expanding our management team and meeting financial budgetary goals. The individual performance objectives were set separately and specifically for each participating executive officer. For a more detailed description of our Management Incentive Plan, see the section entitled "Compensation Discussion and Analysis."

401(k) Plan

Our retirement plan, which we refer to as the 401(k) plan, is qualified under Section 401 of the Internal Revenue Code, and provides retirement benefits to all full-time employees. Eligible employees may elect to reduce their current compensation by an amount no greater than the statutorily prescribed annual limit and may have that amount contributed to the 401(k) plan. Matching contributions may be made to the 401(k) plan at the discretion of our board. To date, we have not made any contributions to the 401(k) plan.

Indemnification of Officers and Directors

Article 6 of our certificate of incorporation, to become effective upon the completion of the offering made pursuant to this registration statement, provides that no director of our company shall be personally liable to us or our stockholders for monetary damages for any breach of fiduciary duty as a director, notwithstanding any provision of law imposing such liability, except for liability (i) for any breach of the director's duty of loyalty to our company or its stockholders, (ii) for acts or omissions not in good faith or which involved intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law, or (iv) for any transaction from which the director derived an improper personal benefit.

Article 8 of our bylaws provides that we will indemnify each person who was or is otherwise involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he or she, or a person of whom he or she is the legal representative, is or was a director or officer of our company or is or was serving at the request of our company as a director, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise, whether the basis of such proceeding is alleged action in an official capacity as a director, officer, employee or agent or in any other capacity while serving as a director, officer, employee or agent (all such persons are referred to as an indemnitee), shall be indemnified and held harmless by our company, against all expenses, liability and loss (including attorneys' fees, judgments, fines, penalties and amounts paid or to be paid in settlement) reasonably incurred or suffered by such indemnitee in connection with such action, suit or proceeding and any appeal therefrom, if such indemnitee acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to, our best interests, and, with respect to any criminal action or proceeding, he or she had no reasonable cause to believe his or her conduct was unlawful. Our bylaws provide that we will indemnify any indemnitee seeking indemnity in connection with a proceeding (or part thereof) initiated by such person only if such proceeding (or part thereof) was authorized by our board of directors. We will indemnify the indemnitee for expenses incurred in defending any such proceeding in advance of its final disposition to the extent not prohibited by law. Such indemnification will only be made if the indemnitee acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to, our best interests, except that no indemnification shall be made with respect to any claim, issue or matter as to which such person shall have been adjudged to be liable to us, unless a court determines that, despite such adjudication but in view of all of the circumstances, he or she is entitled to indemnification of such expenses. Expenses must be advanced to an indemnitee under certain circumstances.

As a condition precedent to the right of indemnification, an indemnitee must give us notice of the action for which indemnity is sought and we have the right to participate in such action or assume the defense thereof.

Article 8 of our bylaws further provides that the indemnification provided therein is not exclusive, and provides that no amendment, termination or repeal of the relevant provisions of the Delaware law statute or any other applicable law will diminish the rights of any Indemnitee to indemnification under our certificate of incorporation.

At present, there is no pending litigation or proceeding involving any of our directors, officers or employees in which indemnification is sought, nor are we aware of any threatened litigation that may result in claims for indemnification.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers and controlling persons under our certificate of incorporation or bylaws or the indemnification agreements we have entered into with our directors and officers, we have been advised that in the opinion of the SEC this indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

Table of Contents

PRINCIPAL STOCKHOLDERS

The following table sets forth information with respect to the beneficial ownership of our common stock as of May 16, 2007 for:

- each beneficial owner of more than 5% of our outstanding common stock;
- each of our named executive officers and directors; and
- all of our executive officers and directors as a group.

Beneficial ownership is determined in accordance with the rules of the SEC. These rules generally attribute beneficial ownership of securities to persons who possess sole or shared voting power or investment power with respect to those securities and include shares of common stock issuable upon the exercise of stock options, warrants or other convertible securities that are immediately exercisable or exercisable within 60 days after May 16, 2007. Except as otherwise indicated, all of the shares reflected in the table are shares of common stock and all persons listed below have sole voting and investment power with respect to the shares beneficially owned by them, subject to applicable community property laws. The information is not necessarily indicative of beneficial ownership for any other purpose.

Percentage ownership calculations for beneficial ownership prior to this offering are based on 102,808,327 shares outstanding, on an as-converted basis, as of May 24, 2007. Percentage ownership calculations for beneficial ownership after this offering also include the   shares we are selling in this offering. Except as otherwise indicated in the table below, addresses of named beneficial owners are in care of EnteroMedics Inc., 2800 Patton Road, St. Paul, Minnesota 55113.

	Beneficial Ownership Prior to Offering				Beneficial Ownership After Offering	
			Shares Beneficially Owned		Shares Beneficially Owned	
Name and Address of Beneficial Owner	Outstanding Shares Beneficially Owned	Right to Acquire Within 60 Days After May 24, 2007	Number	Percentage	Number	Percentage
5% Stockholders:						
MPM Capital(1) 601 Gateway Blvd., Ste. 360 S. San Francisco, CA 94080	30,943,209	1,146,204	32,089,413	30.9%		
Bay City Capital(2) 750 Battery St., Ste. 400 San Francisco, CA 94111	20,570,571	500,000	21,070,571	20.4%		
Aberdare Ventures(3) One Embarcadero Ctr., Ste. 400 San Francisco, CA 94111	13,215,466	384,280	13,599,746	13.2%		
InterWest Partners(4) 2710 Sand Hill Rd., Second Floor Menlo Park, CA 94025	12,369,280	—	12,369,280	12.0%		
Onset Ventures 2400 Sand Hill Rd., Ste. 150 Menlo Park, CA 94025	7,871,360	—	7,871,360	7.7%		
Charter Life Sciences(5) 3130 Highland Ave., Ste. 3205 Cincinnati, OH 45219	5,665,157	150,000	5,815,157	5.6%		

Table of Contents

Name and Address of Beneficial Owner	Beneficial Ownership Prior to Offering: Outstanding Shares Beneficially Owned	Beneficial Ownership Prior to Offering: Right to Acquire Within 60 Days After May 24, 2007	Beneficial Ownership Prior to Offering: Shares Beneficially Owned: Number	Beneficial Ownership Prior to Offering: Shares Beneficially Owned: Percentage	Beneficial Ownership After Offering: Shares Beneficially Owned: Number	Beneficial Ownership After Offering: Shares Beneficially Owned: Percentage
Executive Officers and Directors:						
Mark B. Knudson, Ph.D.(6)	1,419,814	1,117,612	2,537,426	2.4%		
Greg S. Lea(7)	—	250,000	250,000	*		
David C. Brooks(8)	—	54,484	54,484	*		
Adrianus (Jos) Donders(9)	—	748,444	748,444	*		
Russ Felkey(10)	157,918	193,658	351,576	*		
Katherine S. Tweden(11)	57,500	511,475	568,975	*		
Virginia M. Kirby	46,250	—	46,250	*		
Richard R. Wilson(12)	547,940	78,275	626,215	*		
Luke Evnin, Ph.D.(13)	30,943,209	1,146,204	32,089,413	30.9%		
Catherine Friedman(14)	—	72,918	72,918	*		
Carl Goldfischer, M.D.(15)	20,570,571	500,000	21,070,571	20.4%		
Bobby I. Griffin	1,124,480	—	1,124,480	1.1%		
Donald C. Harrison(16)	5,822,850	159,231	5,982,081	5.8%		
Paul H. Klingenstein(17)	13,744,098	399,600	14,143,698	13.7%		
Ellen Koskinas(18)	12,369,280	—	12,369,280	12.0%		
Nicholas L. Teti, Jr.(19)	—	72,918	72,918	*		
All executive officers and directors as a group (14 persons)(20)	**86,209,720**	**5,428,877**	**91,638,597**	**84.7%**		

* Represents beneficial ownership of less than 1%.

(1) Consists of 1,731,272 shares and warrants to purchase 64,131 shares held by MPM BioVentures III, L.P. (“BV3LP”); 25,749,390 shares and warrants to purchase 953,814 shares held by MPM BioVentures III-QP, L.P. (“BV3QP”); 2,175,924 shares and warrants to purchase 80,600 shares held by MPM BioVentures III GmbH & Co. Beteiligungs KG (“BV3KG”); 777,909 shares and warrants to purchase 28,815 shares held by MPM BioVentures III Parallel Fund L.P. (“BV3PF”); and 508,714 shares and warrants to purchase 18,844 shares held by MPM Asset Management Investors 2002 BV3 (“BV3 AM 2002”). MPM BioVentures III GP, L.P. (“BV3GP”) and MPM BioVentures III LLC (“BV3LLC”) are the direct and indirect general partners of BV3LP, BV3QP, BV2KG and BV3PF. Luke Evnin, one of our directors, is a member of BV3LLC and BV3 AM 2002 and therefore holds shared voting and investment power over the shares held by BV3LP, BV3QP, BV3KG, BV3PF and BV3 AM 2002. Dr. Evnin disclaims beneficial ownership of the shares owned by these entities except to the extent of his proportionate pecuniary interest therein.

(2) Consists of 20,136,533 shares and warrants to purchase 489,450 shares held by Bay City Capital Fund IV, L.P.; 434,038 shares and warrants to purchase 10,550 shares held by Bay City Capital IV Co-Investment Fund IV, L.P. (collectively, the “Bay City Capital Funds”). Carl Goldfischer, one of our directors, is a managing director of Bay City Capital and has shared voting and investment power over the shares held by the Bay City Capital Funds. Dr. Goldfischer disclaims beneficial ownership of the shares owned by the Bay City Capital Funds except to the extent of his proportionate pecuniary interest therein.

(3) Consists of 10,811,333 shares and warrants to purchase 375,760 shares held by Aberdare Ventures II, L.P.; 245,113 shares and warrants to purchase 8,520 shares held by Aberdare Ventures II (Bermuda), L.P.; 2,159,020 shares held by Aberdare II Annex Fund, L.P. (collectively, the “Aberdare Funds”). Mr. Klingenstein, one of our directors, is a managing partner of the Aberdare Funds and has shared voting and investment power over the shares held by these entities; however, Mr. Klingenstein disclaims beneficial ownership of these shares except to the extent of his pecuniary interest therein. See footnote (17).

(4) Consists of 12,369,280 shares held by InterWest Partners IX, L.P. Ellen Koskinas, one of our directors, is a Venture Member with voting and investment power of InterWest Management Partners IX, LLC, the general partner of InterWest Partners IX, L.P. and thereby has shared voting and investment power over the shares held by InterWest Partners IX, L.P. Ms. Koskinas and all other Managing Directors and Venture

Members of InterWest Management Partners IX, L.P. disclaim beneficial ownership of these shares except to the extent of their pro rata partnership interest therein.

(5) Consists of 5,665,157 shares and warrants to purchase 150,000 shares held by Charter Life Sciences. Donald C. Harrison, one of our directors, is a managing partner of Charter Life Sciences and has shared voting and investment power over the shares held by this entity; however, Dr. Harrison disclaims beneficial ownership of these shares except to the extent of his pecuniary interest therein. See footnote (16).

(6) Includes 1,168,838 shares and warrants to purchase 18,463 shares held by the Mark B. Knudson Revocable Trust u/a dtd 4/28/03; 175,507 shares held by the Knudson Family Limited Partnership; 75,468 shares and warrants to purchase 9,231 shares held by the Susan J. Knudson Revocable Trust u/a dtd 4/18/03. Also includes of options to purchase 1,089,918 shares that are currently exercisable or exercisable within 60 days of May 24, 2007 held by Dr. Knudson.

(7) Consists of options to purchase 250,000 shares that are currently exercisable or exercisable within 60 days of May 24, 2007.

(8) Consists of options to purchase 54,484 shares that are currently exercisable or exercisable within 60 days of May 24, 2007.

(9) Consists of options to purchase 748,444 shares that are currently exercisable or exercisable within 60 days of May 24, 2007.

(10) Consists of options to purchase 193,658 shares that are currently exercisable or exercisable within 60 days of May 24, 2007.

(11) Consists of options to purchase 511,475 shares that are currently exercisable or exercisable within 60 days of May 24, 2007.

(12) Consists of warrants to purchase 20,771 shares and options to purchase 57,504 shares that are currently exercisable or exercisable within 60 days of May 24, 2007.

(13) Consists of 30,943,209 shares and warrants to purchase 1,146,204 shares owned by MPM Capital Funds. See footnote (1). Dr. Evnin, one of our directors, also holds shared voting and investment power over the shares held by BV3LP, BV3QP, BV3KG, BV3PF and BV3 AM 2002. Dr. Evnin disclaims beneficial ownership of the shares owned by these entities except to the extent of his proportionate pecuniary interest therein.

(14) Consists of options to purchase 72,918 shares that are currently exercisable or exercisable within 60 days of May 24, 2007.

(15) Consists of 20,570,571 shares and warrants to purchase 500,000 shares held by the Bay City Capital Funds. See footnote (2). Carl Goldfischer, one of our directors, also holds shared voting and investment power over the shares held by the Bay City Capital Funds. Dr. Goldfischer disclaims beneficial ownership of the shares owned by the Bay City Capital Funds except to the extent of his proportionate pecuniary interest therein.

(16) Consists of 157,693 shares and 9,231 warrants to purchase shares held by Donald C. Harrison. Also consists of 5,665,157 shares and warrants to purchase 150,000 shares held by Charter Life Sciences. See footnote (5). Dr. Harrison, one of our directors, also holds shared voting and investment power over the shares held by Charter Life Sciences. Dr. Harrison disclaims beneficial ownership of the shares owned by Charter Life Sciences except to the extent of his proportionate pecuniary interest therein.

(17) Consists of 528,632 shares and warrants to purchase 15,320 shares held by Paul H. Klingenstein. Also consists of 13, 215,466 shares and warrants to purchase 384,280 shares held by the Aberdare Funds. See footnote (3). Mr. Klingenstein, one of our directors, also holds shared voting and investment power over the shares held by the Aberdare Funds. Mr. Klingenstein disclaims beneficial ownership of the shares owned by Aberdare Ventures except to the extent of his proportionate pecuniary interest therein.

(18) Consists of 12,369,280 shares held by InterWest Partners. See footnote (4). Ellen Koskinas, one of our directors, also holds shared voting and investment power over the shares held by InterWest Partners. Ms. Koskinas disclaims beneficial ownership of the shares owned by InterWest Partners except to the extent of her pro rata partnership interest therein.

(19) Consists of options to purchase 72,918 shares that are currently exercisable or exercisable within 60 days of May 24, 2007.

(20) Includes warrants to purchase 2,232,729 shares and 3,196,148 shares of common stock issuable upon exercise of options currently exercisable or exercisable within 60 days of May 24, 2007 held by all of the executive officers and directors named in the table above, excluding Virginia Kirby and Richard Wilson, who terminated their employment with us in 2006, and including Mark Stultz, Vice President of Marketing and Reimbursement.

RELATED PARTY TRANSACTIONS

Since January 1, 2004, we have entered into the following transactions with our directors, director-nominees, officers and holders of more than five percent of our voting securities and affiliates of our directors, director-nominees, officers and five percent stockholders. All share and per share amounts pertaining to common stock have been retroactively adjusted to give effect to a -for- reverse stock split of our common stock to be effected before the completion of this offering. As a result of the -for- reverse stock split to be effected before the completion of this offering, each share of outstanding preferred stock is convertible into of a share of our common stock.

Registration Rights

We have granted registration rights to certain holders of our preferred stock and warrants to purchase our common and preferred stock, pursuant to the terms of an investor rights agreement. As of the date of this prospectus, the holders of preferred stock held an aggregate of 93,856,180 shares of preferred stock and warrants to purchase 2,272,363 shares of common and preferred stock. Upon the completion of this offering, all of the outstanding shares of our preferred stock, including shares issuable upon exercise of outstanding warrants to purchase common and preferred stock, will automatically convert into a total of 100,423,039 shares of our common stock. The holders of 98,999,040 of these common shares will have the right to require us to register these shares. After registration pursuant to these rights, these shares will become freely tradable without restriction under the Securities Act. The following related parties have registration rights:

Name of Stockholder	Number of Registrable Shares
Directors and Officers	
Mark B. Knudson, Ph.D.(1)	362,508
Bobby I. Griffin	1,124,480
Donald Harrison, M.D.	73,174
Paul H. Klingenstein(2)	543,952
5% Stockholders	
MPM Capital(3)	32,089,413
Bay City Capital(4)	21,070,571
Aberdare Ventures(5)	13,599,746
Charter Life Sciences, L.P.	5,815,157
Interwest Partners IX, L.P.	12,369,280
Onset V, L.P.	7,871,360
Total:	94,919,641

(1) Consists of 277,809 registrable shares held by the Mark B. Knudson Revocable Trust and 84,699 registrable shares held by the Susan J. Knudson Revocable Trust.

(2) Paul H. Klingenstein, a member of our board of directors, is also the managing partner of Aberdare Ventures.

(3) Consists of 1,795,403 registrable shares held by MPM BioVentures III, L.P., 26,703,204 registrable shares held by MPM BioVentures III-QP, L.P., 2,256,524 registrable shares held by MPM BioVentures III GmbH & Co. Parallel-Beteiligungs KG, 806,724 registrable shares held by MPM BioVentures III Parallel Fund, L.P. and 527,558 registrable shares held by MPM Asset Management Investors 2002 BVIII LLC. Luke B. Evnin, a member of our board of directors, is a general partner of MPM Capital.

(4) Consists of 20,625,983 registrable shares held by Bay City Capital Fund IV, L.P. and 444,588 registrable shares held by Bay City Capital Fund IV Co-Investment Fund, L.P. Carl Goldfischer, a member of our board of directors, is a managing director of Bay City Capital.

(5) Consists of 11,187,093 registrable shares held by Aberdare Ventures II, L.P., 253,633 registrable shares held by Aberdare Ventures II (Bermuda), L.P. and 2,159,020 registrable shares held by Aberdare II Annex Fund, L.P.

Securities Issued to Insiders

The following summarizes purchases of our securities since January 1, 2004 by our executive officers, directors and holders of more than 5% of our common stock other than compensatory arrangements. All share and per share amounts pertaining to common stock have been retroactively adjusted to give effect to a -for- reverse stock split of our common stock to be effected before the completion of this offering. As a result of the -for- reverse stock split to be effected before the completion of this offering, each share of outstanding preferred stock is convertible into of a share of our common stock.

Series C Preferred Stock

On July 6, 2006 and December 11, 2006, we entered into agreements with 25 individuals and entities, including Mark B. Knudson, Ph.D., MPM Capital, Bay City Capital, Aberdare Ventures, Charter Life Sciences, L.P., Interwest Partners IX, L.P., Onset V, L.P., Donald C. Harrison, M.D., Paul H. Klingenstein and Bobby I. Griffin to sell, in a private placement, an aggregate of 51,957,735 shares of our Series C preferred stock. The total aggregate offering price for these sales was $46,206,019. All shares of Series C preferred stock will be automatically converted into 51,957,735 shares of our common stock upon the completion of this offering.

Of the 51,957,735 shares of Series C preferred stock sold pursuant to the Series C financing, 49,491,882 shares of Series C preferred stock were sold to the following related parties:

Purchaser	Series C Shares	Purchase Price(1)
Directors and Executive Officers		
Mark B. Knudson, Ph.D.(2)	86,440	$ 76,871
Bobby I. Griffin	1,124,480	1,000,000
Donald C. Harrison, M.D.	17,288	15,374
Paul H. Klingenstein(3)	175,066	155,686
5% Stockholders		
MPM Capital(4)	12,266,612	10,908,699
Bay City Capital(5)	9,031,221	8,031,465
Aberdare Ventures(6)	4,346,784	3,865,595
Charter Life Sciences, L.P.	2,203,351	1,959,440
Interwest Partners IX, L.P.	12,369,280	11,000,001
Onset V, L.P.	7,871,360	7,000,000

(1) Of the aggregate $44,013,131 purchase price paid by related parties, an aggregate amount of $5,215,849 was paid by converting all of the outstanding promissory notes, including accrued interest payable, that were convertible into our Series C preferred stock.

(2) Consists of 57,627 shares held by the Mark B. Knudson Revocable Trust and 28,813 shares held by the Susan J. Knudson Revocable Trust.

(3) Paul H. Klingenstein, a member of our board of directors, is also the managing partner of Aberdare Ventures.

(4) Consists of 686, 317 shares of Series C preferred stock held by MPM BioVentures III, L.P., 10,207,663 shares of Series C preferred stock held by MPM BioVentures III-QP, L.P., 862,588 shares of Series C preferred stock held by MPM BioVentures III GmbH & Co. Parallel-Beteiligungs KG, 308,382 shares of Series C Preferred held by MPM BioVentures III Parallel Fund, L.P. and 201,662 shares of Series C preferred stock held by MPM Asset Management Investors 2002 BVIII LLC. Luke B. Evnin, a member of our board of directors, is a general partner of MPM Capital.

(5) Consists of 190,558 shares of Series C preferred stock held by Bay City Capital Fund IV, L.P. and 8,840,663 shares of Series C preferred stock held by Bay City Capital Fund IV Co-Investment Fund, L.P. Carl Goldfischer, a member of our board of directors, is a managing director of Bay City Capital.

(6) Consists of 2,139,283 shares of Series C preferred stock held by Aberdare Ventures II, L.P., 48,481 shares of Series C preferred stock held by Aberdare Ventures II (Bermuda), L.P. and 2,159,020 shares of Series C preferred stock held by Aberdare II Annex Fund, L.P.

Convertible Note Offering

On December 12, 2005, we entered into a Convertible Note Purchase Agreement with 18 individuals and entities, including Mark B. Knudson, Ph.D., MPM Capital, Bay City Capital, Aberdare Ventures, Charter Life Sciences, L.P., Donald C. Harrison, M.D. and Paul H. Klingenstein to sell convertible promissory notes totaling $5,250,003 (2005 Notes). The 2005 Notes were converted into 6,050,839 shares of our Series C Preferred Stock. Of the 6,050,839 shares of Series C Preferred issued upon conversion of the 2005 Notes, 5,865,112 shares were issued to the related parties below.

Of the $5,250,003 of 2005 Notes that were sold pursuant to Convertible Note Purchase Agreement, 5,088,857 of the 2005 Notes were sold to the following related parties:

Purchaser	Note Purchase Price
Directors and Executive Officers	
Mark B. Knudson, Ph.D.(1)	$ 75,000
Donald C. Harrison, M.D.	15,000
Paul H. Klingenstein(2)	45,819
5% Stockholders	
MPM Capital(3)	1,862,228
Bay City Capital(4)	1,494,178
Aberdare Ventures(5)	1,148,378
Charter Life Sciences, L.P.	448,254

(1) Consists of $50,000 of 2005 Notes purchased by the Mark B. Knudson Revocable Trust and $25,000 of 2005 Notes purchased by the Susan J. Knudson Revocable Trust.

(2) Paul H. Klingenstein, a member of our board of directors, is also the managing partner of Aberdare Ventures.

(3) Consists of $104,192 of 2005 Notes purchased by MPM BioVentures III, L.P., $1,549,653 of 2005 Notes purchased by MPM BioVentures III-QP, L.P., $130,952 of 2005 Notes purchased by MPM BioVentures III GmbH & Co. Parallel-Beteiligungs KG, $46,816 of 2005 Notes purchased by MPM BioVentures III Parallel Fund, L.P. and $30,615 of 2005 Notes purchased by MPM Asset Management Investors 2002 BVIII LLC. Luke B. Evnin, a member of our board of directors, is a general partner of MPM Capital.

(4) Consists of $1,462,651 of 2005 Notes purchased by Bay City Capital Fund IV, L.P. and $31,527 of 2005 Notes purchased by Bay City Capital Fund IV Co-Investment Fund, L.P. Carl Goldfischer, a member of our board of directors, is a managing director of Bay City Capital.

(5) Consists of $1,122,923 of 2005 Notes purchased by Aberdare Ventures II, L.P. and $25,455 of 2005 Notes purchased by Aberdare Ventures II (Bermuda), L.P.

Series B Preferred Stock and Common Stock Warrants

On July 30, 2004, June 17, 2005 and December 12, 2005 we entered into agreements with 18 individuals and entities, including Mark B. Knudson, Ph.D., MPM Capital, Bay City Capital, Aberdare Ventures, Charter Life Sciences, L.P., Donald C. Harrison, M.D. and Paul H. Klingenstein to sell, in a private placement, an aggregate of 39,002,196 shares of our Series B preferred stock. The total aggregate offering price for these sales was $16,899,654. All shares of Series B preferred stock will be automatically converted into 39,002,196 shares of our common stock upon the completion of this offering.

On December 12, 2005, in connection with the closing of our Series B preferred stock financing, we issued an aggregate of 1,550,000 warrants to purchase our common stock to 12 individuals and entities, including MPM Capital, Bay City Capital, Aberdare Ventures, Charter Life Sciences and Paul H. Klingenstein. The total aggregate offering price for these warrants was $15,500.00.

Of the 39,002,196 shares of Series B preferred stock and 1,550,000 warrants to purchase common stock sold pursuant to the Series B financing, 38,792,811 shares of Series B preferred stock and 1,549,600 warrants to purchase common stock were sold to the following related parties:

Purchasers	Series B Shares	Purchase Price(1)	Common Warrants
Directors and Executive Officers			
Mark B. Knudson, Ph.D.(2)	141,004	$ 61,097	—
Donald C. Harrison, M.D.	46,655	20,216	—
Paul H. Klingenstein(3)	353,566	153,200	15,320
5% Stockholders			
MPM Capital(4)	14,381,748	6,231,611	500,000
Bay City Capital(5)	11,539,350	5,000,000	500,000
Aberdare Ventures(6)	8,868,682	3,842,800	384,280
Charter Life Sciences, L.P.	3,461,806	1,500,001	150,000

(1) Of the aggregate $16,808,925 purchase price paid by related parties, an aggregate amount of $1,512,923.72 was paid by converting all of the outstanding promissory notes that were convertible into our Series B preferred stock.

(2) Consists of 94,349 shares of Series B preferred stock held by the Mark B. Knudson Revocable Trust and 46,655 shares of Series B preferred stock held by the Susan J. Knudson Revocable Trust.

(3) Paul H. Klingenstein, a member of our board of directors, is also the managing partner of Aberdare Ventures.

(4) Consists of 804,658 shares of Series B preferred stock and 27,976 common stock warrants held by MPM BioVentures III, L.P., 11,967,771 shares of Series B preferred stock and 416,076 common stock warrants held by MPM BioVentures III-QP, L.P., 1,011,323 shares of Series B preferred stock and 35,159 common stock warrants held by MPM BioVentures III GmbH & Co. Parallel-Beteiligungs KG, 361,555 shares of Series B preferred stock and 12,569 common stock warrants held by MPM BioVentures III Parallel Fund, L.P. and 236,441 shares of Series B preferred stock and 8,220 common stock warrants held by MPM Asset Management Investors 2002 BVIII LLC. Luke B. Evnin, a member of our board of directors, is a general partner of MPM Capital.

(5) Consists of 11,295,870 shares of Series B preferred stock and 489,450 common stock warrants held by Bay City Capital Fund IV, L.P. and 243,480 shares of Series B preferred stock and 10,550 common stock warrants held by Bay City Capital Fund IV Co-Investment Fund, L.P. Carl Goldfischer, a member of our board of directors, is a managing director of Bay City Capital.

(6) Consists of 8,672,050 shares of Series B preferred stock and 375,760 common stock warrants held by Aberdare Ventures II, L.P. and 196,632 shares of Series B preferred stock and 8,520 common stock warrants held by Aberdare Ventures II (Bermuda), L.P.

Bridge Loan Financing

On November 13, 2003, we entered into a bridge loan agreement with 12 individuals and entities, which was later amended on April 23, 2004 and June 30, 2004 (Bridge Financing). Pursuant to this bridge loan agreement, certain investors lent a total of $1,564,843 to the company in 2003 and 2004 in exchange for convertible promissory notes bearing interest of 4% per annum (Bridge Notes). In connection with the bridge loan agreement, the company also issued warrants to purchase a total of 722,363 shares of Series B preferred stock. The Bridge Notes were converted into 3,691,784 shares of Series B Preferred. The Bridge Notes held by the related parties below were converted into 3,491,631 shares of Series B Preferred in connection with the Series B financing.

Of the $1,564,843 of Bridge Notes and 722,362 Series B Warrants sold pursuant to the Bridge Financing, $1,479,852 of Bridge Notes and 683,128 Series B Warrants were sold to the following related parties:

Name	Note Purchase Price	Series B Warrants
Directors and Executive Officers		
Mark B. Knudson, Ph.D.(1)	$ 59,994	27,694
Donald C. Harrison, M.D.	19,998	9,231
5% Stockholders		
MPM Capital(2)	1,399,860	646,204

(1) Consists of $39,996 of Bridge Notes purchased by Mark B. Knudson and $19,998 of Bridge Notes purchased by Susan J. Knudson.

(2) Consists of $78,322 of Bridge Notes and 36,155 Series B Warrants purchased by MPM BioVentures III, L.P., $1,164,894 of Bridge Notes and 537,738 Series B Warrants purchased by MPM BioVentures III-QP, L.P., $98,438 of Bridge Notes and 45,441 of Series B Warrants purchased by MPM BioVentures III GmbH & Co. Parallel-Beteiligungs KG, $35,192 of Bridge Notes and 16,246 of Series B Warrants purchased by MPM BioVentures III Parallel Fund, L.P. and $23,014 of Bridge Notes and 10,624 of Series B Warrants purchased by MPM Asset Management Investors 2002 BVIII LLC. Luke B. Evnin, a member of our board of directors, is a general partner of MPM Capital.

Additional Security Issuances

In addition to the transactions set forth above, we have also entered in the following transactions with our officers, directors and holders of more than five percent of our voting securities:

- On October 1, 2003, Dr. Knudson purchased 450,000 shares of restricted stock and Dr. Harrison purchased 73,750 shares of restricted stock for $0.01 per share and we entered into a restricted stock agreement with each of Dr. Knudson and Dr. Harrison in connection with these purchases. The stock restriction agreements provide us with a right to repurchase the shares that lapses in increments of 1/48 each month.

- On April 23, 2004, we amended these restricted stock agreements to provide continued vesting for the holder as long as he or she is a director, officer or employee of the company or makes himself or herself available for advice and consultation following dissolution of Venturi II, LLC. We also entered into a consulting agreement with Dr. Harrison, which provided for continued vesting of his restricted stock pursuant to his restricted stock agreement if he performed certain services for us. Our repurchase option for the stock held by Drs. Knudson and Harrison lapsed on April 30, 2007.

Consulting Agreements

Effective January 2, 2003, we entered into a consulting agreement with Venturi Development, Inc., or VDI. The consulting agreement provided for VDI to receive compensation in the form of cash for services provided. The total cash payments were $1,230,000 in 2004, $46,000 in 2005 and $29,000 in 2006. The majority of the consulting services provided by VDI were recorded as research and development and general and administrative. Mark B. Knudson, our President and Chief Executive Officer and the Chairman of our Board of Directors, is the President and Chief Executive Officer and a director of VDI.

Effective September 21, 2006, we entered into a consulting agreement with Bobby I. Griffin, who is a member of our Board of Directors. The consulting agreement provides for the consultant to receive compensation, in the form of an option to purchase common stock for services provided. Pursuant to this consulting agreement, Mr. Griffin received a one-time option grant to purchase 500,000 shares of common stock at $0.21 per share that vest 25% on the first anniversary the date the consulting agreement was entered into and 1/36th per month each month thereafter for 36 months.

Sublease Agreement

Effective September 2005, we entered into a sublease agreement for office and warehouse space with Restore Medical, Inc. Mark B. Knudson, our President and Chief Executive Officer and the Chairman of our Board of Directors, is the Chairman of the Board of Directors of Restore Medical, Inc. The lease expires on September 30, 2008.

Indemnification Agreements

We expect to enter into indemnification agreements with each of our directors and executive officers. Each indemnification agreement provides that we will indemnify the director or executive officer to the fullest extent permitted by law for claims arising in his or her capacity as our director, officer, employee or agent, provided that he or she acted in good faith and in a manner that he or she reasonably believed to be in, or not opposed to, our best interests and, with respect to any criminal proceeding, had no reasonable cause to believe that his or her conduct was unlawful. If the claim is brought by us or on our behalf, we will not be obligated to indemnify the director or executive officer if he or she is found liable to us, unless the court determines that, despite the adjudication of liability, in view of all the circumstances of the case the director is fairly and reasonably entitled to indemnity. In the event that we do not assume the defense of a claim against our director or executive officer, we are required to advance his or her expenses in connection with his or her defense, provided that he or she undertakes to repay all amounts advanced if it is ultimately determined that he or she is not entitled to be indemnified by us.

Director and Executive Compensation

Please see “Management—Director Compensation” and “—Executive Compensation” for information regarding the compensation of our non-employee directors and executive officers.

DESCRIPTION OF CAPITAL STOCK

General

The following description of our capital stock is intended as a summary only and is qualified in its entirety by reference to our amended and restated certificate of incorporation and amended and restated bylaws filed as exhibits to the registration statement of which this prospectus forms a part and to Delaware law. The descriptions of our common stock and preferred stock reflect changes to our capital structure that will occur prior to or upon the completion of this offering. We refer in this section to our amended and restated certificate of incorporation as our certificate of incorporation and our amended and restated bylaws as our bylaws.

Upon consummation of this offering, our authorized capital stock will consist of 50,000,000 shares of common stock, par value $0.01 per share, and 5,000,000 shares of preferred stock, par value $0.01 per share, all of which preferred stock will be undesignated.

As of April 30, 2007, we had issued and outstanding:

- 5,490,650 shares of common stock, held by 25 holders of record;
- 2,896,249 shares of Series A convertible preferred stock, held by 7 holders of record;
- 39,002,196 shares of Series B convertible preferred stock, held by 19 holders of record; and
- 51,957,735 shares of Series C convertible preferred stock, held by 25 holders of record.

Upon the completion of this offering, all of the outstanding shares of our preferred stock will automatically convert into a total of 95,442,677 shares of our common stock and there will be no preferred stock outstanding. Approximately shares of our common stock will be outstanding immediately after this offering, assuming no exercise by the underwriters of their over-allotment option. This number excludes 4,980,362 shares of common stock issuable upon the exercise of warrants outstanding as of April 30, 2007, on an as-converted basis and at a weighted average exercise price of $0.44 per share; 16,707,968 shares of common stock issuable upon the exercise of options outstanding as of April 30, 2007, at a weighted average exercise price of $0.26 per share; and 18,451,382 shares of common stock expected to be available for future issuance under our stock incentive plans upon completion of this offering.

Common Stock

The holders of our common stock are generally entitled to one vote for each share held on all matters submitted to a vote of the stockholders and do not have any cumulative voting rights. Holders of our common stock are entitled to receive proportionally any dividends declared by our board of directors, subject to any preferential dividend rights of outstanding preferred stock.

In the event of our liquidation or dissolution, holders of our common stock are entitled to share ratably in all assets remaining after payment of all debts and other liabilities, subject to the prior rights of any outstanding preferred stock. Holders of our common stock have no preemptive, subscription, redemption or conversion rights. All outstanding shares of our common stock are validly issued, fully paid and nonassessable. The shares to be issued by us in this offering will be, when issued and paid for, validly issued, fully paid and nonassessable.

The rights, preferences and privileges of holders of our common stock are subject to, and may be adversely affected by, the rights of holders of shares of any series of preferred stock that we may designate and issue in the future.

Preferred Stock

Our certificate of incorporation provides that we may issue up to 5,000,000 shares of preferred stock in one or more series as may be determined by our board of directors. Our board has broad discretionary authority with respect to the rights of any new series of preferred stock and may establish the following with respect to the shares to be included in each series, without any vote or action of the stockholders:

- the number of shares;
- the designations, preferences and relative rights, including voting rights, dividend rights, conversion rights, redemption privileges and liquidation preferences; and
- any qualifications, limitations or restrictions.

We believe that the ability of our board of directors to issue one or more series of preferred stock will provide us with flexibility in structuring possible future financings and acquisitions, and in meeting other corporate needs that may arise. The authorized shares of preferred stock, as well as authorized and unissued shares of common stock, will be available for issuance without action by our stockholders, unless such action is required by applicable law or the rules of any stock exchange or automated quotation system on which our securities may be listed or traded.

Our board of directors may authorize, without stockholder approval, the issuance of preferred stock with voting and conversion rights that could adversely affect the voting power and other rights of holders of common stock. Although our board has no current intention of doing so, it could issue a series of preferred stock that could, depending on the terms of such series, impede the completion of a merger, tender offer or other takeover attempt of our company. Our board could also issue preferred stock having terms that could discourage an acquisition attempt through which an acquiror may be able to change the composition of our board, including a tender offer or other transaction that some, or a majority, of our stockholders might believe to be in their best interests or in which stockholders might receive a premium for their stock over the then-current market price. Any issuance of preferred stock therefore could have the effect of decreasing the market price of our common stock.

Our board of directors will make any determination to issue such shares based on its judgment as to the best interests of our company and stockholders. We have no current plan to issue any preferred stock after this offering.

Registration Rights

We have granted the registration rights described below to the holders of our preferred stock and to certain holders of warrants to purchase our common stock and preferred stock, pursuant to the terms of an investor rights agreement. Upon the completion of this offering, all of the outstanding shares of our preferred stock, including shares that are issued upon exercise of outstanding warrants to purchase preferred stock, will automatically convert into a total of 98,873,039 shares of our common stock. The holders of 98,999,040 of shares of common stock will have the right to require us to register these shares, together with other shares of common stock they hold, under the Securities Act under the circumstances set forth below. After registration pursuant to these rights, these shares will become freely tradable without restriction under the Securities Act. The following description of the terms of the registration rights agreement is intended as a summary only and is qualified in its entirety by reference to the investor rights agreement filed as an exhibit to the registration statement of which this prospectus forms a part.

Demand Registration Rights. Any time after six months after our initial public offering and on no more than one occasion during any twelve-month period, the holders of at least 50% of our registrable shares will have the right to request that we register all or a portion of the registrable shares then held by the requesting stockholders, provided that the shares requested to be registered have an aggregate value of at least $5.0 million. Such a registration is referred to as a demand registration and we are required to use our best efforts to cause any such demand registration to become effective under the Securities Act. The demand registration rights will cease after we have effected two such demand registrations. In addition to the demand registration rights, the holders of registrable shares will have the right to request that we register on Form S-3 all or a portion of the registrable shares held by them, provided that the holders propose to sell registrable securities at an aggregate price of at least $1,000,000 (less any underwriter discounts or fees) pursuant to such registration statement on Form S-3. Such registration is referred to as a Form S-3 registration. We will not be obligated to effect a demand registration or a Form S-3 registration within 180 calendar days of the effective date of an immediately preceding Form S-3 registration of our securities.

Incidental Registration Rights. If we propose to register shares of our common stock under the Securities Act (other than a registration relating solely to the initial public offering of our securities, the sale of securities of participants in our stock option plan, a registration relating to a corporate reorganization or transaction under Rule 145 of the Securities Act, a registration on any form that does not include substantially the same information as would be required to be included in a registration statement covering the sale of registrable securities, or a registration in which the only common stock being registered is common stock issuable upon conversion of debt securities that are also being registered), the holders of registrable shares will have the right to require us to register all or a portion of the registrable shares then held by them. In the event that any registration in which the holders of registrable shares participate pursuant to the registration rights agreement is an underwritten public offering, the number of registrable shares to be included may, in specified circumstances, be limited due to market conditions.

The registration rights described in the investor rights agreement are subject to customary restrictions such as minimums, blackout periods and, if a registration is underwritten, any limitations on the number of shares to be included in the underwritten offering imposed by the managing underwriter. The investor rights agreement also contains customary indemnification and contribution provisions.

All expenses of registration under the investor rights agreement, including the legal fees of one counsel for the holders, but excluding underwriting discounts and commission will be paid by us. The investor rights agreement is governed by Delaware law.

Anti-takeover Effects of Provisions of Delaware Law and Our Certificate of Incorporation and Bylaws

We have elected to be governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally will have an anti-takeover effect for transactions not approved in advance by our board of directors, including discouraging attempts that might result in a premium over the market price for our common stock. In general, Section 203 prohibits a publicly-held Delaware corporation from engaging in a “business combination” with an “interested stockholder” for a three-year period following the time that the stockholder becomes an interested stockholder, unless the business combination is approved in a prescribed manner. A “business combination” includes, among other things, a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. An “interested stockholder” is a person who, together with affiliates and associates, owns, or did own within three years prior to the determination of interested stockholder status, 15% or more of the corporation’s voting stock. Under Section 203, a business combination between a corporation and an interested stockholder is prohibited unless it satisfies one of the following conditions:

- before the stockholder became interested, the board of directors approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder;

- upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the voting stock outstanding, shares owned by persons who are directors and also officers, and employee stock plans, in some instances; or
- at or after the time the stockholder became interested, the business combination was approved by the board and authorized at a stockholder meeting by the affirmative vote of at least two-thirds of the outstanding voting stock not owned by the interested stockholder.

Upon the closing of this offering, our certificate of incorporation and bylaws will provide for the board to be divided into three classes of directors serving staggered, three-year terms. The classification of the board has the effect of requiring at least two annual stockholder meetings, instead of one, to replace a majority of members of the board. Subject to the rights of the holders of any outstanding series of preferred stock, our certificate of incorporation will authorize only the board to fill vacancies, including newly created directorships. Accordingly, this provision could prevent a stockholder from obtaining majority representation on the board by enlarging the board of directors and filling the new directorships with its own nominees. Our certificate of incorporation will also provide that directors may be removed by stockholders only for cause and only by the affirmative vote of holders of a majority of the outstanding shares of our voting stock.

Under our bylaws, any vacancy on our board of directors resulting from an enlargement of our board or the death, resignation, retirement, disqualification or other cause (other than removal for cause), may only be filled by vote of a majority of our directors then in office, even if less than a quorum. The limitations on the removal of directors and filling of vacancies could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from attempting to acquire, control of us.

The affirmative vote of the holders of at least a majority of our voting stock is required to amend or repeal or to adopt any provisions inconsistent with any of the provisions of our certificate of incorporation or bylaws described in the prior two paragraphs.

Our certificate of incorporation provides that stockholders may not take any action by written consent in lieu of a meeting and our bylaws limit the business that may be conducted at an annual meeting of stockholders to those matters properly brought before the meeting. In addition, our bylaws provide that only our board of directors or our chairman may call a special meeting of stockholders. Business transacted at any special meeting of stockholders must be limited to matters relating to the purpose stated in the notice of the special meeting.

To be “properly brought” before an annual meeting, the proposals or nominations must be:

- specified in the notice of meeting;
- brought before the meeting by or at the direction of our board of directors; or
- brought before the meeting by a stockholder entitled to vote at the meeting who has given to our corporate secretary the required advance written notice, in proper form, of the stockholder’s intention to bring that proposal or nomination before the meeting and who was a stockholder of record on the date on which notice is given.

In addition to other applicable requirements, for a stockholder proposal or nomination to be properly brought before an annual meeting by a stockholder, the stockholder generally must have given notice in proper written form to our corporate secretary not less than 90 days nor more than 120 days prior to the first anniversary of the preceding year’s annual meeting of stockholders. In the event that no annual meeting was held in the previous year or the annual meeting is called for a date that is not within 30 days from the anniversary date of the preceding year's annual meeting date, written notice by a stockholder in order to be timely must be received not later than the 10th day following the day on which the first public disclosure of the date of the annual meeting was made. Although our bylaws do not give our board of directors the power to approve or disapprove stockholder nominations of candidates or proposals regarding other business to be conducted at a special or annual meeting, our bylaws may have the effect of precluding the consideration of some business at a meeting if the proper procedures are not followed or may discourage or defer a potential acquiror from conducting a solicitation of proxies to elect its own slate of directors or otherwise attempting to obtain control of us.

Delaware law provides generally that the affirmative vote of a majority of the shares entitled to vote on any matter is required to amend a corporation's certificate of incorporation or bylaws, unless the certificate of incorporation or bylaws require a greater percentage. Our bylaws may be amended or repealed by a majority vote of our board of directors, subject to any limitations set forth in the bylaws, and may also be amended or repealed by the stockholders by the affirmative vote of the holders of a majority of the votes that all the stockholders would be entitled to cast in any annual election of directors. The majority stockholder vote would be in addition to any separate class vote that might in the future be required pursuant to the terms of any series of preferred stock that might be outstanding at the time any of these amendments are submitted to stockholders.

Liability Limitations and Indemnification

Our bylaws provide that we must indemnify our directors and officers and that we must advance expenses, including attorneys' fees, to our directors and officers in connection with legal proceedings, subject to very limited exceptions. In addition, our certificate of incorporation provides that our directors will not be personally liable for monetary damages to us for breaches of their fiduciary duty as directors, except to the extent that the Delaware law statute prohibits the elimination or limitation of liability of directors for breaches of fiduciary duty. For additional information, please see "Management—Liability Limitations and Indemnification."

These provisions may discourage stockholders from bringing a lawsuit against our directors for breach of their fiduciary duties. These provisions may also have the effect of reducing the likelihood of derivative litigation against directors and officers, even though such an action, if successful, might otherwise benefit us and our stockholders. Furthermore, you may lose some or all of your investment in our common stock if we pay the costs of settlement or damage awards against our directors and officers under these provisions. We believe these provisions, the director and officer insurance we maintain, and the indemnification agreements we have entered into with our directors and officers are necessary to attract and retain talented and experienced directors and officers.

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is Wells Fargo Bank, National Association.

Listing

Application will be made for the quotation of our common stock on the Nasdaq Global Market under the symbol "ETRM."

SHARES ELIGIBLE FOR FUTURE SALE

Prior to the offering made by this prospectus, there has been no market for our common stock, and we cannot assure you that a liquid trading market for our common stock will develop or be sustained after this offering. Future sales of substantial numbers of shares of our common stock, including shares issued upon exercise of options, in the public market after this offering, or the anticipation of those sales, could adversely affect market prices of our common stock prevailing from time to time and could impair our ability to raise capital through sales of our equity securities.

Upon completion of this offering, we will have outstanding shares of common stock, after giving effect to the conversion of all outstanding shares of our preferred stock into an aggregate of 95,442,677 shares of common stock prior to the completion of this offering.

The shares sold in this offering will be freely tradable without restriction under the Securities Act unless purchased by our "affiliates," as that term is defined in Rule 144 under the Securities Act. The remaining shares of common stock to be outstanding after this offering will be "restricted securities" under Rule 144. Substantially all of these restricted securities will be subject to the 180-day lock-up period, which may be extended in specified circumstances described below. Within 180 days of the date of this prospectus 3,419,832 shares will qualify for resale under Rule 144(k), 96,116,783 additional shares will qualify for resale under Rule 144, subject to volume limitations, and 272,232 additional shares will qualify for resale under Rule 701.

Restricted securities may be sold in the public market only if they have been registered or if they qualify for an exemption from registration under Rule 144 or 701 under the Securities Act.

Rule 144

In general, under Rule 144, beginning 90 days after the date of this prospectus, a person who has beneficially owned shares of our common stock for at least one year would be entitled to sell within any three-month period a number of shares that does not exceed the greater of:

- 1% of the number of shares of common stock then outstanding, which will equal approximately shares immediately after this offering; and
- the average weekly trading volume of our common stock on the Nasdaq Global Market during the four calendar weeks preceding the filing of a notice on Form 144 with respect to the sale.

Sales under Rule 144 are also subject to manner of sale provisions, notice requirements and the availability of current public information about us.

Rule 144(k)

Subject to the lock-up agreements described below, shares of our common stock eligible for sale under Rule 144(k) may be sold immediately upon the completion of this offering. In general, under Rule 144(k), a person may sell shares of common stock acquired from us immediately upon completion of this offering, without regard to the manner or volume of sale or the availability of public information about us, if:

- the person is not our affiliate and has not been our affiliate at any time during the three months preceding such a sale; and
- the person has beneficially owned the shares proposed to be sold for at least two years, including the holding period of any prior owner other than an affiliate.

Rule 701

In general, under Rule 701 of the Securities Act, any of our employees, consultants or advisors who purchased shares from us in connection with a qualified compensatory stock plan or other written agreement is eligible to resell those shares 90 days after the date of this prospectus in reliance on Rule 144, but without compliance with the holding period or certain other restrictions contained in Rule 144.

Lock-Up Agreements

Each of our officers and directors, and substantially all of our other stockholders and holders of options to purchase our common stock, have agreed not to offer, sell, contract to sell or otherwise dispose of, or enter into any transaction that is designed to, or could be expected to, result in the disposition of any shares of our common stock or other securities convertible into or exchangeable or exercisable for shares of our common stock or derivatives of our common stock owned by these persons prior to this offering or common stock issuable upon exercise of options held by these persons for a period of 180 days after the date of this prospectus without the prior written consent of J.P. Morgan Securities Inc.

J.P. Morgan Securities Inc. does not have any pre-established conditions to waiving the terms of the lock-up agreements. Any determination to release any shares subject to the lock-up agreements would be based on a number of factors at the time of determination, including but not necessarily limited to the market price of the common stock, the liquidity of the trading market for the common stock, general market conditions, the number of shares proposed to be sold and the timing, purpose and terms of the proposed sale.

The 180-day restricted period described above will be extended if:

- during the last 17 days of the 180-day restricted period we issue an earnings release or material news or a material event relating to us occurs; or
- prior to the expiration of the 180-day restricted period, we announce that we will release earnings results during the 16-day period beginning on the last day of the 180-day restricted period,

in which case the restrictions described in the preceding paragraph will continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the occurrence of the material news or material event.

Registration Rights

After this offering, holders of 98,999,040 shares of our common stock, including shares that are issuable upon the exercise of outstanding warrants, will have the right to require us to register these shares under the Securities Act under specific circumstances. After registration pursuant to these rights, these shares will become freely tradable without restriction under the Securities Act. See “Description of Capital Stock—Registration Rights.”

Equity Plans

As of May 15, 2007, we had outstanding options to purchase 16,707,968 shares of our common stock. Following this offering, we intend to file registration statements on Form S-8 under the Securities Act to register all of the shares of common stock issued or issuable under our 2003 plan.

MATERIAL UNITED STATES FEDERAL TAX CONSEQUENCES FOR NON-UNITED STATES HOLDERS OF OUR COMMON STOCK

The following is a general discussion of the material United States federal income and estate tax considerations applicable to non-United States holders with respect to their ownership and disposition of shares of our common stock purchased in this offering. This discussion is for general information only and is not tax advice. Accordingly, all prospective non-United States holders of our common stock should consult their own tax advisors with respect to the United States federal, state, local and non-United States tax consequences of the purchase, ownership and disposition of our common stock. In general, a non-United States holder means a beneficial owner of our common stock who is not for United States federal income tax purposes:

- an individual who is a citizen or resident of the United States;
- a corporation, partnership or any other organization taxable as a corporation or partnership for United States federal tax purposes, created or organized in the United States or under the laws of the United States or of any state thereof or the District of Columbia; or
- an estate, the income of which is included in gross income for United States federal income tax purposes regardless of its source; or
- a trust if (a) a United States court is able to exercise primary supervision over the trust's administration and (b) one or more United States persons have the authority to control all of the trust's substantial decisions.

This discussion is based on current provisions of the United States Internal Revenue Code of 1986, as amended, existing and proposed United States Treasury Regulations promulgated thereunder, current administrative rulings and judicial decisions, in effect as of the date of this prospectus, all of which are subject to change or to differing interpretation, possibly with retroactive effect. Any change could alter the tax consequences to non-United States holders described in this prospectus. We assume in this discussion that a non-United States holder holds shares of our common stock as a capital asset (generally, property held for investment).

This discussion does not address all aspects of United States federal income and estate taxation that may be relevant to a particular non-United States holder in light of that non-United States holder's individual circumstances, nor does it address any aspects of United States state or local or non-United States taxes. This discussion also does not consider any specific tax consequences that may be relevant to a non-United States holder in light of such holder's particular circumstances and does not address the special tax rules applicable to particular non-United States holders, such as:

- insurance companies;
- tax-exempt organizations;
- financial institutions;
- brokers or dealers in securities;
- partnerships or other pass-through entities;
- regulated investment companies or real estate investment trusts;
- pension plans;

- owners of more than 5% of our common stock;
- “controlled foreign corporations” or “passive foreign investment companies”;
- corporations that accumulate earnings to avoid U.S. federal income tax;
- owners that hold our common stock as part of a straddle, hedge, conversion transaction, synthetic security or other integrated investment; and
- certain United States expatriates.

There can be no assurance that the Internal Revenue Service (“IRS”) will not challenge one or more of the tax consequences described herein, and we have not obtained, nor do we intend to obtain, an opinion of counsel or ruling from the IRS with respect to the United States federal income or estate tax consequences to a non-United States holder of the purchase, ownership or disposition of our common stock. We urge prospective investors to consult with their own tax advisors regarding the United States federal, state and local and non-United States income and other tax considerations of purchasing, owning and disposing of shares of our common stock.

Distributions on Our Common Stock

Any distributions on our common stock paid to non-United States holders of common stock generally will constitute dividends for United States federal income tax purposes to the extent paid from our current or accumulated earnings and profits, as determined under United States federal income tax principles. If a distribution exceeds our current and accumulated earnings and profits, the excess will be treated as a tax-free return of the non-United States holder’s investment, up to such holder’s tax basis in the common stock. Any remaining excess will be treated as capital gain, subject to the tax treatment described below in “— Gain on Sale, Exchange or Other Disposition of Our Common Stock.” Dividends paid to a non-United States holder generally will be subject to withholding of United States federal income tax at a 30% rate or such lower rate as may be provided by an applicable income tax treaty between the United States and such holder’s country of residence.

Dividends that are treated as effectively connected with a trade or business conducted by a non-United States holder within the United States (and, if an applicable income tax treaty so provides, are also attributable to a permanent establishment or a fixed base maintained within the United States by such non-United States holder) are generally exempt from the 30% withholding tax if the non-United States holder satisfies applicable certification and disclosure requirements. However, such United States effectively connected income, net of specified deductions and credits, is taxed at the same graduated United States federal income tax rates applicable to United States persons. Any United States effectively connected income received by a non-United States holder that is a corporation may also, under certain circumstances, be subject to an additional branch profits tax at a 30% rate or such lower rate as may be provided by an applicable income tax treaty between the United States and such holder’s country of residence.

In order to claim the benefit of a tax treaty or to claim exemption from withholding because dividends paid on our common stock are effectively connected with the conduct of a trade or business in the United States, a non-United States holder must provide a properly executed IRS Form W-8BEN for treaty benefits or W-8ECI for effectively connected income, or such successor forms as the IRS designates, prior to the payment of dividends. These forms must be periodically updated. Non-United States holders may be eligible to obtain a refund of any excess amounts withheld by timely filing an appropriate claim for refund with the IRS.

Gain on Sale, Exchange or Other Disposition of Our Common Stock

In general, a non-United States holder will not be subject to any United States federal income tax or withholding tax on any gain realized upon such holder's sale, exchange or other disposition of shares of our common stock unless:

- the gain is effectively connected with a United States trade or business (and, if an applicable income tax treaty so provides, is also attributable to a permanent establishment or a fixed base maintained within the United States by such non-United States holder), in which case the graduated United States federal income tax rates applicable to United States persons will apply, and, if the non-United States holder is a foreign corporation, the additional branch profits tax described above in "—Distributions on Our Common Stock" may also apply;

- the non-United States holder is a nonresident alien individual who is present in the United States for 183 days or more in the taxable year of the disposition and certain other conditions are met, in which case the non-United States holder will be subject to a 30% tax on the net gain derived from the disposition, which may be offset by United States-source capital losses of the non-United States holder, if any; or

- we are or have been, at any time during the five-year period preceding such disposition (or the non-United States holder's holding period, if shorter) a "United States real property holding corporation," and our common stock has ceased to be traded on an established securities market prior to the beginning of the calendar year in which the disposition occurs.

We believe that we have not been and are not currently, and we do not anticipate becoming in the future, a "United States real property holding corporation" for United States federal income tax purposes.

United States Federal Estate Tax

Shares of our common stock that are owned or treated as owned by an individual non-United States holder at the time of death are considered United States situs assets and will be included in the individual's gross estate for United States federal estate tax purposes. Such shares, therefore, may be subject to United States federal estate tax, unless an applicable estate tax or other treaty provides otherwise.

Backup Withholding and Information Reporting

Information reporting and backup withholding (currently at a 28% rate of tax) may apply to dividends paid with respect to our common stock and to proceeds from the sale or other disposition of our common stock. In certain circumstances, non-United States holders may avoid information reporting and backup withholding if they certify under penalties of perjury as to their status as non-United States holders or otherwise establish an exemption and certain other requirements are met. Non-United States holders should consult their own tax advisors regarding the application of the information reporting and backup withholding rules to them.

Backup withholding is not an additional tax. Amounts withheld under the backup withholding rules from a payment to a non-United States holder can be refunded or credited against the non-United States holder's United States federal income tax liability, if any, provided that an appropriate claim is timely filed with the IRS.

UNDERWRITING

J.P. Morgan Securities Inc. and Morgan Stanley & Co. Incorporated are acting as joint book-running managers of this offering and, together with Cowen and Company, LLC and Leerink Swann & Co., Inc., are acting as the managing underwriters of this offering. Under the terms and subject to the conditions contained in an underwriting agreement dated the date of this prospectus, the underwriters named below have severally agreed to purchase, and we have agreed to sell to them, the number of shares of common stock indicated in the table below:

Underwriter	Number of Shares
J.P. Morgan Securities Inc.	
Morgan Stanley & Co. Incorporated	
Cowen and Company, LLC	
Leerink Swann & Co., Inc.	
Total	

The underwriters are offering the shares of common stock subject to their acceptance of the shares from us and subject to prior sale. The underwriting agreement provides that the obligations of the several underwriters to pay for and accept delivery of the shares of common stock offered by this prospectus are subject to the approval of certain legal matters by their counsel and to other conditions. The underwriters are obligated to take and pay for all of the shares of common stock offered by this prospectus if any such shares are taken. However, the underwriters are not required to take or pay for the shares covered by the underwriters' over-allotment option described below.

The underwriters initially propose to offer part of the shares of common stock directly to the public at the public offering price listed on the cover page of this prospectus, less underwriting discounts and commissions, and part to certain dealers at a price that represents a concession not in excess of $ a share under the public offering price. After the initial offering of the shares of common stock, the offering price and other selling terms may from time to time be varied by the representatives.

We have granted to the underwriters an option, exercisable for 30 days from the date of this prospectus, to purchase up to an aggregate of additional shares of common stock at the public offering price, less underwriting discounts and commissions. The underwriters may exercise this option solely for the purpose of covering over-allotments, if any, made in connection with the offering of the shares of common stock offered by this prospectus. To the extent the option is exercised, each underwriter will become obligated, subject to certain conditions, to purchase approximately the same percentage of the additional shares of common stock as the number listed next to the underwriter's name in the preceding table bears to the total number of shares of common stock listed next to the names of all underwriters in the preceding table. If the underwriters' over-allotment option is exercised in full, the total price to the public would be $, the total underwriters' discounts and commissions would be $ and the total proceeds to us would be $.

The following table shows the per share and total underwriting discounts and commissions that we are to pay to the underwriters in connection with this offering. These amounts are shown assuming both no exercise and full exercise of the underwriters' option.

	No Exercise	Full Exercise
Per Share	$	$
Total		

In addition, we estimate that the expenses of this offering other than underwriting discounts and commissions payable by us will be approximately $ million.

The underwriters have informed us that they do not intend sales to discretionary accounts to exceed 5% of the total number of shares of common stock offered by them.

We, all of our directors and officers and holders of substantially all of our outstanding stockholders and holders of securities exercisable for or convertible into shares of common stock have agreed that, without the prior written consent of J.P. Morgan Securities Inc. and Morgan Stanley & Co. Incorporated, on behalf of the underwriters, we and they will not, during the period beginning on the date of this prospectus and ending 180 days thereafter:

- offer, pledge, sell, announce the intention to sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend, or otherwise transfer or dispose of, directly or indirectly, any shares of common stock or any securities convertible into or exercisable or exchangeable for common stock;

- enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of common stock; or

- make any demand for or exercise any right with respect to, the registration of any shares of common stock or any security convertible into or exercisable or exchangeable for common stock;

whether any such transaction described above is to be settled by delivery of common stock or such other securities, in cash or otherwise.

The restrictions described in the preceding paragraphs do not apply to:

- the sale by us of shares to the underwriters in connection with the offering;

- transactions by any person other than us relating to shares of common stock or other securities convertible or exchangeable into common stock acquired in open market transactions after the completion of the offering of the shares;

- the issuance by us of shares of common stock upon the exercise of an option or a warrant or the conversion of a security outstanding on the date of this prospectus of which the underwriters have been advised in writing;

- the grant of options or the issuance of shares of common stock by us to employees, officers, directors, advisors or consultants pursuant to equity incentive plans and the issuance by us of any shares of common stock upon the exercise of such options; or

- the transfer of shares of common stock or any security convertible or exchangeable into shares of common stock as a bona fide gift, as a distribution to general or limited partners, stockholders, members or affiliates of our stockholders, or by will or intestate succession to a member of the immediate family of our stockholders, or to a trust for the benefit of such immediate family member.

With respect to the last bullet, it shall be a condition to the transfer or distribution that the transferee provide prior written notice of such transfer or distribution to J.P. Morgan Securities Inc. and Morgan Stanley & Co. Incorporated, execute a copy of the lock-up agreement, that no filing by any donee or transferee with the SEC shall be required or shall be made voluntarily in connection with such transfer or distribution, other than a filing on Form 5, and no such transfer or distribution may include a disposition for value.

The 180-day restricted period described in the preceding paragraph will be extended if:

- during the last 17 days of the 180-day restricted period we issue an earnings release or material news or a material event relating to us occurs; or
- prior to the expiration of the 180-day restricted period, we announce that we will release earnings results during the 16-day period beginning on the last day of the 180-day restricted period,

in which case the restrictions described in the preceding paragraph will continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the occurrence of the material news or material event.

In order to facilitate this offering of common stock, the underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the common stock. Specifically, the underwriters may sell more shares than they are obligated to purchase under the underwriting agreement, creating a short position. A short sale is covered if the short position is no greater than the number of shares available for purchase by the underwriters under the over-allotment option. The underwriters can close out a covered short sale by exercising the over-allotment option or by purchasing shares in the open market. In determining the source of shares to close out a covered short sale, the underwriters will consider, among other things, the open market price of shares compared to the price available under the over-allotment option. The underwriters may also sell shares in excess of the over-allotment option, creating a naked short position. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the common stock in the open market after pricing that could adversely affect investors who purchase in this offering. In addition, to stabilize the price of the common stock, the underwriters may bid for and purchase shares of common stock in the open market. Finally, the underwriting syndicate may reclaim selling concessions allowed to an underwriter or a dealer for distributing the common stock in the offering, if the syndicate repurchases previously distributed common stock to cover syndicate short positions or to stabilize the price of the common stock. These activities may raise or maintain the market price of the common stock above independent market levels or prevent or retard a decline in the market price of the common stock. The underwriters are not required to engage in these activities and may end any of these activities at any time.

We will apply to have our common stock approved for quotation on the NASDAQ Global Market under the symbol “ETRM.”

We and the underwriters have agreed to indemnify each other against certain liabilities, including liabilities under the Securities Act.

Prior to this offering, there has been no public market for the shares of common stock. The initial public offering price will be determined by negotiations between us and the representatives of the underwriters. Among the factors to be considered in determining the initial public offering price will be our future prospects and those of our industry in general; sales, earnings and other financial operating information in recent periods; and the price-earnings ratios, price-sales ratios and market prices of securities and certain financial and operating information of companies engaged in activities similar to ours. The estimated initial public offering price range set forth on the cover page of this preliminary prospectus is subject to change as a result of market conditions and other factors. An active trading market for the shares may not develop, and it is possible that after the offering the shares will not trade in the market above their initial offering price. A prospectus in electronic format may be made available on the web sites maintained by one or more of the underwriters, and one or more of the underwriters may distribute prospectuses electronically. The underwriters may agree to allocate a number of shares to underwriters for sale to their online brokerage account holders. Internet distributions will be allocated by the underwriters that make Internet distributions on the same basis as other allocations.

LEGAL MATTERS

Dorsey & Whitney LLP will pass upon the validity of the shares of common stock offered by this prospectus. Latham & Watkins LLP, Costa Mesa, California is acting as counsel for the underwriters.

EXPERTS

The financial statements included in this prospectus have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their reports appearing herein, and are included in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the SEC a registration statement on Form S-1 under the Securities Act with respect to the shares of common stock offered by this prospectus. This prospectus does not contain all of the information included in the registration statement, portions of which are omitted as permitted by the rules and regulations of the SEC. For further information pertaining to us and the common stock to be sold in this offering, you should refer to the registration statement and its exhibits. Whenever we make reference in this prospectus to any of our contracts, agreements or other documents, the references are not necessarily complete, and you should refer to the exhibits attached to the registration statement for copies of the actual contract, agreement or other document filed as an exhibit to the registration statement or such other document, each such statement being qualified in all respects by such reference. On the completion of this offering, we will be subject to the informational requirements of the Securities Exchange Act and will be required to file annual, quarterly and current reports, proxy statements and other information with the SEC. We anticipate making these documents publicly available, free of charge, on our website at www.enteromedics.com as soon as reasonably practicable after filing such documents with the SEC.

You can read the registration statement and our future filings with the SEC over the Internet at the SEC's website at www.sec.gov. You may also read and copy any document we file with the SEC at its public reference facility at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference facilities.

EnteroMedics Inc.
Index to Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
EnteroMedics Inc.
St. Paul, Minnesota

We have audited the accompanying consolidated balance sheets of EnteroMedics Inc. and subsidiary (a development stage company) (the "Company"), as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of EnteroMedics Inc. at December 31, 2006 and 2005 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2006 the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R, "Share-Based Payment."

Minneapolis, Minnesota
May 21, 2007

Table of Contents

EnteroMedics Inc.
(A development stage company)

Consolidated Balance Sheets

	December 31, 2006	December 31, 2005	March 31, 2007	Pro Forma at March 31, 2007 (Note 2)
			(Unaudited)	
ASSETS				
Current assets:				
Cash and cash equivalents (Note 2)	$ 17,536,472	$ 10,718,501	$ 14,472,734	
Short-term investments available for sale	5,755,000	—	5,555,000	
Short-term investments held to maturity	11,440,540	—	8,519,499	
Interest receivable	109,401	—	141,154	
Other receivables	46,120	21,601	46,098	
Prepaid expenses and other current assets	67,646	141,636	314,831	
Total current assets	34,955,179	10,881,738	29,049,316	
Property and equipment, net	1,102,327	642,548	1,305,605	
Other assets	6,395	36,564	13,712	
Total assets	$ 36,063,901	$ 11,560,850	$ 30,368,633	
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Current portion of notes payable	$ 2,651,336	$ 998,055	$ 2,836,621	
Accounts payable	678,762	316,850	852,409	
Accrued expenses	1,704,231	914,473	1,360,493	
Accrued interest payable	—	12,658	—	
Total current liabilities	5,034,329	2,242,036	5,049,523	
Convertible notes payable	—	5,250,003	—	
Notes payable, less current portion (net discounts of $90,075, $33,586 and $76,141 at December 31, 2006 and 2005 and March 31, 2007 (unaudited), respectively)	1,726,959	2,094,259	914,954	
Convertible preferred stock warrant liability	728,841	—	972,916	$ —
Total liabilities	7,490,129	9,586,298	6,937,393	
Stockholders' equity:				
Series C convertible preferred stock, $0.01 par value 53,000,000 shares authorized; 51,957,735 shares issued and outstanding at December 31, 2006 and March 31, 2007 (unaudited) (liquidation value of $46,206,014); no shares issued and outstanding pro forma (unaudited)	519,577	—	519,577	—
Series B convertible preferred stock, $0.01 par value 41,089,088 shares authorized; 39,002,196 shares issued and outstanding at December 31, 2006 and 2005 and March 31, 2007 (unaudited) (liquidation value of $16,899,652); no shares issued and outstanding pro forma (unaudited)	390,022	390,022	390,022	—
Series A convertible preferred stock, $0.01 par value 2,896,249 shares authorized; 2,896,249 shares issued and outstanding at December 31, 2006 and 2005 and March 31, 2007 (unaudited) (liquidation value of $2,087,616); no shares issued and outstanding pro forma (unaudited)	28,963	28,963	28,963	—
Common stock, $0.01 par value 130,000,000 shares authorized; 5,275,922, 4,369,000 and 5,490,650 shares issued and outstanding at December 31, 2006 and 2005 and March 31, 2007 (unaudited), respectively; 100,933,327 shares issued and outstanding pro forma (unaudited)	52,759	43,690	54,907	1,009,334
Additional paid-in capital	62,506,986	18,766,983	62,753,818	63,710,869
Deferred compensation	(66,479)	(87,527)	(60,167)	(60,167)
Deficit accumulated during development stage	(34,858,056)	(17,167,579)	(40,255,880)	(40,255,880)
Total stockholders' equity	$ 28,573,772	$ 1,974,552	$ 23,431,240	$ 24,404,156
Total liabilities and stockholders' equity	$ 36,063,901	$ 11,560,850	$ 30,368,633	

See accompanying notes to consolidated financial statements.

EnteroMedics Inc.
(A development stage company)

Consolidated Statements Of Operations

	Years Ended December 31, 2006	Years Ended December 31, 2005	Years Ended December 31, 2004	Three Months Ended March 31, 2007 (Unaudited)	Three Months Ended March 31, 2006 (Unaudited)	Period From December 19, 2002 (Inception) to March 31, 2007 (Unaudited)
Operating expenses:						
Research and development	$ 14,361,226	$ 8,832,722	$ 1,754,537	$ 4,077,897	$ 3,644,727	$ 31,379,510
Selling, general and administrative	3,760,590	2,319,561	1,491,254	1,347,983	846,200	9,054,244
Total operating expenses	18,121,816	11,152,283	3,245,791	5,425,880	4,490,927	40,433,754
Other income (expense):						
Interest income	1,135,855	109,884	34,857	415,318	86,611	1,695,914
Interest expense	(710,108)	(181,151)	(237,818)	(136,789)	(168,918)	(1,281,518)
Change in value of the convertible preferred stock warrant liability	6,597	—	—	(244,075)	—	(237,478)
Other, net	(1,005)	8,359	—	(6,398)	(6,364)	956
Net loss	$ (17,690,477)	$ (11,215,191)	$ (3,448,752)	$ (5,397,824)	$ (4,579,598)	$ (40,255,880)
Net loss per share—basic and diluted	$ (3.76)	$ (3.17)	$ (2.68)	$ (1.01)	$ (1.11)	
Shares used to compute basic and diluted net loss per share	4,709,008	3,540,896	1,288,312	5,361,719	4,117,984	

See accompanying notes to consolidated financial statements.

[THIS PAGE INTENTIONALLY LEFT BLANK]

EnteroMedics Inc.
(A development stage company)

Consolidated Statements of Stockholders' Equity (Deficit)
Period from December 19, 2002 (Inception) to March 31, 2007

	Series C Convertible Preferred Stock		Series B Convertible Preferred Stock		Series A Convertible Preferred Stock	
	Shares	Amount	Shares	Amount	Shares	Amount
Common stock issued at inception of Alpha Medical, Inc. on December 19, 2002 at $0.01 per share for cash	—	$ —	—	$ —	—	$ —
Common stock issued at inception of Beta Medical, Inc. on December 19, 2002 at $0.01 per share for cash	—	—	—	—	—	—
Alpha Medical, Inc. Series A convertible preferred stock issued on December 31, 2002 at $1.00 per share for cash	—	—	—	—	301,674	3,017
Beta Medical, Inc. Series A convertible preferred stock issued on December 31, 2002 at $1.00 per share for cash	—	—	—	—	301,674	3,017
Net loss for the period ended December 31, 2002	—	—	—	—	—	—
Alpha Medical, Inc. Series A convertible preferred stock issued on October 1, 2003 at $1.00 per share for cash	—	—	—	—	350,000	3,500
Beta Medical, Inc. Series A convertible preferred stock issued on October 1, 2003 at $1.00 per share for cash	—	—	—	—	850,000	8,500
Cancellation of Alpha Medical, Inc. Series A convertible preferred stock and common stock upon merger with Beta Medical, Inc. effective October 1, 2003 (Note 1)	—	—	—	—	(651,674)	(6,517)
Issuance of Series A convertible preferred stock upon merger of Alpha Medical, Inc. and Beta Medical, Inc. effective October 1, 2003 (Note 1)	—	—	—	—	600,000	6,000
Common stock issued in October 2003 at $0.01 per share for cash	—	—	—	—	—	—
Warrants issued for the purchase of 214,000 shares of Series B convertible preferred stock for cash at $0.0005 per share in connection with the November 13, 2003 convertible bridge notes	—	—	—	—	—	—
Net loss for the year ended December 31, 2003	—	—	—	—	—	—
Balance, December 31, 2003 (unaudited)	—	$ —	—	$ —	1,751,674	$17,517

See accompanying notes to consolidated financial statements.

Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
1,000,000	$ 10,000	$ —	$ —	$ —	$ 10,000
1,000,000	10,000	—	—	—	10,000
—	—	298,657	—	—	301,674
—	—	298,657	—	—	301,674
—	—	—	—	(603,348)	(603,348)
—	—	346,500	—	—	350,000
—	—	841,500	—	—	850,000
(1,000,000)	(10,000)	(645,157)	—	—	(661,674)
—	—	655,674	—	—	661,674
1,050,000	10,500	—	—	—	10,500
—	—	107	—	—	107
—	—	—	—	(1,900,288)	(1,900,288)
2,050,000	$ 20,500	$1,795,938	$ —	$ (2,503,636)	$ (669,681)

EnteroMedics Inc.
(A development stage company)

Consolidated Statements of Stockholders' Equity (Deficit) (Continued)
Period from December 19, 2002 (Inception) to March 31, 2007

	Series C Convertible Preferred Stock		Series B Convertible Preferred Stock		Series A Convertible Preferred Stock	
	Shares	Amount	Shares	Amount	Shares	Amount
Balance, December 31, 2003	—	$ —	—	$ —	1,751,674	$ 17,517
Warrants issued for the purchase of 59,000 shares of Series B convertible preferred stock for cash at $0.0005 per share in connection with the April 23, 2004 convertible bridge notes	—	—	—	—	—	—
Exercise of 1,144,575 Series A convertible preferred stock warrants on April 23, 2004 for cash at $0.163949 per share	—	—	—	—	1,144,575	11,446
Warrants issued for the purchase of 39,998 shares of Series B convertible preferred stock for cash at $0.0005 per share in connection with the June 30, 2004 convertible bridge notes	—	—	—	—	—	—
Fair value of warrants related to convertible bridge notes	—	—	—	—	—	—
Series B convertible preferred stock issued upon conversion of $1,564,843 of convertible bridge notes and $34,809 of accrued interest payable on July 30, 2004 at $0.4333 per share	—	—	3,691,784	36,918	—	—
Series B convertible preferred stock issued on July 30, 2004 for cash at $0.4333 per share, net of financing costs of $94,776	—	—	17,424,419	174,244	—	—
Warrants issued for the purchase of 412,532 shares of Series B convertible preferred stock on December 1, 2004 valued at $0.1181 per warrant for debt commitment	—	—	—	—	—	—
Issuance of 208,500 common stock options to nonemployees in 2004 valued at $0.0173 per option	—	—	—	—	—	—
Amortization of deferred compensation	—	—	—	—	—	—
Net loss	—	—	—	—	—	—
Balance, December 31, 2004	—	$ —	21,116,203	$ 211,162	2,896,249	$ 28,963

See accompanying notes to consolidated financial statements.

Table of Contents

Common Stock		Additional Paid-In Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
Shares	Amount				
2,050,000	$ 20,500	$1,795,938	$ —	$ (2,503,636)	$ (669,681)
—	—	30	—	—	30
—	—	176,206	—	—	187,652
—	—	20	—	—	20
—	—	153,722	—	—	153,722
—	—	1,562,734	—	—	1,599,652
—	—	7,280,981	—	—	7,455,225
—	—	48,720	—	—	48,720
—	—	3,610	(3,610)	—	—
—	—	—	830	—	830
—	—	—	—	(3,448,752)	(3,448,752)
2,050,000	$ 20,500	$11,021,961	$ (2,780)	$ (5,952,388)	$ 5,327,418

EnteroMedics Inc.
(A development stage company)

Consolidated Statements of Stockholders' Equity
(Deficit) (Continued)
Period from December 19, 2002 (Inception) to March 31, 2007

	Series C Convertible Preferred Stock		Series B Convertible Preferred Stock		Series A Convertible Preferred Stock	
	Shares	Amount	Shares	Amount	Shares	Amount
Balance, December 31, 2004	—	$ —	21,116,203	$ 211,162	2,896,249	$ 28,963
Series B convertible preferred stock issued on June 17, 2005 for cash at $0.4333 per share, net of financing costs of $5,218	—	—	6,923,610	69,236	—	—
Warrants issued for the purchase of 634,664 shares of Series B convertible preferred stock in September 2005 valued at $0.1176 per warrant for debt commitment and funding	—	—	—	—	—	—
Warrants issued for the purchase of 1,550,000 shares of common stock on December 12, 2005 for cash at $0.01 per warrant	—	—	—	—	—	—
Series B convertible preferred stock issued on December 12, 2005 at $0.4333 per share, net of financing costs of $11,085	—	—	10,962,383	109,624	—	—
Common stock issued to non-employees in 2005 valued at $0.05 per share	—	—	—	—	—	—
Issuance of 423,500 common stock options to non-employees in 2005 valued at $0.0172 per option	—	—	—	—	—	—
Exercise of 269,000 common stock options in 2005 for cash at $0.05 per share	—	—	—	—	—	—
Amortization of deferred compensation	—	—	—	—	—	—
Net loss	—	—	—	—	—	—
Balance, December 31, 2005	—	$ —	39,002,196	$ 390,022	2,896,249	$ 28,963

See accompanying notes to consolidated financial statements.

Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
2,050,000	$ 20,500	$ 11,021,961	$ (2,780)	$ (5,952,388)	$ 5,327,418
—	—	2,925,546	—	—	2,994,782
—	—	74,636	—	—	74,636
—	—	15,500	—	—	15,500
—	—	4,629,292	—	—	4,738,916
2,050,000	20,500	82,000	(102,500)	—	—
—	—	7,288	(7,288)	—	—
269,000	2,690	10,760	—	—	13,450
—	—	—	25,041	—	25,041
—	—	—	—	(11,215,191)	(11,215,191)
4,369,000	$ 43,690	$ 18,766,983	$ (87,527)	$ (17,167,579)	$ 1,974,552

Table of Contents

EnteroMedics Inc.
(A development stage company)

Consolidated Statements of Stockholders' Equity
(Deficit) (Continued)
Period from December 19, 2002 (Inception) to March 31, 2007

	Series C Convertible Preferred Stock		Series B Convertible Preferred Stock		Series A Convertible Preferred Stock	
	Shares	Amount	Shares	Amount	Shares	Amount
Balance, December 31, 2005	—	$ —	39,002,196	$ 390,022	2,896,249	$ 28,963
Warrants issued for the purchase of 317,322 shares of Series B convertible preferred stock in March 2006 valued at $0.3215 per warrant for debt funding	—	—	—	—	—	—
Series C convertible preferred stock issued upon conversion of $5,250,003 of convertible bridge notes and $131,013 of accrued interest payable on July 6, 2006 at $0.8893 per share	6,050,839	60,508	—	—	—	—
Series C convertible preferred stock issued on July 6, 2006 for cash at $0.8893 per share, net of financing costs of $2,222,342	44,782,416	447,824	—	—	—	—
Warrants issued for the purchase of 1,343,472 shares of Series C convertible preferred stock on July 6, 2006 valued at $0.5474 per warrant for equity financing	—	—	—	—	—	—
Series C convertible preferred stock issued on December 11, 2006 for cash at $0.8893 per share	1,124,480	11,245	—	—	—	—
Series C convertible preferred stock warrants reclassified to convertible preferred stock warrant liability on December 11, 2006	—	—	—	—	—	—
Common stock issued to nonemployees in 2006 valued at $0.05 per share	—	—	—	—	—	—
Common stock issued to nonemployees in 2006 valued at $0.21 per share	—	—	—	—	—	—
Employee stock-based compensation expense	—	—	—	—	—	—
Non-employee stock-based compensation expense	—	—	—	—	—	—
Exercise of 791,922 common stock options in 2006 for cash at $0.05 per share	—	—	—	—	—	—
Amortization of deferred compensation	—	—	—	—	—	—
Net loss	—	—	—	—	—	—
Balance, December 31, 2006	51,957,735	519,577	39,002,196	390,022	2,896,249	28,963
Employee stock-based compensation expense (Unaudited)	—	—	—	—	—	—
Non-employee stock-based compensation expense (Unaudited)	—	—	—	—	—	—
Exercise of 214,728 common stock options in 2007 for cash at $0.05 per share (Unaudited)	—	—	—	—	—	—
Amortization of deferred compensation (Unaudited)	—	—	—	—	—	—
Net loss (Unaudited)	—	—	—	—	—	—
Balance, March 31, 2007 (Unaudited)	51,957,735	$ 519,577	39,002,196	$ 390,022	2,896,249	$ 28,963

See accompanying notes to consolidated financial statements.

Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
4,369,000	$ 43,690	$ 18,766,983	$ (87,527)	$ (17,167,579)	$ 1,974,552
—	—	102,022	—	—	102,022
—	—	5,320,508	—	—	5,381,016
—	—	37,154,837	—	—	37,602,661
—	—	735,438	—	—	735,438
—	—	988,755	—	—	1,000,000
—	—	(735,438)	—	—	(735,438)
90,000	900	3,600	(4,500)	—	—
25,000	250	5,000	(5,250)	—	—
—	—	47,479	—	—	47,479
—	—	86,125	—	—	86,125
791,922	7,919	31,677	—	—	39,596
—	—	—	30,798	—	30,798
—	—	—	—	(17,690,477)	(17,690,477)
5,275,922	52,759	62,506,986	(66,479)	(34,858,056)	28,573,772
—	—	81,821	—	—	81,821
—	—	156,421	—	—	156,421
214,728	2,148	8,590	—	—	10,738
—	—	—	6,312	—	6,312
—	—	—	—	(5,397,824)	(5,397,824)
5,490,650	$ 54,907	$ 62,753,818	$ (60,167)	$ (40,255,880)	$ 23,431,240

See accompanying notes to consolidated financial statements.

EnteroMedics Inc.
(A development stage company)

Consolidated Statements of Cash Flows

	Years Ended December 31, 2006	Years Ended December 31, 2005	Years Ended December 31, 2004	Three Months Ended March 31, 2007 (Unaudited)	Three Months Ended March 31, 2006 (Unaudited)	Period from December 19, 2002 (Inception) to March 31, 2007 (Unaudited)
Cash flows from operating activities:						
Net loss	$ (17,690,477)	$ (11,215,191)	$ (3,448,752)	$ (5,397,824)	$ (4,579,598)	$ (40,255,880)
Adjustments to reconcile net loss to net cash used in operating activities:						
Depreciation	175,194	58,407	5,085	67,440	31,732	307,295
Loss on sale of equipment	—	—	2,361	—	—	2,361
Employee stock-based compensation	47,479	—	—	81,821	1,631	129,300
Nonemployee stock-based compensation	116,923	25,041	830	162,733	13,493	305,527
Amortization of debt issuance costs and original issue discount	77,097	84,824	208,716	13,934	27,063	394,517
Amortization of short-term investment discount	(156,442)	—	—	(59,281)	—	(215,723)
Change in carrying value of warrant liability	(6,597)	—	—	244,075	—	237,478
Change in operating assets and liabilities:						
Interest receivable	(109,401)	—	—	(31,753)	—	(141,154)
Other receivables	(24,519)	(9,570)	(11,999)	22	16,140	(46,098)
Prepaid expenses and other current assets	73,990	(88,625)	(36,051)	(247,185)	(99,387)	(314,831)
Other assets	(1,395)	(5,000)	—	(7,317)	—	(13,712)
Accounts payable	361,912	159,311	134,714	173,647	(132,074)	852,409
Accrued expenses	789,758	700,055	10,769	(343,738)	321,093	1,360,493
Accrued interest payable	118,355	12,658	29,103	—	56,963	165,822
Net cash used in operating activities	(16,228,123)	(10,278,090)	(3,105,224)	(5,343,426)	(4,342,944)	(37,232,196)
Cash flows from investing activities:						
Purchases of short-term investments available for sale	(5,755,000)	—	—	—	—	(5,755,000)
Maturities of short-term investments available for sale	—	—	—	200,000	—	200,000
Purchases of short-term investments held to maturity	(14,284,098)	—	—	(1,769,678)	—	(16,053,776)
Maturities of short-term investments held to maturity	3,000,000	—	—	4,750,000	—	7,750,000
Purchases of property and equipment	(634,973)	(449,811)	(241,664)	(270,718)	(61,537)	(1,615,261)
Net cash (used in) provided by investing activities	(17,674,071)	(449,811)	(241,664)	2,909,604	(61,537)	(15,474,037)
Cash flows from financing activities:						
Proceeds from stock options exercised	39,596	13,450	—	10,738	7,896	63,784
Proceeds from warrants issued	—	15,500	50	—	—	15,657
Proceeds from warrants exercised	—	—	187,652	—	—	187,652
Proceeds from sale of common stock	—	—	—	—	—	30,500
Proceeds from sale of Series A convertible preferred stock	—	—	—	—	—	1,803,348

See accompanying notes to consolidated financial statements.

EnteroMedics Inc.
(A development stage company)

Consolidated Statements of Cash Flows (Continued)

	Years Ended December 31, 2006	Years Ended December 31, 2005	Years Ended December 31, 2004	Three Months Ended March 31, 2007 (Unaudited)	Three Months Ended March 31, 2006 (Unaudited)	Period from December 19, 2002 (Inception) to March 31, 2007 (Unaudited)
Proceeds from sale of Series B convertible preferred stock	—	7,750,001	7,550,001	—	—	15,300,002
Series B convertible preferred stock financing costs	—	(16,303)	(94,776)	—	—	(111,079)
Proceeds from sale of Series C convertible preferred stock	40,825,003	—	—	—	—	40,825,003
Series C convertible preferred stock financing costs	(1,486,904)	—	—	—	—	(1,486,904)
Proceeds from convertible notes payable	—	5,250,003	494,950	—	—	6,814,846
Proceeds from notes payable	2,620,221	3,125,900	—	—	2,500,000	5,831,121
Repayments on notes payable	(1,277,751)	—	(85,000)	(640,654)	(21,384)	(2,003,405)
Debt issuance costs	—	(23,748)	(37,971)	—	—	(91,558)
Net cash provided by (used in) financing activities	40,720,165	16,114,803	8,014,906	(629,916)	2,486,512	67,178,967
Net increase (decrease) in cash and cash equivalents	6,817,971	5,386,902	4,668,018	(3,063,738)	(1,917,969)	14,472,734
Cash and cash equivalents:						
Beginning of year	10,718,501	5,331,599	663,581	17,536,472	10,718,501	—
End of year	$ 17,536,472	$ 10,718,501	$ 5,331,599	$ 14,472,734	$ 8,800,532	$ 14,472,734
Supplemental disclosure:						
Interest paid	$ 514,655	$ 83,669	$ —	$ 122,855	$ 84,893	$ 721,179
Noncash investing and financing activities:						
Cancellation of Alpha Medical, Inc. Series A convertible preferred stock and common stock	$ —	$ —	$ —	$ —	$ —	$ (661,674)
Issuance of Beta Medical, Inc. Series A convertible preferred stock in exchange for Alpha Medical, Inc. Series A convertible preferred stock and common stock	—	—	—	—	—	661,674
Value of warrants issued with debt	102,022	37,318	153,722	—	102,022	293,062
Value of warrants issued for debt commitment	—	37,318	48,720	—	—	86,038
Value of warrants issued with Series C financing	735,438	—	—	—	—	735,438
Conversion of notes payable to Series B convertible preferred shares	—	—	1,564,843	—	—	1,564,843
Conversion of interest payable to Series B convertible preferred shares	—	—	34,809	—	—	34,809
Conversion of notes payable to Series C convertible preferred shares	5,250,003	—	—	—	—	5,250,003
Conversion of interest payable to Series C convertible preferred shares	131,013	—	—	—	—	131,013
Value of options issued for deferred compensation	—	7,288	3,610	—	—	10,898
Common stock issued for deferred compensation	9,750	102,500	—	—	4,500	112,250

See accompanying notes to consolidated financial statements.

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements

(1) Formation and Business of the Company

EnteroMedics Inc. (EnteroMedics or the Company) is developing implantable systems to treat obesity and other gastrointestinal disorders. The Company was incorporated in the state of Minnesota on December 19, 2002, originally as two separate legal entities, Alpha Medical, Inc. (Alpha) and Beta Medical, Inc. (Beta), both of which were owned 100% by a common stockholder. Effective October 1, 2003, the two entities were combined and changed its name to EnteroMedics Inc. The Company changed its state of incorporation to Delaware on July 22, 2004. The Company is in the development stage and since inception has devoted substantially all of its resources to recruiting personnel, developing its product technology, obtaining patents to protect its intellectual property and raising capital, and has not derived revenues from its primary business activity. Accordingly, the Company is in the development stage, as defined by Statement of Financial Accounting Standards No. 7, *Accounting and Reporting by Development Stage Enterprises.* The Company is headquartered in St. Paul, Minnesota.

Pursuant to Statement of Financial Accounting Standards No. 141, *Business Combinations*, the term business combinations excludes transfer of net assets or exchange of equity interest between entities under common control. The merger of Alpha into Beta was a merger between entities under common control and, therefore, related assets and liabilities were recorded at their carrying amount at the date of merger and prior period statements of operations, stockholders' equity and cash flows are shown as previously reported. At the time of the merger, each share of common stock and Series A convertible preferred stock of Alpha was converted into Series A convertible preferred stock of Beta, the surviving entity, at a rate of 0.363267812 per share. Alpha had 1,000,000 shares of common stock and 651,674 shares of Series A convertible preferred stock outstanding, which were converted into 600,000 shares of Beta Series A convertible preferred stock.

EnteroMedics Europe Sárl (EnteroMedics Europe) was formed in January 2006. EnteroMedics Europe is a Switzerland entity established as a means to conduct clinical trials in Switzerland. Upon establishment there were 20 shares of EnteroMedics Europe issued and outstanding with a par value of 1,000 Swiss Francs. EnteroMedics purchased 100% of the shares and then issued one share to a fiduciary agent. The one share is the property of EnteroMedics and is held by the fiduciary in a fiduciary capacity under terms of the Fiduciary Agreement. Pursuant to Statement of Financial Accounting Standards No. 52, *Foreign Currency Translation*, the functional currency of EnteroMedics Europe has been determined to be the U.S. Dollar.

Since inception, EnteroMedics has incurred losses through March 31, 2007 totaling approximately $40.3 million and has not generated positive cash flows from operations. The Company expects such losses to continue into the foreseeable future as it continues to develop and commercialize its technologies. The Company may need to obtain additional financing and there can be no assurance that the Company will be successful in obtaining additional financing on favorable terms, or at all. If adequate funds are not available, the Company may have to delay development or commercialization of products or license to third parties the rights to commercialize products or technologies that the Company would otherwise seek to commercialize.

(2) Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The accompanying consolidated balance sheet as of March 31, 2007, the consolidated statements of operations and cash flows for the three months ended March 31, 2007 and 2006 and for the period from December 19, 2002 (inception) to March 31, 2007 and the consolidated statements of stockholders' equity (deficit) for the three months ended March 31, 2007 are unaudited. The unaudited interim financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

Company's financial position and results of operations and cash flows for the three months ended March 31, 2007 and 2006 and for the period from inception to March 31, 2007. The financial data and other information disclosed in these notes to the consolidated financial statements related to the three-month periods are unaudited. The results of the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for the year ending December 31, 2007 or for any other interim period or for any other future year.

Unaudited Pro Forma Presentation

The unaudited pro forma consolidated balance sheet data presented as of March 31, 2007 reflects the conversion of all outstanding shares of convertible preferred stock as of that date into 95,442,677 shares of common stock, which will occur upon closing of the proposed initial public offering, as if the conversion had occurred on March 31, 2007. It does not include 1,875,000 shares issued to the Mayo Foundation discussed at Note 16. The unaudited pro forma information reflects the conversion of all the outstanding shares of Series A convertible preferred stock, par value of $0.01 per share, Series B convertible preferred stock, par value of $0.01 per share, and Series C convertible preferred stock, par value of $0.01 per share, as defined in the certificate of incorporation. Upon closing of the proposed initial public offering, the Company's authorized capital stock will consist of 50,000,000 shares of common stock, par value $0.01 per share, and 5,000,000 shares of preferred stock, par value $0.01 per share.

Basis of Presentation

The Company has prepared the accompanying consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. The Company's fiscal year ends on December 31.

Use of Estimates

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

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All intercompany transactions and accounts have been eliminated in consolidation.

Concentration of Credit Risk and Other Risks and Uncertainties

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and short-term investments. Cash and cash equivalents are deposited in demand and money market accounts at two financial institutions. At times, such deposits may be in excess of insured limits. The Company has not experienced any losses on its deposits of cash and cash equivalents.

Most of the products developed by the Company will require clearance from the U.S. Food and Drug Administration (FDA) or corresponding foreign regulatory agencies prior to commercial sales. There can be no assurance the Company's products will receive the necessary clearances. If the Company is denied clearance or clearance is delayed, it will have a material adverse impact on the Company.

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

The medical device industry is characterized by frequent and extensive litigation and administrative proceedings over patent and other intellectual property rights. Whether a product infringes a patent involves complex legal and factual issues, the determination of which is often difficult to predict, and the outcome may be uncertain until the court has entered final judgment and all appeals are exhausted. The Company's competitors may assert that its products or the use of the Company's products are covered by U.S. or foreign patents held by them.

Fair Value of Financial Instruments

Carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, prepaid expenses and other current assets, accounts payable and accrued liabilities approximate fair value due to their short maturities. The fair values of investments in debt and equity securities are disclosed in Note 3. The fair value of the Company's long-term debt is $4,612,710 as of December 31, 2006 based on borrowing rates available to the Company.

Cash and Cash Equivalents

The Company considers highly liquid investments with maturities of 90 days or less when purchased to be cash equivalents. Cash equivalents are stated at cost, which approximates market value. The Company's cash equivalents are primarily in money market funds and commercial paper. The Company deposits its cash and cash equivalents in high-quality credit institutions. Under terms of the Company's notes payable agreements (see Note 6), in the event of default, the lender has the right to enforce account control agreements and restrict the Company's access to their cash and investment accounts.

Short-Term Investments

The Company considers all investments with maturities greater than three months and less than one year at the time of purchase as short-term investments and classifies them as either available for sale or held to maturity.

Available-for-sale securities are carried at fair value based on quoted market prices, with the unrealized gains and losses included in other comprehensive income within stockholders' equity (deficit) in the consolidated balance sheets. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in interest and other income. Interest and dividends on securities classified as available for sale are included in interest income. The cost of securities sold is based on the specific identification method.

Short-term investments in debt securities which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income, using the interest method, over the period to maturity. Unrealized losses on held-to-maturity securities reflecting a decline in value determined to be other than temporary are charged to income.

Property and Equipment, Net

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation of property and equipment is computed using the straight-line method over their estimated useful lives of three to seven years. Leasehold improvements are amortized on a straight-line basis over the lesser of their useful life or the term of the lease. Upon retirement or sale, the cost and related accumulated depreciation are removed from the consolidated balance sheets and the resulting gain or loss is reflected in the consolidated statements of operations. Repairs and maintenance are expensed as incurred.

Impairment of Long-Lived Assets

The Company evaluates its long-lived assets for indicators of possible impairment by comparison of the carrying amounts to future net undiscounted cash flows expected to be generated by such assets when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Should an impairment exist, the impairment loss would be measured based on the excess carrying value of the asset over the asset's fair value or estimates of future discounted cash flows. The Company has not identified any such impairment losses to date.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance for deferred income tax assets is recorded when it is more likely than not that some portion or all of the deferred income tax assets will not be realized. The Company has provided a full valuation allowance against the gross deferred tax assets as of December 31, 2006 and 2005 (see Note 12).

Research and Development Expenses

Research and development expenses are charged to expense as incurred. Research and development expenses include, but are not limited to, product development, clinical and regulatory expenses, payroll and other personnel expenses, materials, supplies, and consulting costs.

Patent Costs

Costs associated with the submission of a patent application are expensed as incurred given the uncertainty of the patents resulting in probable future economic benefits to the Company. Patent-related legal expenses included in general and administrative costs were $274,665, $214,300 and $129,272 for the years ended December 31, 2006, 2005 and 2004, respectively, and $763,034 for the period from December 19, 2002 (inception) to March 31, 2007 (unaudited). Patent-related legal expenses included in general and administrative costs for the three months ended March 31, 2007 and 2006 were $131,810 (unaudited) and $23,622 (unaudited), respectively.

Derivative Instruments

The Company accounts for the Series C preferred stock warrants as derivatives under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and related

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

Emerging Issues Task Force (EITF) interpretations and Securities and Exchange Commission (SEC) rules, which require that the warrants be classified as a liability and measured at fair value with changes in fair value recognized currently in earnings, when there are not enough authorized shares to be issued upon exercise of the warrants. The Company has recorded changes in fair value as interest expense in the consolidated statements of operations.

Stock-Based Compensation

Prior to January 1, 2006, the Company accounted for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*, and related interpretations, and followed the disclosure provisions of Statement of Financial Accounting Standards No. 123 (SFAS 123), *Accounting for Stock-Based Compensation*. Under APB 25, compensation expense is based on the difference, if any, on the date of the grant, between the fair value of the Company's stock and the exercise price. Employee stock-based compensation determined under APB 25 is recognized over the option vesting period.

The following table illustrates the effect on net loss if the company had applied the fair value recognition provision of SFAS 123:

	Years Ended December 31	
	2005	2004
Net loss, as reported	$ (11,215,191)	$ (3,448,752)
Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards	(26,560)	(16,819)
Net loss, pro forma	$ (11,241,751)	$ (3,465,571)
Net loss per common share, basic and diluted:		
As reported	$ (3.17)	$ (2.68)
Pro forma	$ (3.17)	$ (2.69)

In accordance with the provisions of the minimum value method prescribed by SFAS 123, the fair value of each option grant was estimated using the following assumptions:

	Years Ended December 31	
	2005	2004
Risk-free interest rates	4.28%	4.26%
Expected life	10 years	10 years
Expected dividends	0%	0%

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

The weighted-average fair value of options granted to employees was $0.02 for the years ended December 31, 2005 and 2004.

Effective January 1, 2006, the Company adopted the fair value provisions of Statement of Financial Accounting Standards No. 123R (SFAS 123R), *Share-Based Payment*, which supersedes its previous accounting under APB 25. SFAS 123R requires the recognition of compensation expense, using a fair-value-based method, for costs related to all share-based payments including stock options. SFAS 123R requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The Company adopted SFAS 123R using the prospective transition method, which requires that for nonpublic entities that used the minimum value method for either pro forma or financial statement recognition purposes, SFAS 123R shall be applied to option grants or modifications to existing options after the required effective date. For options granted prior to the new SFAS 123R effective date and for which the requisite service period has not been performed as of January 1, 2006, the Company will continue to apply the intrinsic value provisions of APB 25 on the remaining unvested awards. All option grants valued after January 1, 2006 will be expensed on a straight-line basis over the vesting period.

The Company accounts for stock-based compensation arrangements with nonemployees in accordance with the Emerging Issues Task Force Abstract No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services.* The Company records the expense of such services based on the estimated fair value of the equity instrument using the Black-Scholes pricing model. The value of the equity instrument is charged to earnings over the term of the service agreement.

Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding during the period. The Company's potential dilutive shares, which include outstanding common stock options, unvested common shares subject to repurchase, convertible preferred stock and warrants, have not been included in the computation of diluted net loss per share for all periods as the result would be anti-dilutive. Such potentially dilutive shares are excluded when the effect would be to reduce a net loss per share.

	Year Ended December 31,			Three Months Ended March 31,	
	2006	2005	2004	2007	2006
				(Unaudited)	
Numerator:					
Net loss	$ (17,690,477)	$ (11,215,191)	$ (3,448,752)	$ (5,397,824)	$ (4,579,598)
Denominator for historical and basic and diluted net loss per share:					
Weighted-average common shares outstanding	4,945,426	4,039,814	2,050,000	5,434,643	4,453,408
Weighted-average unvested common shares subject to repurchase	(236,418)	(498,918)	(761,688)	(72,924)	(335,424)
Denominator for net loss per common share—basic and diluted	4,709,008	3,540,896	1,288,312	5,361,719	4,117,984
Net loss per share—basic and diluted	$ (3.76)	$ (3.17)	$ (2.68)	$ (1.01)	$ (1.11)

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

The following table sets forth the potential shares of common stock that are not included in the calculation of diluted net loss per share because to do so would be anti-dilutive as of the end of each period presented:

	December 31,			March 31,	
	2006	2005	2004	2007	2006
				(Unaudited)	
Convertible preferred stock	93,856,180	41,898,445	24,012,452	93,856,180	41,898,445
Stock options outstanding	11,482,396	7,028,800	3,102,600	15,772,968	7,529,625
Warrants to purchase convertible preferred stock	3,430,362	1,769,558	1,134,894	3,430,362	2,086,890
Warrants to purchase common stock	1,550,000	1,550,000	—	1,550,000	1,550,000

Recently Issued Accounting Standards

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109*, which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that the Company recognize in its financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of the Company's 2007 fiscal year, with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to opening retained earnings. The adoption of FIN 48 had no impact on the Company's consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (SFAS 157), *Fair Value Measurements*, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided the company has not yet issued financial statements, including for interim periods, for that fiscal year. The Company is currently evaluating the impact of SFAS 157.

In September 2006, the United Stated Securities and Exchange Commission issued Staff Accounting Bulletin No. 108 (SAB 108), *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements*, which provides interpretive guidance on how registrants should quantify financial statement misstatements. Under SAB 108, registrants are required to consider both a "rollover" method which focuses primarily on the income statement impact of misstatements and the "iron curtain" method which focuses primarily on the balance sheet impact of misstatements. SAB 108 was effective for 2006 and had no impact on the Company's consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The amendment to SFAS 115 applies to all entities with investments in available-for-sale or trading securities. The statement is effective for fiscal years beginning after November 15, 2007. The Company has not yet determined the effect SFAS 159 will have on its consolidated financial statements.

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

(3) Short-term Investments

The amortized cost and fair value of short-term investments available for sale, with gross unrealized gains and losses, were as follows:

As of March 31, 2007 (unaudited)

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
State and municipal tax-exempt bonds	$1,000,000	$ —	$ —	$1,000,000
Corporate debt	4,555,000	—	—	4,555,000
Total investment securities available for sale	$5,555,000	$ —	$ —	$5,555,000

As of December 31, 2006

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
State and municipal tax-exempt bonds	$1,000,000	$ —	$ —	$1,000,000
Corporate debt	4,755,000	—	—	4,755,000
Total investment securities available for sale	$5,755,000	$ —	$ —	$5,755,000

Short-term investments available for sale at March 31, 2007 (unaudited) and December 31, 2006 consist solely of variable rate demand notes with a seven-day put option and interest rates that reset on a weekly basis. There were no short-term investments available for sale as of December 31, 2005.

The amortized cost and fair value of short-term investments held to maturity, with gross unrealized gains and losses, were as follows:

As of March 31, 2007 (unaudited)

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
Corporate debt	$5,252,326	$ 156	$ (502)	$5,251,980
U.S. Treasury and agencies	1,475,918	646	—	1,476,564
Commercial paper	1,791,255	183	(87)	1,791,351
Total investment securities held to maturity	$8,519,499	$ 985	$ (589)	$8,519,895

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

As of December 31, 2006

	Cost	Gross unrealized Gains	Gross unrealized Losses	Fair value
Corporate debt	$ 6,998,355	$ 1,572	$ (606)	$ 6,999,321
U.S. Treasury and agencies	2,945,510	2,289	—	2,947,799
Commercial paper	1,496,675	—	—	1,496,675
Total investment securities held to maturity	$ 11,440,540	$ 3,861	$ (606)	$ 11,443,795

There were no short-term investments held to maturity as of December 31, 2005.

(4) Property and Equipment

Property and equipment consist of the following as of:

	March 31, 2007 (Unaudited)	December 31, 2006	December 31, 2005
Furniture and equipment	$ 1,157,187	$ 943,159	$ 359,900
Computer hardware and software	315,730	255,609	170,265
Leasehold improvements	137,923	142,821	176,451
	1,610,840	1,341,589	706,616
Less accumulated depreciation and amortization	(305,235)	(239,262)	(64,068)
Property and equipment, net	$ 1,305,605	$ 1,102,327	$ 642,548

Depreciation expense included in general and administrative costs was $175,194, $58,407 and $5,085 for the years ended December 31, 2006, 2005 and 2004, respectively, and $307,295 for the period from December 19, 2002 (inception) to March 31, 2007 (unaudited). Depreciation expense included in general and administrative costs for the three months ended March 31, 2007 and 2006 was $67,440 (unaudited) and $31,732 (unaudited), respectively.

(5) Accrued Expenses

Accrued expenses consist of the following as of December 31:

	March 31, 2007 (Unaudited)	December 31, 2006	December 31, 2005
Professional service related expenses	$ 731,740	$ 694,953	$ 414,824
Payroll related expenses	515,818	601,733	345,200
Other expenses	112,935	407,545	154,449
Accrued expenses	$ 1,360,493	$ 1,704,231	$ 914,473

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

(6) Notes payable

Notes payable consists of the following as of:

	March 31, 2007 (Unaudited)	December 31, 2006	December 31, 2005
Equipment loan dated June 7, 2005	$ 109,442	$ 128,170	$ 199,450
Equipment loan dated June 7, 2005	25,017	29,607	46,710
Growth capital loan dated September 30, 2005 (net discounts of $14,927 (unaudited), $18,659 and $33,586 at March 31, 2007 and December 31, 2006 and 2005, respectively)	1,347,750	1,637,427	2,466,414
Equipment loan dated December 30, 2005	248,608	278,763	337,023
Equipment loan dated December 30, 2005	31,288	35,219	42,717
Growth capital loan dated March 31, 2006 (net discounts of $12,243 (unaudited) and $14,283 at March 31, 2007 and December 31, 2006, respectively)	377,289	431,136	—
Growth capital loan dated March 31, 2006 (net discounts of $48,971 (unaudited) and $57,133 at March 31, 2007 and December 31, 2006, respectively)	1,509,158	1,724,543	—
Equipment loan dated April 28, 2006	86,187	94,867	—
Equipment loan dated April 28, 2006	16,836	18,563	—
Total debt	3,751,575	4,378,295	3,092,314
Less current portion	(2,836,621)	(2,651,336)	(998,055)
Total long-term debt	$ 914,954	$ 1,726,959	$2,094,259

The Company entered into a loan agreement on December 1, 2004 that provided for equipment loans and growth capital loans up to an aggregate original principal amount of $250,000 and $3,000,000, respectively, through June 30, 2005. In conjunction with this loan agreement, the Company issued detachable warrants to acquire 412,532 shares of Series B convertible preferred stock (Series B) at $0.4333 per share. The warrants have a seven and a half year life. The fair value of the warrants at the time of issuance was determined to be $48,720 and was recorded as interest expense over the term of the commitment. $41,760 and $6,960 was recorded in 2005 and 2004, respectively. This fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 60%, dividend rate of 0%, risk-free interest rate of 4.38% and the seven and a half year warrant life.

The above December 1, 2004 loan agreement was amended on September 29, 2005. The amendment provided for additional lender commitments for equipment loans and growth capital loans to the Company up to an aggregate original principal amount of $500,000 and $2,000,000, respectively. The termination date of the original growth capital loan commitment was amended to September 30, 2005 and the termination date for the additional equipment loans and growth capital loans was March 31, 2006 (see below). In conjunction with the amendment, the Company issued detachable warrants to acquire 317,332 shares of Series B stock at $0.4333 per share or shares of Series C convertible preferred stock (Series C) having an aggregate exercise price of $137,500. On June 21, 2006, prior to the close of the Series C stock financing round, the lender informed the Company of its intent to have the warrants be for Series B stock. The warrants have a seven and a half year life. The fair value

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

of the warrants at the time of issuance was determined to be $37,318 and was recorded as interest expense over the term of the commitment. $18,659 was recorded in both 2006 and 2005. This fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 55%, dividend rate of 0%, risk-free interest rate of 4.29% and the seven and a half year warrant life.

The aggregate amount funded by the lender as noted above was $5,746,121 and $3,125,900 as of December 31, 2006 and 2005, respectively. The Company entered into two separate equipment loans (aggregate of $120,221) during 2006 and four separate equipment loans (aggregate of $625,900) during 2005 with the below terms:

1. *Equipment Loan Dated June 7, 2005*—Face amount of $199,450 payable in 30 equal principal and interest installments beginning January 1, 2006 through May 2008 with a final payment of $17,283 on June 1, 2008 at an annual percentage rate of 8.023%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.

2. *Equipment Loan Dated June 7, 2005*—Face amount of $46,710 payable in 30 equal principal and interest installments beginning January 1, 2006 through June 1, 2008 at an annual percentage rate of 11.461%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.

3. *Equipment Loan Dated December 30, 2005*—Face amount of $337,023 payable in 30 equal principal and interest installments beginning July 1, 2006 through November 2008 with a final payment of $29,384 on December 1, 2008 at an annual percentage rate of 9.273%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.

4. *Equipment Loan Dated December 30, 2005*—Face amount of $42,717 payable in 30 equal principal and interest installments beginning July 1, 2006 through December 1, 2008 at an annual percentage rate of 12.71%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.

5. *Equipment Loan Dated April 28, 2006*—Face amount of $100,537 payable in 30 equal principal and interest installments beginning November 1, 2006 through March 2009 with a final payment of $8,787 on April 1, 2009 at an annual percentage rate of 9.773%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.

6. *Equipment Loan Dated April 28, 2006*—Face amount of $19,684 payable in 30 equal principal and interest installments beginning November 1, 2006 through April 1, 2009 at an annual percentage rate of 13.21%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.

The Company entered into a growth capital loan on September 30, 2005 with a face amount of $2,500,000 payable in 23 equal principal and interest installments beginning April 1, 2006 through February 2008 with a final payment of $237,825 on March 1, 2008 at an annual percentage rate of 8.486%, an effective rate of 10.12%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10.999%. In conjunction with the funding of the growth capital loan, the Company issued detachable warrants to acquire 317,332 shares of Series B stock at $0.4333 per share or shares of Series C stock having an aggregate exercise price of $137,500. On June 21, 2006, prior to the close of the Series C stock financing round, the lender informed the Company of its intent to have the warrants be for Series B stock. The warrants have a seven and a half year life. The fair value of the warrants at the time of issuance was determined to be $37,318 and is recorded as

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

interest expense over the term of the loan. $14,927 and $3,732 was recorded in 2006 and 2005, respectively. Interest expense for the three months ended March 31, 2007 and 2006 was $3,732 (unaudited) and $3,732 (unaudited), respectively. This fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 55%, dividend rate of 0%, risk-free interest rate of 4.33% and the seven and a half year warrant life.

The Company entered into two separate growth capital loans on March 31, 2006 with a combined face amount of $2,500,000 payable in 23 equal principal and interest installments beginning October 1, 2006 through August 2008 with a final payment of $238,875 on September 1, 2008 at an annual percentage rate of 9.49%, an effective rate of 14.07%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10.999%. In conjunction with the funding of the growth capital loan, the Company issued detachable warrants to acquire 317,332 shares of Series B stock at $0.4333 per share or shares of Series C stock having an aggregate exercise price of $137,500. On June 21, 2006, prior to the close of the Series C stock financing round, the lender informed the Company of its intent to have the warrants be for Series B stock. The warrants have a seven year life. The fair value of the warrants at the time of issuance was determined to be $102,022 and is recorded as interest expense over the term of the loan. $30,606 was recorded in 2006. Interest expense for the three months ended March 31, 2007 was $10,202 (unaudited). This fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 54%, dividend rate of 0%, risk-free interest rate of 4.85% and the seven year warrant life.

Each of the above loans is collateralized by a first security priority lien on all of the Company's assets, excluding intellectual property. Should the Company's remaining months of liquidity fall to four months or less, the Company is required to grant a temporary lien on intellectual property. Remaining months of liquidity is defined as cash and cash equivalents divided by a rolling four months average of prior usage. The Company was in compliance with all covenants related to the notes payable at March 31, 2007 (unaudited) and December 31, 2006.

Scheduled debt principal payments are as follows as of March 31, 2007 (unaudited):

Years Ending December 31:	
2007	$ 2,010,682
2008	1,794,877
2009	22,157
	3,827,716
Less: Original issue discount	(76,141)
Notes payable, net	$ 3,751,575

Table of Contents

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

Scheduled debt principal payments are as follows as of December 31, 2006:

Years Ending December 31:	
2007	$ 2,651,336
2008	1,794,877
2009	22,157
	4,468,370
Less: Original issue discount	(90,075)
Notes payable, net	$ 4,378,295

(7) Convertible notes payable

On December 12, 2005, the Company issued convertible notes payable, to various investors, including some officers of the Company, with an original aggregate face amount of $5,250,003. The convertible notes payable accrued interest at a fixed rate per annum equal to 4.34%. Accrued interest payable on the convertible notes payable was $12,658 as of December 31, 2005.

Accrued interest and principal were due in full at the earliest to occur of (i) the maturity date (December 12, 2008), (ii) an equity conversion event, or (iii) an acquisition conversion event. On July 6, 2006, the Company completed an equity conversion event when it closed a Series C convertible preferred stock financing. As a result, the outstanding principal balance of $5,250,003 and the accrued interest payable balance of $131,013 were automatically converted into 6,050,839 shares of Series C convertible preferred stock at $0.8893 per share.

See Note 9 for details of the Series C convertible preferred stock financing.

(8) Convertible Bridge Notes

November 13, 2003 Convertible Bridge Note

On November 13, 2003, the Company entered into a 4% Bridge Loan Agreement with various investors, including some officers of the Company. The Company received aggregate proceeds in the amount of $1,069,893. Accrued interest and principal was convertible contingent upon subsequent financing. The due date was May 31, 2004 provided a definitive term sheet for an equity sale had been executed by the Company on or before April 30, 2004. In consideration for entering into the Bridge Loan Agreement, the Company issued Series B stock warrants with an exercise price equal to the price paid per share at the next equity financing. The number of warrants to be issued were defined as the committed capital balance multiplied by 0.2 and divided by the price paid per share at the next equity financing. In closing the November 13, 2003 Bridge Loan Agreement, the price paid per share at the next equity financing was estimated to be $1.00, resulting in 214,000 warrants. The Company received cash consideration for the 214,000 warrants at a rate of $0.0005 per share or an aggregate amount of $107, which was recorded as additional paid-in capital during 2003. Upon closing the Series B equity financing on July 30, 2004, the price paid per share was set at $0.4333 resulting in a total of 493,888 seven-year warrants being issued.

The fair value of the warrants at the time of issuance was determined to be $103,320 and was recorded as additional paid-in capital and interest expense in 2004. The fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 66%, dividend rate of 0%, risk-free interest rate of 4.27%, and the maximum seven-year warrant life.

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

April 23, 2004 Convertible Bridge Note

On April 23, 2004, the Company amended the November 13, 2003 Bridge Loan Agreement to provide for additional capital. The terms and investors of the November 13, 2003 Bridge Loan Agreement remained the same with the only changes being to the amount of capital being committed and the number of warrants being issued as additional consideration. The Company received additional aggregate proceeds in the amount of $294,970 for a combined outstanding total of $1,364,863. In consideration for entering into the Amended Bridge Loan Agreement, the Company issued additional Series B stock warrants with an exercise price equal to the price paid per share at the next equity financing. The number of warrants to be issued were defined as the committed capital balance multiplied by 0.2 and divided by the price paid per share at the next equity financing. In closing the Amended Bridge Loan Agreement, the price paid per share at the next equity financing was estimated to be $1.00, resulting in 59,000 additional warrants. The Company received cash consideration for the 59,000 warrants at a rate of $0.0005 per share or an aggregate amount of $30, which was recorded as additional paid-in capital during 2004. Upon closing the Series B equity financing on July 30, 2004, the price paid per share was set at $0.4333 resulting in a total of 136,162 seven-year warrants being issued.

The fair value of the warrants at the time of issuance was determined to be $30,038 and was recorded as additional paid-in capital and interest expense in 2004. The fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 65%, dividend rate of 0%, risk-free interest rate of 4.45%, and the maximum seven-year warrant life.

June 30, 2004 Convertible Bridge Note

On June 30, 2004, the Company amended the November 13, 2003 Bridge Loan Agreement for a second time to provide for additional capital. The terms and investors of the November 13, 2003 Bridge Loan Agreement remained the same with the only changes being to the amount of capital being committed and the number of warrants being issued as additional consideration and a due date of July 31, 2004. The Company received additional aggregate proceeds in the amount of $199,980 for a combined outstanding total of $1,564,843. In consideration for entering into the Second Amended Bridge Loan Agreement, the Company issued additional Series B stock warrants with an exercise price equal to the price paid per share at the next equity financing. The number of warrants to be issued were defined as the committed capital balance multiplied by 0.2 and divided by the price paid per share at the next equity financing. In closing the Second Amended Bridge Loan Agreement, the price paid per share at the next equity financing was estimated to be $1.00, resulting in 39,998 additional warrants. The Company received cash consideration for the 39,998 warrants at a rate of $0.0005 per share or an aggregate amount of $20, which was recorded as additional paid-in capital during 2004. Upon closing the Series B equity financing on July 30, 2004, the price paid per share was set at $0.4333 resulting in a total of 92,312 seven-year warrants being issued.

The fair value of the warrants at the time of issuance was determined to be $20,364 and was recorded as additional paid-in capital and interest expense in 2004. The fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 65%, dividend rate of 0%, risk-free interest rate of 4.62%, and the maximum seven-year warrant life.

See Note 10 for the conversion of the above convertible notes payable to Series B convertible preferred stock.

A total of 722,362 warrants to purchase Series B convertible preferred stock were issued as a result of the three convertible bridge loans.

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

(9) Series C Convertible Preferred Stock Financing

On July 6, 2006, the Company closed the Series C convertible preferred stock (Series C) financing. The Company sold 44,782,416 shares of Series C stock for $0.8893 per share, or total gross proceeds of $39,825,003. In addition, $5,250,003 of Convertible Notes Payable principal and $131,013 of accrued interest payable were converted into 6,050,839 shares of Series C stock. The Company incurred $2,222,342 in costs, which were recorded as a reduction to additional paid-in capital. Included in the Series C financing costs was $735,438 of value related to 1,343,472 Series C warrants issued to the private placement underwriter. The fair value of the warrants was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 55%, dividend rate of 0%, risk-free interest rate of 5.18%, and the maximum seven-year warrant life. The fair value of the warrants was recorded in additional paid-in capital.

On December 11, 2006, the Company sold an additional 1,124,480 shares of Series C stock for $0.8893 per share, or total gross proceeds of $1,000,000.

As of the closing date of the additional sale of 1,124,480 shares of Series C stock, the Company had insufficient authorized and unissued Series C stock available to share settle the Series C warrants which requires the instrument to be accounted for under Statement of Financial Accounting Standards No. 133 and classified as a liability in accordance with EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*. The fair market value of the warrant as of March 31, 2007 and December 31, 2006 was $972,916 (unaudited) and $728,841, respectively. The change in fair value is recorded separately in the consolidated statements of operations.

(10) Series B Convertible Preferred Stock Financing

On July 30, 2004, the Company closed the first tranche of the Series B convertible preferred stock (Series B) financing. The Company sold 17,424,419 shares of Series B stock for $0.4333 per share, or total gross proceeds of $7,550,001. In addition, $1,564,843 of Convertible Bridge Loan principal and $34,809 of accrued interest were converted into 3,691,784 shares of Series B stock. The Company incurred $94,776 in costs, which were recorded as a reduction to additional paid-in capital.

During 2005, the Company closed the final two tranches of the Series B convertible preferred stock financing. On June 17, 2005, the Company sold 6,923,610 shares of Series B stock for $0.4333 per share, or total gross proceeds of $3,000,000. On December 12, 2005, the Company sold 10,962,383 shares of Series B stock for $0.4333 per share, or total gross proceeds of $4,750,001. The Company incurred a total of $16,303 in costs related to the 2005 closings, which were recorded as a reduction to additional paid-in capital.

The Company also issued 1,550,000 common stock warrants on December 12, 2005 to various Series B stockholders at a price of $0.01 per share. The warrants have an exercise price of $0.05 and terminate in five years. The fair value of the warrants at the time of issuance was determined to be $15,500 and was recorded as additional paid-in capital. The fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 49%, dividend rate of 0%, risk-free interest rate of 4.55%, and the maximum five-year warrant life.

(11) Convertible Participating Preferred Stock

The Company has 2,896,249 shares of Series A convertible preferred stock (Series A) and 39,002,196 shares of Series B convertible preferred stock outstanding as of March 31, 2007 (unaudited) and December 31, 2006 and 2005, and 51,957,735 shares of Series C convertible preferred stock outstanding as of March 31, 2007 (unaudited) and December 31, 2006. The following are preferred stock terms in accordance with the certificate of incorporation:

Redemption Rights

No class of preferred stock has redemption rights.

Liquidation Preferences

The stockholders of Series C and Series B convertible preferred stock share senior liquidation rights on a *pari passu* basis of $0.8893 and $0.4333 per share, respectively, prior to Series A's liquidation preference of $0.7208 per share. After all of the above liquidation preferences have been paid, any remaining liquidation proceeds are paid to common stockholders and all classes of preferred stock on an as-if converted basis.

A liquidation of the Company includes the sale, lease, exchange, exclusive licensing or other disposition of all or substantially all of the Company's assets or intellectual property; the merger, business combination, reorganization, or consolidation of the Company with another entity gaining more than 50% ownership; or a liquidation, dissolution or winding up of the Company.

Dividends

Series C and Series B stockholders are entitled to a noncumulative dividend on a *pari passu* basis prior to the payment of dividends on Series A and common stock. The Series C and Series B dividend rates are $0.0711 per annum (8%) and $0.0347 per annum (8%), respectively. After payment of the combined Series C and Series B dividends and prior to the payment of dividends to common stockholders, Series A stockholders are entitled to a non-cumulative dividend of $0.0577 per annum (8%). After all preferred stock dividend preferences have been paid, the common stockholders participate with preferred stockholders on an as-if converted basis.

Anti-dilution Rights

If the Company issues equity or convertible instruments that are not subject to defined carve out provisions, below the then applicable conversion price for each preferred stock series, the conversion price to common stock will be adjusted on a weighted average basis.

Conversion Rights

All classes of preferred stock are convertible into common stock at the option of the holder. As noted above, the conversion price of all outstanding preferred stock issuances is subject to weighted average anti-dilution protection. At March 31, 2007 (unaudited) and December 31, 2006, Series A, Series B and Series C shares are convertible into 4,482,746, 39,002,196 and 51,957,735 shares of common stock based on the terms of the agreement, respectively.

All classes of preferred stock are mandatorily convertible upon a qualified initial public offering whereby the public offering price is not less than $2.64 per share (as adjusted for any stock splits, stock dividends,

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

combinations, subdivisions, recapitalizations or the like) and results in gross proceeds to the Company of at least $30 million in the aggregate after deducting underwriting commissions and discounts, as defined in the certificate of incorporation.

Voting Rights

Preferred stockholders have the same voting rights as common stockholders. Preferred stockholders have one vote for each share of common stock deemed held, as determined by the then current conversion price. As a result of the preferred stockholders' board of directors' representation and voting rights, they effectively control the affairs of the Company, including its liquidation.

(12) Income Taxes

The Company has incurred net operating losses (NOLs) since inception. The Company has not reflected any benefit of such net operating loss carryforwards in the accompanying consolidated financial statements.

The income tax expense benefit differed from the amount computed by applying the U.S. federal income tax rate of 34% to income before income taxes as a result of the following:

	2006	2005	2004
Computed 'expected' tax benefit	34.0%	34.0%	34.0%
Other permanent adjustments	-0.4%	-0.4%	-2.4%
Federal research and development credit	2.3%	3.5%	2.9%
State income taxes, net of federal benefit	6.0%	7.0%	6.6%
Effect of foreign operations	-1.5%	0.0%	0.0%
Change in federal valuation allowance	-40.4%	-44.1%	-41.1%
	0.0%	0.0%	0.0%

The tax effect of temporary differences that give rise to significant portions of the deferred tax assets as of December 31 is presented below:

	2006	2005
Deferred tax assets (liabilities):		
Start-up costs	$ 5,505,000	$ 2,315,000
Reserves and accruals	157,000	38,000
Property and equipment	16,000	1,000
Research and development credit	1,107,000	692,000
Net operating loss carry forwards	7,784,000	4,444,000
Total gross deferred tax assets	14,569,000	7,490,000
Valuation allowance	(14,569,000)	(7,490,000)
Net deferred tax assets	$ —	$ —

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible.

Based on the level of historical taxable losses and projections of future taxable income (losses) over the periods in which the deferred tax assets are deductible, management currently believes that it is more likely than not that the Company will not realize the benefits of these deductible differences. Accordingly, the Company has provided a valuation allowance against the gross deferred tax assets as of December 31, 2006 and 2005.

As of December 31, 2006, the Company has U.S. federal net operating loss carry forwards of approximately $17,856,000. The federal net operating loss carry forwards expire in the years 2022 through 2026.

Federal tax laws impose significant restrictions on the utilization of net operating loss carry forwards and research and development credits in the event of a change in ownership of the Company, as defined by the Internal Revenue Code Section 382. The Company's net operating loss carry forwards and research and development credits may be subject to the above limitations.

In July 2006 the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109 (SFAS 109), *Accounting for Income Taxes*. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted FIN 48 effective January 1, 2007. At the date of adoption of FIN 48, the Company had no unrecognized tax benefits and expected no significant changes in unrecognized tax benefits in the next 12 months. The adoption of this statement did not result in a cumulative accounting adjustment and did not impact the financial position, results of operations or cash flows. In accordance with FIN 48, paragraph 19, the Company has decided to classify any interest and penalties as a component of tax expense. To date, there have been no interest or penalties charged to us in relation to the underpayment of income taxes.

(13) Stock Options

The Company has adopted the EnteroMedics Inc. 2003 Stock Incentive Plan (the Plan) that includes both incentive stock options and nonqualified stock options to be granted to employees, officers, consultants, independent contractors, directors and affiliates of the Company. At March 31, 2007 (unaudited) and December 31, 2006, according to the Plan, 21,724,838 shares and 15,724,838 shares, respectively, have been authorized and reserved. The board of directors establishes the terms and conditions of all stock option grants, subject to the Plan and applicable provisions of the Internal Revenue Code. Incentive stock options must be granted at an exercise price not less than the fair market value of the common stock on the grant date. The options granted to participants owning more than 10% of the Company's outstanding voting stock must be granted at an exercise price not less than 110% of fair market value of the common stock on the grant date. The options expire on the date determined by the board of directors, but may not extend more than 10 years from the grant date, while incentive stock options granted to participants owning more than 10% of the Company's outstanding voting stock expire five years from the grant date. The vesting period for employees is generally over four years. The vesting period for non-employees is determined based on the services being provided.

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

Stock option activity is as follows:

	Shares Available For Grant	Outstanding Options: Number of Shares	Outstanding Options: Weighted-Average Exercise Price	Aggregate Intrinsic Value
Shares reserved at Plan inception	390,000	—	$ —	
Balance, December 31, 2003 (unaudited)	390,000	—	—	
Shares reserved	4,000,000	—	—	
Options granted	(3,137,600)	3,137,600	0.05	
Options exercised	—	—	—	
Options cancelled	35,000	(35,000)	0.05	
Balance, December 31, 2004	1,287,400	3,102,600	0.05	
Shares reserved	6,177,900	—	—	
Options granted	(4,588,800)	4,588,800	0.05	
Options exercised	—	(269,000)	0.05	
Options cancelled	393,600	(393,600)	0.05	
Balance, December 31, 2005	3,270,100	7,028,800	0.05	
Shares reserved	5,156,938	—	—	
Options granted	(6,186,750)	6,186,750	0.13	
Options exercised	—	(791,922)	0.05	
Options cancelled	941,232	(941,232)	0.05	
Balance, December 31, 2006	3,181,520	11,482,396	0.09	$1,362,935
Shares reserved (unaudited)	6,000,000	—	—	
Options granted (unaudited)	(4,540,300)	4,540,300	0.57	
Options exercised (unaudited)	—	(214,728)	0.05	
Options cancelled (unaudited)	35,000	(35,000)	0.21	
Balance, March 31, 2007 (unaudited)	4,676,220	15,772,968	$ 0.23	$5,372,339

The options outstanding, vested and currently exercisable by exercise price at March 31, 2007 (unaudited):

Exercise Price	Outstanding Options and Expected to Vest: Number of Shares Outstanding	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value	Options Exercisable and Vested: Number of Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value
$0.05	8,303,618	8.3	$4,317,881	3,821,565	$ 0.05	$1,987,214
$0.21	2,929,050	9.5	1,054,458	5,000	$ 0.21	1,800
$0.57	4,540,300	9.9	—	20,000	$ 0.57	—
	15,772,968		$5,372,339	3,846,565	$ 0.05	$1,989,014

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

The options outstanding, vested and currently exercisable by exercise price at December 31, 2006:

Outstanding Options and Expected to Vest				Options Exercisable and Vested		
Exercise Price	Number of Shares Outstanding	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value	Number of Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value
$ 0.05	8,518,346	8.6	$1,362,935	3,474,921	$ 0.05	$555,987
$ 0.21	2,964,050	9.8	—	5,000	$ 0.21	—
	11,482,396		$1,362,935	3,479,921	$ 0.05	$555,987

Stock-Based Compensation for Non-employees

Stock-based compensation expenses related to stock options granted to nonemployees is recognized on an accelerated basis as the stock options are earned. The Company believes that the fair value of the stock options is more reliably measurable than the fair value of the services received. The fair value of the stock options granted is calculated at each reporting date, using the Black-Scholes option-pricing model, until the award vests or there is a substantial disincentive for the non-employee not to perform the required services. The fair value for the years ended December 31, 2006, 2005 and 2004, and for the three months ended March 31, 2007 (unaudited) was calculated using the following assumptions:

	Three Months Ended March 31, 2007	Years Ended December 31, 2006	2005	2004
Risk-free interest rates	4.65%–4.76%	4.48%–5.14%	4.14%–4.56%	4.22%–4.47%
Expected life	10 years	10 years	10 years	10 years
Expected dividends	0%	0%	0%	0%
Expected volatility	62.88%–63.25%	62.83%–66.57%	62.67%–69.60%	64.50%–73.75%

Stock-based compensation expense charged to operations on options granted to nonemployees for the years ended December 31, 2006, 2005 and 2004 was $90,840, $5,354 and $830, respectively, and $253,445 for the period from December 19, 2002 (inception) to March 31, 2007 (unaudited). Stock-based compensation expense charged to operations on options granted to non-employees for the three months ended March 31, 2007 and 2006 was $156,421 (unaudited) and $3,681 (unaudited), respectively.

Employee Stock-Based Awards Granted on or Subsequent to January 1, 2006

On January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123R, using the prospective transition method. Under this transition method, beginning January 1, 2006, compensation cost recognized includes: (a) compensation cost for all stock-based awards granted prior to, but not yet vested as of December 31, 2005, based on the intrinsic value method in accordance with the provisions of APB 25, and (b) compensation cost for all stock-based payments granted or modified subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R.

As a result of adopting SFAS 123R on January 1, 2006, the Company's net loss for the three months ended March 31, 2007 and for the year ended December 31, 2006 was $81,821 (unaudited) and $47,479, respectively, higher than if it had continued to account for employee stock-based compensation under APB 25.

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

Under SFAS 123R, compensation cost for employee stock-based awards is based on the estimated grant-date fair value and is recognized over the vesting period of the applicable award on a straight-line basis. For the period from January 1, 2006 to March 31, 2007, the Company issued employee stock-based awards in the form of stock options. The weighted average estimated fair value of the employee stock options granted for the three months ended March 31, 2007 (unaudited) and for the year ended December 31, 2006 was $0.344 and $0.075 per share, respectively.

The Company uses the Black-Scholes pricing model to determine the fair value of stock options. The determination of the fair value of stock-based payment awards on the date of grant is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rates and expected dividends. The estimated grant-date fair values of the employee stock options were calculated using the Black-Scholes valuation model, based on the following assumptions for the three months ended March 31, 2007 (unaudited) and for the year ended December 31, 2006:

	Three Months Ended March 31, 2007	Year Ended December 31, 2006
Risk-free interest rates	4.65%–4.76%	4.39%–5.04%
Expected life	6.25 years	5 years–6.25 years
Expected dividends	0%	0%
Expected volatility	58.63%	55.17%–62.86%

Expected Life. The expected life is based on the “simplified” method described in the SEC Staff Accounting Bulletin, Topic 14: *Share-Based Payment*.

Volatility. Since the Company is a private entity with no historical data regarding the volatility of its common stock, the expected volatility used for 2006 and 2007 is based on volatility of similar entities, referred to as “guideline” companies. In evaluating similarity, the Company considered factors such as industry, stage of life cycle and size.

Risk-Free Interest Rate. The risk-free rate is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options.

Dividend Yield. The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and, therefore, used an expected dividend yield of zero in the valuation model.

Forfeitures. SFAS No. 123R also requires the Company to estimate forfeitures at the time of grant, and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. If the Company’s actual forfeiture rate is materially different from its estimate, the stock-based compensation expense could be significantly different from what the Company has recorded in the current period.

As of March 31, 2007 (unaudited) and December 31, 2006, there was $1,770,657 and $358,474, respectively, of total unrecognized compensation costs related to non-vested stock option awards granted after

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

January 1, 2006, which are expected to be recognized over a weighted-average period of 3.76 years and 3.61 years, respectively.

The weighted-average grant-date fair value of stock options granted to employees for the three months ended March 31, 2007 (unaudited) and for the year ended December 31, 2006 was $0.34 and $0.08, respectively, per share. The aggregate intrinsic value of stock options (the amount by which the market price of the stock on the date of exercise exceeded the exercise price of the option) exercised during the three months ended March 31, 2007 (unaudited) and for the years ended December 31, 2006 and 2005, was $34,356, $13,198 and $0, respectively.

(14) Warrants

Stock warrant activity is as follows:

	Common Shares	Price(1)	Series A Preferred Shares	Price(1)	Series B Preferred Shares	Price(1)	Series C Preferred Shares	Price(1)
Balance as of:								
December 31, 2002 (unaudited)	—		—		—		—	
Granted	—		1,144,575	$ 0.10	214,000	$ 0.4333	—	
Exercised	—		—		—		—	
Cancelled	—		—		—		—	
December 31, 2003 (unaudited)	—		1,144,575	$ 0.10	214,000	$ 0.4333	—	
Granted	—		—		920,894	$ 0.4333	—	
Exercised	—		(1,144,575)	$ 0.16	—		—	
Cancelled	—		—		—		—	
December 31, 2004	—		—		1,134,894	$ 0.4333	—	
Granted	1,550,000	$ 0.05	—		634,664	$ 0.4333	—	
Exercised	—		—		—		—	
Cancelled	—		—		—		—	
December 31, 2005	1,550,000	$ 0.05	—		1,769,558	$ 0.4333	—	
Granted	—		—		317,332	$ 0.4333	1,343,472	$ 0.8893
Exercised	—		—		—		—	
Cancelled	—		—		—		—	
December 31, 2006	1,550,000	$ 0.05	—		2,086,890	$ 0.4333	1,343,472	$ 0.8893
Granted (unaudited)	—		—		—		—	
Exercised (unaudited)	—		—		—		—	
Cancelled (unaudited)	—		—		—		—	
March 31, 2007 (unaudited)	1,550,000	$ 0.05	—		2,086,890	$ 0.4333	1,343,472	$ 0.8893

(1) Represents weighted-average exercise price per share.

At March 31, 2007 and December 31, 2006, the weighted-average remaining contractual life of outstanding warrants was 4.98 (unaudited) and 5.22 years, respectively.

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

See Notes 6 and 8 for discussions relating to the Series B stock warrants issued during 2003, 2004, 2005 and 2006 and Note 9 for discussion related to the Series C stock warrants issued during 2006.

On November 13, 2003 the Company granted Venturi II, LLC (Venturi), sole Series A stockholder, 1,144,575 shares of Series A stock warrants with an initial exercise price of $0.10 and a term of 10 years. The warrants were granted as part of Venturi's dissolution plans and were granted with the understanding that they would be exercised as soon as practicable. As the warrants were granted as part of a dissolution plan, no charge related to the warrant grant was required in 2003.

The 1,144,575 warrants granted to Venturi were exercised on April 23, 2004 at a price of $0.163949 per share resulting in gross proceeds of $187,652. Once exercised, Venturi owned 950,000 shares of EnteroMedics common stock and 2,896,249 shares of EnteroMedics Series A convertible preferred stock. Venturi dissolved on April 22, 2004 and transferred its ownership in EnteroMedics common stock and Series A convertible preferred stock to Venturi investors who held Class A Units and Class B Units, respectively, on a pro rata basis.

(15) Related Party Transactions

The Company shares space with Restore Medical, Inc. (Restore), a related party who has directors and stockholders that are officers of the Company. The Company reimburses Restore for various facility expenses, including property taxes, common area maintenance charges, payroll for the use of personnel, and shipping charges. In 2006 and 2005, the Company also reimbursed Restore for rent expense related to the sublease agreement discussed in Note 16. Total expenses recorded were approximately $256,000, $75,000 and $55,000 for the years ended December 31, 2006, 2005 and 2004, respectively, and approximately $476,000 for the period from December 19, 2002 (inception) to March 31, 2007 (unaudited). Total expenses recorded for the three months ended March 31, 2007 and March 31, 2006 were approximately $76,000 (unaudited) and $65,000 (unaudited), respectively. The majority of expenses are included in general and administrative costs on the consolidated statements of operations. Included in accounts payable and accrued expenses is a total of $64,126 (unaudited), $66,076 and $12,603 due to Restore as of March 31, 2007 and December 31, 2006 and 2005, respectively.

The Company obtains consulting services from Venturi Development Inc. (VDI), whose stockholders and officers are investors in the Company. The consultants receive cash compensation for services provided. Total expenses recorded were approximately $29,000, $46,000 and $1,230,000 for the years ended December 31, 2006, 2005 and 2004, respectively, and approximately $2,650,000 for the period from December 19, 2002 (inception) to December 31, 2006. Total expenses recorded for the three months ended March 31, 2007 and March 31, 2006 were approximately $21,000 (unaudited) and $13,000 (unaudited), respectively. Expenses paid to VDI are primarily included in research and development and general and administrative expense on the consolidated statements of operations. On March 31, 2007 and December 31, 2006 and 2005, the Company had an outstanding payable balance to VDI of $0 (unaudited), $0 and $5,380, respectively.

(16) Commitments and Contingencies

In September 2005, the Company entered into a three-year noncancelable operating sublease agreement for office/warehouse space with Restore. The lease expires on September 30, 2008 with monthly base rent ranging from $7,518 to $7,676. Effective January 1, 2007, the sublease was amended to include additional square footage. Under the amended sublease agreement, the monthly base rent ranges from $11,476 to $11,596. Rent

EnteroMedics Inc.
(A development stage company)

Notes to Consolidated Financial Statements — (Continued)

expense recognized for the years ended December 31, 2006 and 2005 was $127,766 and $22,555, respectively. Rent expense recognized for the three months ended March 31, 2007 and 2006 was $30,064 (unaudited) and $22,555 (unaudited), respectively. The Company also reimburses Restore for various facility and personnel related expenses discussed in Note 15. Prior to entering into the sublease agreement with Restore, the Company assumed VDI's sublease agreement with Integ Inc. (Integ) and paid Integ directly for rent and other facility charges in the amount of $32,370 and $41,648 for the years ended December 31, 2005 and 2004, respectively, and $111,953 for the period from December 19, 2002 (inception) to December 31, 2005. Facility related expenses are included as general and administrative costs on the consolidated statements of operations.

The following is a schedule of total future minimum lease payments due as of March 31, 2007 (unaudited):

Periods ending December 31:	
2007	103,647
2008	104,364
	$ 208,011

The following is a schedule of total future minimum lease payments due as of December 31, 2006:

Years ending December 31:	
2007	138,076
2008	104,364
	$ 242,440

The Company is exposed to product liability claims that are inherent in the testing, production, marketing and sale of medical devices. Management believes any losses that may occur from these matters are adequately covered by insurance, and the ultimate outcome of these matters will not have a material effect on the Company's financial position or results of operations.

In 2005, EnteroMedics entered into an exclusive collaborative obesity device research and development agreement with the Mayo Foundation for Medical Education and Research (Mayo Foundation), Rochester, Minnesota. Through this agreement, EnteroMedics will collaborate with a group of physicians and researchers at Mayo Clinic in the field of obesity. Under the terms of this five-year agreement, EnteroMedics and this group of Mayo specialists will collectively work toward the development of new and innovative medical devices for the treatment of obesity. The agreement also includes a similar collaboration for the development of products to address a wide variety of disorders susceptible to treatment by electrically blocking neural impulses on the vagus nerve.

Under this agreement, the Company issued 2,000,000 shares of common stock to the Mayo Foundation in 2005 and recorded $100,000 as deferred compensation, which is being amortized over the term of the five-year agreement. Unamortized deferred compensation related to the agreement was $56,667 (unaudited), $61,667 and $81,667 at March 31, 2007 and December 31, 2006 and 2005, respectively. EnteroMedics may also be obligated to issue up to 1,875,000 shares of common stock as consideration if future Mayo patents are issued or if the FDA approves a product patented by the Mayo or jointly patented by the Mayo and EnteroMedics. Should the Company complete an initial public offering (IPO) prior to the achievement of the previously discussed milestones, the 1,875,000 shares of common stock become immediately issuable to the Mayo Foundation. Upon issuance of these shares related to an IPO, the Company will record a one-time stock-based compensation expense at the then current fair value.

The Company is also obligated to pay the Mayo Foundation either minimum or earned royalty payments contingent upon the occurrence of certain future events. The earned royalty payments, based on a percentage of sales related to the product under development and subject to a minimum amount as defined by the agreement, would commence upon the first commercial sale. The Mayo Foundation will also receive an annual $250,000 retainer fee through January 2009. The annual retainer fee paid to the Mayo Foundation is recorded on the statement of operations as research and development expense.

(17) Retirement Plan

The Company has a 401(k) profit-sharing plan that provides retirement benefits to employees. Eligible employees may contribute a percentage of their annual compensation, subject to Internal Revenue Service limitations. The Company's matching is at the discretion of the Company's board of directors. For the three months ended March 31, 2007 (unaudited) and the years ended December 31, 2006, 2005 and 2004 and for the period from December 19, 2002 (inception) to March 31, 2007 (unaudited), the Company did not provide any matching of employees' contributions.

(18) Subsequent Events

On April 27, 2007 the Company filed amended certificate of incorporation to increase the number of authorized shares of Series C stock to 55,000,000. As a result of the amendment, the Company had sufficient authorized and unissued Series C stock available to share settle the Series C warrants described in Note 9. The fair market value of the warrant on April 27, 2007 was determined to be $1,068,542. The change in fair value from March 31, 2007 to the amendment date of $339,701 will be recorded as interest expense and the convertible preferred stock liability will be reclassified to additional paid-in capital in the second quarter of 2007.

On May 17, 2007 the Company entered into a $15.0 million debt facility. The initial commitment under the debt facility is for $10.0 million and allows for two $5.0 million draw periods, the first of which was required upon closing and the second of which is available through August 31, 2007. Upon close of the initial commitment, the Company issued 618,462 Series C stock warrants with an exercise price of $0.8893 per share and an expiration date of August 31, 2014. The Company entered into a growth capital loan on May 22, 2007 with a face amount of $5.0 million payable in 29 equal principal and interest installments beginning December 1, 2007 through April 1, 2010 with a final payment of $343,050 on May 1, 2010 at an annual percentage rate of 10.25%. Interest only payments for the first six months of the loan are at an annual percentage rate of 12.48%. In conjunction with the funding of the growth capital loan, the Company issued detachable warrants to acquire 309,231 shares of Series C stock at an exercise price of $0.8893 per share and an expiration date of August 31, 2014.

The additional $5.0 million available to the Company under the terms of the debt facility is subject to the Company closing a next round of financing and would be available to be drawn on by the Company through 2008. The Company is not required to pay any additional equity consideration for this portion of the facility unless it is utilized.

[Table of Contents](#)

Through and including , 2007 (25 days after the date of this prospectus), all dealers that buy, sell or trade our common stock, whether or not participating in this offering, may be required to deliver a prospectus. This delivery requirement is in addition to the obligation of dealers to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

Shares

EnteroMedics
ORCHESTRATING OBESITY SOLUTIONS

Common Stock

PROSPECTUS

JPMorgan **Morgan Stanley**

Cowen and Company

Leerink Swann & Company

, 2007

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 13. *Other Expenses of Issuance and Distribution*

The following table sets forth the costs and expenses, other than the underwriting discounts and commission, payable by us in connection with the sale of common stock being registered. All amounts are estimated except the fees payable to the SEC and the National Association of Securities Dealers, Inc.

SEC registration fee	$ 2,648
National Association of Securities Dealers, Inc. fee	9,125
Nasdaq Global Market listing fee	100,000
Printing and mailing	*
Legal fees and expenses	*
Accounting fees and expenses	*
Transfer agent fees	*
Miscellaneous	*
	$ *

* To be completed by amendment.

ITEM 14. *Indemnification of Directors and Officers*

Article 6 of our amended and restated certificate of incorporation, to become effective upon the completion of the offering made pursuant to this registration statement, provides that no director of our company shall be personally liable to us or our stockholders for monetary damages for any breach of fiduciary duty as a director, notwithstanding any provision of law imposing such liability, except for liability (i) for any breach of the director's duty of loyalty to our company or its stockholders, (ii) for acts or omissions not in good faith or which involved intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law, or (iv) for any transaction from which the director derived an improper personal benefit.

Article 8 of our bylaws provides that we will indemnify each person who was or is otherwise involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he or she, or a person of whom he or she is the legal representative, is or was a director or officer of our company or is or was serving at the request of our company as a director, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise, whether the basis of such proceeding is alleged action in an official capacity as a director, officer, employee or agent or in any other capacity while serving as a director, officer, employee or agent (all such persons are referred to as an indemnitee), shall be indemnified and held harmless by our company, against all expenses, liability and loss (including attorneys' fees, judgments, fines, penalties and amounts paid or to be paid in settlement) reasonably incurred or suffered by such indemnitee in connection with such action, suit or proceeding and any appeal therefrom, if such indemnitee acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to, our best interests, and, with respect to any criminal action or proceeding, he or she had no reasonable cause to believe his or her conduct was unlawful. Our bylaws provide that we will indemnify any indemnitee seeking indemnity in connection with a proceeding (or part thereof) initiated by such person only if such proceeding (or part thereof) was authorized by our board of directors. We will indemnify the indemnitee for expenses incurred in defending any such proceeding in advance of its final disposition to the extent not prohibited by law. Such indemnification will only be made if the indemnitee acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to, our best interests, except that no indemnification shall be made with respect to any claim, issue or matter as to which such person shall have been adjudged to be liable to us, unless a court determines that, despite such adjudication but in view of all of the circumstances, he or she is entitled to indemnification of such expenses. Expenses must be advanced to an indemnitee under certain circumstances.

As a condition precedent to the right of indemnification, an indemnitee must give us notice of the action for which indemnity is sought and we have the right to participate in such action or assume the defense thereof.

Article 8 of our bylaws further provides that the indemnification provided therein is not exclusive, and provides that no amendment, termination or repeal of the relevant provisions of the Delaware law statute or any other applicable law will diminish the rights of any Indemnitee to indemnification under our certificate of incorporation.

Section 145 of the Delaware law statute provides that a corporation has the power to indemnify a director, officer, employee, or agent of the corporation and certain other persons serving at the request of the corporation in related capacities against expenses (including attorneys' fees), judgments, fines and amounts paid in settlements actually and reasonably incurred by the person in connection with an action, suit or proceeding to which he or she is or is threatened to be made a party by reason of such position, if such person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the corporation, and, in any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful, except that, in the case of actions brought by or in the right of the corporation, no indemnification shall be made with respect to any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or other adjudicating court determines that, despite the adjudication of liability but in view of all of the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses that the Court of Chancery or such other court shall deem proper.

We have obtained director and officer insurance providing for indemnification for our directors and officers for certain liabilities and expect that, prior to the consummation of this offering, such insurance will provide for indemnification of our directors and officers for liabilities under the Securities Act.

In the underwriting agreement we enter into in connection with the sale of common stock being registered hereby, the underwriters will agree to indemnify, under certain conditions, us, our directors, our officers and persons who control us within the meaning of the Securities Act against certain liabilities.

ITEM 15. ***Recent Sales of Unregistered Securities***

Set forth below is information regarding all unregistered securities sold by us within the past three years and does not give effect to the -for- reverse split of our common stock to be effected prior to the completion of this offering. Also included is the consideration, if any, received by us for such shares, warrants, promissory notes and options and information relating to the section of the Securities Act, or rules of the SEC, under which exemption from registration was claimed. Some of the transactions described below involved directors, officers and five percent stockholders.

Since January 1, 2004, we have granted options under our 2003 Stock Incentive Plan to purchase an aggregate of 20,638,450 shares of our common stock at a weighted average exercise price of $0.28 per share to our employees, officers, directors and advisors.

Since January 1, 2004, we have issued an aggregate of 1,275,650 shares of our common stock to our employees, officers, directors and advisors pursuant to the exercise of stock options for an aggregate consideration of $63,784.

On November 13, 2003, we entered into a bridge loan agreement with MPM Capital and certain individuals, which was later amended on April 23, 2004 and June 30, 2004. Pursuant to this bridge loan agreement, certain investors lent a total of $1,564,843 to the company in 2003 and 2004 in exchange for convertible promissory notes bearing interest of 4% per annum. In connection with the bridge loan agreement, we also issued warrants to purchase a total of 722,362 shares of Series B preferred stock.

In July 2004, we entered into an agreement with MPM Capital, Bay City Capital, Aberdare Ventures, Charter Life Sciences and certain individuals to sell, in a private placement, an aggregate of 39,002,196 shares of Series B preferred stock. Of these shares, 6,923,610 were sold in a closing in June 2005 and 10,962,383 were sold in a closing in December 2005. The total aggregate offering price for these sales was $16,899,654. In connection with the closing on December 2005, we issued warrants to purchase 1,550,000 shares of common stock to MPM Capital, Bay City Capital, Aberdare Ventures and certain individuals in exchange for an aggregate purchase price of $15,500. The warrants have an exercise price of $0.05 per share and terminate in five years.

In December 2004, we entered into a loan agreement with Venture Lending and Leasing IV, Inc., (VLL IV), an affiliate of Western Technology Investments, providing for equipment loans and growth capital loans up to an aggregate original principal amount of $250,000 and $3,000,000. In connection with the loan agreement, on December 1, 2004 we issued VLL IV a warrant to acquire 412,532 shares of Series B preferred stock at $0.4333 per share.

In September 2005, we amended the loan agreement with VLL IV to provide for additional commitments for equipment loans and growth capital loans up to an aggregate amount of $500,000 and $2,000,000. In connection with the commitment, on September 29, 2005 we issued VLL IV a warrant to purchase 317,332 shares of our Series B Preferred Stock.

In December 2005, we entered into a convertible note purchase agreement with MPM Capital, Bay City Capital, Aberdare Ventures, Charter Life Sciences and certain individuals, to sell, in a private placement, an aggregate of $5,250,003 of convertible promissory notes.

In July 2006, we entered into an agreement with Interwest Partners, Onset V, Mayo Foundation for Medical Education and Research, Pacific Asset Partners, MPM Capital, Bay City Capital, Aberdare Ventures, Charter Life Sciences and certain other individuals, to sell, in a private placement, an aggregate of 50,833,255 shares of our Series C preferred stock. In December 2006, we sold an additional 1,124,480 shares of Series C preferred stock to Bobby I. Griffin. The total aggregate offering price for these sales was $46,206,019. In July 2006 we issued a warrant to purchase 1,343,472 shares of Series C preferred stock to Piper Jaffray & Co., which acted as our private placement agent in connection with the Series C private placement.

In May 2007, we entered into a loan and security agreement with VLL IV and Venture Lending and Leasing V, Inc. (VLL V), affiliates of Western Technology Investments, to provide for a $10,000,000 growth line of credit with a commitment for an additional $5,000,000 under the growth line of credit if we close on at least $15,000,000 in equity financing. In connection with the commitment, on May 17, 2007 we issued warrants to VLL IV and VLL V to purchase an aggregate of 618,462 shares of Series C preferred stock. On May 22, 2007, we drew $5,000,000 on the growth line of credit and issued warrants to VLL IV and VLL V to purchase an aggregate of 309,231 shares of Series C preferred stock.

The issuance of stock options and the common stock issuable upon the exercise of stock options as described in this Item 15 were issued pursuant to written compensatory plans or arrangements with our employees, officers, directors and advisors, in reliance on the exemption provided by Rule 701 promulgated under Section 3(b) of the Securities Act. All recipients either received adequate information about us or had access, through employment or other relationships, to such information.

All other issuances described above were exempt from registration pursuant to Section 4(2) of the Securities Act. With respect to each transaction listed above, no general solicitation was made by either the company or any person acting on its behalf; the securities sold are subject to transfer restrictions, and the certificates for the shares contained an appropriate legend stating such securities have not been registered under the Securities Act and may not be offered or sold absent registration or pursuant to an exemption therefrom. No underwriters were involved in connection with the sales of securities referred to in this Item 15.

ITEM 16. *Exhibits*

(a) *Exhibits*

Exhibit Number	Description
1.1*	Form of Underwriting Agreement
3.1	Restated Certificate of Incorporation of the Registrant, as currently in effect
3.2*	Amended and Restated Certificate of Incorporation, to become effective upon completion of the offering
3.3	Bylaws of the Registrant, as currently in effect
3.4*	Amended and Restated Bylaws, to become effective upon completion of the offering
4.1*	Specimen certificate for shares of common stock
4.2	Amended and Restated Investors’ Rights Agreement, dated as of July 6, 2006, by and between the Registrant and the parties named therein.
5.1*	Opinion of Dorsey & Whitney LLP
10.1#	Licensing Agreement, by and between Mayo Foundation for Medical Education and Research and the Registrant, dated February 3, 2005.
10.2#	Supply Agreement, by and between Atrotech OY and the Registrant, dated September 11, 2006.
10.3	Loan and Security Agreement, dated December 1, 2004, between the Registrant and Venture Lending and Leasing IV, Inc.
10.4	Supplement to the Loan and Security Agreement, dated December 1, 2004, between the Registrant and Venture Lending and Leasing IV, Inc.
10.5	Amendment No. 1, dated as of September 29, 2005, to Supplement to the Loan and Security Agreement, dated December 1, 2004, between the Registrant and Venture Lending and Leasing IV, Inc.
10.6	Loan and Security Agreement, dated as of May 17, 2007, between the Registrant, Venture Lending and Leasing IV, Inc. and Venture Lending and Leasing V, Inc.
10.7	Supplement to the Loan and Security Agreement, dated as of May 17, 2007, between the Registrant, Venture Lending and Leasing IV, Inc. and Venture Lending and Leasing V, Inc.
10.8†	Executive Employment Agreement, dated June 22, 2005, by and between the Registrant and Mark B. Knudson.
10.9†	Executive Employment, dated May 21, 2007, by and between the Registrant and Greg Lea.
10.10†	Executive Employment Agreement, dated February 9, 2007, by and between the Registrant and Adrianus Donders.
10.11†	Executive Employment, dated May 16, 2007, by and between the Registrant and Russell Felkey.
10.12†	2003 Stock Incentive Plan
10.13†	Standard form of Incentive Stock Option Agreement pursuant to the 2003 Stock Incentive Plan
10.14†	Standard form of Non-Incentive Stock Option Agreement pursuant to the 2003 Stock Incentive Plan
10.15†	Standard form of Restricted Stock Agreement
10.16†*	Management Incentive Plan
10.17*	Form of Indemnification Agreement entered into by and between the Registrant and each of its executive officers and directors

Table of Contents

Exhibit Number	Description
14.1	Code of Conduct and Ethics, to become effective upon completion of the offering
23.1	Consent of Deloitte & Touche LLP, Independent Registered Public Accounting Firm
23.2*	Consent of Dorsey & Whitney (included in Exhibit 5.1)
24.1	Powers of Attorney

* To be filed by amendment.

† Management contract or compensatory plan or arrangement.

\# Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been filed separately with the Securities and Exchange Commission.

(b) *Financial Statements Schedules*.

None.

ITEM 17. ***Undertakings***

The undersigned registrant hereby undertakes to provide to the underwriter at the completion of the offering specified in the underwriting agreements, certificates in such denominations and registered in such names as required by the underwriter to permit prompt delivery to each purchaser.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act, and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by the controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

The undersigned registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of Prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4), or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) For the purpose of determining liability under the Securities Act of 1933 to any purchaser, if the registrant is subject to Rule 430C, each prospectus filed pursuant to Rule 424(b) as part of a registration statement relating to an offering, other than registration statements relying on Rule 430B or other than prospectuses filed in reliance on Rule 430A, shall be deemed to be part of and included in the registration statement as of the date it is first used after effectiveness. *Provided, however,* that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration

statement will, as to a purchaser with a time of contract of sale prior to such first use, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use.

(4) For the purpose of determining liability of the registrant under the Securities Act of 1933 to any purchaser in the initial distribution of the securities: The undersigned registrant undertakes that in a primary offering of securities of the undersigned registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:

(A) Any preliminary prospectus or prospectus of the undersigned registrant relating to the offering required to be filed pursuant to Rule 424;

(B) Any free writing prospectus relating to the offering prepared by or on behalf of the undersigned registrant or used or referred to by the undersigned registrant;

(C) The portion of any other free writing prospectus relating to the offering containing material information about the undersigned registrant or its securities provided by or on behalf of the undersigned registrant; and

(D) Any other communication that is an offer in the offering made by the undersigned registrant to the purchaser.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this Registration Statement on Form S-1 to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of St. Paul, State of Minnesota, on May 25, 2007.

ENTEROMEDICS INC.

By /s/ Mark B. Knudson, Ph.D.
Mark B. Knudson, Ph.D.
President and Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement on Form S-1 has been signed by the following persons in the capacities indicated on May 25, 2007.

Signature	Title
/s/ Mark B. Knudson, Ph.D. Mark B. Knudson, Ph.D.	President, Chief Executive Officer, Chairman and Director *(Principal Executive Officer)*
/s/ Greg S. Lea Greg S. Lea	Senior Vice President and Chief Financial Officer *(Principal Financial and Accounting Officer)*
/s/ Luke Evnin, Ph.D. Luke Evnin, Ph.D.	Director
/s/ Catherine Friedman Catherine Friedman	Director
/s/ Carl Goldfischer, M.D. Carl Goldfischer, M.D.	Director
/s/ Bobby I. Griffin Bobby I. Griffin	Director
/s/ Donald C. Harrison, M.D. Donald C. Harrison M.D.	Director
/s/ Paul H. Klingenstein Paul H. Klingenstein	Director
/s/ Ellen Koskinas Ellen Koskinas	Director
/s/ Nicholas L. Teti, Jr. Nicholas L. Teti, Jr.	Director

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description
1.1*	Form of Underwriting Agreement
3.1	Restated Certificate of Incorporation of the Registrant, as currently in effect
3.2*	Amended and Restated Certificate of Incorporation, to become effective upon completion of the offering
3.3	Bylaws of the Registrant, as currently in effect
3.4*	Amended and Restated Bylaws, to become effective upon completion of the offering
4.1*	Specimen certificate for shares of common stock
4.2	Amended and Restated Investors' Rights Agreement, dated as of July 6, 2006, by and between the Registrant and the parties named therein.
5.1*	Opinion of Dorsey & Whitney LLP
10.1#	Licensing Agreement, by and between Mayo Foundation for Medical Education and Research and the Registrant, dated February 3, 2005.
10.2#	Supply Agreement, by and between Atrotech OY and the Registrant, dated September 11, 2006.
10.3	Loan and Security Agreement, dated December 1, 2004, between the Registrant and Venture Lending and Leasing IV, Inc.
10.4	Supplement to the Loan and Security Agreement, dated December 1, 2004, between the Registrant and Venture Lending and Leasing IV, Inc.
10.5	Amendment No. 1, dated as of September 29, 2005, to Supplement to the Loan and Security Agreement, dated December 1, 2004, between the Registrant and Venture Lending and Leasing IV, Inc.
10.6	Loan and Security Agreement, dated as of May 17, 2007, between the Registrant, Venture Lending and Leasing IV, Inc. and Venture Lending and Leasing V, Inc.
10.7	Supplement to the Loan and Security Agreement, dated as of May 17, 2007, between the Registrant, Venture Lending and Leasing IV, Inc. and Venture Lending and Leasing V, Inc.
10.8†	Executive Employment Agreement, dated June 22, 2005, by and between the Registrant and Mark B. Knudson.
10.9†	Executive Employment, dated May 21, 2007, by and between the Registrant and Greg Lea.
10.10†	Executive Employment Agreement, dated February 9, 2007, by and between the Registrant and Adrianus Donders.
10.11†	Executive Employment, dated May 16, 2007, by and between the Registrant and Russell Felkey.
10.12†	2003 Stock Incentive Plan
10.13†	Standard form of Incentive Stock Option Agreement pursuant to the 2003 Stock Incentive Plan
10.14†	Standard form of Non-Incentive Stock Option Agreement pursuant to the 2003 Stock Incentive Plan
10.15†	Standard form of Restricted Stock Agreement
10.16†*	Management Incentive Plan
10.17*	Form of Indemnification Agreement entered into by and between the Registrant and each of its executive officers and directors

[Table of Contents](#)

Exhibit Number	Description
14.1	Code of Conduct and Ethics, to become effective upon completion of the offering
23.1	Consent of Deloitte & Touche LLP, Independent Registered Public Accounting Firm
23.2*	Consent of Dorsey & Whitney (included in Exhibit 5.1)
24.1	Power of Attorney

* To be filed by amendment.

† Management contract or compensatory plan or arrangement.

\# Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been filed separately with the Securities and Exchange Commission.

RESTATED
CERTIFICATE OF INCORPORATION
OF
ENTEROMEDICS INC.

Pursuant to Section 245
of the General Corporation Law
of the State of Delaware

EnteroMedics Inc., a corporation organized and existing under the General Corporation Law of the State of Delaware (as amended from time to time, the "Delaware General Corporation Law"), does hereby certify as follows:

FIRST: The name of the corporation is EnteroMedics Inc. and the name under which the corporation was originally incorporated is EnteroMedics Inc.

SECOND: The date of filing the original Certificate of Incorporation of this corporation with the Secretary of State of the State of Delaware was July 22, 2004.

THIRD: This Restated Certificate of Incorporation, having been duly adopted in accordance with Section 245 of the Delaware General Corporation Law, restates and integrates and does not further amend the provisions of the Second Amended and Restated Certificate of Incorporation of this corporation as heretofore amended or supplemented and there is no discrepancy between those provisions and the provisions of this Restated Certificate of Incorporation. As so restated and integrated without further amendments or changes, the Restated Certificate of Incorporation of the corporation (the "Certificate of Incorporation") reads as follows:

ARTICLE I

The name of the corporation is "EnteroMedics Inc."

ARTICLE II

The address of the registered office of the corporation is The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, DE 19801, County of New Castle, and the name of its registered agent at that address is The Corporation Trust Company.

ARTICLE III

The purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the Delaware General Corporation Law.

ARTICLE IV

A. Authorization of Stock. The aggregate number of authorized shares of the corporation is 230,985,337 shares. The total number of shares of common stock authorized to be issued is 132,000,000, par value $.01 per share (the "Common Stock"). The total number of shares of preferred stock authorized to be issued is 98,985,337 par value $.01 per share (the "Preferred Stock"), of which 2,896,249 shares are designated as "Series A Preferred Stock", 41,089,088 shares are designated as "Series B Preferred Stock" and 55,000,000 shares are designated as "Series C Preferred Stock". The number of authorized shares of Common Stock may be increased or decreased (but not below the number of shares of Common Stock then outstanding) by the affirmative vote of the holders of a majority of the stock of the Company entitled to vote (voting together as a single class on an as-if-converted basis).

B. Rights, Preferences and Restrictions of Preferred Stock. The rights, preferences, privileges and restrictions granted to and imposed on the Preferred Stock are as set forth below in this Article IV(B).

1. Dividend Provisions.

(a) The holders of shares of Series C Preferred Stock shall be entitled to receive dividends, out of any assets legally available therefor, on a *pari passu* basis with the holders of Series B Preferred Stock and prior and in preference to any declaration or payment of any dividend (payable other than in Common Stock or other securities and rights convertible into or entitling the holder thereof to receive, directly or indirectly, additional shares of Common Stock of this corporation) on the Series A Preferred Stock or Common Stock of this corporation, at the Series C Dividend Rate (as defined below), payable when, as and if declared by the Board of Directors. Such dividends shall not be cumulative. The holders of the outstanding Series C Preferred Stock can waive any dividend preference that such holders shall be entitled to receive under this Section 1 upon the affirmative vote or written consent of the holders of at least sixty-six and two thirds percent (66 2/3%) of the shares of Series C Preferred Stock then outstanding, voting as a separate series. For purposes of this subsection 1(a), "Series C Dividend Rate" shall mean $0.0711 per annum for each share of Series C Preferred Stock (as adjusted for any stock splits, stock dividends, combinations, subdivisions, recapitalizations or the like).

(b) The holders of shares of Series B Preferred Stock shall be entitled to receive dividends, out of any assets legally available therefor, on a *pari passu* basis with the holders of Series C Preferred Stock and prior and in preference to any declaration or payment of any dividend (payable other than in Common Stock or other securities and rights convertible into or entitling the holder thereof to receive, directly or indirectly, additional shares of Common Stock of this corporation) on the Series A Preferred Stock or Common Stock of this corporation, at the Series B Dividend Rate (as defined below), payable when, as and if declared by the Board of Directors. Such dividends shall not be cumulative. The holders of the outstanding Series B Preferred Stock can waive any dividend preference that such holders shall be entitled to receive under this Section 1 upon the affirmative vote or written consent of the holders of at least a majority of the shares of Series B Preferred Stock then outstanding, voting as a separate series. For purposes of this subsection 1(b), "Series B Dividend Rate" shall mean $0.0347 per annum for each share of Series B Preferred Stock (as adjusted for any stock splits, stock dividends, combinations, subdivisions, recapitalizations or the like).

(c) After payment of the dividends provided for in subsections 1(a) and 1(b) above, the holders of shares of Series A Preferred Stock shall be entitled to receive dividends, out of any assets legally available therefor, prior and in preference to any declaration or payment of any dividend (payable other than in Common Stock or other securities and rights convertible into or entitling the holder thereof to receive, directly or indirectly, additional shares of Common Stock of this corporation) on the Common Stock of this corporation, at the Series A Dividend Rate (as defined below), payable when, as and if declared by the Board of Directors. Such dividends shall not be cumulative. The holders of the outstanding Series A Preferred Stock can waive any dividend preference that such holders shall be entitled to receive under this Section 1(b) upon the affirmative vote or written consent of the holders of at least a majority of the shares of Series A Preferred Stock then outstanding. For purposes of this subsection 1(c), "Series A Dividend Rate" shall mean $0.0577 per annum for each share of Series A Preferred Stock (as adjusted for any stock splits, stock dividends, combinations, subdivisions, recapitalizations or the like).

(d) In the event dividends are paid on any share of Common Stock after payment of the dividends provided for in subsections 1(a), 1(b) and 1(c) above, an additional dividend shall be paid on the Preferred Stock out of funds legally available for the declaration of dividends, when, as and if declared by the Board of Directors. Such dividends shall be distributed among all holders of Common Stock and Preferred Stock in proportion to the number of shares of Common Stock that would be held by each such holder if all shares of Preferred Stock were converted to Common Stock at then effective conversion rate for each series of Preferred Stock.

2. <u>Liquidation Preference</u>.

(a)

(i) In the event of any Liquidation Event (as defined below), either voluntary or involuntary, the holders of Series C Preferred Stock (on a *pari passu* basis with holders of Series B Preferred Stock) shall be entitled to receive, prior and in preference to any distribution of the proceeds of such Liquidation Event (the "Proceeds") to the holders of Series A Preferred Stock or Common Stock by reason of their ownership thereof, an amount per share equal to the Series C Original Issue Price (as defined below), plus declared but unpaid dividends on such share. The "Series C Original Issue Price" shall mean $0.8893 per share (as adjusted for any stock splits, stock dividends, combinations, subdivisions, recapitalizations or the like with respect to such series of Preferred Stock).

(ii) In the event of any Liquidation Event, either voluntary or involuntary, the holders of Series B Preferred Stock (on a *pari passu* basis with holders of Series C Preferred Stock) shall be entitled to receive, prior and in preference to any distribution of the Proceeds to the holders of Series A Preferred Stock or Common Stock by reason of their ownership thereof, an amount per share equal to the Series B Original Issue Price (as defined below), plus declared but unpaid dividends on such share. The "Series B Original Issue Price" shall mean $0.4333 per share (as adjusted for any stock splits, stock dividends, combinations, subdivisions, recapitalizations or the like with respect to such series of Preferred Stock).

(iii) If, upon the occurrence of a Liquidation Event, the Proceeds distributed among the holders of the Series C Preferred Stock and Series B Preferred Stock shall be insufficient to permit the payment to the holders of Series C Preferred Stock and Series B Preferred Stock of the full preferential amounts in subsections (i) and (ii) of Section 2(a), then the entire Proceeds legally available for distribution shall be distributed ratably among the holders of the Series C and Series B Preferred Stock in proportion to the full preferential amount that each such holder is otherwise entitled to receive under Sections 2(a)(i) and (ii).

(b) Upon the completion of the distribution required by subsection (a) of this Section 2, the holders of Series A Preferred Stock shall be entitled to receive, prior and in preference to any distribution of any of the assets of this corporation to the holders of Common Stock by reason of their ownership thereof, an amount per share equal to $0.7208 per share plus declared but unpaid dividends on such share. If upon the occurrence of such event, the assets and funds thus distributed among the holders of the Series A Preferred Stock shall be insufficient to permit the payment to such holders of the full aforesaid preferential amounts, then the entire Proceeds legally available for distribution after payment of any amounts under Section 2(a) above shall be distributed ratably among the holders of Series A Preferred Stock in proportion to the full preferential amount each such holder is otherwise entitled to receive under this subsection 2(b).

(c) Upon the completion of the distributions required by subsections (a) and (b) of this Section 2, the remaining Proceeds available for distribution to stockholders shall be distributed among the holders of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and Common Stock pro rata based on the number of shares of Common Stock held by each (assuming full conversion of all such Preferred Stock at the then applicable conversion rate).

(d)

(i) For purposes of this Section 2, a “Liquidation Event” shall include (A) the closing of the sale, lease, exchange, exclusive licensing or other disposition of all or substantially all of this corporation’s assets or intellectual property (whether in one transaction or a series of related transactions), (B) the consummation of the merger, business combination, reorganization or consolidation of this corporation with or into another entity (except a merger or consolidation in which the holders of capital stock of this corporation immediately prior to such merger or consolidation continue to hold at least 50% of the voting power of the capital stock of this corporation or the surviving or acquiring entity in substantially the same proportions, (C) the closing of the transfer (whether by merger, consolidation or otherwise), in one transaction or a series of related transactions, to a person or group of affiliated persons (other than an underwriter of this corporation’s securities), of this corporation’s securities if, after such closing, such person or group of affiliated persons would hold 50% or more of the outstanding voting stock of this corporation (or the surviving or acquiring entity) or (D) a liquidation, dissolution or winding up of this corporation; provided, however, that a transaction shall not constitute a Liquidation Event if its sole purpose is to change the state of this corporation’s incorporation or to create a holding company that will have substantially similar series and classes of shares with the same terms as existed immediately prior to such transaction and be owned in substantially the same proportions by the persons who held this corporation’s securities immediately prior to such transaction. Notwithstanding the prior sentence, the sale of shares of Series C Preferred Stock in a bona fide financing transaction in which cash is received by this corporation or any successor or indebtedness of this corporation is cancelled or converted or a consolidation thereof shall not be deemed a "Liquidation Event."

(ii) In any Liquidation Event, if Proceeds received by this corporation or its stockholders are other than cash, its value will be deemed its fair market value. Any securities shall be valued as follows:

(A) Securities not subject to investment letter or other similar restrictions on free marketability covered by (B) below:

(1) If traded on a securities exchange or through the Nasdaq National Market, the value shall be deemed to be the average of the closing prices of the securities on such exchange or system over the twenty (20) trading-day period ending three (3) trading days prior to the closing of the Liquidation Event;

(2) If actively traded over-the-counter, the value shall be deemed to be the average of the closing bid or sale prices (whichever is applicable) over the twenty (20) trading-day period ending three (3) trading days prior to the closing of the Liquidation Event; and

(3) If there is no active public market, the value shall be the fair market value thereof, as mutually determined by this corporation and the holders of at least sixty-three percent (63%) of the then outstanding shares of Series C Preferred Stock and Series B Preferred Stock (voting together as a single class and not as separate series, and on an as-converted basis).

(B) The method of valuation of securities subject to investment letter or other restrictions on free marketability (other than restrictions arising solely by virtue of a stockholder's status as an affiliate or former affiliate) shall be to make an appropriate discount from the market value determined as above in (A) (1), (2) or (3) to reflect the approximate fair market value thereof, as mutually determined by this corporation and the holders of at least sixty-three percent (63%) of the then outstanding shares of Series C Preferred Stock and Series B Preferred Stock (voting together as a single class and not as separate series, and on an as-converted basis).

(C) The foregoing methods for valuing non-cash consideration to be distributed in connection with a Liquidation Event may be superseded by any determination of such value set forth in the definitive agreements governing such Liquidation Event (to which the holders of at least sixty-three percent (63%) of the then outstanding shares of Series C Preferred Stock and Series B Preferred Stock (together as a single class and not as separate series, and on an as-converted basis) must be parties).

(iii) In the event the requirements of this Section 2 are not complied with, this corporation shall forthwith either:

(A) cause the closing of such Liquidation Event to be postponed until such time as the requirements of this Section 2 have been complied with; or

(B) cancel such transaction, in which event the rights, preferences and privileges of the holders of the Preferred Stock shall revert to and be the same as such rights, preferences and privileges existing immediately prior to the date of the first notice referred to in subsection 2(e)(iv) hereof.

(iv) This corporation shall give each holder of record of Preferred Stock written notice of such impending Liquidation Event not later than twenty (20) days prior to the shareholders' meeting called to approve such transaction, or twenty (20) days prior to the closing of such transaction, whichever is earlier, and shall also notify such holders in writing of the final approval of such transaction. The first of such notices shall describe the material terms and conditions of the impending transaction and the provisions of this Section 2, and this corporation shall thereafter give such holders prompt notice of any material changes. The transaction shall in no event take place sooner than twenty (20) days after this corporation has given the first notice provided for herein or sooner than ten (10) days after this corporation has given notice of any material changes provided for herein; provided, however, that subject to compliance with the Delaware General Corporation Law, such periods may be shortened or waived upon the vote or written consent of the holders of at least sixty-three percent (63%) of the then outstanding shares of Series C Preferred Stock and Series B Preferred Stock (voting together as a single class and not as separate series, and on an as-converted basis).

3. Redemption. The Preferred Stock is not redeemable at the option of the holder thereof.

4. Conversion. The holders of the Preferred Stock shall have conversion rights as follows (the "Conversion Rights"):

(a) Right to Convert. Each share of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, shall be convertible, at the option of the holder thereof, at any time after the date of issuance of such share, at the office of this corporation or any transfer agent for such stock, into such number of fully paid and nonassessable shares of Common Stock as is determined by dividing the Series A Price (as defined below), the Series B Original Issue Price and the Series C Original Issue Price (plus all declared but unpaid dividends on each such share), as the case may be, by the applicable Conversion Price for such series (the conversion rate for a series of Preferred Stock into Common Stock is referred to herein as the "Conversion Rate" for such series), determined as hereafter provided, in effect on the date the certificate is surrendered for conversion. The Conversion Price per share for the Series A Preferred Stock shall be $0.4657, the Conversion Price per share for the Series B Preferred Stock shall be $0.4333 and the initial Conversion Price per share for the Series C Preferred Stock shall be $0.8893; provided, however, that the Conversion Price for the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock shall be subject to adjustment as set forth in subsection 4(d). For purposes of this subsection (a), the "Series A Price" shall be $0.7208.

(b) Automatic Conversion. Each share of Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock shall automatically be converted into shares of Common Stock at the Conversion Rate at the time in effect for such series of Preferred Stock immediately upon the earlier of (i) this corporation's sale of its Common Stock in a firm commitment underwritten public offering pursuant to a registration statement on Form S-1 or

Form SB-2 under the Securities Act of 1933, as amended, the public offering price of which was not less than $2.64 per share (as adjusted for any stock splits, stock dividends, combinations, subdivisions, recapitalizations or the like) which results in gross proceeds to the corporation of at least $30,000,000 in the aggregate after deducting underwriting commissions and discounts (a “Qualified Public Offering”) or (ii) the date specified by written consent or agreement of the holders of at least sixty-three percent (63%) of the then outstanding shares of Series C Preferred Stock and Series B Preferred Stock (voting together as a single class and not as separate series, and on an as-converted basis).

(c) Mechanics of Conversion. Before any holder of Preferred Stock shall be entitled to voluntarily convert the same into shares of Common Stock, he or she shall surrender the certificate or certificates therefor, duly endorsed, at the office of this corporation or of any transfer agent for the Preferred Stock, and shall give written notice to this corporation at its principal corporate office, of the election to convert the same and shall state therein the name or names in which the certificate or certificates for shares of Common Stock are to be issued. This corporation shall, as soon as practicable thereafter, issue and deliver at such office to such holder of Preferred Stock, or to the nominee or nominees of such holder, a certificate or certificates for the number of shares of Common Stock to which such holder shall be entitled as aforesaid. Such conversion shall be deemed to have been made immediately prior to the close of business on the date of such surrender of the shares of Preferred Stock to be converted, and the person or persons entitled to receive the shares of Common Stock issuable upon such conversion shall be treated for all purposes as the record holder or holders of such shares of Common Stock as of such date. If the conversion is in connection with an underwritten offering of securities registered pursuant to the Securities Act of 1933, as amended, the conversion may, at the option of any holder tendering Preferred Stock for conversion, be conditioned upon the closing with the underwriters of the sale of securities pursuant to such offering, in which event the persons entitled to receive the Common Stock upon conversion of the Preferred Stock shall not be deemed to have converted such Preferred Stock until immediately prior to the closing of such sale of securities. If the conversion is in connection with the automatic conversion provisions of subsection 4(b)(ii) above, such conversion shall be deemed to have been made on the conversion date described in the stockholder consent approving such conversion, and the persons entitled to receive shares of Common Stock issuable upon such conversion shall be treated for all purposes as the record holders of such shares of Common Stock as of such date.

(d) Conversion Price Adjustments of Preferred Stock for Certain Dilutive Issuances, Splits and Combinations. The Conversion Price of the Preferred Stock shall be subject to adjustment from time to time as follows:

(i)

(A) If this corporation shall issue, on or after the date upon which this Certificate is accepted for filing by the Secretary of State of the State of Delaware (the “Filing Date”), any Additional Stock (as defined below) without consideration or for a consideration per share less than the Conversion Price applicable to a series of Preferred Stock in effect immediately prior to the issuance of such Additional Stock (a “Qualifying Dilutive Issuance”), the Conversion Price for such series in effect immediately prior to each such issuance shall forthwith (except as otherwise provided in this clause (i)) be adjusted to a price determined by multiplying such Conversion Price by a fraction, the numerator of which shall be the number of shares of Common Stock Outstanding (as defined below) immediately prior to such issuance plus the number of shares of Common Stock that the aggregate consideration received by this corporation for such issuance would purchase at such Conversion Price; and the denominator of which shall be the number of shares of Common Stock Outstanding (as defined below) immediately prior to such issuance plus the number of shares of such Additional Stock. For purposes of this Section 4(d)(i)(A), the term "Common Stock Outstanding" shall mean and include the following: (1) outstanding Common Stock and (2) Common Stock issuable upon conversion of outstanding Preferred Stock. Shares described in (1) and (2) above shall be included whether vested or unvested, whether contingent or non-contingent and whether exercisable or not yet exercisable.

(B) No adjustment of the Conversion Price for the Preferred Stock shall be made in an amount less than one cent per share, provided that any adjustments that are not required to be made by reason of this sentence shall be carried forward and shall be (1) taken into account in any subsequent adjustment made prior to three (3) years from the date of the event giving rise to the adjustment being carried forward, (2) taken into account immediately prior to the conversion of any shares of Preferred Stock into Common Stock or (3) shall be made at the end of three (3) years from the date of the event giving rise to the adjustment being carried forward, whichever occurs earliest. Except to the limited extent provided for in subsections (E)(3) and (E)(4), no adjustment of such Conversion Price pursuant to this subsection 4(d)(i) shall have the effect of increasing the Conversion Price above the Conversion Price in effect immediately prior to such adjustment.

(C) In the case of the issuance of Additional Stock for cash, the consideration shall be deemed to be the amount of cash paid therefor before deducting any reasonable discounts, commissions or other expenses allowed, paid or incurred by this corporation for any underwriting or otherwise in connection with the issuance and sale thereof.

(D) In the case of the issuance of the Additional Stock for a consideration in whole or in part other than cash, the consideration other than cash shall be deemed to be the fair market value thereof as determined by the Board of Directors irrespective of any accounting treatment.

(E) In the case of the issuance of options to purchase or rights to subscribe for Common Stock, securities by their terms convertible into or exchangeable for Common Stock or options to purchase or rights to subscribe for such convertible or exchangeable securities, the following provisions shall apply for purposes of determining the number of shares of Additional Stock issued and the consideration paid therefor:

(1) The aggregate maximum number of shares of Common Stock deliverable upon exercise (assuming the satisfaction of any conditions to exercisability, including without limitation, the passage of time, but without taking into account potential antidilution adjustments) of such options to purchase or rights to subscribe for Common Stock shall be deemed to have been issued at the time such options or rights were issued and for a consideration equal to the consideration (determined in the manner provided in subsections 4(d)(i)(C) and (d)(i)(D)), if any, received by this corporation upon the issuance of such options

or rights plus the minimum exercise price provided in such options or rights (without taking into account potential antidilution adjustments) for the Common Stock covered thereby.

(2) The aggregate maximum number of shares of Common Stock deliverable upon conversion of, or in exchange (assuming the satisfaction of any conditions to convertibility or exchangeability, including, without limitation, the passage of time, but without taking into account potential antidilution adjustments) for, any such convertible or exchangeable securities or upon the exercise of options to purchase or rights to subscribe for such convertible or exchangeable securities and subsequent conversion or exchange thereof shall be deemed to have been issued at the time such securities were issued or such options or rights were issued and for a consideration equal to the consideration, if any, received by this corporation for any such securities and related options or rights (excluding any cash received on account of accrued interest or accrued dividends), plus the minimum additional consideration, if any, to be received by this corporation (without taking into account potential antidilution adjustments) upon the conversion or exchange of such securities or the exercise of any related options or rights (the consideration in each case to be determined in the manner provided in subsections 4(d)(i)(C) and (d)(i)(D)).

(3) In the event of any change in the number of shares of Common Stock deliverable or in the consideration payable to this corporation upon exercise of such options or rights or upon conversion of or in exchange for such convertible or exchangeable securities, the Conversion Price of the Preferred Stock, to the extent in any way affected by or computed using such options, rights or securities, shall be recomputed to reflect such change, but no further adjustment shall be made for the actual issuance of Common Stock or any payment of such consideration upon the exercise of any such options or rights or the conversion or exchange of such securities.

(4) Upon the expiration of any such options or rights, the termination of any such rights to convert or exchange or the expiration of any options or rights related to such convertible or exchangeable securities, the Conversion Price of the Preferred Stock, to the extent in any way affected by or computed using such options, rights or securities or options or rights related to such securities, shall be recomputed to reflect the issuance of only the number of shares of Common Stock (and convertible or exchangeable securities that remain in effect) actually issued upon the exercise of such options or rights, upon the conversion or exchange of such securities or upon the exercise of the options or rights related to such securities.

(5) The number of shares of Additional Stock deemed issued and the consideration deemed paid therefor pursuant to subsections 4(d)(i)(E)(1) and (2) shall be appropriately adjusted to reflect any change, termination or expiration of the type described in either subsection 4(d)(i)(E)(3) or (4).

(ii) "Additional Stock" shall mean any shares of Common Stock issued (or deemed to have been issued pursuant to subsection 4(d)(i)(E)) by this corporation on or after the Filing Date other than:

(A) Common Stock issued pursuant to a transaction described in subsection 4(d)(iv) hereof;

(B) Common Stock issued to employees, directors, consultants and other service providers for the primary purpose of soliciting or retaining their services pursuant to this corporation's 2003 Stock Incentive Plan, as amended from time to time;

(C) Common Stock issued pursuant to a Qualified Public Offering;

(D) Common Stock issued pursuant to the conversion or exercise of convertible or exercisable securities outstanding on the Filing Date;

(E) Common Stock issued in connection with a bona fide business acquisition by this corporation, whether by merger, consolidation, sale of assets, sale or exchange of stock or otherwise;

(F) Common Stock issued or deemed issued pursuant to subsection 4(d)(i)(E) as a result of a decrease in the Conversion Price of any series of Preferred Stock resulting from the operation of Section 4(d); or

(G) Common Stock issued to persons or entities with which this corporation has business relationships, provided such issuance is primarily for other than equity financing purposes and which issuance has been approved by a majority of the Board of Directors of this corporation.

(iii) In the event that this corporation issues or sells, or is deemed to have issued or sold, Additional Stock in a Qualifying Dilutive Issuance (the "First Dilutive Issuance"), then in the event that the corporation issues or sells, or is deemed to have issued or sold, Additional Stock in a Qualifying Dilutive Issuance other than the First Dilutive Issuance pursuant to the same instruments as the First Dilutive Issuance (a "Subsequent Dilutive Issuance"), then and in each such case upon a Subsequent Dilutive Issuance the Conversion Price in effect for such series of Preferred Stock shall be reduced to the Conversion Price that would have been in effect had the First Dilutive Issuance and each Subsequent Dilutive Issuance all occurred on the closing date of the First Dilutive Issuance.

(iv) In the event this corporation should at any time or from time to time after the Filing Date fix a record date for the effectuation of a split or subdivision of the outstanding shares of Common Stock or the determination of holders of Common Stock entitled to receive a dividend or other distribution payable in additional shares of Common Stock or other securities or rights convertible into, or entitling the holder thereof to receive directly or indirectly, additional shares of Common Stock (hereinafter referred to as "Common Stock Equivalents") without payment of any consideration by such holder for the additional shares of Common Stock or the Common Stock Equivalents (including the additional shares of Common Stock issuable upon conversion or exercise thereof), then, as of such record date (or the date of such dividend distribution, split or subdivision if no record date is fixed), the Conversion Price of the Preferred Stock shall be appropriately decreased so that the number of shares of Common Stock issuable on conversion of each share of such series shall be increased in proportion to such increase of the aggregate of shares of Common Stock outstanding and those issuable with respect to such Common Stock Equivalents.

(v) If the number of shares of Common Stock outstanding at any time after the Filing Date is decreased by a combination of the outstanding shares of Common Stock, then, following the record date of such combination, the Conversion Price for the Preferred Stock shall be appropriately increased so that the number of shares of Common Stock issuable on conversion of each share of such series shall be decreased in proportion to such decrease in outstanding shares.

(e) Other Distributions. In the event this corporation shall declare a distribution payable in securities of other persons, evidences of indebtedness issued by this corporation or other persons, assets (excluding cash dividends) or options or rights not referred to in subsection 4(d)(iv), then, in each such case for the purpose of this subsection 4(e), the holders of the Preferred Stock shall be entitled to a proportionate share of any such distribution as though they were the holders of the number of shares of Common Stock of this corporation into which their shares of Preferred Stock are convertible as of the record date fixed for the determination of the holders of Common Stock of this corporation entitled to receive such distribution.

(f) Recapitalizations. If at any time or from time to time there shall be a recapitalization of the Common Stock (other than a subdivision, combination or merger or sale of assets transaction provided for elsewhere in this Section 4 or in Section 2) provision shall be made so that the holders of the Preferred Stock shall thereafter be entitled to receive upon conversion of the Preferred Stock the number of shares of stock or other securities or property of this corporation or otherwise, to which a holder of Common Stock deliverable upon conversion would have been entitled on such recapitalization. In any such case, appropriate adjustment shall be made in the application of the provisions of this Section 4 with respect to the rights of the holders of the Preferred Stock after the recapitalization to the end that the provisions of this Section 4 (including adjustment of the Conversion Price then in effect and the number of shares purchasable upon conversion of the Preferred Stock) shall be applicable after that event as nearly equivalently as may be practicable.

(g) No Impairment. This corporation will not, without the appropriate vote of the stockholders under the Delaware General Corporation Law or Section 6 of this Article IV(B), by amendment of its Certificate of Incorporation or through any reorganization, recapitalization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by this corporation, but will at all times in good faith assist in the carrying out of all the provisions of this Section 4 and in the taking of all such action as may be necessary or appropriate in order to protect the Conversion Rights of the holders of the Preferred Stock against impairment.

(h) No Fractional Shares and Certificate as to Adjustments.

(i) No fractional shares shall be issued upon the conversion of any share or shares of the Preferred Stock and the aggregate number of shares of Common Stock to be issued to particular stockholders, shall be rounded down to the nearest whole share and the corporation shall pay in cash the fair market value of any fractional shares as of the time when entitlement to receive such fractions is determined. Whether or not fractional shares would be issuable upon such conversion shall be determined on the basis of the total number of shares of Preferred Stock the holder is at the time converting into Common Stock and the number of shares of Common Stock issuable upon such conversion.

(ii) Upon the occurrence of each adjustment or readjustment of the Conversion Price of Preferred Stock pursuant to this Section 4, this corporation, at its expense, shall promptly compute such adjustment or readjustment in accordance with the terms hereof and prepare and furnish to each holder of Preferred Stock a certificate setting forth such adjustment or readjustment and showing in detail the facts upon which such adjustment or readjustment is based. This corporation shall, upon the written request at any time of any holder of Preferred Stock, furnish or cause to be furnished to such holder a like certificate setting forth (A) such adjustment and readjustment, (B) the Conversion Price for such series of Preferred Stock at the time in effect, and (C) the number of shares of Common Stock and the amount, if any, of other property that at the time would be received upon the conversion of a share of Preferred Stock.

(i) Notices of Record Date. In the event of any taking by this corporation of a record of the holders of any class of securities for the purpose of determining the holders thereof who are entitled to receive any dividend (other than a cash dividend) or other distribution, this corporation shall mail to each holder of Preferred Stock, at least ten (10) days prior to the date specified therein, a notice specifying the date on which any such record is to be taken for the purpose of such dividend or distribution, and the amount and character of such dividend or distribution.

(j) Reservation of Stock Issuable Upon Conversion. This corporation shall at all times reserve and keep available out of its authorized but unissued shares of Common Stock, solely for the purpose of effecting the conversion of the shares of the Preferred Stock, such number of its shares of Common Stock as shall from time to time be sufficient to effect the conversion of all outstanding shares of the Preferred Stock; and if at any time the number of authorized but unissued shares of Common Stock shall not be sufficient to effect the conversion of all then outstanding shares of the Preferred Stock, in addition to such other remedies as shall be available to the holder of such Preferred Stock, this corporation will take such corporate action as may, in the opinion of its counsel, be necessary to increase its authorized but unissued shares of Common Stock to such number of shares as shall be sufficient for such purposes, including, without limitation, engaging in best efforts to obtain the requisite stockholder approval of any necessary amendment to this Certificate.

(k) Notices. Any notice required by the provisions of this Section 4 to be given to the holders of shares of Preferred Stock shall be deemed given if deposited in the United States mail, postage prepaid, and addressed to each holder of record at his address appearing on the books of this corporation.

(l) Waiver of Adjustment to Conversion Price. Notwithstanding anything herein to the contrary, any downward adjustment of the Conversion Price of the Series C Preferred Stock may be waived, either prospectively or retroactively and either generally or in a particular instance, by the consent or vote of the holders of at least sixty-six and two-thirds percent (66 2/3%) of the outstanding shares of Series C Preferred Stock. Notwithstanding anything herein to the contrary, any downward adjustment of the Conversion Price of the Series B Preferred Stock may be waived, either prospectively or retroactively and either generally or in a particular instance, by the consent or vote of the holders of at least a majority of the outstanding shares of Series B Preferred Stock. Notwithstanding anything herein to the contrary, any downward adjustment of the Conversion Price of the Series A Preferred Stock may be waived, either prospectively or retroactively and either generally or in a particular instance, by the consent or vote of the holders of a majority of the outstanding shares of Series A Preferred Stock. Any such waiver shall bind all future holders of shares of such series of Preferred Stock.

5. Voting Rights.

(a) General Voting Rights. The holder of each share of Preferred Stock shall have the right to one vote for each share of Common Stock into which such Preferred Stock could then be converted, and with respect to such vote, such holder shall have full voting rights and powers equal to the voting rights and powers of the holders of Common Stock, and shall be entitled, notwithstanding any provision hereof, to notice of any stockholders' meeting in accordance with the Bylaws of this corporation, and except as provided in subsection 5(b) below with respect to the election of directors by the separate class vote of the holders of Common Stock or as required under the Delaware General Corporation Law, shall be entitled to vote, together with holders of Common Stock, with respect to any question upon which holders of Common Stock have the right to vote. Fractional votes shall not, however, be permitted and any fractional voting rights available on an as-converted basis (after aggregating all shares into which shares of Preferred Stock held by each holder could be converted) shall be rounded to the nearest whole number (with one-half being rounded upward).

(b) Voting for the Election of Directors.

(i) For so long as any shares of Series C Preferred Stock remain outstanding the holders of Series C Preferred Stock, voting as a separate class, shall be entitled to elect one (1) member of the Board of Directors of this corporation at each meeting or pursuant to each consent of the Company's stockholders for the election of directors.

(ii) For so long as any shares of Series B Preferred Stock remain outstanding the holders of Series B Preferred Stock, voting as a separate class, shall be entitled to elect one (1) member of the Board of Directors of this corporation at each meeting or pursuant to each consent of the Company's stockholders for the election of directors.

(iii) For so long as any shares of Series A Preferred Stock remain outstanding the holders of Series A Preferred Stock, voting as a separate class, shall be entitled to elect one (1) member of the Board of Directors of this corporation at each meeting or pursuant to each consent of the Company's stockholders for the election of directors.

(iv) The holders of Common Stock and Preferred Stock (voting together as a single class and not as a separate series, and on an as-converted basis) shall be entitled to elect four (4) members of the Board of Directors of this corporation at each meeting or pursuant to each consent of the Company's stockholders for the election of directors.

(v) The holders of Common Stock shall be entitled to elect one (1) member of the Board of Directors of this corporation at each meeting or pursuant to each consent of the Company's stockholders for the election of directors.

(vi) The holders of Common Stock and Preferred Stock (voting together as a single class and not as separate series, and on an as-converted basis) shall be entitled to elect two (2) members of the Board of Directors of this corporation at each meeting or pursuant to each consent of the Company's stockholders for the election of directors.

(c) Filling of Vacancy; Removal of Directors. Any vacancy, including newly created directorships resulting from any increase in the authorized number of directors or amendment of this Certificate, and vacancies created by removal or resignation of a director, may be filled by a majority of the directors then in office, though less than a quorum, or by a sole remaining director, and the directors so chosen shall hold office until the next annual election and until their successors are duly elected and shall qualify, unless sooner displaced; provided, however, that where such vacancy occurs among the directors elected by the holders of a class or series of stock, the holders of shares of such class or series may override the Board of Directors' action to fill such vacancy by (i) voting for their own designee to fill such vacancy at a meeting of the corporation's stockholders or (ii) written consent, if the consenting stockholders hold a sufficient number of shares to elect their designee at a meeting of the stockholders. Any director may be removed during his or her term of office, either with or without cause, by, and only by, the affirmative vote of the holders of the shares of the class or series of stock entitled to elect such director or directors, given either at a special meeting of such stockholders duly called for that purpose or pursuant to a written consent of stockholders, and any vacancy thereby created may be filled by the holders of that class or series of stock represented at the meeting or pursuant to written consent.

6. Protective Provisions.

(a) So long as at least 9,734,261 shares of Series C Preferred Stock remain outstanding (as adjusted for any stock splits, stock dividends, combinations, subdivisions, recapitalizations or the like), this corporation shall not (by amendment, merger, consolidation or otherwise, unless such transaction constitutes a Liquidation Event in which the Proceeds are distributed in accordance with Section 2 above) without first obtaining the approval (by vote or written consent, as provided by law) of the holders of at least sixty-six and two-thirds percent (66 2/3%) of the then outstanding shares of Series C Preferred Stock increase or decrease (other than by conversion pursuant to Section 4 hereof) the authorized number of shares of Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock or amend or repeal its Certificate of Incorporation or bylaws in a manner that would waive, alter or change any of the rights, preferences or privileges of the Series A Preferred Stock, Series B Preferred Stock or Series C Preferred Stock.

(b) So long as at least 2,500,000 shares of Series B Preferred Stock remain outstanding (as adjusted for any stock splits, stock dividends, combinations, subdivisions, recapitalizations or the like), this corporation shall not (by amendment, merger, consolidation or otherwise, unless such transaction constitutes a Liquidation Event in which the Proceeds are distributed in accordance with Section 2 above) without first obtaining the approval (by vote or written consent, as provided by law) of the holders of at least a majority of the then outstanding shares of Series B Preferred Stock increase or decrease (other than by conversion pursuant to Section 4 hereof) the authorized number of shares of Series A Preferred Stock or Series B Preferred Stock or amend or repeal its Certificate of Incorporation or bylaws in a manner that would waive, alter or change any of the rights, preferences or privileges of the Series A Preferred Stock or Series B Preferred Stock.

(c) So long as at least 19,340,000 shares of Preferred Stock (calculated on an as-converted basis) remain outstanding (as adjusted for any stock splits, stock dividends, combinations, subdivisions, recapitalizations or the like), this corporation shall not (by amendment, merger, consolidation or otherwise) without first obtaining the approval (by vote or written consent, as provided by law) of the holders of at least sixty-three percent (63%) of the then outstanding shares of Preferred Stock (voting together as a single class and not as separate series, and on an as-converted basis):

(i) consummate a Liquidation Event;

(ii) alter, amend or change the preferences, rights, privileges or powers of the Preferred Stock so as to adversely affect such shares;

(iii) increase or decrease (other than by conversion pursuant to Section 4 hereof) the total number of authorized shares of Preferred Stock;

(iv) authorize, designate or issue, or obligate itself to issue, whether by reclassification or otherwise, any equity security (including any other security convertible into or exercisable for any such equity security) having a preference over, or being on a parity with, any series of Preferred Stock with respect to dividends, liquidation, redemption or voting rights, other than the issuance of any authorized but unissued shares of Series C Preferred Stock designated in this Certificate (including any security convertible into or exercisable for such shares of Series C Preferred Stock);

(v) declare or pay any dividend on, or make any other distribution with respect to, any shares of capital stock;

(vi) redeem, purchase or otherwise acquire (or pay into or set aside for a sinking fund for such purpose) any share or shares of capital stock; provided, however, that this restriction shall not apply to the repurchase of shares of Common Stock from employees, officers, directors, consultants or other persons performing services for this corporation or any subsidiary pursuant to agreements under which this corporation has the option to repurchase such shares upon the occurrence of certain events, such as the termination of employment or service, or pursuant to a right of first refusal;

(vii) change the size of this corporation’s Board of Directors;

(viii) create any new stock option or stock incentive plan, or amend any provisions of any of the corporation's existing stock incentive plan to increase the number of shares of Common stock issued or issuable to officers, directors, employees or bona fide consultants to the corporation;

(ix) change the principal business of the corporation, enter new lines of business, or exit the corporation's current line of business;

(x) acquire the business of another entity or make an investment in another entity, in either case, in excess of $100,000; or

(xi) enter into any agreement to do any of the foregoing, or cause or permit any subsidiary to do any of the foregoing.

7. Status of Converted Stock. In the event any shares of Preferred Stock shall be converted pursuant to Section 4 hereof, the shares of Preferred Stock so converted shall be cancelled and shall not be issuable by this corporation. The Certificate of Incorporation of this corporation shall be appropriately amended to effect the corresponding reduction in this corporation's authorized Preferred Stock.

C. Common Stock. The rights, preferences, privileges and restrictions granted to and imposed on the Common Stock are as set forth below in this Article IV(B).

1. Dividend Rights. Subject to the prior rights of holders of all classes of stock at the time outstanding having prior rights as to dividends, the holders of the Common Stock shall be entitled to receive, when, as and if declared by the Board of Directors, out of any assets of this corporation legally available therefor, any dividends as may be declared from time to time by the Board of Directors.

2. Liquidation Rights. Upon the liquidation, dissolution or winding up of this corporation, the assets of this corporation shall be distributed as provided in Section 2 of Article IV(C) hereof.

3. Redemption. The Common Stock is not redeemable at the option of the holder.

4. Voting Rights. The holder of each share of Common Stock shall have the right to one vote for each such share, and shall be entitled to notice of any stockholders' meeting in accordance with the Bylaws of this corporation, and shall be entitled to vote upon such matters and in such manner as may be provided by law.

ARTICLE V

Except as otherwise provided in this Certificate, in furtherance and not in limitation of the powers conferred by statute, the Board of Directors is expressly authorized to make, repeal, alter, amend and rescind any or all of the Bylaws of this corporation.

ARTICLE VI

The number of directors of this corporation shall be determined in the manner set forth in the Bylaws of this corporation. Elections of directors need not be by written ballot unless the Bylaws of the corporation shall so provide.

ARTICLE VII

To the fullest extent permitted by the Delaware General Corporation Law as the same exists or may hereafter be amended, a director of this corporation shall not be liable to this corporation or its stockholders for monetary damages for breach of fiduciary duty as a director.

Any repeal or modification of the foregoing provisions of this Article VII by the stockholders of this corporation shall not adversely affect any right or protection of a director of this corporation existing at the time of, or increase the liability of any director of this corporation with respect to any acts or omissions of such director occurring prior to, such repeal or modification.

ARTICLE VIII

In the event that a member of the Board of Directors of this corporation who is also a partner or employee of an entity that is a holder of Preferred Stock and that is in the business of investing and reinvesting in other entities, or an employee of an entity that manages such an entity (each, a "Fund") acquires knowledge of a potential transaction or other matter in such individual's capacity as a partner or employee of the Fund or the manager or general partner of the Fund (and other than directly in connection with such individual's service as a member of the Board of Directors of this corporation) and that may be an opportunity of interest for both this corporation and such Fund (a "Corporate Opportunity"), then this corporation (i) renounces any expectancy that such director or Fund offer an opportunity to participate in such Corporate Opportunity to this corporation and (ii) to the fullest extent permitted by law, waives any claim that such opportunity constituted a Corporate Opportunity that should have been presented by such director or Fund to this corporation or any of its affiliates; provided, however, that such director acts in good faith.

ARTICLE IX

This corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate, in the manner now or hereafter prescribed by statute, and all rights conferred upon stockholders herein are granted subject to this reservation.

IN WITNESS WHEREOF, the undersigned has caused this Restated Certificate of Incorporation to be executed by its duly authorized officer as of this 18th day of May, 2007.

ENTEROMEDICS INC.

By: /s/ Mark B. Knudson
Name: Mark B. Knudson
Title: Chief Executive Officer

EXHIBIT 3.3

ENTEROMEDICS INC.

BYLAWS

JULY 22, 2004

Table of Contents

AMENDED AND RESTATED
BYLAWS
OF
ENTEROMEDICS INC.

(As adopted by the Board of Directors on July 22, 2004).

Article 1. Stockholders' Meetings

1.1 Place of Meetings. Meetings of the stockholders shall be held at such place, either within or without the State of Delaware, as the board of directors shall determine. Rather than holding a meeting at any place, the board of directors may determine that a meeting shall be held solely by means of remote communications, which means shall meet the requirements of the Delaware General Corporation Law.

1.2 Annual Meeting. The annual meeting of the stockholders for the election of the directors and the transaction of such other business as may properly be brought before the meeting shall be held on the date and at the time designated by the board of directors.

1.3 Special Meetings. Special meetings of the stockholders for any purpose or purposes may be called by the board of directors or the holders of at least 25% of all the votes entitled to be cast on any issue proposed to be considered at such special meeting. No other person or persons may call a special meeting. The business to be transacted at any special meeting shall be limited to the purposes stated in the notice.

1.4 Remote Communications. The board of directors may permit the stockholders and their proxy holders to participate in meetings of the stockholders (whether such meetings are held at a designated place or solely by means of remote communication) using one or more methods of remote communication that satisfy the requirements of the Delaware General Corporation Law. The board of directors may adopt such guidelines and procedures applicable to participation in stockholders' meetings by means of remote communication as it deems appropriate. Participation in a stockholders' meeting by means of a method of remote communication permitted by the board of directors shall constitute presence in person at the meeting.

1.5 Notice of Meetings. Notice of the place, if any, date and hour of any stockholders' meeting shall be given to each stockholder entitled to vote. The notice shall state the means of remote communications, if any, by which stockholders and proxy holders may be deemed present in person and vote at the meeting. If the voting list for the meeting is to be made available by means of an electronic network or if the meeting is to be held solely by remote communication, the notice shall include the information required to access the reasonably accessible electronic network on which the corporation will make its voting list available either prior to the meeting or, in the case of a meeting held solely by remote communication, during the meeting. Notice of a special meeting shall also state the purpose or purposes for which the meeting has been called. Unless otherwise provided in the Delaware General Corporation Law, notice shall be given at least 10 days but not more than 60 days before the date of the meeting.

Without limiting the manner by which notice may otherwise be given, notice may be given by a form of electronic transmission that satisfies the requirements of the Delaware General Corporation Law and has been consented to by the stockholder to whom notice is given. If mailed, notice shall be deemed given when deposited in the U.S. mail, postage prepaid, directed to the stockholder's address as it appears in the corporation's records. If given by a form of electronic transmission consented to by the stockholder to whom notice is given, notice shall be deemed given at the times specified with respect to the giving of notice by electronic transmission in the Delaware General Corporation Law. An affidavit of the corporation's secretary, an assistant secretary or an agent of the corporation that notice has been given shall, in the absence of fraud, be prima facie evidence of the facts stated in the affidavit.

1.6 Quorum. The presence, in person or by proxy, of the holders of a majority of the voting power of the stock entitled to vote at a meeting shall constitute a quorum. Where a separate vote by a class or series or classes or series of stock is required at a meeting, the presence, in person or by proxy, of the holders of a majority of the voting power of each such class or series shall also be required to constitute a quorum. In the absence of a quorum, either the chairperson of the meeting or the holders of a majority of the voting power of the stock present, in person or by proxy, and entitled to vote at the meeting may adjourn the meeting in the manner provided in Section 1.7 until a quorum shall be present. A quorum, once established at a meeting, shall not be broken by the withdrawal of the holders of enough voting power to leave less than a quorum. If a quorum is present at an original meeting, a quorum need not be present at an adjourned session of that meeting.

1.7 Adjournment of Meetings. Either the chairperson of the meeting or the holders of a majority of the voting power of the stock present, in person or by proxy, and entitled to vote at the meeting may adjourn any meeting of stockholders from time to time. At any adjourned meeting the stockholders may transact any business that they might have transacted at the original meeting. Notice of an adjourned meeting need not be given if the time and place, if any, or the means of remote communications to be used rather than holding the meeting at any place are announced at the meeting so adjourned, except that notice of the adjourned meeting shall be required if the adjournment is for more than 30 days or if after the adjournment a new record date is fixed for the adjourned meeting.

1.8 Voting List. At least 10 days before every meeting of the stockholders, the secretary of the corporation shall prepare a complete alphabetical list of the stockholders entitled to vote at the meeting showing each stockholder's address and number of shares. This voting list does not need to include electronic mail addresses or other electronic contact information for any stockholder nor need it contain any information with respect to beneficial owners of the shares of stock owned, although it may do so. For a period of at least 10 days before the meeting, the voting list shall be open to the examination of any stockholder for any purpose germane to the meeting either on a reasonably accessible electronic network (*provided that* the information required to gain access to the list is provided with the notice of the meeting) or during ordinary business hours at the corporation's principal place of business. If the list is made available on an electronic network, the corporation may take reasonable steps to ensure that it is available only to stockholders. If the stockholders' meeting is held at a place, the voting list shall be produced and kept at that place during the whole time of the meeting. If the stockholders' meeting is held solely by means of remote communications, the voting list shall be made available for inspection on a reasonably accessible electronic network during the whole time of the meeting. In either case, any stockholder may inspect the voting list at any time during the meeting.

1.9 Vote Required. Subject to the provisions of the Delaware General Corporation Law requiring a higher level of votes to take certain specified actions and to the terms of the corporation's certificate of incorporation that set special voting requirements, the stockholders shall take action on all matters other than the election of directors by a majority of the voting power of the stock present, in person or by proxy, at the meeting and entitled to vote on the matter. The stockholders shall elect directors by a plurality of the voting power of the stock present, in person or by proxy, at the meeting and entitled to vote on the matter.

1.10 Chairperson; Secretary. The following people shall preside over any meeting of the stockholders: the chairperson of the board of directors, if any, or, in the chairperson's absence, the vice chairperson of the board of directors, if any, or in the vice chairperson's absence, the chief executive officer, or, in the absence of all of the foregoing persons, a chairperson designated by the board of directors, or, in the absence of a chairperson designated by the board of directors, a chairperson chosen by the stockholders at the meeting. In the absence of the secretary and any assistant secretary, the chairperson of the meeting may appoint any person to act as secretary of the meeting.

1.11 Rules of Conduct. The board of directors may adopt such rules, regulations and procedures for the conduct of any meeting of the stockholders as it deems appropriate including rules, regulations and procedures regarding participation in the meeting by means of remote communication. Except to the extent inconsistent with any applicable rules, regulations or procedures adopted by the board of directors, the chairperson of any meeting may adopt such rules, regulations and procedures for the meeting, and take such actions with respect to the conduct of the meeting, as the chairperson of the meeting deems appropriate. The rules, regulations and procedures adopted may include, without limitation, ones that (i) establish an agenda or order of business, (ii) are intended to maintain order and safety at the meeting, (iii) restrict entry to the meeting after the time fixed for its commencement and (iv) limit the time allotted to stockholder questions or comments. Unless otherwise determined by the board of directors or the chairperson of the meeting, meetings of the stockholders need not be held in accordance with the rules of parliamentary procedure.

1.12 Inspectors of Elections. The board of directors or the chairperson of a stockholders' meeting may appoint one or more inspectors of election and any substitute inspectors to act at the meeting or any adjournment thereof. Inspectors may be officers, employees or agents of the corporation. Each inspector, before entering on the discharge of the inspector's duties, shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of the inspector's ability. Inspectors shall have the duties prescribed by the Delaware General Corporation Law. At the request of the chairperson of the meeting, the inspector or inspectors shall prepare a written report of the results of the votes taken and of any other question or matter that that inspector or inspectors determined.

1.13 Record Date. If the corporation proposes to take any action for which the Delaware General Corporation Law would permit it to set a record date, the board of directors may set such a record date as provided under the Delaware General Corporation Law.

1.14 Written Consent. Any action required or permitted to be taken at a meeting of the stockholders may be taken without a meeting, without prior notice and without a vote by means of a stockholder written consent meeting the requirements of the Delaware General Corporation Law. Prompt notice of the taking of action without a meeting by less than a unanimous written consent shall be given to those stockholders who have not consented as required by the Delaware General Corporation Law.

Article 2. Directors

2.1 Number and Qualifications. The number of directors of the corporation shall consist of such number as may be fixed from time to time by the board of directors. Directors need not be stockholders.

2.2 Term of Office. Each director shall hold office until his or her successor is elected or until his or her earlier death, resignation or removal.

2.3 Resignation. A director may resign, as a director or as a committee member or both, at any time by giving notice in writing or by electronic transmission to the corporation addressed to the board of directors, the chairperson of the board of directors, the president or the secretary. A resignation will be effective upon its receipt by the corporation unless the resignation specifies that it is to be effective at some later time or upon the occurrence of some specified later event.

2.4 Removal. Unless otherwise provided by the certificate of incorporation or otherwise, a director may be removed at any time, with or without cause, by the affirmative vote of the stockholders holding a majority of the shares entitled to vote at an election of directors. A director named by the board of directors to fill a vacancy may be removed from office at any time, with or without cause, by the affirmative vote of the remaining directors if the stockholders have not elected such director to the board in the interim between the time of the appointment to fill such vacancy and the time of the removal. New directors may be elected at a meeting at which directors are removed.

2.5 Vacancies. Any vacancy in the board of directors, including a vacancy resulting from an enlargement of the board of directors, may be filled by a vote of the majority of the remaining directors, although less than a quorum, or by a sole remaining director. If the corporation at the time has outstanding any classes or series or class or series of stock that have or has the right, alone or with one or more other classes or series or class or series, to elect one or more directors, then any vacancy in the board of directors caused by the death, resignation or removal of a director so elected shall be filled only by a vote of the majority of the remaining directors so elected, by a sole remaining director so elected or, if no director so elected remains, by the holders of those classes or series or that class or series. A director appointed by the board of directors shall hold office for the remainder of the term of the director he or she is replacing.

2.6 Regular Meetings. The board of directors may hold regular meetings without notice at such times and places as it may from time to time determine, *provided that* notice of any such determination shall be given to any director who is absent when such a determination is made. A regular meeting of the board of directors may be held without notice immediately after and at the same place as the annual meeting of the stockholders.

2.7 Special Meetings. Special meetings of the board of directors may be called by the chairperson of the board of directors, the chief executive officer or by any director. Notice of any special meeting shall be given to each director and shall state the time and place for the special meeting.

2.8 Notice. Any time it is necessary to give notice of a board of directors' meeting, notice shall be given (i) in person or by telephone to the director at least 24 hours in advance of the meeting, (ii) by personally delivering written notice to the director's last known business or home address at least 48 hours in advance of the meeting, (iii) by delivering an electronic transmission (including, without limitation, via telefacsimile or electronic mail) to the director's last known number or address for receiving electronic transmissions of that type at least 48 hours in advance of the meeting, (iv) by depositing written notice with a reputable delivery service or overnight carrier addressed to the director's last known business or home address for delivery to that address no later than the business day preceding the date of the meeting or (v) by depositing written notice in the U.S. mail, postage prepaid, addressed to the director's last known business or home address no later than the third business day preceding the date of the meeting. Notice of a meeting need not be given to any director who attends a meeting without protesting prior to the meeting or at its commencement to the lack of notice to that director. A notice of meeting need not specify the purposes of the meeting.

2.9 Quorum. A majority of the directors in office at the time shall constitute a quorum. Thereafter, a quorum shall be deemed present for purposes of conducting business and determining the vote required to take action for so long as at least a third of the total number of directors are present. In the absence of a quorum, the directors present may adjourn the meeting without notice until a quorum shall be present, at which point the meeting may be held.

2.10 Vote Required. The board of directors shall act by the vote of a majority of the directors present at a meeting at which a quorum is present.

2.11 Chairperson; Secretary. If the chairperson and the vice chairperson are not present at any meeting of the board of directors, or if no such officers have been elected, then the board of directors shall choose a director who is present at the meeting to preside over it. In the absence of the secretary and any assistant secretary, the chairperson may appoint any person to act as secretary of the meeting.

2.12 Use of Communications Equipment. Directors may participate in meetings of the board of directors or any committee of the board of directors by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear each other. Participation in a meeting in this manner shall constitute presence in person at the meeting.

2.13 Action Without a Meeting. Any action required or permitted to be taken at any meeting of the board of directors may be taken without a meeting if all of the directors consent to the action in writing or by electronic transmission. The writing or writings or electronic transmission or transmissions shall be filed with the minutes of the proceedings of the board of directors or of the relevant committee.

2.14 Compensation of Directors. The board of directors shall from time to time determine the amount and type of compensation to be paid to directors for their service on the board of directors and its committees.

2.15 Committees. The board of directors may designate one or more committees, each of which shall consist of one or more directors. The board of directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of a member of a committee, the member or members present at any meeting and not disqualified from voting, whether or not such member or members constitute a quorum, may unanimously appoint another member of the board of directors to act at the meeting in place of any such absent or disqualified member. Any committee shall, to the extent provided in a resolution of the board of directors and subject to the limitations contained in the Delaware General Corporation Law, have and may exercise all the powers and authority of the board of directors in the management of the business and affairs of the corporation. Each committee shall keep such records and report to the board of directors in such manner as the board of directors may from time to time determine. Except as the board of directors may otherwise determine, any committee may make rules for the conduct of its business. Unless otherwise provided in a resolution of the board of directors or in rules adopted by the committee, each committee shall conduct its business as nearly as possible in the same manner as is provided in these bylaws for the board of directors.

2.16 Chairperson and Vice Chairperson of the Board. The board of directors may elect from its members a chairperson of the board and a vice chairperson. If a chairperson has been elected and is present, the chairperson shall preside at all meetings of the board of directors and the stockholders. The chairperson shall have such other powers and perform such other duties as the board of directors may designate. If the board of directors elects a vice chairperson, the vice chairperson shall, in the absence or disability of the chairperson, perform the duties and exercise the powers of the chairperson and have such other powers and perform such other duties as the board of directors may designate.

Article 3. Officers

3.1 Offices Created; Qualifications; Election. The corporation shall have a chief executive officer, a chief financial officer and such other officers, if any, as the board of directors from time to time may elect. Any number of offices or functions of those offices may be held or exercised by the same person. The board of directors may elect officers at any time.

3.2 Term of Office. Each officer shall hold office until his or her successor has been elected, unless a different term is specified in the resolution electing the officer, or until his or her earlier death, resignation or removal.

3.3 Removal of Officers. Any officer may be removed from office at any time, with or without cause, by the board of directors.

3.4 Resignation. An officer may resign at any time by giving notice in writing or by electronic transmission to the corporation addressed to the board of directors, the chairperson of the board of directors, the president or the secretary. A resignation will be effective upon its receipt by the corporation unless the resignation specifies that it is to be effective at some later time or upon the occurrence of some specified later event.

3.5 Vacancies. A vacancy in any office may be filled by the board of directors.

3.6 Compensation. Officers shall receive such amounts and types of compensation for their services as shall be fixed by the board of directors.

3.7 Powers. Unless otherwise specified by the board of directors, each officer shall have those powers and shall perform those duties that are (i) set forth in these bylaws (if any are so set forth), (ii) set forth in the resolution of the board of directors electing that officer or any subsequent resolution of the board of directors with respect to that officer’s duties or (iii) commonly incident to the office held.

3.8 Chief Executive Officer. The chief executive officer shall have general active management of the business of the corporation. In the absence of the chairperson of the board, if any, the chief executive officer shall preside at all meetings of the stockholders and directors. The chief executive officer shall see that all orders and resolutions of the board of directors are carried into effect. The chief executive officer shall execute and deliver, in the name of the corporation, any deeds, mortgages, bonds, contracts or other instruments pertaining to the business of the corporation unless the authority to execute and deliver is required by law to be exercised by another person or is expressly delegated by the certificate of incorporation or bylaws or by the board of directors to some other officer or agent of the corporation. The chief executive officer shall maintain records of and, whenever necessary, certify all proceedings of the board of directors and the shareholders, and in general, shall perform all duties usually incident to the office of the president. The chief executive officer shall have such other duties as may, from time to time, be prescribed by the board of directors.

3.9 President. The president, if any, shall be subject to the direction and control of the chief executive officer and the board of directors and shall have such powers and duties as the board of directors, or the chief executive officer may assign to the president. If the chief executive officer is absent, disqualified from acting, unable to act or refuses to act, then the president shall have the powers of, and shall perform the duties of, the chief executive officer.

3.10 Vice Presidents. The vice presidents, if any, shall be subject to the direction and control of the board of directors, the chief executive officer and the president and shall have such powers and duties as the board of directors, the chief executive officer or the president may assign to them. If the board of directors elects more than one vice president, then it shall determine their respective titles, seniority and duties. If the president is absent, disqualified from acting, unable to act or refuses to act, the most senior in rank of the vice presidents (as determined by the board of directors) shall have the powers of, and shall perform the duties of, the president.

3.11 Chief Financial Officer. The chief financial officer shall keep accurate financial records for the corporation. The chief financial officer shall deposit all moneys, drafts and checks in the name of, and to the credit of, the corporation in such banks and depositories as the board of directors shall, from time to time, designate. The chief financial officer shall have power to endorse for deposit, all notes, checks and drafts received by the corporation. The chief financial officer shall disburse the funds of the corporation, as ordered by the board of directors, making proper vouchers therefore. The chief financial officer shall render to the chief executive officer and the directors, whenever requested, an account of all transactions entered into as chief financial officer and of the financial condition of the corporation, and shall perform such other duties as may, from time to time, be prescribed by the board of directors or by the chief executive officer.

3.12 Chief Operating Officer. The chief operating officer, if any, shall be subject to the direction and control of the board of directors and the chief executive officer, shall have primary responsibility for the management and supervision of the day-to-day operations of the corporation and shall perform such other duties as the chief executive officer may assign.

3.13 Treasurer. The treasurer, if any, shall be subject to the direction and control of the board of directors, the chief executive officer and the chief financial officer, and shall have such powers and duties as the board of directors, the chief executive officer or the chief financial officer may assign to the treasurer.

3.14 Assistant Treasurers. The assistant treasurers, if any, shall have such powers and duties as the board of directors, the chief executive officer, the president or the treasurer may assign to them. If the board of directors elects more than one assistant treasurers, then it shall determine their respective titles, seniority and duties. If the treasurer is absent, disqualified from acting, unable to act or refuses to act, the most senior in rank of the assistant treasurers (as determined by the board of directors) shall have the powers of, and shall perform the duties of, the treasurer.

3.15 Controller. The controller, if any, shall be the chief accounting officer of the corporation and shall be subject to the direction and control of the board of directors, the chief executive officer and the chief financial officer, and shall have such powers and duties as the board of directors, the chief executive officer or the chief financial officer may assign to the controller.

3.16 Secretary. The secretary, if any, shall be subject to the direction and control of the board of directors, the chief executive officer and the chief financial officer, and shall have such powers and duties as the board of directors, the chief executive officer or the chief financial officer may assign to the secretary.

3.17 Assistant Secretaries. The assistant secretaries, if any, shall be subject to the direction and control of the board of directors, the chief executive officer and the chief financial officer, and shall have such powers and duties as the board of directors, the chief executive officer or the chief financial officer may assign to the assistant secretary. If the board of directors elects more than one assistant secretary, then it shall determine their respective titles, seniority and duties. If the secretary is absent, disqualified from acting, unable to act or refuses to act, the most senior in rank of the assistant secretaries (as determined by the board of directors) shall have the powers of, and shall perform the duties of, the secretary.

Article 4. Capital Stock

4.1 Stock Certificates. The corporation's shares of stock shall be represented by certificates, *provided that* the board of directors may, subject to the limits imposed by law, provide by resolution or resolutions that some or all of any or all classes or series shall be uncertificated shares. Notwithstanding the adoption of such a resolution, every holder of shares of stock represented by certificates and every holder of uncertificated shares, upon request, shall be entitled to have a certificate representing such shares in such form as shall be approved by the board of directors. Stock certificates shall be numbered in the order of their issue and shall be signed by or in the name of the corporation by (i) the chairperson or vice chairperson, if any, of the board of directors, the president or a vice president *and* (ii) the treasurer, an assistant treasurer, the secretary or an assistant secretary. Any or all of the signatures on a certificate may be a facsimile. In case any officer, transfer agent or registrar who signed or whose facsimile signature has been placed upon a certificate shall have ceased to be an officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if such person were such officer, transfer agent or registrar at the date of issue. Each certificate that is subject to any restriction on transfer shall have conspicuously noted on its face or back either the full text of the restriction or a statement of the existence of the restriction. Each certificate shall have on its face or back a statement that the corporation will furnish without charge to each stockholder who so requests the powers, designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences or rights.

4.2 Registration; Registered Owners. The name of each person owning a share of the corporation's capital stock shall be entered on the books of the corporation together with the number of shares owned, the number or numbers of the certificate or certificates covering such shares and the dates of issue of each certificate. The corporation shall be entitled to treat the record holder of stock as shown on its books as the owner of such stock for all purposes regardless of any transfer, pledge or other disposition of such stock until the shares have been properly transferred on the books of the corporation.

4.3 Stockholder Addresses. It shall be the duty of each stockholder to notify the corporation of the stockholder's address.

4.4 Transfer of Shares. Registration of transfer of shares of the corporation's stock shall be made only on the books of the corporation at the request of the registered holder or of the registered holder's duly authorized attorney (as evidenced by a duly executed power of attorney provided to the corporation) and upon surrender of the certificate or certificates representing those shares properly endorsed or accompanied by a duly executed stock power. The board of directors may make further rules and regulations concerning the transfer and registration of shares of stock and the certificates representing them and may appoint a transfer agent or registrar or both and may require all stock certificates to bear the signature of either or both.

4.5 Lost, Stolen, Destroyed or Mutilated Certificates. The corporation may issue a new stock certificate of stock in the place of any certificate theretofore issued by it alleged to have been lost, stolen, destroyed or mutilated. The board of directors may require the owner of the allegedly lost, stolen or destroyed certificate, or the owner's legal representatives, to give the corporation such bond or such surety or sureties as the board of directors, in its sole discretion, deems sufficient to indemnify the corporation against any claim that may be made against it on account of the alleged loss, theft or destruction or the issuance of such new certificate and, in the case of a certificate alleged to have been mutilated, to surrender the mutilated certificate.

Article 5. Loans, Guarantees, Suretyship

The corporation may lend money to, guarantee an obligation of, become a surety for or otherwise financially assist any person if the transaction, or a class of transactions to which the transaction belongs, has been approved by the affirmative vote of a majority of the directors present at a duly called meeting, and (i) is in the usual and regular course of business of the corporation; (ii) is with, or for the benefit of, a related organization, an organization in which the corporation has a financial interest, an organization with which the corporation has a business relationship, or an organization to which the corporation has the power to make donations, any of which relationships constitute consideration sufficient to make the loan/guarantee, suretyship, or other financial assistance so approved enforceable against the corporation; (iii) is with, or for the benefit of, an officer or other employee of the corporation or a subsidiary, including an officer or employee who is a director of the corporation or a subsidiary, and may reasonably be expected, in the judgment of the board, to benefit the corporation; or (iv) whether or not any separate consideration has been paid or promised to the corporation, has been approved by (a) the holders of two-thirds of the voting power of the shares entitled to vote which are owned by persons other than the interested person or persons, or (b) the unanimous affirmative vote of the holders of all outstanding shares, whether or not entitled to vote. Such loan, guarantee, surety contract or other financial assistance may be with or without interest, and may be unsecured, or may be secured in the manner as a majority of the directors present approve, including, without limitation, a pledge of or other security interest in shares of the corporation.

Article 6. General Provisions

6.1 Waiver of Notice. Any stockholder or director may execute a written waiver or give a waiver by electronic transmission of notice of the meeting, either before or after such meeting. Any such waiver shall be filed with the records of the corporation. If any stockholder or director shall be present at any meeting it shall constitute a waiver of notice of the meeting, except when that stockholder or director attends for the express purpose of objecting at the beginning of the meeting to the transaction of any business because the meeting is not lawfully called or convened. A waiver of notice of meeting need not specify the purposes of the meeting.

6.2 Share Register. The corporation shall keep at its principal executive office, or at another place or places within the United States determined by the board of directors: (i) a share register not more than one year old, containing the names and addresses of the stockholders and the number and classes of shares held by each stockholder and (ii) a record of the dates on which certificates or transaction statements representing uncertificated shares were issued.

6.3 Electronic Transmissions. For purposes of these bylaws, "*electronic transmission*" shall mean a form of communication not directly involving the physical transmission of paper that satisfies the requirements with respect to such communications contained in the Delaware General Corporation Law.

6.4 Fiscal Year. The fiscal year of the corporation shall be fixed by resolution of the board of directors.

6.5 Voting Stock of Other Organizations. Except as the board of directors may otherwise designate, each of the chief executive officer and the treasurer may waive notice of, and act as, or appoint any person or persons to act as, proxy or attorney-in-fact for the corporation (with power of substitution) at any meeting of the stockholders, members or other owners of any other corporation or organization the securities or ownership interests of which are owned by the corporation.

6.6 Corporate Seal. The corporation shall have no seal.

6.7 Amendment of Bylaws. These bylaws may be amended or repealed by the board of directors. Such authority of the board of directors is subject to the power of the stockholders, exercisable in the manner provided in the Delaware General Corporation Law to adopt, amend or repeal bylaws adopted, amended or repealed by the board of directors. After the adoption of the initial bylaws, the board of directors shall not adopt, amend or repeal a bylaw fixing a quorum for meetings of stockholders, prescribing procedures for removing directors or filling vacancies in the board of directors or fixing the number of directors or their classifications, qualifications or terms of office, except that the board of directors may adopt or amend any bylaw to increase the number of directors.

6.8 Record Date for Distributions. The board of directors may fix a date preceding the date fixed for the payment of any distribution as the record date for the determination of the stockholders entitled to receive payment of the distribution and, in such case, only stockholders of record on the date so fixed shall be entitled to receive payment of such distribution notwithstanding any transfer of shares on the books of the corporation after the record date.

Article 7. Indemnification

7.1 Indemnification. The corporation shall, to the fullest extent permitted by law, indemnify every person who is or was a party or is or was threatened to be made a party to any action, suit or proceeding, whether civil, criminal, administrative or investigative (an "*Action*"), by reason of the fact that such person is or was a director or officer of the corporation or is or was serving at the request of the corporation as a director, officer, trustee, plan administrator or plan fiduciary of another corporation, partnership, limited liability company, trust, employee benefit plan or other enterprise (an "*Indemnified Person*"), against all expenses (including attorneys' fees), judgments, fines and amounts paid in settlement or other disposition that the Indemnified Person actually and reasonably incurs in connection with the Action and shall reimburse each such person for all legal fees and expenses reasonably incurred by such person in seeking to enforce its rights to indemnification under this Article (by means of legal action or otherwise).

7.2 Advancement of Expenses. Upon written request from an Indemnified Person, the corporation shall pay the expenses (including attorneys' fees) incurred by such Indemnified Person in connection with any Action in advance of the final disposition of such Action. The corporation's obligation to pay expenses pursuant to this Section shall be contingent upon the Indemnified Person providing the undertaking required by the Delaware General Corporation Law.

7.3 Non-Exclusivity. The rights of indemnification and advancement of expenses contained in this Article shall not be exclusive of any other rights to indemnification or similar protection to which any Indemnified Person may be entitled under any agreement, vote of stockholders or disinterested directors, insurance policy or otherwise.

7.4 Heirs and Beneficiaries. The rights created by this Article shall inure to the benefit of each Indemnified Person and each heir, executor and administrator of such Indemnified Person.

7.5 Effect of Amendment. Neither the amendment, modification or repeal of this Article nor the adoption of any provision in these bylaws inconsistent with this Article shall adversely affect any right or protection of an Indemnified Person with respect to any act or omission that occurred prior to the time of such amendment, modification, repeal or adoption.

EXHIBIT 4.2

Execution Copy

AMENDED AND RESTATED INVESTORS' RIGHTS AGREEMENT

This AMENDED AND RESTATED INVESTORS' RIGHTS AGREEMENT (the "Agreement") is made as of the 6th day of July, 2006, by and among EnteroMedics Inc., a Delaware corporation (the "Company"), and the investors listed on Schedule A hereto, each of which is herein referred to as an "Investor."

RECITALS

WHEREAS, the Company and certain Investors are parties to the Series C Preferred Stock Purchase Agreement of even date herewith (the "Series C Agreement"), pursuant to which such Investors are purchasing shares of the Company's Series C Preferred Stock; and

WHEREAS, the Company and certain of the Investors (the "Existing Investors") have previously entered into that certain Investors' Rights Agreement dated as of July 31, 2004 (the "Prior Agreement") and, pursuant to Section 4.7 of the Prior Agreement, desire to amend and restate the Prior Agreement and to accept the rights created pursuant hereto in lieu of the rights created under the Prior Agreement; and

WHEREAS, as a material inducement to the Investors who are a party to the Series C Agreement to purchase shares of Series C Preferred Stock, the Parties desire to replace by substitution the Prior Agreement with this Amended and Restated Investor Rights Agreement.

AGREEMENT

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

1. Registration Rights. The Parties covenant and agree as follows:

1.1 Definitions. For purposes of this Section 1:

(a) The term "Act" means the Securities Act of 1933, as amended.

(b) The term "Common Stock" means the Company's Common Stock, par value $0.01 per share.

(c) The term "Form S-3" means such form under the Act as in effect on the date hereof or any registration form under the Act subsequently adopted by the SEC that permits inclusion or incorporation of substantial information by reference to other documents filed by the Company with the SEC.

(d) The term "Holder" means any person owning or having the right to acquire Registrable Securities or any assignee thereof in accordance with Section 1.11 hereof.

(e) The term "Initial Offering" means the Company's first firm commitment underwritten public offering of its Common Stock under the Act.

(f) The term "1934 Act" means the Securities Exchange Act of 1934, as amended.

(g) The term "Preferred Stock" means the Company's Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock, each with a par value of $0.01 per share.

(h) The terms "register," "registered," and "registration" refer to a registration effected by preparing and filing a registration statement or similar document in compliance with the Act, and the declaration or ordering of effectiveness of such registration statement or document.

(i) The term "Registrable Securities" means (i) the Common Stock issuable or issued upon conversion of the Preferred Stock (including Preferred Stock issued upon the exercise of warrants outstanding on the date hereof) and (ii) any Common Stock of the Company issued as (or issuable upon the conversion or exercise of any warrant, right or other security that is issued as) a dividend or other distribution with respect to, or in exchange for, or in replacement of, the shares referenced in (i) above, excluding in all cases, however, any Registrable Securities (x) sold by a person in a transaction in which his rights under this Section 1 are not assigned or (y) sold by a person to the public either pursuant to a registration statement or Rule 144.

(j) The number of shares of "Registrable Securities" outstanding shall be determined by the number of shares of Common Stock outstanding that are, and the number of shares of Common Stock issuable pursuant to then exercisable or convertible securities that are, Registrable Securities.

(k) The term "Rule 144" shall mean Rule 144 under the Act.

(l) The term "SEC" shall mean the Securities and Exchange Commission.

1.2 Request for Registration.

(a) Subject to the conditions of this Section 1.2, if at any time after the earlier of (i) three (3) years after the date of this Agreement or (ii) six (6) months after the effective date of the Initial Offering, the Company shall receive a written request from the Holders of fifty percent (50%) or more of the Registrable Securities then outstanding (for purposes of this Section 1.2, the "Initiating Holders") that the Company file a registration statement under the Act covering the registration of at least 20% of the Registrable Securities then outstanding with an anticipated aggregate offering price of at least $5,000,000 then the Company shall, within twenty (20) days of the receipt thereof, give written notice of such request to all Holders, and subject to the limitations of this Section 1.2, use all commercially reasonable efforts to effect, as soon as practicable, the registration under the Act of all Registrable Securities that the Holders request to be registered in a written request received by the Company within twenty (20) days of the mailing of the Company's notice pursuant to this Section 1.2(a); provided, however, that only one such request may be made by Holders during any twelve (12) month period.

(b) If the Initiating Holders intend to distribute the Registrable Securities covered by their request by means of an underwriting, they shall so advise the Company as a part of their request made pursuant to this Section 1.2 and the Company shall include such information in the written notice referred to in Section 1.2(a). In such event the right of any Holder to include its Registrable Securities in such registration shall be conditioned upon such Holder's participation in such underwriting and the inclusion of such Holder's Registrable Securities in the underwriting (unless otherwise mutually agreed by a majority in interest of the Initiating Holders and such Holder) to the extent provided herein. All Holders proposing to distribute their securities through such underwriting shall enter into an underwriting agreement in customary form with the underwriter or underwriters selected for such underwriting by a majority in interest of the Initiating Holders (which underwriter or underwriters shall be reasonably acceptable to the Company). Notwithstanding any other provision of this Section 1.2, if the underwriter advises the Company that marketing factors require a limitation on the number of securities underwritten (including Registrable Securities), then the Company shall so advise all Holders of Registrable Securities that would otherwise be underwritten pursuant hereto, and the number of shares that may be included in the underwriting shall be allocated to the Holders of such Registrable Securities pro rata based on the number of Registrable Securities held by all such Holders (including the Initiating Holders). In no event shall any Registrable Securities be excluded from such underwriting unless all other securities are first excluded. Any Registrable Securities excluded or withdrawn from such underwriting shall be withdrawn from the registration.

(c) Notwithstanding the foregoing, the Company shall not be required to effect a registration pursuant to this Section 1.2:

(i) in any particular jurisdiction in which the Company would be required to execute a general consent to service of process in effecting such registration, unless the Company is already subject to service in such jurisdiction and except as may be required under the Act; or

(ii) after the Company has effected two (2) registrations pursuant to this Section 1.2, and such registrations have been declared or ordered effective; or

(iii) during the period starting with the date ninety (90) days prior to the Company's good faith estimate of the date of the filing of and ending on a date one hundred eighty (180) days following the effective date of a Company-initiated registration subject to Section 1.3 below, provided that the Company delivers notice of such proposed registration to the holders of the Registrable Securities within 30 days of any registration request by the holders and that the Company is actively employing in good faith all commercially reasonable efforts to cause such registration statement to become effective; or

(iv) if the Initiating Holders propose to dispose of Registrable Securities that may immediately be registered on Form S-3 pursuant to Section 1.4 hereof; or

(v) if the Company shall furnish to Holders requesting a registration statement pursuant to this Section 1.2 a certificate signed by the Company's Chief Executive Officer or Chairman of the Board stating that in the good faith judgment of the Board of Directors of the Company, it would be seriously detrimental to the Company and its stockholders for such registration statement to be effected at such time, in which event the Company shall have the right to defer such filing for a period of not more than ninety (90) days after receipt of the request of the Initiating Holders, provided that such right shall be exercised by the Company not more than once in any twelve (12) month period and provided further that the Company shall not register any securities for the account of itself or any other stockholder during such ninety (90) day period (other than a registration relating solely to the sale of securities of participants in a Company stock plan, a registration relating to a corporate reorganization or transaction under Rule 145 of the Act, a registration on any form that does not include substantially the same information as would be required to be included in a registration statement covering the sale of the Registrable Securities, or a registration in which the only Common Stock being registered is Common Stock issuable upon conversion of debt securities that are also being registered).

1.3 Company Registration.

(a) If (but without any obligation to do so) the Company proposes to register (including for this purpose a registration effected by the Company for stockholders other than the Holders) any of its stock or other securities under the Act in connection with the public offering of such securities (other than a registration relating solely to the sale of securities of participants in a Company stock plan, a registration relating to a corporate reorganization or transaction under Rule 145 of the Act, a registration on any form that does not include substantially the same information as would be required to be included in a registration statement covering the sale of the Registrable Securities, or a registration in which the only Common Stock being registered is Common Stock issuable upon conversion of debt securities that are also being registered), the Company shall, at such time, promptly give each Holder written notice of such registration. Upon the written request of each Holder given within twenty (20) days after mailing of such notice by the Company in accordance with Section 6.5, the Company shall, subject to the provisions of Section 1.3(c), use all commercially reasonable efforts to cause to be registered under the Act all of the Registrable Securities that each such Holder requests to be registered.

(b) Right to Terminate Registration. The Company shall have the right to terminate or withdraw any registration initiated by it under this Section 1.3 prior to the effectiveness of such registration whether or not any Holder has elected to include securities in such registration. The expenses of such withdrawn registration shall be borne by the Company in accordance with Section 1.7 hereof.

(c) Underwriting Requirements. In connection with any offering involving an underwriting of shares of the Company's capital stock, the Company shall not be required under this Section 1.3 to include any of the Holders' securities in such underwriting unless they accept the terms of the underwriting as agreed upon between the Company and the underwriters selected by the Company (or by other persons entitled to select the underwriters) and enter into an underwriting agreement in customary form with such underwriters, and then only in such quantity as the underwriters determine in their sole discretion will not jeopardize the success of the offering by the Company. If the total amount of securities, including Registrable Securities, requested by stockholders to be included in such offering exceeds the amount of securities sold other than by the Company that the underwriters determine in their sole discretion is compatible with the success of the offering, then the Company shall be required to include in the offering only that number of such securities, including Registrable Securities, that the underwriters determine in their sole discretion will not jeopardize the success of the offering. In no event shall any Registrable Securities be excluded from such offering unless all other stockholders' securities have first been excluded. In the event that the underwriters determine that less than all of the Registrable Securities requested to be registered can be included in such offering, then the Registrable Securities that are included in such offering shall be apportioned pro rata among the selling Holders based on the number of Registrable Securities held by all selling Holders or in such other proportions as shall mutually be agreed to by all such selling Holders. Notwithstanding the foregoing, in no event shall (i) the amount of securities of the selling Holders included in the offering be reduced below thirty percent (30%) of the total amount of securities included in such offering, unless such offering is the initial public offering of the Company's securities, in which case the selling Holders may be excluded if the underwriters make the determination described above and no other stockholder's securities are included in such offering. For purposes of the preceding sentence concerning apportionment, for any selling stockholder that is a Holder of Registrable Securities and that is a venture capital fund, mutual fund, business trust, partnership or corporation, the affiliated venture capital funds, mutual funds, business trusts, partners, retired partners and stockholders of such Holder, or the estates and family members of any such partners and retired partners and any trusts for the benefit of any of the foregoing persons shall be deemed to be a single "selling Holder," and any pro rata reduction with respect to such "selling Holder" shall be based upon the aggregate amount of Registrable Securities owned by all such related entities and individuals.

1.4 Form S-3 Registration. In case the Company shall receive from Holders of Registrable Securities (for purposes of this Section 1.4, the "Initiating Holders") a written request or requests that the Company effect a registration on Form S-3 and any related qualification or compliance with respect to all or a part of the Registrable Securities owned by such Holder or Holders, the Company shall:

(a) promptly give written notice of the proposed registration, and any related qualification or compliance, to all other Holders; and

(b) use all commercially reasonable efforts to effect, as soon as practicable, such registration and all such qualifications and compliances as may be so requested and as would permit or facilitate the sale and distribution of all or such portion of such Holders' Registrable Securities as are specified in such request, together with all or such portion of the Registrable Securities of any other Holders joining in such request as are specified in a written request given within fifteen (15) days after receipt of such written notice from the Company, provided, however, that the Company shall not be obligated to effect any such registration, qualification or compliance, pursuant to this Section 1.4:

(i) if Form S-3 is not available for such offering by the Holders;

(ii) if the Holders, together with the holders of any other securities of the Company entitled to inclusion in such registration, propose to sell Registrable Securities and such other securities (if any) at an aggregate price to the public (net of any underwriters' discounts or commissions) of less than $1,000,000;

(iii) if the Company has, within the twelve (12) month period preceding the date of such request, already effected two registrations on Form S-3 for the Holders pursuant to this Section 1.4;

(iv) in any particular jurisdiction in which the Company would be required to qualify to do business or to execute a general consent to service of process in effecting such registration, qualification or compliance;

(v) during the period starting with the date ninety (90) days prior to the Company's good faith estimate of the date of the filing of and ending on a date one hundred eighty (180) days following the effective date of a Company-initiated registration subject to Section 1.3 below, provided that the Company delivers notice of such proposed registration to the holders of the Registrable Securities within 30 days of any registration request by the holders and that the Company is actively employing in good faith all commercially reasonable efforts to cause such registration statement to become effective; or

(vi) if the Company shall furnish to the Initiating Holders a certificate signed by the Company's Chief Executive Officer or Chairman of the Board stating that in the good faith judgment of the Board of Directors of the Company, it would be seriously detrimental to the Company and its stockholders for such registration statement to be effected at such time, in which event the Company shall have the right to defer such filing for a period of not more than ninety (90) days after receipt of the request of the Initiating Holders, provided that such right shall be exercised by the Company not more than once in any twelve (12) month period and provided further that the Company shall not register any securities for the account of itself or any other stockholder during such ninety (90) day period (other than a registration relating solely to the sale of securities of participants in a Company stock plan, a registration relating to a corporate reorganization or transaction under Rule 145 of the Act, a registration on any form that does not include substantially the same information as would be required to be included in a registration statement covering the sale of the Registrable Securities, or a registration in which the only Common Stock being registered is Common Stock issuable upon conversion of debt securities that are also being registered).

(c) If the Initiating Holders intend to distribute the Registrable Securities covered by their request by means of an underwriting, they shall so advise the Company as a part of their request made pursuant to this Section 1.4 and the Company shall include such information in the written notice referred to in Section 1.4(a). The provisions of Section 1.2(b) shall be applicable to such request (with the substitution of Section 1.4 for references to Section 1.2).

(d) Subject to the foregoing, the Company shall file a registration statement covering the Registrable Securities and other securities so requested to be registered as soon as practicable after receipt of the request or requests of the Initiating Holders. Registrations effected pursuant to this Section 1.4 shall not be counted as requests for registration effected pursuant to Sections 1.2.

1.5 Obligations of the Company. Whenever required under this Section 1 to effect the registration of any Registrable Securities, the Company shall, as expeditiously as reasonably possible:

(a) prepare and file with the SEC a registration statement with respect to such Registrable Securities and use all commercially reasonable efforts to cause such registration statement to become effective, and, upon the request of the Holders of a majority of the Registrable Securities registered thereunder, keep such registration statement effective for a period of up to one hundred twenty (120) days or, if earlier, until the distribution contemplated in the Registration Statement has been completed;

(b) prepare and file with the SEC such amendments and supplements to such registration statement and the prospectus used in connection with such registration statement as may be necessary to comply with the provisions of the Act with respect to the disposition of all securities covered by such registration statement;

(c) furnish to the Holders such number of copies of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Act, and such other documents as they may reasonably request in order to facilitate the disposition of Registrable Securities owned by them;

(d) use all commercially reasonable efforts to register and qualify the securities covered by such registration statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Holders, provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions;

(e) in the event of any underwritten public offering, enter into and perform its obligations under an underwriting agreement, in usual and customary form, with the managing underwriter of such offering;

(f) notify each Holder of Registrable Securities covered by such registration statement at any time when a prospectus relating thereto is required to be delivered under the Act of the happening of any event as a result of which the prospectus included in such registration statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances then existing. The Company will use reasonable efforts to amend or supplement such prospectus in order to cause such prospectus not to include any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances then existing.

(g) Use its reasonable efforts to furnish, on the date that such Registrable Securities are delivered to the underwriters for sale, if such securities are being sold through underwriters, (i) an opinion, dated as of such date, of the counsel representing the Company for the purposes of such registration, in form and substance as is customarily given to underwriters in an underwritten public offering, addressed to the underwriters, if any, and (ii) a letter, dated as of such date, from the independent certified public accountants of the Company, in form and substance as is customarily given by independent certified public accountants to underwriters in an underwritten public offering addressed to the underwriters.

(h) cause all such Registrable Securities registered pursuant to this Section 1 to be listed on a national exchange or trading system and on each securities exchange and trading system on which similar securities issued by the Company are then listed; and

(i) provide a transfer agent and registrar for all Registrable Securities registered pursuant hereunder and a CUSIP number for all such Registrable Securities, in each case not later than the effective date of such registration.

1.6 Information from Holder. It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Section 1 with respect to the Registrable Securities of any selling Holder that such Holder shall furnish to the Company such information regarding itself, the Registrable Securities held by it, and the intended method of disposition of such securities as shall be reasonably required to effect the registration of such Holder's Registrable Securities.

1.7 Expenses of Registration. All expenses other than underwriting discounts and commissions incurred in connection with registrations, filings or qualifications pursuant to Sections 1.2, 1.3 and 1.4, including (without limitation) all registration, filing and qualification fees, printers' and accounting fees, fees and disbursements of counsel for the Company and the reasonable fees and disbursements of one counsel for the selling Holders shall be borne by the Company. Notwithstanding the foregoing, the Company shall not be required to pay for any expenses of any registration proceeding begun pursuant to Section 1.2 or Section 1.4 if the registration request is subsequently withdrawn at the request of the Holders of a majority of the Registrable Securities to be registered (in which case all participating Holders shall bear such expenses pro rata based upon the number of Registrable Securities that were to be included in the withdrawn registration), unless, in the case of a registration requested under Section 1.2, the Holders of a majority of the Registrable Securities requested to be included in such registration agree to forfeit their right to one demand registration pursuant to Section 1.2 and provided, however, that if at the time of such withdrawal, the Holders have learned of a material adverse change in the condition, business or prospects of the Company from that known to the Holders at the time of their request and have withdrawn the request with reasonable promptness following disclosure by the Company of such material adverse change, then the Holders shall not be required to pay any of such expenses and shall retain their rights pursuant to Section 1.2 and 1.4.

1.8 Delay of Registration. No Holder shall have any right to obtain or seek an injunction restraining or otherwise delaying any such registration as the result of any controversy that might arise with respect to the interpretation or implementation of this Section 1.

1.9 Indemnification. In the event any Registrable Securities are included in a registration statement under this Section 1:

(a) To the extent permitted by law, the Company will indemnify and hold harmless each Holder, the partners, members, officers, directors, trustees and stockholders of each Holder, legal counsel and accountants for each Holder, any underwriter (as defined in the Act) for such Holder and each person, if any, who controls such Holder or underwriter within the meaning of the Act or the 1934 Act, against any losses, claims, damages or liabilities (joint or several) to which they may become subject under the Act, the 1934 Act, any state securities laws or any rule or regulation promulgated under the Act, insofar as such losses, claims, damages, or liabilities (or actions in respect thereof) arise out of or are based upon any of the following statements, omissions or violations (collectively a “Violation”): (i) any untrue statement or alleged untrue statement of a material fact contained in such registration statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto, (ii) the omission or alleged omission to state in such registration statement a material fact required to be stated therein, or necessary to make the statements therein not misleading or (iii) any violation or alleged violation by the Company of the Act, the 1934 Act, any state securities laws or any rule or regulation promulgated under the Act, the 1934 Act or any state securities laws, and the Company will reimburse each such Holder, underwriter, controlling person or other aforementioned person for any legal or other expenses reasonably incurred by them in connection with investigating or defending any such loss, claim, damage, liability or action as such expenses are incurred; provided, however, that the indemnity agreement contained in this subsection l.9(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Company (which consent shall not be unreasonably withheld), nor shall the Company be liable in any such case for any such loss, claim, damage, liability or action to the extent that it arises out of or is based upon a Violation that occurs in reliance upon and in conformity with written information furnished expressly for use in connection with such registration by any such Holder, underwriter, controlling person or other aforementioned person.

(b) To the extent permitted by law, each selling Holder will indemnify and hold harmless, severally and not jointly, the Company, each of its directors, each of its officers who has signed the registration statement, each person, if any, who controls the Company within the meaning of the Act, legal counsel and accountants for the Company, any underwriter, any other Holder selling securities in such registration statement and any controlling person of any such underwriter or other Holder, against any losses, claims, damages or liabilities (joint or several) to which any of the foregoing persons may become subject, under the Act, the 1934 Act, any state securities laws or any rule or regulation promulgated under the Act, the 1934 Act or any state securities laws, insofar as such losses, claims, damages or liabilities (or actions in respect thereto) arise out of or are based upon any Violation, in each case to the extent (and only to the extent) that such Violation occurs in reliance upon and in conformity with written information furnished by such Holder expressly for use in connection with such registration; and each such Holder will reimburse any person intended to be indemnified pursuant to this subsection l.9(b) for any legal or other expenses reasonably incurred by such person in connection with investigating or defending any such loss, claim, damage, liability or action as such expenses are incurred; provided, however, that the indemnity agreement contained in this subsection l.9(b) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Holder (which consent shall not be unreasonably withheld), and provided that in no event shall any indemnity under this subsection l.9(b) exceed the net proceeds from the offering received by such Holder.

(c) Promptly after receipt by an indemnified party under this Section 1.9 of notice of the commencement of any action (including any governmental action), such indemnified party will, if a claim in respect thereof is to be made against any indemnifying party under this Section 1.9, deliver to the indemnifying party a written notice of the commencement thereof and the indemnifying party shall have the right to participate in and, to the extent the indemnifying party so desires, jointly with any other indemnifying party similarly noticed, to assume the defense thereof with counsel mutually satisfactory to the parties; provided, however, that an indemnified party (together with all other indemnified parties that may be represented without conflict by one counsel) shall have the right to retain one separate counsel, with the fees and expenses to be paid by the indemnifying party, if representation of such indemnified party by the counsel retained by the indemnifying party would be inappropriate due to actual or potential differing interests between such indemnified party and any other party represented by such counsel in such proceeding. The failure to deliver written notice to the indemnifying party within a reasonable time of the commencement of any such action, if prejudicial to its ability to defend such action, shall relieve such indemnifying party of liability to the indemnified party under this Section 1.9 to the extent of such prejudice, but the omission to so deliver written notice to the indemnifying party will not relieve it of any liability that it may have to any indemnified party otherwise than under this Section 1.9.

(d) If the indemnification provided for in this Section 1.9 is held by a court of competent jurisdiction to be unavailable to an indemnified party with respect to any loss, liability, claim, damage or expense referred to herein, then the indemnifying party, in lieu of indemnifying such indemnified party hereunder, shall contribute to the amount paid or payable by such indemnified party as a result of such loss, liability, claim, damage or expense in such proportion as is appropriate to reflect the relative fault of the indemnifying party on the one hand and the indemnified party on the other hand in connection with the statements or omissions that resulted in such loss, liability, claim, damage or expense, as well as any other relevant equitable considerations; provided, however, that no contribution by any Holder, when combined with any amounts paid by such Holder pursuant to Section 1.9(b), shall exceed the net proceeds from the offering received by such Holder. The relative fault of the indemnifying party and the indemnified party shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information supplied by the indemnifying party or by the indemnified party and the parties’ relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission.

(e) The obligations of the Company and Holders under this Section 1.9 shall survive the completion of any offering of Registrable Securities in a registration statement under this Section 1 and otherwise.

1.10 Reports Under the 1934 Act. With a view to making available to the Holders the benefits of Rule 144 and any other rule or regulation of the SEC that may at any time permit a Holder to sell securities of the Company to the public without registration or pursuant to a registration on Form S-3, the Company agrees to:

(a) make and keep public information available, as those terms are understood and defined in Rule 144, at all times after the effective date of the Initial Offering;

(b) file with the SEC in a timely manner all reports and other documents required of the Company under the Act and the 1934 Act; and

(c) furnish to any Holder, so long as the Holder owns any Registrable Securities, forthwith upon request (i) a written statement by the Company that it has complied with the reporting requirements of Rule 144 (at any time after the effective date of the first registration statement filed by the Company), the Act and the 1934 Act (at any time after it has become subject to such reporting requirements), or that it qualifies as a registrant whose securities may be resold pursuant to Form S-3 (at any time after it so qualifies), (ii) a copy of the most recent annual or quarterly report of the Company and such other reports and documents so filed by the Company, and (iii) such other information as may be reasonably requested to avail any Holder of any rule or regulation of the SEC that permits the selling of any such securities without registration or pursuant to such form.

1.11 Assignment of Registration Rights. The rights to cause the Company to register Registrable Securities pursuant to this Section 1 may be assigned (but only with all related obligations) by a Holder to a transferee or assignee of such securities that (i) is a subsidiary, parent, partner, limited partner, retired partner, member, retired member, affiliated venture capital fund, affiliated mutual fund, affiliated business trust or stockholder of a Holder, (ii) is a Holder's family member or trust for the benefit of an individual Holder, or (iii) after such assignment or transfer, holds at least 1,000,000 shares of Registrable Securities (subject to appropriate adjustment for stock splits, stock dividends, combinations or the like), provided: (a) the Company is, within ten (10) days after such transfer, furnished with written notice of the name and address of such transferee or assignee and the securities with respect to which such registration rights are being assigned; (b) such transferee or assignee agrees in writing to be bound by and subject to the terms and conditions of this Agreement, including, without limitation, the provisions of Section 1.13 below; (c) such assignment shall be effective only if immediately following such transfer the further disposition of such securities by the transferee or assignee is restricted under the Act; and (d) such transferee is not a direct competitor of the Company, as determined in the good faith judgment of the Board of Directors, at the time of such transfer.

1.12 Limitations on Subsequent Registration Rights. From and after the date of this Agreement, the Company shall not, without the prior written consent of the holders of at least sixty-three percent (63%) of the Registrable Securities held by holders of the Company's Series B Preferred Stock and Series C Preferred Stock (together and not as a separate class on an as-converted basis), enter into any agreement with any holder or prospective holder of any securities of the Company that would allow such holder or prospective holder (a) to include any of such securities in any registration filed under Section 1.2, Section 1.3 or Section 1.4 hereof, unless under the terms of such agreement, such holder or prospective holder may include such securities in any such registration only to the extent that the inclusion of such securities will not reduce the amount of the Registrable Securities of the Holders that are included or (b) to demand registration of their securities.

1.13 "Market Stand-Off" Agreement.

(a) Each Holder hereby agrees that it will not, without the prior written consent of the managing underwriter, during the period commencing on the date of the final prospectus relating to the Company's Initial Offering and ending on the date specified by the Company and the managing underwriter (such period not to exceed one hundred eighty (180) days) (i) lend, offer, pledge, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, or otherwise transfer or dispose of, directly or indirectly, any shares of Common Stock or any securities convertible into or exercisable or exchangeable for Common Stock held immediately prior to the effectiveness of the Registration Statement for such offering, or (ii) enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of the Common Stock, whether any such transaction described in clause (i) or (ii) above is to be settled by delivery of Common Stock or other securities, in cash or otherwise. The foregoing provisions of this Section 1.13 shall apply only to the Company's initial offering of equity securities, shall not apply to the sale of any shares to an underwriter pursuant to an underwriting agreement, and shall only be applicable to the Holders if all officers, directors and greater than two percent (2%) stockholders of the Company enter into similar agreements and such restrictions are not waived as to them. The underwriters in connection with the Company's Initial Offering are intended third-party beneficiaries of this Section 1.13 and shall have the right, power and authority to enforce the provisions hereof as though they were a party hereto. Each Holder further agrees to execute such agreements as may be reasonably requested by the underwriters in the Company's Initial Offering that are consistent with this Section 1.13 or that are necessary to give further effect thereto. Any discretionary waiver or termination of the restrictions of any or all of such agreements by the Company or the underwriters shall apply to all Holders subject to such agreements pro rata based on the number of shares subject to such agreements.

In order to enforce the foregoing covenant, the Company may impose stop-transfer instructions with respect to the Registrable Securities of each Holder (and the shares or securities of every other person subject to the foregoing restriction) until the end of such period.

(b) Each Holder agrees that a legend reading substantially as follows shall be placed on all certificates representing all Registrable Securities of each Holder (and the shares or securities of every other person subject to the restriction contained in this Section 1.13):

THE SECURITIES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO A LOCK-UP PERIOD OF UP TO 180 DAYS AFTER THE EFFECTIVE DATE OF THE ISSUER'S REGISTRATION STATEMENT FILED UNDER THE ACT, AS AMENDED, AS SET FORTH IN AN AGREEMENT BETWEEN THE COMPANY AND THE ORIGINAL HOLDER OF THESE SECURITIES, A COPY OF WHICH MAY BE OBTAINED AT THE ISSUER'S PRINCIPAL OFFICE. SUCH LOCK-UP PERIOD IS BINDING ON TRANSFEREES OF THESE SHARES.

1.14 Termination of Registration Rights. No Holder shall be entitled to exercise any right provided for in this Section 1 (i) after five (5) years following the consummation of the Initial Offering, (ii) as to any Holder, such earlier time after the Initial Offering at which all Registrable Securities held by such Holder (together with any affiliate of the Holder with whom such Holder must aggregate its sales under Rule 144) that holds less than one percent (1%) of the Company's outstanding Common Stock (treating all shares of Preferred Stock on an as converted basis) and all such Registrable Securities can be sold in any three (3)-month period without registration in compliance with Rule 144 or (iii) after the consummation of a Liquidation Event, as that term is defined in the Company's Amended and Restated Certificate of Incorporation (as amended from time to time) (the "Restated Certificate").

1.15 Black-Out Period.

(a) Following the effectiveness of any registration statement and the filings with any state securities commissions, the Company shall be entitled to postpone or suspend, for a reasonable period of time, but in any event such period shall not exceed ninety days (the "Suspension Period") sales of Registrable Securities under such registration statement or any such filings upon written notice to the Holders that the Company has determined that such sales would in the good faith judgment of the Board of Directors of the Company (a) materially adversely impair the consummation of any pending or proposed material offering or sale of any class of securities by the Company or (b) require disclosure of material nonpublic information that, if disclosed at such time, would be materially harmful to the interest of the Company and its shareholders; provided, however, that during any such period all executive officers and directors of the Company are also prohibited from selling securities of the Company (or any security of any of the Company's subsidiaries or affiliates). The Holder may recommence effecting sales of the Registrable Securities pursuant to the registration statement or such filings following further notice to such effect from the Company, such notice to be given by the Company not later than five (5) business days after the conclusion of the reason for the postponement or suspension. The Company shall use its best efforts to limit the length of any such period of suspended sales and shall use its best efforts to correct, amend or update any incomplete or misleading registration statement. No more than two (2) such Suspension Periods shall occur in any twelve month period.

(b) In the event of the suspension of effectiveness of any registration statement or other filings pursuant to this Section 1.15, the applicable time period during which such registration statement or other filing is to remain effective shall be extended by that number of days equal to the number of days the effectiveness of such registration statement or filing was suspended.

2. Covenants of the Company.

2.1 Delivery of Financial Statements. So long as any shares of Preferred Stock remain outstanding, the Company shall deliver to each Investor (or transferee of an Investor) that holds at least 1,000,000 shares of Registrable Securities (as adjusted for stock splits, stock dividends, combinations or the like) (a “Major Investor”):

(a) as soon as practicable, but in any event within one hundred and twenty (120) days after the end of each fiscal year of the Company, an income statement for such fiscal year, a balance sheet of the Company and statement of stockholders’ equity as of the end of such year, and a statement of cash flows for such year, such year-end financial reports to be in reasonable detail, prepared in accordance with generally accepted accounting principles (“GAAP”), and audited and certified by independent public accountants selected by the Company and approved by the directors nominated by the holders of Series B Preferred Stock and Series C Preferred Stock pursuant to Sections 3.1 and 3.2 of the Second Amended and Restated Voting Agreement among the Company and the other parties thereto dated as of the date hereof;

(b) as soon as practicable, but in any event within forty-five (45) days after the end of each of the first three (3) quarters of each fiscal year of the Company, an unaudited income statement, statement of cash flows for such fiscal quarter and an unaudited balance sheet as of the end of such fiscal quarter in reasonable detail including a comparison to plan figures for such period, prepared in accordance with generally accepted accounting principles consistently applied (except as noted therein), with the exception that no notes need be attached to such statements and year-end audit adjustments may not have been made; and

(c) within forty-five (45) days of the end of each month, an unaudited income statement and statement of cash flows and balance sheet for and as of the end of such month, in reasonable detail including a comparison to plan figures for such period, prepared in accordance with generally accepted accounting principles consistently applied (except as noted therein), with the exception that no notes need be attached to such statements and year-end audit adjustments may not have been made; and

(d) as soon as practicable, but in any event at least thirty (30) days prior to the end of each fiscal year, a capital and operating budget and business plan for the next fiscal year, prepared on a monthly basis, including balance sheets, income statements and statements of cash flows for such months and, as soon as prepared, any other budgets or revised budgets prepared by the Company.

2.2 Inspection. The Company shall permit each Major Investor that holds at least 3,000,000 shares of Registrable Securities (as adjusted for stock splits, stock dividends, combinations or the like), at such Major Investor’s expense, to visit and inspect the Company’s properties, to examine its books of account and records and to discuss the Company’s affairs, finances and accounts with its officers, all at such reasonable times as may be requested by such Major Investor; provided, however, that the Company shall not be obligated pursuant to this Section 2.2 to provide access to any information that it reasonably considers to be a trade secret or similar confidential information.

2.3 Termination of Information and Inspection Covenants. The covenants set forth in Sections 2.1 and 2.2 shall terminate and be of no further force or effect upon the earlier to occur of (i) the consummation of the sale of securities pursuant to a registration statement filed by the Company under the Act in connection with the firm commitment underwritten offering of its securities to the general public, (ii) when the Company first becomes subject to the periodic reporting requirements of Sections 13 or 15(d) of the 1934 Act, whichever event shall first occur or (iii) the consummation of a Liquidation Event, as that term is defined in the Restated Certificate.

2.4 Right of First Offer. Subject to the terms and conditions specified in this Section 2.4, the Company hereby grants to each Major Investor who holds shares of Preferred Stock a right of first offer with respect to future sales by the Company of its Shares (as hereinafter defined). For purposes of this Section 2.4, the term “Major Investor” includes any general partners and affiliates of a Major Investor. A Major Investor shall be entitled to apportion the right of first offer hereby granted it among itself and its partners and affiliates in such proportions as it deems appropriate.

Each time the Company proposes to offer any shares of, or securities convertible into or exchangeable or exercisable for any shares of, its capital stock (“Shares”), the Company shall first make an offering of such Shares to each Major Investor who holds shares of Preferred Stock in accordance with the following provisions:

(a) The Company shall deliver a notice in accordance with Section 3.5 (“Notice”) to the Major Investors stating (i) its bona fide intention to offer such Shares, (ii) the number of such Shares to be offered and (iii) the price and terms upon which it proposes to offer such Shares.

(b) By written notification received by the Company within twenty (20) calendar days after the giving of Notice, each Major Investor may elect to purchase, at the price and on the terms specified in the Notice, up to that portion of such Shares that equals the product of the number of Shares times the fraction obtained by dividing (i) the sum of the total number of shares of (A) Common Stock issuable or issued upon conversion of the Preferred Stock then held by such Major Investor and (B) Common Stock issuable upon exercise of any options or warrants then held by such Major Investor by (ii) the sum of the total number of shares of (A) Common Stock, (B) Common Stock issuable upon the conversion of the Preferred Stock and (C) Common Stock issuable upon any exercise of any options or warrants then outstanding. The Company shall promptly, in writing, inform each Major Investor that elects to purchase all the shares available to it (a “Fully-Exercising Investor”) of any other Major Investor’s failure to do likewise. During the ten (10) day period commencing after such information is given, each Fully-Exercising Investor may elect to purchase that portion of the Shares for which Major Investors were entitled to subscribe, but which were not subscribed for by the Major Investors, that is equal to the proportion that the number of shares of (A) Common Stock issuable or issued upon conversion of the Preferred Stock then held by such Fully-

Exercising Investor and (B) Common Stock issuable upon exercise of any options or warrants then held by such Fully-Exercising Investor bears to the total number of shares of (A) Common Stock, (B) Common Stock issuable upon the conversion of the Preferred Stock and (C) Common Stock issuable upon any exercise of any options or warrants then outstanding.

(c) If all Shares that Major Investors are entitled to obtain pursuant to subsection 2.4(b) are not elected to be obtained as provided in subsection 2.4(b) hereof, the Company may, during the ninety (90) day period following the expiration of the period provided in subsection 2.4(b) hereof, offer the remaining unsubscribed portion of such Shares to any person or persons at a price not less than that, and upon terms no more favorable to the offeree than those, specified in the Notice. If the Company does not enter into an agreement for the sale of the Shares within such period, or if such is not consummated within sixty (60) days of the execution thereof, the right provided hereunder shall be deemed to be revived and such Shares shall not be offered unless first reoffered to the Major Investors in accordance herewith.

(d) The right of first offer in this Section 2.4 shall not be applicable to (i) the issuance or sale of shares of Common Stock (or options therefor) to employees, directors, consultants and other service providers for the primary purpose of soliciting or retaining their services pursuant to plans or agreements approved by the Company's Board of Directors; (ii) the issuance of securities pursuant to a bona fide, firmly underwritten public offering of shares of Common Stock registered under the Act, (iii) the issuance of securities pursuant to the conversion or exercise of convertible or exercisable securities, (iv) the issuance of securities in connection with a bona fide business acquisition of or by the Company approved by the Company's Board of Directors, whether by merger, consolidation, sale of assets, sale or exchange of stock or otherwise, (v) the issuance and sale of Series C Preferred Stock pursuant to the Series C Agreement, or (vi) the issuance of stock, warrants or other securities or rights to persons or entities with which the Company has business relationships, provided such issuances are primarily for other than equity financing purposes and which issuances have been approved by a majority of the Board of Directors. In addition to the foregoing, the right of first offer in this Section 2.4 shall not be applicable with respect to any Major Investor in any subsequent offering of Shares if (i) at the time of such offering, the Major Investor is not an "accredited investor," as that term is then defined in Rule 501(a) of the Act and (ii) such offering of Shares is otherwise being offered only to accredited investors.

(e) The rights provided in this Section 2.4 may not be assigned or transferred by any Major Investor to a competitor of the Company (as determined in good faith by the Board of Directors of the Company).

(f) The covenants set forth in this Section 2.4 shall terminate and be of no further force or effect upon the consummation of (i) the Company's sale of its Common Stock or other securities pursuant to a Qualified Public Offering, as that term is defined in the Restated Certificate or (ii) a Liquidation Event, as that term is defined in the Restated Certificate.

2.5 <u>Proprietary Information and Inventions Agreements</u>. The Company shall require all employees and consultants with access to confidential information to execute and deliver a proprietary information and inventions agreement or a consulting agreement, as applicable, in substantially the form approved by the Company's Board of Directors.

2.6 Director and Officer Liability Insurance. To the extent that such coverage is available on commercially reasonable terms (as determined in the good faith judgment of the Board of Directors), the Company shall purchase and at all times maintain director and officer liability insurance with coverage limits customary for similarly situated companies.

2.7 Reimbursement of Expenses. The Company shall reimburse members of the Board of Directors for reasonable expenses incurred in connection with the performance of their duties as a member of the Board of Directors.

2.8 Qualified Small Business Stock.

(a) The Company shall not make any purchases of its stock or take other actions which would jeopardize the status of the Series B Preferred or Series C Preferred as "qualified small business stock" under Section 1202 of the Internal Revenue Code.

(b) The Company will use commercially reasonable efforts to comply with any applicable filing and reporting requirements of Section 1202 of the Internal Revenue Code, as amended or as may be amended from time to time, and any regulations promulgated thereunder; provided, however, that "reasonable efforts" as used in this Section 2.7(b) shall not be construed to require the Company to operate its business in a manner which would adversely affect its business, limit its future prospects or alter the timing or resource allocation related to its planned operations or financing activities.

2.9 Compensation and Audit Committees. The Company's Board of Directors shall create and maintain a Compensation Committee and an Audit Committee, both of which shall consist of no more than four directors, at least two of which shall be directors designated by the directors elected by the holders of Preferred Stock and one of whom shall be the director that serves as the Chief Executive Officer of the Company (the "CEO Director"); provided, that the CEO Director shall be a non-voting member of such committees.

2.10 Directors' Liability and Indemnification. The Company's Certificate of Incorporation and Bylaws shall provide (a) for elimination of the liability of director to the maximum extent permitted by law and (b) for indemnification of directors for acts on behalf of the Company to the maximum extent permitted by law. In addition, the Company shall enter into and use its best efforts to at all times maintain indemnification agreements substantially in the form attached as Exhibit G to the Series C Agreement with each of its directors to indemnify such directors to the maximum extent permissible under applicable law.

2.11 Visitation Rights. The Company shall allow one representative designated by Onset Ventures to attend all meetings of the Company's Board of Directors in a nonvoting capacity, and in connection therewith, the Company shall give such representative copies of all notices, minutes, consents and other materials, financial or otherwise, which the Company provides to its Board of Directors; provided, however, that the Company reserves the right to exclude such representative from access to any material or meeting or portion thereof if the Company believes upon advice of counsel that such exclusion is reasonably necessary to preserve the attorney-client privilege, to protect confidential information or for other similar reasons. The decision of the Board with respect to the privileged or confidential nature of such information shall be final and binding.

3. Miscellaneous.

3.1 Successors and Assigns. Except as otherwise provided herein, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective heirs, personal representatives, successors and permitted assigns (including transferees of any shares of Registrable Securities). Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

3.2 Governing Law. This Agreement shall be interpreted under the laws of the State of Minnesota without reference to Minnesota conflicts of law provisions.

3.3 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument. This Agreement may also be executed and delivered by facsimile signature and in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

3.4 Titles and Subtitles. The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

3.5 Notices. All notices and other communications given or made pursuant hereto shall be in writing and shall be deemed effectively given: (i) upon personal delivery to the party to be notified, (ii) when sent by confirmed facsimile if sent during normal business hours of the recipient; if not, then on the next business day, (iii) five (5) days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (iv) one (1) day after deposit with a nationally recognized overnight courier, specifying next day delivery, with written verification of receipt. All communications shall be sent to the respective parties at the addresses set forth on the signature pages attached hereto (or at such other addresses as shall be specified by notice given in accordance with this Section 3.5).

3.6 Expenses. If any action at law or in equity is necessary to enforce or interpret the terms of this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees, costs and necessary disbursements in addition to any other relief to which such party may be entitled.

3.7 Entire Agreement; Amendments and Waivers. This Agreement (including the Exhibits hereto, if any) constitutes the full and entire understanding and agreement among the parties with regard to the subjects hereof and thereof. Any term of this Agreement (other than Section 2.1, Section 2.2, Section 2.3 and Section 2.4) may be amended and the observance of any term of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively) only with the written consent of the Company and the holders of at least sixty-three percent (63%) of the issued and outstanding shares of Series B Preferred Stock and Series C Preferred Stock (together and not as a separate class). The provisions of Section 2.1, Section 2.2, Section 2.3 and Section 2.4 may be amended or waived (either generally or in a particular instance and either retroactively or prospectively) only with the written consent of the Company and the holders of at least sixty-three percent (63%) of the Registrable Securities that are held by the Major Investors; provided, however, that notwithstanding any such waiver of rights under Section 2.4, in the event that any Major Investor actually purchases Shares in any such offering by the Company, then each other Major Investor shall be permitted to participate on a pro rata basis (based on the level of participation of the other Major Investor purchasing the largest portion of such other Major Investor's pro rata share) in accordance with the other provisions, including notice and election periods, as set forth in Section 2.4(a) and (b). Any amendment or waiver effected in accordance with this paragraph shall be binding upon all the parties hereto.

3.8 Severability. If one or more provisions of this Agreement are held to be unenforceable under applicable law, such provision(s) shall be excluded from this Agreement and the balance of the Agreement shall be interpreted as if such provision(s) were so excluded and shall be enforceable in accordance with its terms.

3.9 Aggregation of Stock. All shares of Registrable Securities held or acquired by affiliated entities (including affiliated venture capital funds) or persons shall be aggregated together for the purpose of determining the availability of any rights under this Agreement.

3.10 Restrictions on Transfer. In addition to, and not in limitation of the rights of an Investor to transfer its rights hereunder, an Investor's rights and obligations hereunder may be transferred to any of such Investor's "affiliates," as that term is defined under the Securities Act, so long as such affiliate is an "accredited investor" (within the meaning of Regulation D under the Securities Act); provided that the prospective transferee agrees in writing to be subject to the terms hereof to the same extent as if he, she or it were an original Investor hereunder.

3.11 Substitution. This Amended and Restated Investors' Rights Agreement replaces by substitution that certain Investors' Rights Agreement, dated July 31, 2004, by and among the Company and the parties listed on Schedule A thereto.

IN WITNESS WHEREOF, the parties have executed this Amended and Restated Investors’ Rights Agreement as of the date first above written.

ENTEROMEDICS INC.

By:	/s/ Mark B. Knudson
Name:	Mark B. Knudson
Title:	President and Chief Executive Officer
Address:	2800 Patton Road St. Paul, MN 55113

SIGNATURE PAGE TO ENTEROMEDICS INC.
AMENDED AND RESTATED INVESTORS’ RIGHTS AGREEMENT

INVESTORS:

INTERWEST PARTNERS IX, LP

By: InterWest Management Partners IX, LLC its general partner

By: /s/ Ellen Koskinas
Name: Ellen Koskinas
Title: Venture Member

ONSET V, L.P.

By: ONSET V Management, LLC its General Partner

By: /s/ Leslie Bottorff
Name: Leslie Bottorff,
Title: Managing Director

MAYO FOUNDATION FOR MEDICAL EDUCATION AND RESEARCH

By: /s/ Steven P. VanNurden
Name: Steven P. VanNurden
Title: Assistant Treasurer

INVESTORS:

MPM BIOVENTURES III, L.P.
By: MPM BioVentures III GP, L.P., its General Partner
By: MPM BioVentures III LLC, its General Partner

By: /s/ Luke B. Evnin
Name: Luke B. Evnin
Title: Series A Member

MPM BIOVENTURES III-QP, L.P.
By: MPM BioVentures III GP, L.P., its General Partner
By: MPM BioVentures III LLC, its General Partner

By: /s/ Luke B. Evnin
Name: Luke B. Evnin
Title: Series A Member

MPM BIOVENTURES III Parallel Fund, L.P.
By: MPM BioVentures III GP, L.P., its General Partner
By: MPM BioVentures III LLC, its General Partner

By: /s/ Luke B. Evnin
Name: Luke B. Evnin
Title: Series A Member

MPM BIOVENTURES III GMBH & CO. BETEILIGUNGS KG
By: MPM BioVentures III GP, L.P., in its capacity as the Managing Limited Partner
By: MPM BioVentures III LLC, its General Partner

By: /s/ Luke B. Evnin
Name: Luke B. Evnin
Title: Series A Member

MPM ASSET MANAGEMENT INVESTORS 2002 BVIII LLC

By: /s/ Luke B. Evnin
Name: Luke B. Evnin
Title: Manager

SIGNATURE PAGE TO ENTEROMEDICS INC.
AMENDED AND RESTATED INVESTORS’ RIGHTS AGREEMENT

INVESTORS:

PACIFIC ASSET PARTNERS

/s/ Robert M. Stafford

Robert M. Stafford
Managing Partner
Pacific Asset Partners

SIGNATURE PAGE TO ENTEROMEDICS INC.
AMENDED AND RESTATED INVESTORS' RIGHTS AGREEMENT

INVESTORS:

/s/ Kenneth Martin

Kenneth Martin

SIGNATURE PAGE TO ENTEROMEDICS INC.
AMENDED AND RESTATED INVESTORS' RIGHTS AGREEMENT

INVESTORS:

MARK B. KNUDSON REVOCABLE TRUST U/A DTD APRIL 18, 2003 WITH SUSAN J. KNUDSON AS DONOR

/s/ Mark B. Knudson
Mark B. Knudson, Trustee

Dorsey & Whitney Trust Company LLC, Trustee

By: /s/ Barry J. Newman
Name: Barry J. Newman
Its: Vice President

SUSAN J. KNUDSON REVOCABLE TRUST U/A DTD APRIL 18, 2003 WITH SUSAN J. KNUDSON AS DONOR

/s/ Mark B. Knudson
Mark B. Knudson, Trustee

Dorsey & Whitney Trust Company LLC, Trustee

By: /s/ Barry J. Newman
Name: Barry J. Newman
Its: Vice President

THE SPRAKER FAMILY TRUST U/A/D 10/13/98

/s/ Terry Spraker
Terry Spraker, Trustee

/s/ Linda Spraker
Linda Spraker, Trustee

/s/ Timothy R. Conrad
Timothy R. Conrad

/s/ Robert S. Nickoloff
Robert S. Nickoloff

/s/ Richard R. Wilson, M.D.
Richard R. Wilson, M.D.

SIGNATURE PAGE TO ENTEROMEDICS INC.
AMENDED AND RESTATED INVESTORS' RIGHTS AGREEMENT

/s/ Donald C. Harrison, M.D.
Donald C. Harrison, M.D.

/s/ Susan J. Knudson
Susan J. Knudson

/s/ Anne H. Nickoloff
Anne H. Nickoloff

**SIGNATURE PAGE TO ENTEROMEDICS INC.
AMENDED AND RESTATED INVESTORS’ RIGHTS AGREEMENT**

INVESTORS:

CHARTER LIFE SCIENCES, L.P.

By: /s/ A. Barr Dolan
Name: A. Barr Dolan
Title: Managing Director of CLS Management, LLC
The General Partner of CLS Partners, L.P.,
The General Partner of Charter Life Sciences, L.P.

SIGNATURE PAGE TO ENTEROMEDICS INC.
AMENDED AND RESTATED INVESTORS' RIGHTS AGREEMENT

INVESTORS:

BAY CITY CAPITAL MANAGEMENT IV, LLC

/s/ Carl Goldfischer

General Partner of:
Bay City Capital Fund IV Co-Investment Fund, L.P.
By: Bay City Capital LLC, its Manager
By: Fred Craves, Manager and Managing Director

BAY CITY CAPITAL MANAGEMENT IV, LLC

/s/ Carl Goldfischer

General Partner of:
Bay City Capital Fund IV, L.P.
By: Bay City Capital LLC, its Manager
By: Fred Craves, Manager and Managing Director

INVESTORS:

ABERDARE VENTURES II, L.P.
By: Aberdare GP II, L.L.C.
its General Partner

By: /s/ Paul H. Klingenstein
Paul H. Klingenstein
Managing Director

ABERDARE VENTURES II (Bermuda), L.P.
By: Aberdare GP II, L.L.C.
its General Partner

By: /s/ Paul H. Klingenstein
Paul H. Klingenstein
Managing Director

ABERDARE II ANNEX FUND, L.P.
By: Aberdare GP II, L.L.C.
its General Partner

By: /s/ Paul H. Klingenstein
Paul H. Klingenstein
Managing Director

/s/ Paul H. Klingenstein
Paul H. Klingenstein

/s/ John H. Odden
John H. Odden

SIGNATURE PAGE TO ENTEROMEDICS INC.
AMENDED AND RESTATED INVESTORS' RIGHTS AGREEMENT

SCHEDULE A

Interwest Partners IX, LP

Onset V, L.P.

MAYO Foundation for Medical Education and Research

Pacific Asset Partners

Kenneth Martin

MPM BioVentures III, L.P.

MPM BioVentures III-QP, L.P.

MPM BioVentures III Parallel Fund, L.P.

MPM BioVentures III GmbH & Co. Beteiligungs KG

MPM Asset Management Investors 2002 BVIII LLC

Bay City Capital Fund IV, L.P.

Bay City Capital Fund IV Co-Investment Fund, L.P.

Aberdare Ventures II, L.P.

Aberdare Ventures II (Bermuda), L.P.

Aberdare II Annex Fund, L.P.

Paul H. Klingenstein

John H. Odden

Charter Life Sciences, L.P.

MARK B. KNUDSON REVOCABLE TRUST U/A DTD APRIL 18, 2003 WITH SUSAN J. KNUDSON AS DONOR

SUSAN J. KNUDSON REVOCABLE TRUST U/A DTD APRIL 18, 2003 WITH SUSAN J. KNUDSON AS DONOR

THE SPRAKER FAMILY TRUST U/A/D 10/13/98

Timothy R. Conrad

Robert S. Nickoloff

Richard R. Wilson, M.D.

Donald C. Harrison, M.D.

Susan J. Knudson

Anne H. Nickoloff

SIGNATURE PAGE TO ENTEROMEDICS INC.
AMENDED AND RESTATED INVESTORS' RIGHTS AGREEMENT

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

MAYO FOUNDATION FOR MEDICAL EDUCATION AND RESEARCH
LICENSE AGREEMENT

This license agreement ("Agreement") is by and between Mayo Foundation for Medical Education and Research, a Minnesota charitable corporation, located at 200 First Street SW, Rochester, Minnesota 55905-0001 ("MAYO"), and EnteroMedics Inc., a private for-profit COMPANY located at 2800 Patton Road, Roseville, MN 55113 ("COMPANY").

WHEREAS, MAYO desires to make certain patent rights available for the development and commercialization of medical devices for public use and benefit; and

WHEREAS, COMPANY represents itself as being knowledgeable in developing devices to treat obesity and GI disorders; and

WHEREAS, MAYO is willing to grant and COMPANY is willing to accept an exclusive license under certain patent rights and is willing to confer with COMPANY on development of such devices as set forth below; and

WHEREAS, COMPANY will be solely responsible for regulatory compliance, marketing and selling any products in accordance with the grant of rights hereunder.

NOW THEREFORE, in consideration of the foregoing and the promises and covenants set forth below, the parties hereby agree as follows:

Article 1.00 - Definitions

For purposes of this Agreement, the terms defined in this Article will have the meaning specified and will be applicable both to the singular and plural forms:

1.01 "Affiliate": For MAYO: shall mean any corporation or other entity within the same "controlled group of corporations" as MAYO or its parent Mayo Foundation. For purposes of this definition, the term "controlled group of corporations" will have the same definition as Section 1563 of the Internal Revenue Code as of November 10, 1998, but will include corporations or other entities which, if not a stock corporation, more than 50% of the board of directors or other governing body of such corporation or other entity is controlled by a corporation within the controlled group of corporations of MAYO or Mayo Foundation. MAYO's Affiliates include, but are not limited to: Mayo Foundation; Mayo Collaborative Services, Inc.; Rochester Methodist Hospital; Saint Marys Hospital; Mayo Clinic Rochester; Mayo Clinic Jacksonville, Florida; St. Luke's Hospital, Jacksonville, Florida; Mayo Clinic Arizona; Mayo Clinic Hospital, Arizona; Mayo Regional Practices, P.C., Decorah, Iowa; and Mayo Health System West Central Wisconsin and controlled or wholly-owned subsidiary corporations of all of the above.

1.02 "COMPANY Product(s)": shall mean MAYO Patented Product, Jointly Patented Product and Know-How Product.

1.03 "COMPANY Sublicense Revenue": shall mean all revenue (including but not limited to consideration payments, upfront fees, milestone payments, and royalties) received by COMPANY from sublicensing of its rights to third parties per the terms of this Agreement for the Licensed Patents, Jointly Owned Patents and Know-How.

1.04 "Effective Date": February 3, 2005.

1.05 "Field": The treatment of obesity using devices or the use of electrical signaling to block the vagal nerve.

1.06 "First Commercial Sale": First Company Product sale in the US following a United States regulatory allowance for sale or first sale in Europe following a CE mark of a COMPANY Product.

1.07 "Future Patents": shall mean all patent applications assigned exclusively to MAYO filed on inventions arising out of Product Development by the Obesity Device Group and Vagal Blocking Device Group, including any continuation, division, substitution, reissue, or reexamination and any patents issuing from any of the foregoing and any foreign counterpart of any of the foregoing. Future Patents shall not be interpreted to include Jointly Owned Patents.

1.08 "Know–How": shall mean Obesity Device Group Know-How and Vagal Blocking Device Group Know-How.

1.09 "Jointly Owned Patents": any patent or patent application filed on inventions arising out of Product Development and where such patent or patent application is filed in the names of at least two individuals one of which has an obligation to assign to MAYO and one of which has an obligation to assign to the COMPANY.

1.10 "Jointly Patented Product": means products or services that are covered by a Valid Claim within the Jointly Owned Patents

1.11 "Know-How Product": shall mean products or services that incorporate, use, are manufactured using or are developed using (including tested) Know-How including but not limited to a COMPANY Vagal Device or other obesity devices.

1.12 "License Year": begins on the Effective Date, and thereafter begins on the first day of each January during the Term.

1.13 "Licensed Patents": shall mean MAYO Patents and Future Patents.

1.14 “MAYO Patented Product”: means products or services that are covered by a Valid Claim within the Licensed Patents.

1.15 “MAYO Patents”: shall mean U.S. Patent Application Serial Numbers:

(a) 60/547,483;
(b) 60/576,826;
(c) 60/589,429
(d) 60/589,481;
(e) 60/603,705;
(f) 60/589,291;
(g) 10/924,249;
(h) 60/612,088; and
(i) any continuation, division, substitution, reissue, or reexamination and any patents issuing from any of the foregoing and any foreign counterpart of any of the foregoing.

1.16 “Net Sales”: the amount invoiced by COMPANY for sales of COMPANY Products to a third party, less sales, excise or use taxes shown on the face of the invoice; less credits for defective or returned COMPANY Products; and less all regular trade and discount allowances. Leasing, lending, consigning or any other activity by means of which a third party acquires the right to possession or use of a COMPANY Product will be considered a sale for the purpose of determining Net Sales

1.17 “Obesity Device Group”: The Obesity Device Group includes the following members:

Michael Camilleri, M.D. ;
Amy Foxx-Orenstein, D.O.;
Christopher Gostout, M.D.;
Michael Levy, M.D.;
Joseph Murray, M.D.;
Elizabeth Rajan, M.D.;
Kevin Bennet; and
William Sandborn, M.D.

1.18 “Obesity Device Group Know-How”: shall mean information, whether patentable or not, developed for and provided to COMPANY by the Obesity Device Group through Product Development or Product Testing.

1.19 “Product Development”: shall mean the development, design and/or enhancement of devices.

1.20 “Product Testing”: shall mean protocol, assay and/or measurement tool design and development, and participation in preclinical and clinical testing and/or validation.

1.21 "Vagal Blocking Device Group": The Vagal Blocking Device Group includes the following members:

Michael Kendrick, MD;
Bret Petersen, MD; and
Michael Sarr, MD

1.22 "Vagal Blocking Device Group Know-How": shall mean information, whether patentable or not, developed for and provided to COMPANY by the Vagal Blocking Device Group through Product Development or Product Testing.

1.23 "Vagal Device": shall mean any device that blocks the vagus nerve by using electrical signaling.

1.24 "Valid Claim": shall mean a claim of an unexpired, issued patent that has not lapsed or been abandoned or determined by a court from which no further appeal can be taken to be invalid or unenforceable.

Article 2.00 - Grant Of Rights

2.01 MAYO GRANTS. Subject to the reservation of rights set forth in Section 2.03, below, MAYO grants the COMPANY a worldwide, royalty-bearing, exclusive license under the Licensed Patents and its interests in the Jointly Owned Patents to make, have made, use, offer for sale, sell and import COMPANY Products in the Field.

During the term of the Know-How commitment set forth below, COMPANY is hereby granted a first option to obtain an exclusive, royalty-bearing, worldwide license under the Licensed Patents and MAYO's interest in the Jointly Owned Patents to make, have made, use, offer for sale, sell, and import COMPANY Products outside the Field. In order to exercise the option, COMPANY will notify MAYO of its desire to exercise the option and the parties will negotiate in good faith for one hundred and eighty days (180) to consummate a license. If the parties are unable to do so after such one hundred and eighty (180) days, MAYO shall be free to grant a license outside the Field to any third party.

COMPANY shall have the right to sublicense the Licensed Patents and the Jointly Owned Patents in the Field. Any such sublicense will include obligations of confidentiality, name use, warranties, waivers and indemnification for the benefit of MAYO to the same scope as set forth herein. COMPANY will be responsible for the performance of its sublicensees under any such sublicense. COMPANY will notify MAYO of any sublicense within thirty (30) days of execution thereof and provide MAYO a copy of the same.

2.02 MAYO KNOW-HOW COMMITMENT. For a period of five (5) years from the Effective Date, unless terminated earlier by either COMPANY or MAYO as provided for in this Agreement, MAYO commits to the following:

(a) Subject to existing obligations to third parties, MAYO policies and for so long as members are employees of MAYO, the Obesity Device Group would confer with the COMPANY in the Field as follows: (i) exclusively for Product Development for devices to treat obesity and nonexclusively for Product Testing; and (ii) non-exclusively for Product Development and Product Testing with COMPANY for Vagal Devices to treat gastrointestinal disorders other than obesity (for example, pancreatitis and irritable bowel syndrome) and excluding obesity.

(b) Subject to existing obligations to third parties and MAYO policies and for so long as members are employees of MAYO, the Vagal Blocking Device Group would confer exclusively with the COMPANY for Product Development and nonexclusively for Product Testing, all for Vagal Devices.

(c) Subject to existing obligations to third parties, MAYO policies and for so long as members are employees of MAYO, MAYO hereby grants COMPANY a royalty-bearing, worldwide license to use the Know-How in the Field to develop, make, use and sell COMPANY Products as provided below:

1. With respect to Obesity Device Group Know-How for:

   (a) Product Development, such license shall be exclusive for obesity devices and non-exclusive for Vagal Devices for treating conditions other than obesity; and

   (b) Product Testing, such license shall be non-exclusive.

2. With respect to the Vagal Blocking Device Group Know-How for:

   (a) Product Development, such license shall be exclusive; and

   (b) Product Testing, such license shall be non-exclusive.

COMPANY shall have the right to sublicense such know-how, but not any obligation of MAYO to confer, on the same terms and conditions as set forth above with respect to Licensed Patents.

(d) MAYO represents and warrants that to the best of internal patent counsel's knowledge as of the Effective Date and without a duty to inquire, MAYO is not aware of any existing third party obligations that will materially interfere with the Obesity Device Group and the Vagal Blocking Device Group from conferring with COMPANY under Section 2.02, in accordance the terms and conditions of this Agreement.

Each member of the Obesity Device Group and the Vagal Blocking Device Group shall use reasonable efforts to attend meetings, achieve specific Product Development objectives and milestones, and conduct Product Testing, contributing on average among the individuals of the groups between **[*]** person hours per month to achieve an intended aggregate contribution of **[*]** hours per month as requested by COMPANY. Any time credited under this Section shall not also be subject to compensation under any other agreement including any agreement referenced under Section 3.14 of this Agreement.

2.03 RESERVATION OF RIGHTS. The grant of rights in Sections 2.01 and 2.02 are subject to the rights of the United States government, if any, in the Licensed Patents, the Jointly Owned Patents and Know-How and MAYO's and its Affiliates' reserved, irrevocable and royalty free right under the Licensed Patents and Jointly Owned Patents to make, have made, use**,** offer for sale and sell (for the benefit solely of MAYO and its Affiliate's programs, including research), any product or service and to use the Know-How for the same. For avoidance of doubt, MAYO reserves the right to conduct Product Testing with third parties.

2.04 ALL OTHER RIGHTS RESERVED. This Agreement does not grant a license to any patent or patent application not defined in the Licensed Patents or the Jointly Owned Patents or know-how that exists prior to the Effective Date or arising outside of MAYO Product Development or MAYO Product Testing. Except as granted in Sections 2.01 and 2.02, no other license is granted by MAYO under any intellectual property rights owned or controlled by MAYO, including any patents, know-how, copyrights, proprietary information, and trademarks. All such rights are expressly reserved by MAYO. COMPANY acknowledges that in no event will this Agreement be construed as an assignment by MAYO to COMPANY of any intellectual property rights. During the term of the obligation to confer under Section 2.02, subject to any obligations to third parties and MAYO policies, if MAYO, through Mayo Medical Ventures, becomes aware of any MAYO owned patent or patent application in the Field that is required for COMPANY to make use or sell a COMPANY Product in the Field, and such patent or patent application is not otherwise licensed under this Agreement, MAYO will make its best efforts to so notify the COMPANY to permit the COMPANY to consider negotiating rights thereto before any third parties.

2.05 CONFIDENTIALITY. During the Term, and for a period of five (5) years thereafter, each Party agrees to keep confidential by not disclosing to any third party any information (i) relating to this Agreement, including the terms and conditions thereof, or (ii) transmitted to one Party by the other Party. Each Party may use this information solely as necessary for complying with the terms and conditions of this Agreement. The obligations of non-disclosure and non-use will not apply when and to the extent such information:

(a) becomes part of the public domain through no action or fault of the receiving Party; or

(b) was in the receiving Party's possession before disclosure, as demonstrated by the receiving Party's written records, and was not acquired, directly or indirectly, from the disclosing Party; or

(c) was received by the receiving Party from a third party having a legal right to transmit such information.

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

At a Party's request, the other Party will cooperate fully, except financially, in any legal actions taken by the requesting Party to protect its rights in the information disclosed hereunder.

For avoidance of doubt, any violation of the receiving Party's obligations stated in this Section 2.05 constitutes a material breach of this Agreement.

2.06 PURCHASE AT DISCOUNT. MAYO may, at its sole option, purchase the COMPANY Products in any quantity at a discount price of **[*]** percent from the price that would otherwise be available to MAYO from COMPANY for use within MAYO's and its Affiliates' own programs. This discount shall only apply to devices implanted at St. Mary's Hospital, Methodist Hospital, or any other MAYO facility in Rochester, Minnesota, USA.

Article 3.00 - Consideration and Royalties.

3.01 CONSIDERATION. Upon execution of the Agreement, the COMPANY will issue MAYO **[*]** shares of COMPANY common stock as partial consideration for MAYO Patents and Future Patents of the Obesity Device Group and the Obesity Device Group Know-How. This initial issuance is not an advance or creditable against any payments otherwise due under this Agreement. Failure to provide such shares is a material breach of this Agreement.

3.02 EARNED ROYALTIES. The COMPANY will pay MAYO the following earned royalties on Net Sales ("Earned Royalties") for each COMPANY Product:

(a) for each MAYO Patented Product, **[*]** percent;

(b) for each Know-How Product, **[*]** percent;

(c) for each Jointly Patented Product, **[*]** percent.

COMPANY shall be responsible for paying only the highest royalty rate due to MAYO for each COMPANY Product. In the event COMPANY is paying a royalty on a Know-How Product and a patent within Licensed Patent issues with a Valid Claim covering such Know-How Product, then COMPANY shall begin paying the MAYO Patented Product royalty rate of **[*]** percent from such date.

The obligation to pay royalties on a Know-How Product shall, on a product by product basis, commence upon the First Commercial Sale of such COMPANY Product and cease on December 31st of the tenth calendar year after the year within which the First Commercial Sale occurred, unless it becomes a MAYO Patented Product. Thereafter, such license, with respect to Know-How for such COMPANY Product, shall be considered paid-up. The obligation to pay earned royalties under Sections 3.02(a) or 3.02(c) shall run until the last to expire Valid Claim within the Licensed Patents and Jointly Owned Patents, respectively.

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

The Earned Royalties are payable as described in Section 4.01.

3.03 MINIMUM ROYALTIES. In order for COMPANY to maintain its license, COMPANY will pay MAYO a minimum annual royalty of **[*]** dollars for the second and third year after First Commercial Sale of the initial COMPANY Product. The Earned Royalties due and accrued under Section 3.02 within a given License Year are fully creditable against minimum royalties due only for that License Year. If the Earned Royalty does not equal or exceed the minimum royalty due, COMPANY will pay the difference. Payment must be made within (30) thirty days of the last relevant License Year and failure to do so constitutes a material breach of this Agreement. It is a material breach of this Agreement if such payment is not made to MAYO.

3.04 ROYALTY STACKING. If COMPANY is a party to a license agreement with any third party, which license required for the manufacture, use and/or sale of a COMPANY Product and the total royalty due such third party and MAYO (to be paid by COMPANY) exceeds [*] of Net Sales on a product-by-product basis, COMPANY may reduce the royalty rate applicable hereunder on such COMPANY Product (on a product by product basis) by **[*]** for each **[*]** of the royalty rate payable to such third party; provided, however, that in no event will the royalty rate otherwise due to MAYO be reduced to less than **[*]** percent for a MAYO Patented Product and **[*]** of a percent **[*]** for a Know-How Product or a Jointly Patented Product. If such other license includes a royalty stacking provision of like intent to this Section, the royalty rate reduction provided for in this Section that would be calculated as if such provision in such other license were absent.

3.05 OBESITY DEVICE GROUP MILESTONE PAYMENTS. MAYO shall receive shares of COMPANY stock for obtaining the following milestones:

(a) Two Hundred and Fifty Thousand (250,000) shares of COMPANY common stock within thirty (30) days on the first to issue patent within Licensed Patents; and

(b) Eight Hundred Thousand (800,000) shares of COMPANY common stock within thirty (30) days of the first F.D.A. regulatory approval in the United States on a COMPANY Product.

3.06 KNOW-HOW RETAINER FEES: The COMPANY shall pay MAYO a minimum annual retainer fee of **[*]** for the Obesity Device Group as partial compensation for its Know-How. The COMPANY shall also pay MAYO an additional minimum annual retainer fee of **[*]** for the Vagal Blocking Device Group as partial compensation for its Know-How. The following payments shall be made within ten (10) days of the dates listed:

Date	Retainer fee payment due MAYO
a) The Effective Date	**[*]**
b) November 1, 2005	**[*]**

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

c) January 1, 2006	**[*]**
d) July 1, 2006	**[*]**
f) January 1, 2007	**[*]**
g) January 1, 2008	**[*]**
h) January 1, 2009	**[*]**

It is a material breach of this Agreement if MAYO does not receive such payments.

3.07 KNOW-HOW MILESTONE PAYMENTS: The COMPANY shall have a pool of COMPANY common shares (825,000 in aggregate, [*]) to issue MAYO within ninety (90) days of FDA approval for a Company Product for providing Know-How. It is a material breach of this agreement if such shares are not received within ninety (90) days of achieving the milestone.

3.08 CERTAIN COMMON STOCK PROVISIONS. In connection with the COMPANY's obligation to issue shares of its common stock to MAYO under Sections 3.01, 3.05 and 3.07, the COMPANY and MAYO hereby covenant and agree as follows:

(a) The COMPANY hereby represents and warrants that the terms of this Agreement have been duly and validly approved and authorized by all requisite corporate action of the Board of Directors of the COMPANY, and that the performance of the COMPANY's obligations under this Agreement will not result in the violation of the terms or provisions of any other agreements to which the COMPANY is a party or is otherwise bound.

(b) The COMPANY represents and warrants that a sufficient number of shares of COMPANY common stock for performance of the COMPANY's obligations under this Agreement have been and will continue to be duly and validly reserved for issuance by all requisite corporate action of the Board of Directors of the COMPANY, and upon the issuance of the common stock in accordance with this Agreement such shares of common stock will be duly and validly issued and fully paid and non-assessable shares of capital stock of the COMPANY.

(c) The COMPANY and MAYO covenant and agree that the number of shares of COMPANY common stock that may be issued from time to time to MAYO in the future pursuant to the Sections 3.05 and 3.07 shall be equitably adjusted to give effect to all stock combinations or stock splits affecting COMPANY common stock and all dividend distributions payable to holders of COMPANY common stock in shares of additional COMPANY common stock.

(d) The COMPANY agrees that, simultaneous with the occurrence of a Liquidation Event (as defined in Section B.2. of Article IV the COMPANY's Amended and Restated Certificate of Incorporation), or simultaneous with the initial closing in an arrangement involving the COMPANY's first firm commitment underwritten public offering of its common stock under the Securities Act of 1933, as amended, MAYO shall automatically, and without need for further action, be entitled to receive, and shall be deemed the beneficial owner of, all shares of

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

COMPANY common stock issuable pursuant to Sections 3.05 and 3.07, regardless of whether the conditions precedent to such issuance as set forth in each such Section have theretofore been achieved or satisfied. If at any time there is a recapitalization of COMPANY common stock (other than as contemplated upon the occurrence of a Liquidation Event), the COMPANY agrees that MAYO shall automatically, and without need for further action, be entitled to receive the number of shares of capital stock or other securities or property to which a holder of an aggregate number of shares of COMPANY common stock equal to the maximum number of shares which MAYO may have become entitled to receive in the future pursuant to Sections 3.05 and 3.07 would be entitled to receive in connection with such recapitalization, regardless of whether the conditions precedent to such issuances as set forth in Section 3.05 or 3.07 have theretofore been achieved or satisfied. Upon issuance of common stock, capital stock or other securities pursuant to this subsection, the COMPANY shall have no further obligation to issue common stock to MAYO pursuant to the terms of this Agreement.

(e) The COMPANY hereby represents and warrants that the issuance the common stock of the COMPANY to MAYO is excepted from the provisions of Section 2.4 of the Investors’ Rights Agreement dated July 30, 2004 to which the COMPANY is a party and from Section 4(d) of the COMPANY’s Amended and Restated Certificate of Incorporation.

(f) MAYO hereby represents and warrants that it is an investor in securities of companies in the development stage and acknowledges that it is able to fend for itself, can bear the economic risk of its investment, and has such knowledge and experience in financial or business matters that it is capable of evaluating the merits and risks of the investment in the common stock of the COMPANY. MAYO also represents it has not been organized for the purpose of acquiring the common stock of the COMPANY.

(g) MAYO hereby represents and warrants that it is an “accredited investor” within the meaning of SEC Rule 501 of Regulation D, as presently in effect.

(h) MAYO understands that the common stock of the COMPANY will be characterized as “restricted securities” under the federal securities laws inasmuch as they are being acquired from the COMPANY in a transaction not involving a public offering and that under such laws and applicable regulations such securities may be resold without registration under the Securities Act of 1933, as amended, (the “Act”), only in certain limited circumstances. In this connection, MAYO represents that it is familiar with SEC Rule 144, as presently in effect, and understands the resale limitations imposed thereby and by the Act.

(i) Without in any way limiting the representations set forth above, MAYO further agrees not to make any disposition of all or any portion of the shares of common stock of the COMPANY unless and until:

(1) There is then in effect a registration statement under the Act covering such proposed disposition and such disposition is made in accordance with such registration statement; or

(2) If requested by the COMPANY, MAYO shall have furnished the COMPANY with an opinion of counsel, reasonably satisfactory to the COMPANY that such disposition will not require registration of such shares under the Act. It is agreed that the COMPANY will not require opinions of counsel for transactions made in reliance upon Rule 144 except in unusual circumstances.

(3) Notwithstanding the provisions of subsections (1) and (2) above, no such registration statement or opinion of counsel shall be necessary for a transfer by MAYO to any of its “affiliates,” as that term is defined under the Act, so long as such affiliate is an “accredited investor” (within the meaning of Regulation D under the Act).

(j) It is understood that the certificates evidencing the common stock of the COMPANY may bear the following legend:

> “These securities have not been registered under the Securities Act of 1933, as amended. They may not be sold, offered for sale, pledged or hypothecated in the absence of a registration statement in effect with respect to the securities under such Act or an opinion of counsel satisfactory to the Company that such registration is not required or unless sold pursuant to Rule 144 of such Act.”

3.09 SUBLICENSE REVENUE:

(a) For Future Patents, Jointly Owned Patents and Know-How, the COMPANY shall pay MAYO [*] percent of all COMPANY Sublicense Revenue it receives during the Term.

(b) For MAYO Patents the COMPANY shall pay MAYO **[*]** percent of all COMPANY Sublicensing Revenue it receives during the Term for sublicenses executed within one (1) year of the Effective Date. The COMPANY shall pay MAYO **[*]** percent of all COMPANY Sublicensing Revenue it receives during the Term for sublicenses executed between the first (1st) year anniversary and the third (3rd) year anniversary of the Effective Date of this Agreement. The COMPANY shall pay MAYO **[*]** percent of all COMPANY Sublicensing Revenue it receives for sublicenses executed after such third (3rd) year anniversary.

(c) COMPANY Sublicensing Revenue is payable as described in Section 4.01 below.

3.10 TAXES. The COMPANY is responsible for all taxes (other than net income taxes), duties, import deposits, assessments, and other governmental charges, however designated, which are now or hereafter will be imposed by any authority on the COMPANY, (a) by reason of the performance by MAYO of its obligations under this Agreement, or the payment of any amounts by the COMPANY to MAYO under this Agreement; (b) based on the Licensed Patents or use or sale of the COMPANY Product.

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

3.11 NO DEDUCTIONS. All payments to be made by the COMPANY to MAYO under this Agreement represent net amounts MAYO is entitled to receive, and will not be subject to any deductions or offsets for any reason whatsoever.

3.12 U.S. CURRENCY. All payments to MAYO under this Agreement will be made by draft drawn on a United States bank, and payable in United States dollars.

3.13 DISTRIBUTION OF CONSIDERATION WITHIN MAYO. MAYO may distribute any shares or funds received by reason of this Article 3 to individuals within the Obesity Device Group or Vagal Blocking Device Group as MAYO, in its sole discretion, deems advisable and will hold the COMPANY harmless from any claims by any employee member of the Obesity Device Group or Vagal Blocking Device Group that any such distribution or related allocation is inadequate or unreasonable.

3.14 RESEARCH AND CLINICAL TRIALS. The Parties acknowledge that any COMPANY sponsored research or clinical trial at MAYO related to this Agreement will be subject to a separate agreement consisting of a defined protocol, associated budget and any terms and conditions that may be required by law or MAYO policy, but will be governed by the intellectual property provisions of this Agreement. Any such agreement will not require any compensation beyond the mutually agreed upon costs for conducting the research or clinical trial.

Article 4.00 - Accounting and Reports.

4.01 PAYMENT. The COMPANY will deliver to MAYO on or before 1 February a detailed written report stating Net Sales on which Earned Royalties are based, COMPANY Sublicense Revenue on which sublicense revenue payment is due MAYO and all activities for all other payments due under Article 3.00 for the preceding License Year. Each such report will be accompanied by the payment(s) due to MAYO for such License Year. In the event no royalties are due, the COMPANY shall submit a detailed written report on the progress of the development of COMPANY Products and a timeline for commercialization of the same, including a description of activities conducted as set forth in Section 7.02. It is a material breach of this agreement if MAYO does not receive such reports and payments.

4.02 ACCOUNTING. The COMPANY will keep complete, true, and accurate books of accounts and records sufficient to support calculation of Net Sales, COMPANY Sublicense Revenue and all other payment payable to MAYO under this Agreement. Such books and records will be kept at the COMPANY’s principal place of business for at least three (3) years after the end of the License Year to which they pertain, and will be open at all reasonable times for inspection by a representative of MAYO for verification of payments. The MAYO representative will treat as confidential all relevant matters and will be a person or firm reasonably acceptable to the COMPANY. In the event such audit reveals an underpayment by COMPANY, COMPANY will within thirty (30) days pay the amount due in excess of the payments actually paid. In the event the audit reveals an underpayment by COMPANY of more than five percent of the amount due, COMPANY will pay interest on the amount due in excess of the amount actually paid at the highest rate then permitted by law. In either event, COMPANY will pay all of MAYO's costs in conducting the audit. Failure by COMPANY to make any payment required under this Section 4.02 constitutes a material breach of this Agreement.

Article 5.00 - Warranties and Indemnification.

5.01 USE OF NAME AND LOGO. The COMPANY will not use publicly for publicity, promotion, or otherwise, any logo, name, trade name, service mark, or trademark of MAYO or its Affiliates, including, but not limited to, the terms "MAYO®," "MAYO Clinic®," and the triple shield MAYO logo, or any simulation, abbreviation, or adaptation of the same, or the name of any MAYO employee or agent, without MAYO's prior, written, express consent. MAYO may withhold such consent in MAYO's absolute discretion. Violation of this Section 5.01 constitutes a material breach of this Agreement.

5.02 NO WARRANTIES. Nothing in this Agreement will be construed as:

(a) a warranty or representation by MAYO as to the validity or scope of any of the Licensed Patents, Jointly Owned Patents and Know-How; or

(b) an obligation to bring or to prosecute actions against third parties for infringement of the Licensed Patents, Jointly Owned Patents or Know-How; or

(c) a warranty or representation that the manufacture, use, sale, offer for sale or importation of any COMPANY Product or the use or practice of any of the Licensed Patents, Jointly Owned Patents or Know-How are free from infringement or misappropriation of a third party's intellectual property rights.

5.03 DISCLAIMER. MAYO HAS NOT MADE AND PRESENTLY MAKES NO PROMISES, GUARANTEES, REPRESENTATIONS OR WARRANTIES OF ANY NATURE, DIRECTLY OR INDIRECTLY, EXPRESS OR IMPLIED, REGARDING THE MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, OR NON-INFRINGEMENT FOR THE COMPANY PRODUCTS, LICENSED PATENTS, JOINTLY OWNED PATENTS OR KNOW-HOW. THE KNOW-HOW, JOINTLY OWNED PATENTS AND LICENSED PATENTS, LICENSED UNDER THIS AGREEMENT ARE PROVIDED "AS IS," "WITH ALL FAULTS," AND "WITH ALL DEFECTS," AND COMPANY EXPRESSLY WAIVES ALL RIGHTS TO MAKE ANY CLAIM WHATSOEVER AGAINST MAYO FOR MISREPRESENTATION OR FOR BREACH OF PROMISE, GUARANTEE, OR WARRANTY OF ANY KIND RELATING TO THE COMPANY PRODUCTS, KNOW-HOW, JOINTLY OWNED PATENTS AND LICENSED PATENTS. COMPANY IS SOLELY RESPONSIBLE FOR DETERMINING WHETHER THE LICENSED PATENTS, JOINTLY OWNED PATENTS AND KNOW-HOW HEREUNDER HAVE APPLICABILITY OR UTILITY IN THE COMPANY'S MANUFACTURING, DESIGN, MARKETING AND SALES ACTIVITIES. COMPANY ASSUMES ALL RISK AND LIABILITY IN CONNECTION WITH SUCH DETERMINATION.

5.04 INDEMNIFICATION. The COMPANY will defend, indemnify, and hold harmless MAYO and MAYO's Affiliates from any and all claims, actions, demands, judgments, losses, costs, expenses, damages and liabilities (including but not limited to attorneys fees and other expenses of litigation) ("Claim"), regardless of the legal theory asserted, arising out of or connected with:(a) use by the COMPANY of Licensed Patents, Jointly Owned Patents or Know-How furnished or licensed under this Agreement; (b) design, manufacture, distribution, use, sale, or other disposition of COMPANY Products by the COMPANY, transferees or sublicensees; and (c) the Product Development and Product Testing to be conducted for COMPANY hereunder. The foregoing obligations of COMPANY to indemnify are contingent upon MAYO or MAYO's Affiliates giving COMPANY prompt and timely notice of any claim requiring indemnification, granting to COMPANY the right to control the defense of any such claim including selection of counsel and the right to settle any such claim (including the right to grant sublicenses, without royalty to MAYO of MAYO's Affiliates) of any right licensed under this Agreement. Notwithstanding the foregoing, COMPANY shall not, without MAYO's prior written consent, settle or compromise any Claim in a manner that would require MAYO to admit liability or incur financial obligation. MAYO may be represented by counsel of its own choosing, at its own expense.

5.05 INSURANCE. As used in Sections 5.04 and 5.05, MAYO and its Affiliates include the trustees, officers, agents, and employees of MAYO and its Affiliates. The parties agree that the indemnity stated in this Section 5.04 should be construed and applied in favor of indemnification. The COMPANY will, during the Term, carry claim-based liability insurance, including products liability and contractual liability, in an amount and for a time period sufficient to cover the liability assumed by COMPANY hereunder, such amount being at least **[*]**. In addition, such policy will name MAYO as an additional-named insured. COMPANY may not settle any Claim in a manner that would require an admission of liability or incur financial obligation on the part of MAYO, without MAYO's prior written consent.

5.06 WAIVER OF SUBROGATION. The COMPANY expressly waives any right of subrogation that it may have against MAYO resulting from any claim, demand, liability, judgment, settlement, costs, fees (including attorneys' fees), and expenses for which the COMPANY has agreed to indemnify MAYO and its Affiliates or hold MAYO and its Affiliates harmless under this Agreement.

5.07 ADDITIONAL WAIVERS. EXCEPT WITH RESPECT TO ANY LIABILITY OF MAYO FOR BREACH OF THIS AGREEMENT (INCLUDING BREACH OF THE REPRESENTATIONS OR WARRANTIES OF MAYO IN THIS AGREEMENT), THE COMPANY AGREES THAT MAYO WILL NOT BE LIABLE FOR ANY LOSS OR DAMAGE CAUSED BY OR ARISING OUT OF ANY PERFORMANCE UNDER THIS AGREEMENT, WHETHER TO COMPANY OR A THIRD PARTY. IN NO EVENT WILL MAYO'S LIABILITY OF ANY KIND INCLUDE ANY SPECIAL, INDIRECT, INCIDENTAL, CONSEQUENTIAL OR PUNITIVE LOSSES OR DAMAGES, EVEN IF MAYO HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. IN NO CASE

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

WILL MAYO'S LIABILITY OF ANY KIND EXCEED THE TOTAL ROYALTIES WHICH HAVE ACTUALLY BEEN PAID TO MAYO BY THE COMPANY AS OF THE DATE OF FILING OF THE ACTION AGAINST MAYO WHICH RESULTS IN THE SETTLEMENT OR AWARD OF DAMAGES.

5.08 REPRESENTATION AND WARRANTY. MAYO represents and warrants that to the best of internal patent counsel's knowledge, as of the Effective Date and without a duty to inquire, the MAYO inventors are under an obligation to assign their rights to MAYO, MAYO is otherwise the sole and lawful owner of the MAYO Patents licensed hereunder and the patent rights licensed hereunder are provided free and clear of any third party ownership rights. Notwithstanding the foregoing, nothing herein shall be construed as an express or implied representation or warranty of non-infringement and COMPANY acknowledges that it may require rights to third party intellectual property in order to practice the licenses granted hereunder.

Article 6.00 - Term and Termination.

6.01 TERM. This Agreement will terminate upon the last to expire patent application or Valid Claim within the Patent Rights or the COMPANY's last obligation to make payments under Article 3.00, whichever occurs last.

6.02 TERMINATION FOR BREACH. If either party commits a material breach of this Agreement, including without limitation for COMPANY, the failure to make any required payments hereunder, the other party may notify the breaching party in writing of such breach and the breaching party will have sixty (60) days after such notice becomes effective as set forth in Section 9.07 to cure such breach, or this Agreement will automatically terminate.

6.03 INSOLVENCY OF COMPANY. MAYO may terminate this Agreement by transmitting a notice of termination to COMPANY in the event COMPANY ceases conducting business in the normal course, becomes insolvent or bankrupt, makes a general assignment for the benefit of creditors, admits in writing its inability to pay its debts as they are due, permits the appointment of a receiver for its business or assets, or avails itself of or becomes subject to any proceeding under any statute of any governing authority relating to insolvency or the protection of rights of creditors.

6.04 EARLY TERMINATION OF CONFERENCE RIGHTS. Starting three (3) years after the Effective Date of this Agreement, MAYO, at its discretion and without a showing of cause, may terminate the obligations to confer under Sections 2.02(a) and 2.02(b) by giving notice of such election to the COMPANY. If MAYO so terminates, then, upon such notice:

(a) all licenses granted to the COMPANY for the Licensed Patents, the Jointly Owned Patents and the Know-How shall be fully paid-up and royalty-free;

(b) any Obesity Group Milestone Payments obligations under Section 3.05 that have not accrued shall expire;

(c) any Know-How Retainer Fees obligations under Section 3.06 that have not accrued shall expire;

(d) any Know-How Milestone Payments obligations under Section 3.07 that have not accrued shall expire; and

(e) the grant of licenses from MAYO to the COMPANY shall become non-exclusive.

6.05 CONSEQUENCES OF TERMINATION.

(a) In the event of termination under Section 6.02 of this Agreement for COMPANY's breach, the licenses to Licensed Patents and Jointly Owned Patents from MAYO to COMPANY shall immediately terminate. All licenses to Know-How shall become non-exclusive and any obligation to confer shall immediately terminate.

(b) In the event of termination of this Agreement under Section 6.02 for MAYO's breach, then the events of Section 6.04(a) through 6.04 (e) shall apply as if MAYO had terminated conference rights under Section 6.04.

(c) In the event of termination of this Agreement under Section 6.03, all licenses granted hereunder shall immediately terminate.

(d) Subject to the foregoing, nothing in this Agreement shall be construed to prohibit or enjoin the COMPANY from continuing to use Know-How licensed from MAYO for any reason. In the event of any claim of breach, except as set forth above, MAYO waives any remedy that would otherwise enjoin the COMPANY from using Know-How as licensed hereunder. In the event MAYO terminates this Agreement under Section 6.02, the COMPANY's license under such Know-How shall not be terminated and the COMPANY's license to such Know-How (and obligation to make payments therefore) shall continue, but only on a non-exclusive basis. In any arbitration or court proceeding involving this Agreement, it is the intention of the parties that the relief for MAYO and the effect on COMPANY be as least as significant as MAYO having the right to terminate the Know-How license and in this regard, an arbitrator or court may grant MAYO such additional relief as such arbitrator or court deems equitable to compensate MAYO including, but not limited to, granting MAYO a multiple of any royalties otherwise due or granting payment to MAYO for a fully paid-up license for such Know-How.

6.06 Survival. Subject to the foregoing, the following sections survive any termination or expiration of this Agreement, per their terms: 2.05; 2.06; any payment obligations that accrued or are accruable up to the date of termination and thereafter as may be set forth in Article 3; 3.08(g) and (i); Article 4 for such obligations; Article 5; Article 6; all payment obligations of COMPANY that accrued or are accruable under Article 8 and Article 9.

Article 7.00 - Representation and Warranties.

7.01 REPRESENTATIONS OF THE COMPANY. The COMPANY represents and warrants to MAYO that it has independently evaluated the Licensed Patents, Jointly Owned Patents and Know-How and is entering into this Agreement on the basis of its own evaluation and not in reliance of any representation by MAYO.

7.02 COMMERCIALIZATION EFFORTS. The COMPANY will use commercially reasonable efforts to research, develop and commercialize COMPANY Product(s). If COMPANY has not submitted an application for IDE for an obesity trial to the FDA for a COMPANY Product within Seven (7) years of the Effective Date, the license to COMPANY for Licensed Patents and Know-How shall terminate unless COMPANY pays MAYO an annual license maintenance fee of **[*]** per year for each year such trial is not started. The first such payment is due within Thirty (30) days of the Seventh (7^{th}) anniversary of the Effective Date and subsequent maintenance fees are due within Thirty (30) days of subsequent anniversary dates or the Effective Date.

Article 8.00 - Patents

8.01 Patent Filing, Prosecution, Maintenance and Enforcement: All patent applications filed within the Licensed Patents shall be assigned to MAYO . All Jointly Owned Patent applications shall be assigned to both COMPANY and MAYO. The COMPANY shall have control and authority to direct prosecution of the Licensed Patents and Jointly Owned Patents, including the right to amend such patent applications and file new patent applications which shall be considered within the definition of Licensed Patents and/or Jointly Owned Patents and MAYO will be afforded the opportunity to advise and consult on all such filings and the prosecution. In addition, the COMPANY will provide MAYO with copies of all papers submitted to or received from the United States Patent and Trademark Office on a timely basis. For so long as the license to Licensed Patents and Jointly Owned Patents remains exclusive, the COMPANY shall have control and authority to direct the enforcement and defense of the Licensed Patents in the Field and the Jointly Owned Patents. The COMPANY shall be responsible for all costs and expenses related to prosecution, maintenance, enforcement and defense of the Licensed Patents after the Effective Date and reimbursement of Licensed Patents invoice costs incurred prior to the Effective Date (such invoice costs to be limited to **[*]** in total). The COMPANY shall be responsible for all costs and expenses related to prosecution, maintenance, enforcement and defense of the Jointly Owned Patents. MAYO agrees to take such actions as are reasonably necessary for COMPANY to file, prosecute, maintain, enforce and defend the Licensed Patents and Jointly Owned Patents, and will cooperate with COMPANY in any such matters except financially. MAYO may not be joined as a party to any litigation, unless deemed a necessary party by law. If MAYO is joined, COMPANY will pay all costs on a monthly basis, including attorneys fees, incurred by MAYO with respect thereto and will indemnify MAYO for any damages that may result from such litigation. MAYO may be represented by counsel of its own choosing. Any recoveries will first be used to reimburse COMPANY’s costs and thereafter, will be shared equally by the parties.

If the COMPANY determines in its sole discretion to abandon any patent application or not to file any continuation patent application with claims suggested by MAYO within the Licensed Patents or Jointly Owned Patent Rights, COMPANY will provide MAYO with thirty (30) days prior

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

written notice of such determination and provide MAYO with the opportunity to prosecute, enforce, defend and maintain such patent or patent application at MAYO's sole expense and the license granted to COMPANY with respect to such patent or patent application shall convert to a non-exclusive license. This conversion of rights to non-exclusive shall not apply to any decision by COMPANY not to file in any country other than the U.S. COMPANY shall have the sole discretion, without penalty, to opt to forego any foreign filing. Upon termination of this Agreement, the parties shall confer as to the responsibility of prosecution, maintenance, enforcement and defense of Jointly-Owned Patents and MAYO shall retain sole rights to prosecute, maintain, enforce and defend Licensed Patents.

8.02 THIRD PARTY LITIGATION. In the event a third party institutes a suit against COMPANY for patent infringement involving a COMPANY Product, COMPANY will promptly inform MAYO and keep MAYO regularly informed of the proceedings. In the event the third party sues or joins MAYO, COMPANY will defend MAYO pursuant to the indemnification obligation in Section 5.04. Any recovery, after reimbursement of COMPANY's costs, including its obligations under Section 5.04, will be shared equally by the parties.

Article 9.00 - General Provisions.

9.01 AMENDMENTS. This Agreement may not be amended or modified except by a writing signed by both parties and identified as an amendment to this Agreement.

9.02 NO ASSIGNMENT. Neither party may assign its rights hereunder to any third party without the prior written consent of the other party; provided, that a party may assign its rights without the prior written consent of the other party to any affiliate or other entity that controls, is controlled by or is under common control with such party. Notwithstanding the foregoing, COMPANY is free to transfer or assign this Agreement (or any rights granted under this Agreement) with the sale or transfer of assets of that portion of its business to which this Agreement pertains. Nothing herein shall give COMPANY the right to assign the obligations to confer in Sections 2.02(a) and 2.02(b). COMPANY will promptly notify MAYO of any such assignment. Any purported assignment in violation of this clause is void. Any assignment shall not in any manner relieve the assignor from liability for the performance of this Agreement by its assignee. Upon the occurrence of an assignment pursuant to this Section 9.02, MAYO may, in its sole discretion, provide notice that it desires to continue to confer per the terms of this Agreement. If MAYO fails to provide such notice within sixty (60) days of notification of assignment in writing by COMPANY, (1) no Obesity Group Milestone Payments under Section 3.05 shall thereafter accrue and be payable; (2) no Know-How Retainer Fees under Section 3.06 shall thereafter accrue and be payable; and (3) no Know-How Milestone Payments under Section 3.07 shall thereafter accrue and be payable.

9.03 BINDING EFFECT. This Agreement shall be binding upon and inure to the benefit of the parties, their heirs, legal representatives, successors and assigns.

9.04 ENTIRE AGREEMENT. This Agreement constitutes the final, complete and exclusive agreement between the parties with respect to its subject matter and supercedes all past and contemporaneous agreements, promises, and understandings, whether oral or written, between the parties, and, as of the Effective date of this Agreement, terminates the consulting agreement between MAYO and COMPANY, dated November 3, 2003 for the services of Dr. Michael Camilleri and the consulting agreement between MAYO and COMPANY, dated February 1, 2004 for the services of Dr. Bret Petersen.

9.05 INDEPENDENT CONTRACTOR. It is mutually understood and agreed that the relationship between the parties is that of independent contractors. Neither party is the agent, employee, or servant of the other. Except as specifically set forth herein, neither party shall have nor exercise any control or direction over the methods by which the other party performs work or obligations under this Agreement. Further, nothing in this Agreement is intended to create any partnership, joint venture, lease, or equity relationship, expressly or by implication, between the parties.

9.06 ARBITRATION. Any disputes as described in Exhibit A will be arbitrated as set forth therein.

9.07 NOTICES. All notices and other business communications between the parties related to this Agreement shall be in writing, sent by certified mail, addressed as follows:

If to COMPANY:	EnteroMedics Inc. Attn: CEO 2800 Patton Road St. Paul, MN 55113 Facsimile: (651) 634-3212
If to MAYO:	Mayo Medical Ventures Attn: Leif Nelson 200 First Street SW Rochester, MN 55905 Facsimile: (507) 284-5410
	with a copy to: MAYO Legal Department Attn: General Counsel 200 First Street SW Rochester, MN 55905 Facsimile: (507) 284-0929

Notices sent by certified mail shall be deemed delivered on the third day following the date of mailing. Either party may change its address or facsimile number by giving written notice in compliance with this section.

9.08 SEVERABILITY. In the event any provision of this Agreement is held to be invalid or unenforceable, the remainder of this Agreement shall remain in full force and effect as if the invalid or unenforceable provision had never been a part of the Agreement.

9.09 WAIVER. The failure of either party to complain of any default by the other party or to enforce any of such party's rights, no matter how long such failure may continue, will not constitute a waiver of the party's rights under this Agreement. The waiver by either party of any breach of any provision of this Agreement shall not be construed as a waiver of any subsequent breach of the same or any other provision. No part of this Agreement may be waived except by the further written agreement of the parties.

9.10 LIMITATION OF RIGHTS. This Agreement is intended only to benefit the parties hereto. They have no intention to create any interests for any other party. Specifically, no interests are intended to be created for any customer, patient, research subjects, or other persons (or their relatives, heirs, dependents, or personal representatives) by or upon whom the COMPANY Products may be used.

9.11 CONSTRUCTION. Both parties agree to all of the terms of this Agreement. Both parties execute this Agreement only after reviewing it thoroughly. That one party or the other may have drafted all or a part of this Agreement will not cause this Agreement to be read more strictly against the drafting party. This Agreement, and any changes to it, will be interpreted on the basis that both parties contributed equally to the drafting of each of its parts.

9.12 FORCE MAJEURE. Neither party shall be responsible for the non-performance of its obligations under this Agreement if such non-performance is caused directly or indirectly by acts of God, acts of civil or military authority, civil disturbance, war, terrorism, fires, or strikes. The party so affected shall give notice to the other party and shall do everything reasonably possible to resume performance.

9.13 NON-DISCLOSURE. Neither party will disclose any of the terms of this Agreement without the express, prior, written consent of the other party, or unless required by law.

MAYO FOUNDATION FOR MEDICAL EDUCATION AND RESEARCH:

Signed: /s/ Jonathan J. Oviatt
Printed Name: Jonathan J. Oviatt
Title: Secretary
Date: February 3, 2005

COMPANY:

Signed: /s/ Mark B. Knudson
Printed Name: Mark B. Knudson
Title: President and CEO
Date: February 3, 2005

EXHIBIT A

MANDATORY MEDIATION AND BINDING ARBITRATION

1. NOTICE OF DISPUTE. Any dispute related to this Agreement between the parties, including its formation, performance, or termination, which cannot be resolved by the parties themselves within thirty (30) days of written notice by one party to the other of the existence of a dispute, may be referred by either of the parties to mandatory mediation and binding arbitration under the terms of this Exhibit. The parties intend the mediation/arbitration procedure described in this Exhibit to substitute in all cases for litigation related to any such dispute, subject only to Section 7, below, and this agreement to submit all such disputes to mandatory mediation and binding arbitration is irrevocable.

2. LIMITATION PERIOD. No demand for mediation/arbitration may be made regarding any claim more than one hundred eighty (180) days after written notice by one party to the other of the existence of a dispute, regardless of any otherwise applicable statute of limitations.

3. MEDIATOR/ARBITRATOR. If the parties cannot agree upon a single mediator/arbitrator within fourteen (14) days after written demand by either of them for mediation/arbitration, then a single mediator/arbitrator shall be chosen by the American Arbitration Association office in Minneapolis, Minnesota, within thirty (30) additional days after the fourteen (14) day period. The mediator/arbitrator shall be generally experienced in the legal and technical matters related to the dispute.

4. MEDIATION. Within thirty (30) days of the appointment of the mediator/arbitrator, the parties must attend a mediation session at which the mediator/arbitrator personally shall attempt to guide the parties to a settlement. Each party may be represented by counsel at the mediation, but each party must attend through an officer having authority to agree to a settlement at the mediation. The mediation session shall occur in Minneapolis or in St. Paul, Minnesota, and shall extend no longer than a single day. Statements or offers made at the mediation session shall not be admissible in any later arbitration hearing.

5. ARBITRATION. If such mediation has not resulted in a mutually-executed settlement agreement (or withdrawal of claim) within five (5) business days after the date of mediation, then the parties shall proceed to arbitration as described below. Such arbitration, which the parties intend to be final and to substitute for litigation, shall occur in Minneapolis or in St. Paul, Minnesota, and the arbitration results may be entered as a final judgment in any court with jurisdiction. The decision of the arbitrator shall be final and binding upon the parties both as to law and fact.

(a) Initial Disclosures. Within twenty-one (21) days after the date of mediation, the parties shall exchange written disclosures listing with reasonable specificity: (i) all exhibits expected to be used by the party at arbitration, and complete copies of such exhibits, (ii) all witnesses expected to be called by the party at arbitration, and (iii) the substance of the testimony of each witness. Copies of such disclosures shall be sent to the arbitrator. No exhibit or witness may be called if the same does not appear on such disclosure, and no witness may testify as to matters not described in such disclosure, except for rebuttal testimony as may be permitted by the arbitrator.

(b) Discovery Period. Within fourteen (14) days after exchange of the disclosure notices, the parties shall make specific discovery requests to the arbitrator, and within an additional fourteen (14) days the arbitrator shall issue to both parties a joint discovery order. The discovery period preceding the arbitration hearing shall not exceed sixty (60) days from the issuance of the discovery order by the arbitrator.

(c) Scope of Discovery. Discovery shall be limited to that ordered by the arbitrator as being reasonable and necessary, and in no case shall exceed the deposition of two (2) witnesses for each party, and/or the exchange of more than a total of twenty-five (25) specific and non-compound interrogatories by each party, and/or two specific requests by each party for the production of documents considered by the arbitrator to be reasonably relevant and not unduly burdensome.

(d) Hearing. The arbitration hearing, which shall be confidential to the parties and not open to the public, shall not exceed two (2) separate days, and shall be completed within thirty (30) days of the close of discovery. The arbitrator may admit any testimony or other evidence which the arbitrator decides is reasonably relevant to the issues of the arbitration, but excluding statements or offers made by either party at the mediation session.

(e) Final Decision. The arbitrator shall issue a final written decision no later than sixty (60) days following the end of the arbitration hearing, stating findings as to law and fact. The decision shall be confidential to the parties. The arbitrator shall be limited to determining and ordering the payment of actual and direct damages if any, and may order the payment of indirect, special, incidental, or consequential damages only where bad faith has been shown and/or to the extent required to fulfill any obligations under Article 7 of the Agreement. The arbitrator shall not order the payment of punitive or exemplary damages in any case.

6. COSTS AND FEES. Both parties shall be responsible for their own costs and fees (including attorney’s fees), and shall divide common costs and fees equally; however, if the arbitrator specifically finds bad faith on the part of either party, then the arbitrator may order a different division of costs and fees.

7. EQUITABLE RELIEF. Nothing in this Exhibit prohibits either party from seeking equitable relief to protect its rights to the extent that irreparable harm may occur and damages would not be a sufficient remedy, except that neither party shall seek to enjoin mediation/arbitration as described in this Exhibit.

(a) Specific Performance. Among the equitable remedies that a party may seek under this part 7, either party may petition a court for specific performance of the terms of this Exhibit, including following the failure of either party without good cause to adhere to the time limits set out in this Exhibit. A party securing an order for specific performance under this part 7(a) is entitled to recover costs and reasonable attorneys' fees in connection with such petition for specific performance and any related hearings.

8. SURVIVAL. The rights and obligations of the parties described in this Section 8 survive the termination, expiration, non-renewal, or rescission of this Agreement.

9. GOVERNING RULES AND LAW. To the extent not inconsistent with the terms of this Exhibit, the mediation and arbitration are governed by the rules of the American Arbitration Association, the Minnesota Arbitration Act, and the Federal Arbitration Act (9 U.S.C s. 1 et seq.).

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

SUPPLY AGREEMENT

THIS SUPPLY AGREEMENT (this "Agreement") is made and entered into the 11th day of September, 2006 by and between EnteroMedics, Inc., a Minnesota, USA corporation, 2800 Patton Road, St. Paul, MN 55113 ("EnteroMedics") and Atrotech OY, a limited liability company of Finland, having its corporate offices in, Tampere, Finland and with a mailing address at P.O. Box 28, FIN-33721, Tampere, Finland ("Atrotech").

In consideration of the mutual promises and conditions herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Atrotech and EnteroMedics (each, a "Party" and together, the "Parties") hereby agree as follows:

1. Recitals.

a. Atrotech and EnteroMedics are parties to an agreement entitled RF2 Development Agreement executed September 11, 2006, ("RF2 Agreement") for the development of certain second generation implantable assemblies for use in treating obesity, including the implantable device subsystem ("NR2") and the transmittal coil ("TC2") (together, the "RF2 device").

b. Atrotech and EnteroMedics are interested in entering into this Agreement while retaining the supply portion of the RF1 Development Agreement ("RF1 Agreement") to provide a continuing source of supply of product ("RF1 devices") developed under the RF1 Agreement.

2. Sale. During the term of this Agreement, EnteroMedics agrees to buy from Atrotech and Atrotech agrees to sell to EnteroMedics the RF2 devices for use in the EM RF2 devices ordered by EnteroMedics under the terms of this Agreement.

3. Specifications The RF2 devices shall be manufactured under the specification created under the RF2 Agreement, as accepted by EnteroMedics.

4. Quantity Estimate and Delivery. A nonbinding estimate of EnteroMedics expected orders is attached as Exhibit A. The Parties acknowledge that Atrotech's lead time for delivery of the RF2 devices is **[*]** from EnteroMedics' issuance of the related firm order to Atrotech or receipt of RF2 device circuit assemblies from EnteroMedics. Each order to Atrotech will be accompanied by sufficient RF2 device electronic assemblies and lead extensions to complete the assembly of clinical devices. If Atrotech encounters any problem in delivering the RF2 devices according to the schedule of any purchase order, it shall notify EnteroMedics promptly and communicate any expected failure to deliver. If a completed RF2 device fails final test due to

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

defective components provided by EnteroMedics (Scrap Unit), EnteroMedics shall pay a Scrap Fee to Atrotech in an amount equal to the price in Exhibit A,. Scrap Units shall be marked “Not for human use” and shipped to EnteroMedics, but such Scrap Units shall not be counted as units delivered under this Agreement.

Should EnteroMedics fail to order all the RF2 devices listed in Exhibit A within one (1) year from the Effective Date, EnteroMedics agrees to reimburse Atrotech for any components acquired by Atrotech, as well as Atrotech’s actual cost in building sub-assemblies. In order to claim such reimbursement, Atrotech shall present to EntroMedics invoices evidencing component costs and internal records detailing any costs of producing sub-assemblies.

5. Term. This Agreement shall become effective on the date listed above (“Effective Date”) and shall continue in effect until EnteroMedics no longer needs any RF2 devices, but in no case shall this Agreement extend longer than five (5) years from the Effective Date. If EnteroMedics fails to order any RF2 devices for a period of one (1) year, Atrotech may present reasonable out-of-pocket costs to Enteromedics which are necessary to maintain the manufacturing line in an idle state. Should EnteroMedics elect not to pay any agreed-upon costs, the Agreement shall terminate. If a Party ceases to conduct its operations in the normal course of business (including inability to meet its obligations as they mature); or in the event of such Party’s material breach of its obligations under this Agreement, which breach remains uncured for a period of thirty (30) days following notice of such breach, the other Party may, by written notice to such Party, immediately terminate this Agreement. The respective obligations of the Parties hereunder which by their nature or terms will continue beyond the termination or expiration of this Agreement, shall survive any such termination or expiration. If Atrotech intends to alter its business in any way that would endanger continued supply under this Agreement, such as an intent to cease dealing in this type of implanted device, Atrotech shall give EnteroMedics at least one year’s notice and shall provide EnteroMedics an opportunity to make a last one-time buy of RF2 devices in sufficient quantity for EnteroMedics to continue in business.

6. Purchase Price; Payment. Prices for RF2 devices are as listed in Exhibit A. EnteroMedics agrees that each purchase order submitted pursuant to this Agreement shall be for a **[*]**. AtroTech has the right to adjust the prices once a year to address possibly increasing out-of-pocket material and labor costs. If Atrotech believes a price increase is necessary it shall notify EnteroMedics at least 60 days before the end of the year under this Agreement, including data to support the increase in out-of-pocket costs to AtroTech. EnteroMedics may agree to the increase and continue the Agreement, or terminate this Agreement.

EnteroMedics agrees to pay Atrotech’s invoices for delivered RF2 devices within thirty (30) days from the invoice date. Delinquent balances beyond sixty (60) days are subject to carry charges of 12% per annum or the maximum rate permitted by law, whichever rate is less. Atrotech reserves the right at any time to revoke any credit extended to EnteroMedics because of EnteroMedics’s failure to pay for any RF2 devices when due or for any reason deemed good and sufficient by Atrotech, and in such event, all subsequent shipments shall be paid fifty percent (50%) at the time of placing an order, with the remaining fifty percent (50%) payable within the payment terms stated above.

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

7. Delivery. All RF2 devices are sold by Atrotech to EnteroMedics F.C.A. (Incoterms 2000) through Atrotech's facility in Tampere, Finland. Atrotech reserves the right to make delivery of the RF2 devices in installments, unless otherwise specifically stipulated. All such installments shall be separately invoiced and paid for when due without regard to subsequent deliveries. Delay in delivery of any installment shall not relieve EnteroMedics of its obligation to accept remaining deliveries.

8. Warranty and Disclaimer.

a. Atrotech makes no warranties that the RF2 devices are useful for the intended purposes of EnteroMedics. Atrotech warrants only that the RF2 devices meet all the requirements of the RF2 Agreement and are free from defects in material and workmanship for periods calculated from the date of delivery as follows: (a) for NR2 implanted parts, **[*]**; and (b) for TC2 external parts, **[*]**. Notwithstanding the foregoing, in no event shall the cumulative warranty periods for any RF2 devices, including repaired or replaced parts, extend beyond **[*]** from the date of expiration of the originally applicable warranty period. In the event that EnteroMedics wants to avail itself of this warranty, EnteroMedics shall inform Atrotech in writing without delay, and in any event within thirty (30) calendar days of EnteroMedics being put on notice of the defect. Said writing shall include a description of the defect, the affected RF2 device and RF2 device part, and other necessary information. EnteroMedics shall, immediately upon being put on notice of a defect in the RF2 device, avoid all usage of the RF2 device.

b. In the event of a valid warranty claim, Atrotech shall, at its sole discretion, have the option of repairing or replacing the RF2 device, or the relevant part or parts, free of charge. In such cases, replaced parts may be either new or factory refurbished, at Atrotech's discretion. In no event shall EnteroMedics have a right to return any RF2 device or part without the prior written consent of Atrotech. Upon receipt of prior written consent, EnteroMedics shall at its own cost properly package and ship the allegedly defective RF2 device or relevant part or parts to Atrotech.

c. This warranty shall not extend to any RF2 device which has been: (a) subjected to unusual physical or other stress, misuse, neglect, accident or abuse, or damaged by any other external causes; (b) repaired or altered by any third party; (c) improperly installed by any third party; (d) used or maintained in violation of instructions furnished by Atrotech; (e) rendered defective due to materials, components, sub-assemblies, product specifications or design provided by EnteroMedics or any third party including the end user; (f) rendered in need of repair due to normal wear and tear; (g) rendered defective due to causes specific for EnteroMedics' intended use (including, but not limited to, the stimulation/blocking parameters EnteroMedics intends to use); or (h) rendered defective or in need of repair due to any other cause which is not under the control of Atrotech. In the event that an implanted part is claimed to be defective, Atrotech shall have no liability

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

to pay for any costs related to surgery required to remove or re-implant any such part. For purposes of clarity, travel, per diem and other such costs are excluded from this warranty.

d. EXCEPT AS EXPRESSLY PROVIDED IN THIS SECTION 8., ALL WARRANTIES, CONDITIONS, REPRESENTATIONS, INDEMNITIES AND GUARANTEES WITH RESPECT TO THE RF2 DEVICE, WHETHER EXPRESS OR IMPLIED, ARISING BY LAW, CUSTOM, PRIOR ORAL OR WRITTEN STATEMENTS BY ATROTECH OR OTHERWISE (INCLUDING, BUT NOT LIMITED TO, ANY WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE) ARE HEREBY OVERRIDDEN, EXCLUDED AND DISCLAIMED.

e. EXCEPT WITH RESPECT TO THIRD PARTY CLAIMS SUBJECT TO SECTION 9. OF THIS AGREEMENT, UNDER NO CIRCUMSTANCES WILL ATROTECH OR ITS AFFILIATES BE LIABLE FOR ANY CONSEQUENTIAL, INDIRECT, SPECIAL, PUNITIVE, OR INCIDENTAL DAMAGES OR LOST PROFITS, WHETHER FORESEEABLE OR UNFORESEEABLE, BASED ON CLAIMS OF ENTEROMEDICS OR ITS CUSTOMERS (INCLUDING, BUT NOT LIMITED TO, CLAIMS FOR LOSS OF GOODWILL, LOSS OF SHARE VALUE OR INVESTMENT, USE OF MONEY OR USE OF THE RF2 DEVICES, INTERRUPTION IN USE OR AVAILABILITY, STOPPAGE OF OTHER WORK OR IMPAIRMENT OF OTHER ASSETS), ARISING OUT OF BREACH OR FAILURE OF EXPRESS OR IMPLIED WARRANTIES, BREACH OF CONTRACT, MISREPRESENTATION, NEGLIGENCE, STRICT LIABILITY IN TORT OR OTHERWISE, EXCEPT IN THE CASE OF PERSONAL INJURY CAUSED DESPITE THE PROPER USE OF THE RF2 DEVICES, IF AND TO THE EXTENT REQUIRED BY APPLICABLE LAW. IN NO EVENT WILL THE AGGREGATE LIABILITY WHICH ATROTECH OR ITS OFFICERS, DIRECTORS, EMPLOYEES, AGENTS OR AFFILIATES MAY INCUR IN ANY ACTION OR PROCEEDING EXCEED THE TOTAL AMOUNT ACTUALLY PAID TO ATROTECH BY ENTEROMEDICS FOR THE SPECIFIC RF2 DEVICE THAT DIRECTLY CAUSED THE DAMAGE.

f. Atrotech shall not have any liability of any kind under this Agreement unless EnteroMedics gives Atrotech written notice of its claim within thirty (30) days after the date EnteroMedics knows or should have known of its claim and commences its action against Atrotech on or within one (1) year after such date. EnteroMedics shall not have any liability of any kind under this Agreement unless Atrotech gives EnteroMedics written notice of its claim within thirty (30) days after the date Atrotech knows or should have known of its claim and commences its action against EnteroMedics on or within one (1) year after such date.

9. Indemnification by EnteroMedics. EnteroMedics shall indemnify and hold harmless Atrotech and its directors, officers and employees from and against any and all liabilities, damages, losses, costs or expenses (including reasonable attorneys’ and professional fees and

other expenses of litigation and/or arbitration) resulting from a claim, suit or proceeding brought by a third party against Atrotech by reason of any claim of damage resulting from a product used by EnteroMedics in a clinical study or commercially sold by EnteroMedics unless such claim is due to defect in design or manufacturing supplied by Atrotech, taking in consideration any and all limitations regarding the design or manufacturing addressed in this Agreement. The foregoing obligation to indemnify is contingent upon EnteroMedics receiving prompt notice of any such claim and being tendered the right to control any defense or settlement of such claim.

10. Insurance. EnteroMedics shall, at its own cost and expense, maintain the following insurance policies covering EnteroMedics' business and Atrotech: (a) comprehensive general liability insurance (including products liability and contractual liability coverage) with a liability limit of not less than **[*]** for any one occurrence and in the annual aggregate, and (b) excess liability insurance with a combined single limit of not less than **[*]** for any one occurrence and in the annual aggregate. EnteroMedics shall furnish to Atrotech certificates of such insurance within thirty (30) days of the execution of this Agreement. The certificates shall provide that ten (10) days prior written notice of cancellation or material change of the insurance to which the certificates relate shall be given to Atrotech. The fulfillment of the obligations hereunder in no way modifies EnteroMedics' obligations to indemnify Atrotech. Any insurance carried by Atrotech shall be regarded as excess insurance and non-contributory.

11. Limitation on Liability. Notwithstanding anything herein to the contrary, in no event shall Atrotech be liable for damages of any kind (including incidental and consequential damages) whatsoever, regardless of the legal theory and whether arising in tort, contract or strict liability, in an amount greater than the purchase price of the RF2 devices with respect to which such claim is made.

12. Force Majeure.

a. Delay or failure to carry out the duties imposed on either Party under this Agreement shall not be deemed a default and/or breach of this Agreement, if such failure or delay results from the occurrence of a circumstance of Force Majeure. Notwithstanding the foregoing, a circumstance of Force Majeure shall not excuse EnteroMedics' obligation to make any accrued payments.

b. Circumstances of Force Majeure are events:

   i. the occurrence of which is beyond the reasonable control of the affected Party; and

   ii. the occurrence of which was not reasonably foreseeable at the time of assumption of the obligation concerned; and

   iii. that prevent the performance of a contractual obligation or cause such performance to become unduly burdensome or delayed to the affected Party; or

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

iv. the effects of which are unavoidable only at a cost that is clearly disproportionate to the interest of the affected Party, taking into account the affected transaction as a whole, which shall include, but not be limited to:

(a) transport damage, fire, explosions and other accidents;

(b) general lack or failure of material, energy, other utilities or transportation facilities;

(c) natural disaster and extreme climatic conditions;

(d) strikes, lock-outs and other labor disputes;

(e) war, revolution, demand or requirement of any government or non-issuance of any required permits or authorizations, or loss of certificate or license to sell; or

(f) failure of a third party to perform or supply under a subcontract if such failure is likewise attributable to a circumstance of Force Majeure.

c. The Party affected by Force Majeure shall promptly notify the other Party in writing of its emergence and shall also promptly inform the unaffected Party in writing of the termination of the condition giving rise to the occurrence of Force Majeure.

d. If the condition of Force Majeure lasts more than six (6) months from the date of the above notification and has prevented either Party from performing its obligations in whole or in part, either Party shall have the right to terminate this Agreement by giving not less than thirty (30) days written notice to the other Party. Such notice cannot be given until after expiration of the six-month period.

13. Choice of Law. This Agreement shall be governed by, and construed in accordance with, the laws of Finland without regard to its conflict of laws principles. All disputes arising out of or in connection with this Agreement shall be finally settled under the Arbitration Rules of the International Chamber of Commerce by one arbitrator appointed in accordance with said Rules. The arbitration shall be conducted in London, England, UK in the English language. The award shall be final and binding on the parties and enforceable in any court of competent jurisdiction. The prevailing party in any action brought in connection with this Agreement shall be entitled to recover, in addition to damages, its reasonable attorneys' fees and costs incurred in connection therewith. Nothing herein shall be deemed to preclude the parties from enforcing any arbitration award by filing legal actions, including seeking injunctive relief against the other party, in any court of competent jurisdiction. Where one party owes the other monetary amounts for services performed or products delivered and such performance or delivery is not otherwise in dispute, then actions for such amounts need not be submitted to arbitration before seeking any other remedy for past due amounts in any court of competent jurisdiction. This Agreement shall expressly not be governed by the United Nations Convention for Contracts for the International Sale of Goods.

14. Authority; Compliance with Laws. Each Party represents and warrants that: (a) it has the power and authority to enter into this Agreement; (b) the execution of this Agreement, the performance of its obligations and duties hereunder does not and will not constitute a breach or violation of its organizational documents, its bylaws or any agreement, instrument, order, judgment, law, rule or decree by which it is bound or to which it or its assets are subject; and (c) this Agreement constitutes the legal, valid and binding obligations of it, enforceable against it in accordance with its terms. Each Party covenants to the other Party that: (a) in the performance of its obligations and duties under this Agreement, it shall comply with the provisions of all applicable foreign, federal, state and local laws, regulations, rules and orders (including obtaining and maintaining all applicable occupational or professional licenses and permits); and (b) it shall provide the other Party with all reasonably requested information and data which may be necessary from time to time in order for the other Party to comply with all reporting and notice provisions of any foreign, federal, state or local law.

Atrotech further represents, warrants and covenants that the RF2 devices will be manufactured, under good manufacturing practices which include compliance with ISO 13485. The Parties recognize that United State Food and Drug Administration (FDA) Quality System Rules (QSR) do not technically apply to the manufacture of clinical trial devices. However, Atrotech represents that its practices for manufacturing RF2 devices for clinical trial will be in substantial compliance with QSR. Before Atrotech manufactures any RF2 devices intended for commercial sale by EnteroMedics, Atrotech shall register its manufacturing facility with FDA and comply with the QSR.

15. Notices. All notices, requests, demands and other communications given hereunder or required by law shall be in writing and will be deemed to have been duly given: (a) when personally delivered; (b) when sent by fax to a Party at the fax number for such Party as listed on the signature page of this Agreement (provided that evidence of successful transmission is obtained); (c) one (1) business day after the day on which the same has been deposited, prepaid for overnight domestic delivery, with a national courier service providing evidence of delivery; or (d) five (5) business days after the deposit in the United States mail, registered or certified, return receipt requested, postage prepaid, in each case addressed to the Party to whom such notice is to be given at the address following the signature of such Party on the signature page of this Agreement. Any Party may change its address, fax number or other information for the purpose of notices to that Party by giving written notice specifying such change to the other Party hereto.

16. Independent Contractor. Each Party shall be deemed to be an independent contractor with respect to the performance of its obligations and duties hereunder. Nothing in this Agreement or the arrangement for which it is written shall constitute or create a joint venture, partnership, agency or any other similar arrangement between the Parties. No Party hereto shall have the authority to assume or create obligations on behalf of the other Party, and no Party hereto shall take any action which has the effect of creating the appearance of its having such authority.

17. Amendment; Assignment. No amendment, supplement or modification of any provision of this Agreement will be effective unless made in writing that specifically identifies this Agreement and the provision intended to be amended, supplemented or modified and is signed by authorized officers of Atrotech and EnteroMedics. Each such amendment, supplement or modification will be effective only in the specific instance and for the specific purpose for which given. Neither Party may assign this Agreement or delegate any of its obligations hereunder, in whole or part and whether by operation of law or otherwise, without prior written consent of the other Party. Notwithstanding the foregoing, EnteroMedics is free to assign this Agreement as part of a sale or transfer of the assets of that portion of the business of EnteroMedics to which this Agreement pertains. The rights, duties, and obligations of the Parties under this Agreement shall inure to the benefit of and shall be binding upon their respective permitted successors and assigns.

18. Severability. If any provision of this Agreement is found to be invalid, illegal or unenforceable in any jurisdiction, for any reason, then, to the full extent permitted by law: (a) all other provisions hereof will remain in full force and effect in such jurisdictions and will be liberally construed in order to carry out the intent of the Parties hereto as nearly as may be possible; (b) such invalidity, illegality or unenforceability will not affect the validity, legality or enforceability of any other provision hereof; and (c) any court or arbitrator having jurisdiction thereover will have the power to reform such provision to the extent necessary for such provision to be enforceable under applicable law.

19. Entire Agreement; Further Assurance. This Agreement, together with the Exhibits attached hereto, contains the final, complete and exclusive statement of the agreement between the Parties with respect to the transactions contemplated herein and all prior written agreements and all prior and contemporaneous oral agreements with respect to the subject matter hereof are merged herein. The rights and obligations of the Parties with respect to the purchase and sale of the RF2 devices shall be made and governed exclusively by the terms and conditions of this Agreement, notwithstanding any different or additional terms in the Parties' purchase orders, change orders, order acknowledgements, invoices or other documents. The terms and conditions of this Agreement, as supplemented by the terms on a purchase order, order acknowledgement, invoice or other document as allowed by this Agreement, limited to amount, price, and delivery, shall be the exclusive terms and conditions governing the purchase and sale of the RF2 devices. Each Party hereby expressly objects to any different or additional terms or conditions contained in the other Party's documents. Each party hereto agrees to take (or cause others to take) such other action and to execute and deliver (or cause others to execute and deliver) such other agreements, certificates or documents as may be reasonably necessary or desirable to carry out the provisions of this Agreement.

IN WITNESS WHEREOF, Atrotech and EnteroMedics have caused this Supply Agreement to be executed by their respective duly authorized representatives as of the day and year first above written.

Atrotech OY

By: /s/ Pasi Talonen
Name: Pasi Talonen
Title: CEO September 15, 2006

Address:	P.O. Box 28
	FIN-33721
	Tampere, Finland
	Attention: Tommi Majaus
Phone:	+358 3383 1323
Fax:	+358 3383 1324

EnteroMedics INC.

By: /s/ Mark B. Knudson
Name: Mark B. Knudson
Title: September 12, 2006

Address:	2800 Patton Road
	St. Paul, Minnesota 55113

<u>Exhibit A:</u>

[*]

[*] = Certain confidential information contained in this document, marked by brackets, has been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 406 of the Securities Act of 1933, as amended.

EXHIBIT 10.3

LOAN AND SECURITY AGREEMENT

Dated as of December 1, 2004

between

ENTEROMEDICS INC.,
a Delaware corporation,

as “Borrower”,

and

VENTURE LENDING & LEASING IV, INC.,
a Maryland corporation,

as “Lender”

LOAN AND SECURITY AGREEMENT

The Borrower and Lender identified on the cover page of this document have entered or anticipate entering into one or more transactions pursuant to which Lender agrees to make available to Borrower a loan facility governed by the terms and conditions set forth in this document and one or more Supplements executed by Borrower and Lender which incorporate this document by reference. Each Supplement constitutes a supplement to and forms part of this document, and will be read and construed as one with this document, so that this document and the Supplement constitute a single agreement between the parties (collectively referred to as this "Agreement").

Accordingly, the parties agree as follows:

ARTICLE 1—INTERPRETATION

1.1 Definitions. The terms defined in Article 10 and in the Supplement will have the meanings therein specified for purposes of this Agreement.

1.2 Inconsistency. In the event of any inconsistency between the provisions of any Supplement and this document, the provisions of the Supplement will be controlling for the purpose of all relevant transactions.

ARTICLE 2—THE COMMITMENT AND LOANS

2.1 The Commitment. Subject to the terms and conditions of this Agreement, Lender agrees to make term loans to Borrower from time to time from the Closing Date and to, but not including, the Termination Date in an aggregate principal amount not exceeding the Commitment. The Commitment is not a revolving credit commitment, and Borrower does not have the right to repay and reborrow hereunder. Each Loan requested by Borrower to be made on a single Business Day shall be for a minimum principal amount set forth in the Supplement, except to the extent the remaining Commitment is a lesser amount.

2.2 Notes Evidencing Loans; Repayment. Each Loan shall be evidenced by a separate Note payable to the order of Lender, in the total principal amount of the Loan. Principal and interest of each Loan shall be payable at the times set forth in the Note and regularly scheduled payments thereof and each Terminal Payment shall be effected by automatic debit of the appropriate funds from Borrower's Primary Operating Account as specified in the Supplement hereto.

2.3 Procedures for Borrowing.

(a) Borrower shall give Lender, at least five (5) Business Days' prior to a proposed Borrowing Date, written notice of any request for borrowing hereunder (a "Borrowing Request"). Each Borrowing Request shall be in substantially the form of Exhibit "B" to the Supplement, shall be executed by a responsible executive or financial officer of Borrower, and shall state how much is requested, and shall be accompanied by such other information and documentation as Lender may reasonably request.

(b) No later than 1:00 p.m. Pacific Standard Time on the Borrowing Date, if Borrower has satisfied the conditions precedent in Article 4, Lender shall make the Loan available to Borrower in immediately available funds.

2.4 Interest. Except as otherwise specified in the applicable Note, Basic Interest on the outstanding principal balance of each Loan shall accrue daily at the Designated Rate from the Borrowing Date until the Maturity Date. If the outstanding principal balance of such Loan is not paid on the Maturity Date, interest shall accrue at the Default Rate until paid in full, as further set forth herein.

2.5 Terminal Payment. Except as otherwise provided in the Supplement, Borrower shall pay the Terminal Payment with respect to each Loan on the Maturity Date of such Loan.

2.6 Interest Rate Calculation. Basic Interest, along with charges and fees under this Agreement and any Loan Document, shall be calculated for actual days elapsed on the basis of a 360-day year, which results in higher interest, charge or fee payments than if a 365-day year were used. In no event shall Borrower be obligated to pay Lender interest, charges or fees at a rate in excess of the highest rate permitted by applicable law from time to time in effect.

2.7 Default Interest. Any unpaid payments of principal or interest or the Terminal Payment with respect to any Loan shall bear interest from their respective maturities, whether scheduled or accelerated, at the Designated Rate for such Loan plus five percent

(5.00%) per annum, until paid in full, whether before or after judgment (the “Default Rate”). Borrower shall pay such interest on demand.

2.8 Late Charges. If Borrower is late in making any payment of principal or interest or Terminal Payment under this Agreement by more than five (5) days, Borrower agrees to pay a late charge of five percent (5%) of the installment due, but not less than fifty dollars ($50.00) for any one such delinquent payment. This late charge may be charged by Lender for the purpose of defraying the expenses incidental to the handling of such delinquent amounts. Borrower acknowledges that such late charge represents a reasonable sum considering all of the circumstances existing on the date of this Agreement and represents a fair and reasonable estimate of the costs that will be sustained by Lender due to the failure of Borrower to make timely payments. Borrower further agrees that proof of actual damages would be costly and inconvenient. Such late charge shall be paid without prejudice to the right of Lender to collect any other amounts provided to be paid or to declare a default under this Agreement or any of the other Loan Documents or from exercising any other rights and remedies of Lender.

2.9 Lender’s Records. Principal, Basic Interest, Terminal Payments and all other sums owed under any Loan Document shall be evidenced by entries in records maintained by Lender for such purpose. Each payment on and any other credits with respect to principal, Basic Interest, Terminal Payments and all other sums outstanding under any Loan Document shall be evidenced by entries in such records. Absent manifest error, Lender’s records shall be conclusive evidence thereof.

2.10 Grant of Security Interests; Filing of Financing Statements.

(a) To secure the timely payment and performance of all of Borrower’s Obligations to Lender, Borrower hereby grants to Lender continuing security interests in all of the Collateral. In connection with the foregoing, Borrower authorizes Lender to prepare and file any financing statements describing the Collateral without otherwise obtaining the Borrower’s signature or consent with respect to the filing of such financing statements.

(b) Borrower is and shall remain absolutely and unconditionally liable for the performance of its obligations under the Loan Documents, including, without limitation, any deficiency by reason of the failure of the Collateral to satisfy all amounts due Lender under any of the Loan Documents.

(c) All Collateral pledged by Borrower under this Agreement and any Supplement shall secure the timely payment and performance of all Obligations under this Agreement, the Notes and the other Loan Documents. Except as expressly provided in this Agreement, no Collateral pledged under this Agreement or any Supplement shall be released until such time as all Obligations under this Agreement and the other Loan Documents have been satisfied and paid in full.

ARTICLE 3—REPRESENTATIONS AND WARRANTIES

Borrower represents and warrants that, except as set forth in the Supplement or any schedule of exceptions executed by the parties, as of the Closing Date and each Borrowing Date:

3.1 Due Organization. Borrower is a corporation duly organized and validly existing in good standing under the laws of the jurisdiction of its incorporation, and is duly qualified to conduct business and is in good standing in each other jurisdiction in which its business is conducted or its properties are located, except where the failure to be so qualified would not reasonably be expected to have a Material Adverse Effect.

3.2 Authorization, Validity and Enforceability. The execution, delivery and performance of all Loan Documents executed by Borrower are within Borrower’s powers, have been duly authorized, and are not in conflict with Borrower’s articles or certificate of incorporation or by-laws, or the terms of any charter or other organizational document of Borrower, as amended from time to time; and all such Loan Documents constitute valid and binding obligations of Borrower, enforceable in accordance with their terms (except as may be limited by bankruptcy, insolvency and similar laws affecting the enforcement of creditors’ rights in general, and subject to general principles of equity).

3.3 Compliance with Applicable Laws. Borrower has complied with all licensing, permit and fictitious name requirements necessary to lawfully conduct the business in which it is engaged, and to any sales, leases or the furnishing of services by Borrower, including without limitation those requiring consumer or other disclosures, the noncompliance with which would have a Material Adverse Effect.

3.4 No Conflict. The execution, delivery, and performance by Borrower of all Loan Documents are not in conflict with any law, rule, regulation, order or directive, or any indenture, agreement, or undertaking to which Borrower is a party or by which Borrower may be bound or affected. Without limiting the generality of the foregoing, the issuance of the Warrant to Lender (or its designee) and the grant of registration rights in connection therewith do not violate any agreement or instrument by which Borrower is bound or require the consent of any holders of Borrower's securities other than consents which have been obtained prior to the Closing Date.

3.5 No Litigation, Claims or Proceedings. There is no litigation, tax claim, proceeding or dispute pending, or, to the knowledge of Borrower, threatened against or affecting Borrower, its property or the conduct of its business.

3.6 Correctness of Financial Statements. Borrower's financial statements which have been delivered to Lender fairly and accurately reflect Borrower's financial condition in accordance with GAAP as of the latest date of such financial statements; and, since that date there has been no Material Adverse Change.

3.7 No Subsidiaries. Borrower is not a majority owner of or in a control relationship with any other business entity.

3.8 Environmental Matters. To its knowledge after reasonable inquiry, Borrower has concluded that Borrower is in compliance with Environmental Laws, except to the extent a failure to be in such compliance could not reasonably be expected to have a Material Adverse Effect.

3.9 No Event of Default. No Default or Event of Default has occurred and is continuing.

3.10 Full Disclosure. None of the representations or warranties made by Borrower in the Loan Documents as of the date such representations and warranties are made or deemed made, and none of the statements contained in any exhibit, report, statement or certificate furnished by or on behalf of Borrower in connection with the Loan Documents (including disclosure materials delivered by or on behalf of Borrower to Lender prior to the Closing Date or pursuant to Section 5.2 hereof), contains any untrue statement of a material fact or omits any material fact required to be stated therein or necessary to make the statements made therein, in light of the circumstances under which they are made, not misleading as of the time when made or delivered.

3.11 Specific Representations Regarding Collateral.

(a) Title. Except for the security interests created by this Agreement and Permitted Liens, (i) Borrower is and will be the unconditional legal and beneficial owner of the Collateral, and (ii) the Collateral is genuine and subject to no Liens, rights or defenses of others. There exist no prior assignments or encumbrances of record with the U.S. Patent and Trademark Office or Copyright Office affecting any Collateral in favor of any third party other than Lender.

(b) Rights to Payment. The names of the obligors, amount owing to Borrower, due dates and all other information with respect to the Rights to Payment are and will be correctly stated in all material respects in all Records relating to the Rights to Payment. Borrower further represents and warrants, to its knowledge, that each Person appearing to be obligated on a Right to Payment has authority and capacity to contract and is bound as it appears to be.

(c) Location of Collateral. Borrower's chief executive office, Inventory, Records, Equipment, and any other offices or places of business are located at the address(es) shown on the Supplement.

(d) Business Names. Other than its full corporate name, Borrower has not conducted business using any trade names or fictitious business names except as shown on the Supplement.

3.12 Copyrights, Patents, Trademarks and Licenses.

(a) Borrower owns or is licensed or otherwise has the right to use all of the patents, trademarks, service marks, trade names, copyrights, contractual franchises, authorizations and other similar rights that are reasonably necessary for the operation of its business, without conflict with the rights of any other Person.

(b) To Borrower's knowledge, no slogan or other advertising device, product, process, method, substance, part or other material now employed, or now contemplated to be employed, by Borrower infringes upon any rights held by any other Person.

(c) No claim or litigation regarding any of the foregoing is pending or, to Borrower's knowledge, threatened, and no patent, invention, device, application, principle or any statute, law, rule, regulation, standard or code is pending or proposed which, in either case, could reasonably be expected to have a Material Adverse Effect.

3.13 Survival. The representations and warranties of Borrower as set forth in this Agreement survive the execution and delivery of this Agreement.

ARTICLE 4—CONDITIONS PRECEDENT

4.1 Conditions to First Loan. The obligation of Lender to make its first Loan hereunder is, in addition to the conditions precedent specified in Section 4.2 and in any Supplement, subject to the fulfillment of the following conditions and to the receipt by Lender of the documents described below, duly executed and in form and substance satisfactory to Lender and its counsel:

(a) Resolutions. A certified copy of the resolutions of the Board of Directors of Borrower authorizing the execution, delivery and performance by Borrower of the Loan Documents.

(b) Incumbency and Signatures. A certificate of the secretary of Borrower certifying the names of the officer or officers of Borrower authorized to sign the Loan Documents, together with a sample of the true signature of each such officer.

(c) Legal Opinion. The opinion of legal counsel for Borrower as to such matters as Lender may reasonably request, including the matters covered by Sections 3.1, 3.2, 3.4 and 3.5 hereof.

(d) Articles and By-Laws. Certified copies of the Articles or Certificate of Incorporation and By-Laws of Borrower, as amended through the Closing Date.

(e) This Agreement. A counterpart of this Agreement and an initial Supplement, with all schedules completed and attached thereto, and disclosing such information as is acceptable to Lender.

(f) Financing Statements. Filing copies (or other evidence of filing satisfactory to Lender and its counsel) of such UCC financing statements, collateral assignments, account control agreements, and termination statements, with respect to the Collateral as Lender shall request.

(g) Intentionally Omitted.

(h) Lien Searches. UCC lien, judgment, bankruptcy and tax lien searches of Borrower from such jurisdictions or offices as Lender may reasonably request, all as of a date reasonably satisfactory to Lender and its counsel.

(i) Good Standing Certificate. A Certificate of status or good standing of Borrower as of a date acceptable to Lender from the jurisdiction of Borrower's organization and any foreign jurisdictions where Borrower is qualified to do business.

(j) Warrant(s). One or more warrants issued by Borrower to Lender (or its designee) exercisable for such number, type and class of shares of Borrower's capital stock, and for an initial exercise price as is specified in the Supplement.

(k) Other Documents. Such other documents and instruments as Lender may reasonably request to effectuate the intents and purposes of this Agreement.

4.2 Conditions to All Loans. The obligation of Lender to make its initial Loan and each subsequent Loan is subject to the following further conditions precedent that:

(a) No Default. No Default or Event of Default has occurred and is continuing or will result from the making of any such Loan, and the representations and warranties of Borrower contained in Article 3 of this Agreement and Part 3 of the Supplement are true and correct as of the Borrowing Date of such Loan.

(b) No Material Adverse Change. No event has occurred that has had or could reasonably be expected to have a Material Adverse Change.

(c) Borrowing Request. Borrower shall have delivered to Lender a Borrowing Request for such Loan.

(d) Note. Borrower shall have delivered an executed Note evidencing such Loan, substantially in the form of Exhibit "A" attached to the Supplement.

(e) Supplemental Lien Filings. Borrower shall have executed and delivered such amendments or supplements to this Agreement and additional Security Documents, financing statements and third party waivers as Lender may reasonably request in connection with the proposed Loan, in order to create, protect or perfect or to maintain the perfection of Lender's Liens on the Collateral.

(f) VCOC Limitation. Lender shall not be obligated to make any Loan under its Commitment if at the time of or after giving effect to the proposed Loan Lender would no longer qualify as: (A) a "venture capital operating company" under U.S. Department of Labor Regulations Section 2510.3-101(d), Title 29 of the Code of Federal Regulations, as amended; and (B) a "business development company" under the provisions of federal Investment Company Act of 1940, as amended; and (C) a "regulated investment company" under the provisions of the Internal Revenue Code of 1986, as amended.

(g) Financial Projections. Borrower shall have delivered to Lender Borrower's business plan and/or financial projections or forecasts as most recently approved by Borrower's Board of Directors.

ARTICLE 5—AFFIRMATIVE COVENANTS

During the term of this Agreement and until its performance of all Obligations, Borrower will:

5.1 Notice to Lender. Promptly give written notice to Lender of:

(a) Any litigation or administrative or regulatory proceeding affecting Borrower where the amount claimed against Borrower is at the Threshold Amount or more, or where the granting of the relief requested could have a Material Adverse Effect.

(b) Any substantial dispute which may exist between Borrower or any governmental or regulatory authority.

(c) The occurrence of any Default or any Event of Default.

(d) Any change in the location of any of Borrower's places of business or Collateral at least thirty (30) days in advance of such change, or of the establishment of any new, or the discontinuance of any existing, place of business.

(e) Any dispute or default by Borrower or any other party under any joint venture, partnering, distribution, cross-licensing, strategic alliance, collaborative research or manufacturing, license or similar agreement which could reasonably be expected to have a Material Adverse Effect.

(f) Any other matter which has resulted or might reasonably result in a Material Adverse Change.

5.2 Financial Statements. Deliver to Lender or cause to be delivered to Lender, in form and detail satisfactory to Lender the following financial and other information, which Borrower warrants shall be accurate and complete in all material respects:

(a) Monthly Financial Statements. As soon as available but no later than thirty (30) days after the end of each month, Borrower's balance sheet as of the end of such period, and Borrower's income statement for such period and for that portion of Borrower's financial reporting year ending with such period, prepared in accordance with GAAP and attested by a responsible financial officer of Borrower as being complete and correct and fairly presenting Borrower's financial condition and the results of Borrower's operations. After a Qualified Public Offering, the foregoing interim financial statements shall be delivered no later than 45 days after each fiscal quarter and for the quarter-annual fiscal period then ended.

(b) Year-End Financial Statements. As soon as available but no later than one hundred eighty (180) days after and as of the end of each financial reporting year, a complete copy of Borrower's audit report, which shall include balance sheet, income statement, statement of changes in equity and statement of cash flows for such year, prepared in accordance with GAAP and certified by an independent certified public accountant selected by Borrower and satisfactory to Lender (the "Accountant"). The Accountant's certification shall not be qualified or limited due to a restricted or limited examination by the Accountant of any material portion of Borrower's records or otherwise.

(c) Compliance Certificates. Simultaneously with the delivery of each set of financial statements referred to in paragraphs (a) and (b) above, a certificate of the chief financial officer of Borrower substantially in the form of Exhibit "C" to the Supplement (i) setting forth in reasonable detail any calculations required to establish whether Borrower is in compliance with any financial covenants or tests set forth in the Supplement, and (ii) stating whether any Default or Event of Default exists on the date of such certificate, and if so, setting forth the details thereof and the action which Borrower is taking or proposes to take with respect thereto.

(d) Government Required Reports; Press Releases. Promptly after sending, issuing, making available, or filing, copies of all statements released to any news media for publication, all reports, proxy statements, and financial statements that Borrower sends or makes available to its stockholders, and, not later than five (5) days after actual filing or the date such filing was first due, all registration statements and reports that Borrower files or is required to file with the Securities and Exchange Commission, or any other governmental or regulatory authority.

(e) Other Information. Such other statements, lists of property and accounts, budgets, forecasts, reports, or other information as Lender may from time to time reasonably request.

5.3 Managerial Assistance from Lender. At no cost to Borrower, permit Lender to substantially participate in, and substantially influence the conduct of management of Borrower through the exercise of "management rights," as that term is defined in 29 C.F.R. § 2510.3-101(d), including without limitation the following rights:

(a) Borrower agrees that (i) it will make its officers, directors, employees and affiliates available at such times as Lender may reasonably request for Lender to consult with and advise as to the conduct of Borrower's business, its equipment and financing plans, and its financial condition and prospects, (ii) Lender shall have the right to inspect Borrower's books, records, facilities and properties at reasonable times during normal business hours on reasonable advance notice, and (iii) Lender shall be entitled to recommend prospective candidates for election or nomination for election to Borrower's Board of Directors but Borrower shall not be bound by such recommendations, it being the intention of the parties that Lender shall be entitled through such rights, *inter alia*, to furnish "significant managerial assistance", as defined in Section 2(a)(47) of the Investment Company Act of 1940, to Borrower.

(b) Without limiting the generality of (a) above, if Lender reasonably believes that financial or other developments affecting Borrower have impaired or are likely to impair Borrower's ability to perform its obligations under this Agreement, permit Lender reasonable access to Borrower's management and/or Board of Directors and opportunity to present Lender's views with respect to such developments.

Lender shall cooperate with Borrower to ensure that the exercise of Lender's rights shall not disrupt the business of Borrower. The rights enumerated above shall not be construed as giving Lender control over Borrower's management or policies.

5.4 Existence. Maintain and preserve Borrower's existence, present form of business, and all rights and privileges necessary or desirable in the normal course of its business; and keep all Borrower's property in good working order and condition, ordinary wear and tear excepted.

5.5 Insurance. Obtain and keep in force insurance in such amounts and types as is usual in the type of business conducted by Borrower, with insurance carriers having a policyholder rating of not less than "A" and financial category rating of Class VII in "Best's Insurance Guide," unless otherwise approved by Lender. Such insurance policies must be in form and substance satisfactory to Lender, and shall list Lender as an additional insured or loss payee, as applicable, on endorsement(s) in form reasonably acceptable to Lender. Borrower shall furnish to Lender such endorsements, and upon Lender's request, copies of any or all such policies.

5.6 Accounting Records. Maintain adequate books, accounts and records, and prepare all financial statements in accordance with GAAP, and in compliance with the regulations of any governmental or regulatory authority having jurisdiction over Borrower or Borrower's business; and permit employees or agents of Lender at such reasonable times as Lender may request, at Borrower's expense, to inspect Borrower's properties, and to examine, and make copies and memoranda of Borrower's books, accounts and records.

5.7 Compliance With Laws. Comply with all laws (including Environmental Laws), rules, regulations applicable to, and all orders and directives of any governmental or regulatory authority having jurisdiction over, Borrower or Borrower's business, and with all material agreements to which Borrower is a party, except where the failure to so comply would not have a Material Adverse Effect.

5.8 Taxes and Other Liabilities. Pay all Borrower's Indebtedness when due; pay all taxes and other governmental or regulatory assessments before delinquency or before any penalty attaches thereto, except as may be contested in good faith by the appropriate procedures and for which Borrower shall maintain appropriate reserves; and timely file all required tax returns.

5.9 Special Collateral Covenants.

(a) Maintenance of Collateral; Inspection. Do all things reasonably necessary to maintain, preserve, protect and keep all Collateral in good working order and salable condition, ordinary wear and tear excepted, deal with the Collateral in all ways as are considered good practice by owners of like property, and use the Collateral lawfully and, to the extent applicable, only as permitted by Borrower's insurance policies. Maintain, or cause to be maintained, complete and accurate Records relating to the Collateral. Upon reasonable prior notice at reasonable times during normal business hours, Borrower hereby authorizes Lender's officers, employees, representatives and agents to inspect the Collateral and to discuss the Collateral and the Records relating thereto with Borrower's officers and employees, and, in the case of any Right to Payment, with any Person which is or may be obligated thereon.

(b) Financing Statements and Other Actions. Execute and deliver to Lender all financing statements, notices and other documents (including, without limitation, any filings with the United States Patent and Trademark Office) from time to time reasonably requested by Lender to maintain a first perfected security interest in the Collateral in favor of Lender; perform such other acts, and execute and deliver to Lender such additional conveyances, assignments, agreements and instruments, as Lender may at any time request in connection with the administration and enforcement of this Agreement or Lender's rights, powers and remedies hereunder.

(c) Liens. Not create, incur, assume or permit to exist any Lien or grant any other Person a negative pledge on any Collateral, except Permitted Liens.

(d) Documents of Title. Not sign or authorize the signing of any financing statement or other document naming Borrower as debtor or obligor, or acquiesce or cooperate in the issuance of any bill of lading, warehouse receipt or other document or instrument of title with respect to any Collateral, except those negotiated to Lender, or those naming Lender as secured party.

(e) Change in Location or Name. Without at least 30 days' prior written notice to Lender: (a) not relocate any Collateral or Records, its chief executive office, or establish a place of business at a location other than as specified in the Supplement; and (b) not change its name, mailing address, location of Collateral, jurisdiction of incorporation or its legal structure.

(f) Decals, Markings. At the request of Lender, firmly affix a decal, stencil or other marking to designated items of Equipment, indicating thereon the security interest of Lender.

(g) Agreement With Real Property Owner/Landlord. Obtain and maintain such acknowledgments, consents, waivers and agreements from the owner, lienholder, mortgagee and landlord with respect to any real property on which Equipment is located as Lender may require, all in form and substance satisfactory to Lender. Lender hereby waives the requirement of this Section 5.9(g) with respect to Borrower's principal place of business in St. Paul, Minnesota leased and occupied by Borrower as of the Closing Date based on Borrower's representation that such lease does not give the lessor an interest in the Equipment located at such place of business.

(h) Certain Agreements on Rights to Payment. Other than in the ordinary course of business, not make any material discount, credit, rebate or other reduction in the original amount owing on a Right to Payment or accept in satisfaction of a Right to Payment less than the original amount thereof.

5.10 Authorization for Automated Clearinghouse Funds Transfer. (i) Authorize Lender to initiate debit entries to Borrower's Primary Operating Account, specified in the Supplement attached hereto, through Automated Clearinghouse ("ACH") transfers, in order to satisfy regularly scheduled payments of principal, interest and Terminal Payments; (ii) provide Lender at least thirty (30) days notice of any change in Borrower's Primary Operating Account; and (iii) grant Lender any additional authorizations necessary to begin ACH debits from a new account which becomes the Primary Operating Account.

ARTICLE 6—NEGATIVE COVENANTS

During the term of this Agreement and until the performance of all Obligations, Borrower will not:

6.1 Indebtedness. Be indebted for borrowed money, the deferred purchase price of property, or leases which would be capitalized in accordance with GAAP; or become liable as a surety, guarantor, accommodation party or otherwise for or upon the obligation of any other Person, except:

(a) Indebtedness incurred for the acquisition of supplies or inventory on normal trade credit;

(b) Indebtedness incurred for customer trade payable and other vendor-based operating leases;

(c) Indebtedness incurred pursuant to one or more transactions permitted under Section 6.4;

(d) Indebtedness of Borrower under this Agreement; and

(e) Any Indebtedness approved by Lender prior to the Closing Date and set forth on Schedule 6.1.

6.2 Liens. Create, incur, assume or permit to exist any Lien, or grant any other Person a negative pledge, on any of Borrower's property, except Permitted Liens. Without limiting the generality of the foregoing, and as a material inducement to the Lenders' making of the Commitment and entering into the Loan Documents, Borrower agrees that it shall not assign, mortgage, pledge, grant a security interest in, or encumber any of Borrower's Intellectual Property, or enter into any agreement, document, instrument or other arrangement (except with or in favor of Lenders) with any Person which directly or indirectly prohibits or has the effect of prohibiting Borrower from assigning, mortgaging, pledging, granting a security interest in or upon, or encumbering any of Borrower's Intellectual Property, except as is otherwise permitted in Section 6.5(i) of this Agreement and clause (h) of the definition of "Permitted Lien" herein.

6.3 Dividends. Except after a Qualified Public Offering, pay any dividends or purchase, redeem or otherwise acquire or make any other distribution with respect to any of Borrower's capital stock, except (a) dividends or other distributions solely of capital stock of Borrower, and (b) so long as no Event of Default has occurred and is continuing, repurchases of stock from employees upon termination of employment under reverse vesting or similar repurchase plans not to exceed $100,000 in any calendar year.

6.4 Changes/Mergers. Liquidate or dissolve; or enter into any consolidation, merger or other combination in which the stockholders of the Borrower immediately prior to the first such transaction own less than 50% of the voting stock of the Borrower immediately after giving effect to such transaction or related series of such transactions, except that Borrower may consolidate or merge so long as: (A) the entity that results from such merger or consolidation (the "Surviving Entity") shall have executed and delivered to Lender an agreement in form and substance reasonably satisfactory to Lender, containing an assumption by the Surviving Entity of the due and punctual payment and performance of all Obligations and performance and observance of each covenant and condition of Borrower in the Loan Documents; (B) all such obligations of the Surviving Entity to Lender shall be guaranteed by any entity that directly or indirectly owns or controls more than 50% of the voting stock of the Surviving Entity; (C) immediately after giving effect to such merger or consolidation, no Event of Default or, event which with the lapse of time or giving of notice or both, would result in an Event of Default shall have occurred and be continuing; and (D) the credit risk to Lender, in its sole discretion, of the Surviving Entity shall not be increased. In determining whether the proposed merger or consolidation would result in an increased credit risk, Lender may consider, among other things, changes in Borrower's management team, employee base, access to equity markets, venture capital support, financial position and/or disposition of intellectual property rights which may reasonably be anticipated as a result of the transaction.

6.5 Sales of Assets. Sell, transfer, lease, license or otherwise dispose of (a "Transfer") any of Borrower's assets except (i) exclusive and non-exclusive licenses of Intellectual Property in the ordinary course of business consistent with industry practice; (ii) Transfers of worn-out, obsolete or surplus property (each as determined by the Borrower in its reasonable judgment) not constituting Equipment as to which a Loan was made hereunder; (iii) Transfers of Inventory not constituting Equipment as to which a Loan was made hereunder; (iv) Transfers constituting Permitted Liens; (v) Transfers permitted in Section 6.6 hereunder; and (vi) Transfers of Collateral (other than Intellectual Property and Equipment as to which a Loan was made hereunder) for fair consideration and in the ordinary course of its business.

6.6 Loans/Investments. Make or suffer to exist any loans, guaranties, advances, or investments, except:

(a) Accounts receivable in the ordinary course of Borrower's business;

(b) Investments in domestic certificates of deposit issued by, and other domestic investments with, financial institutions organized under the laws of the United States or a state thereof, having at least One Hundred Million Dollars ($100,000,000) in capital and a rating of at least "investment grade" or "A" by Moody's or any successor rating agency;

(c) Investments in marketable obligations of the United States of America and in open market commercial paper given the highest credit rating by a national credit agency and maturing not more than one year from the creation thereof;

(d) Temporary advances to cover incidental expenses to be incurred in the ordinary course of business;

(e) Investments in joint ventures, strategic alliances, licensing and similar arrangements customary in Borrower's industry and which do not require Borrower to assume or otherwise become liable for the obligations of any third party not directly related to or arising out of such arrangement or, without the prior written consent of Lender, require Borrower to transfer ownership of non-cash assets to such joint venture or other entity; and

(f) Investments in wholly-owned subsidiaries of the Borrower.

6.7 Transactions With Related Persons. Directly or indirectly enter into any transaction with or for the benefit of a Related Person on terms more favorable to the Related Person than would have been obtainable in an "arms' length" dealing.

6.8 Other Business. Engage in any material line of business other than the business Borrower conducts as of the Closing Date.

6.9 Financial Covenants. Fail to comply with any financial covenants or tests set forth in the Supplement.

6.10 Compliance. Become an "investment company" or controlled by an "investment company," within the meaning of the Investment Company Act of 1940, or become principally engaged in, or undertake as one of its important activities, the business of extending credit for the purpose of purchasing or carrying margin stock, or use the proceeds of any Loan for such purpose. Fail to meet the minimum funding requirements of ERISA, permit a Reportable Event or Prohibited Transaction, as defined in ERISA, to occur, fail to comply with the Federal Fair Labor Standards Act or violate any law or regulation, which violation could have a Material Adverse Effect or a material adverse effect on the Collateral or the priority of Lender's Lien on the Collateral, or permit any of its subsidiaries to do any of the foregoing.

6.11 Other Deposit and Securities Accounts. Maintain any deposit accounts or accounts holding securities owned by Borrower except (i) Deposit Accounts and investment/securities accounts as set forth in the Supplement, and (ii) other Deposit Accounts and securities/investment accounts, in each case, with respect to which Borrower and Lender shall have taken such action as Lender reasonably deems necessary to obtain a perfected first security interest therein. Notwithstanding anything contained herein to the contrary, including the Borrower's grant of a security interest in Section 2.10(a), Lender agrees that, in the event the Lender instructs any depositary bank to (i) deliver funds to the Lender or (ii) not to permit the Borrower to withdraw funds from any Deposit Account, the Borrower may withdraw, for a period not to exceed 30 days commencing on the date Lender delivers such instructions, an amount in the Deposit Accounts not to exceed $250,000 for the purpose of meeting Borrower's then current payroll obligations or, with Lender's consent, other outstanding obligations of Borrower, and that any such withdrawal shall be free and clear of any interest of the Lender in such funds. The Lender shall provide instruction to such depositary bank in order to permit the Borrower to make such withdrawal.

ARTICLE 7—EVENTS OF DEFAULT

7.1 Events of Default; Acceleration. Upon the occurrence and during the continuation of any Default, the obligation of Lender to make any additional Loan shall be suspended. The occurrence of any of the following (each, an "Event of Default") shall terminate any obligation of Lender to make any additional Loan; and shall, at the option of Lender (1) make all sums of Basic Interest and principal, all Terminal Payments, and any Obligations and other amounts owing under any Loan Documents immediately due and payable without notice of default, presentment or demand for payment, protest or notice of nonpayment or dishonor or any other notices or demands, and (2) give Lender the right to exercise any other right or remedy provided by contract or applicable law:

(a) Borrower shall fail to pay any principal, interest or Terminal Payment under this Agreement or any Note, or fail to pay any fees or other charges when due under any Loan Document, and such failure continues for three (3) Business Days or more after the same first becomes due; or an Event of Default as defined in any other Loan Document shall have occurred.

(b) Any representation or warranty made, or financial statement, certificate or other document provided, by Borrower under any Loan Document shall prove to have been false or misleading in any material respect when made or deemed made herein.

(c) Borrower shall fail to pay its debts generally as they become due or shall commence any Insolvency Proceeding with respect to itself; an involuntary Insolvency Proceeding shall be filed against Borrower, or a custodian, receiver, trustee, assignee for the benefit of creditors, or other similar official, shall be appointed to take possession, custody or control of the properties of Borrower, and such involuntary Insolvency Proceeding, petition or appointment is acquiesced to by Borrower or is not dismissed within sixty (60) days; or the dissolution or termination of the business of Borrower.

(d) Borrower shall be in default beyond any applicable period of grace or cure under any other agreement involving the borrowing of money, the purchase of property, the advance of credit or any other monetary liability of any kind to Lender or to any Person which results in the acceleration of payment of such obligation in an amount in excess of the Threshold Amount.

(e) Any governmental or regulatory authority shall take any judicial or administrative action, or any defined benefit pension plan maintained by Borrower shall have any unfunded liabilities, any of which, in the reasonable judgment of Lender, might have a Material Adverse Effect.

(f) Except as permitted in Section 6.4, any sale, transfer or other disposition of all or a substantial or material part of the assets of Borrower, including without limitation to any trust or similar entity, shall occur.

(g) Any judgment(s) singly or in the aggregate in excess of the Threshold Amount shall be entered against Borrower which remain unsatisfied, unvacated or unstayed pending appeal for thirty (30) or more days after entry thereof.

(h) At any time prior to the initial sale of Borrower’s equity securities to the public pursuant to a registration statement filed under the Securities Act of 1933, as amended, any Person or two or more Persons (other than any “Excluded Person” as defined below) acting in concert shall have acquired (in a single transaction or series of related transactions occurring within a six-month period) beneficial ownership (within the meaning of Rule 13d-3 of the Securities and Exchange Commission) of outstanding shares of voting stock of Borrower representing fifty percent (50%) or more of the voting power of all shares of Borrower’s voting stock that are outstanding immediately after such acquisition. As used in this paragraph (h), “Excluded Person” means: (i) any Person who is a stockholder of Borrower as of the Closing Date; (ii) a venture capital firm or similar investment fund or institution; (iii) any Strategic Partner of Borrower, or (iv) an affiliate of any Person described in clause (i), (ii) or (iii). For purposes of this Section 7.1(h), “Strategic Partner” means any Person who either prior to first acquiring equity securities of Borrower has an existing contractual relationship with Borrower for the joint development or sharing of, or similar arrangement relating to, Borrower’s technology or products, or enters into such a contractual relationship at the time of acquiring Borrower’s securities.

(i) Borrower shall fail to perform or observe any covenant contained in Article 6 of this Agreement.

(j) Borrower shall fail to perform or observe any covenant contained in Section 5.9 of this Agreement.

(k) Borrower shall fail to perform or observe any covenant contained in this Agreement or any other Loan Document (other than a covenant which is dealt with specifically elsewhere in this Article 7) and, if capable of being cured, the breach of such covenant is not cured within 30 days after the sooner to occur of Borrower’s receipt of notice of such breach from Lender or the date on which such breach first becomes known to any officer of Borrower; provided, however that if such breach is not capable of being cured within such 30-day period and Borrower timely notifies Lender of such fact and Borrower diligently pursues such cure, then the cure period shall be extended to the date requested in Borrower’s notice but in no event more than 90 days from the initial breach; provided, further, that such additional 60-day opportunity to cure shall not apply in the case of any failure to perform or observe any covenant which has been the subject of a prior failure within the preceding 180 days or which is a willful and knowing breach by Borrower.

7.2 Remedies Upon Default. Upon the occurrence and during the continuance of an Event of Default, Lender shall be entitled to, at its option, exercise any or all of the rights and remedies available to a secured party under the UCC or any other applicable law, and exercise any or all of its rights and remedies provided for in this Agreement and in any other Loan Document. The obligations of Borrower under this Agreement shall continue to be effective or be reinstated, as the case may be, if at any time any payment of any Obligations is rescinded or must otherwise be returned by Lender upon, on account of, or in connection with, the insolvency, bankruptcy or reorganization of Borrower or otherwise, all as though such payment had not been made.

7.3 Sale of Collateral. Upon the occurrence and during the continuance of an Event of Default, Lender may sell all or any part of the Collateral, at public or private sales, to itself, a wholesaler, retailer or investor, for cash, upon credit or for future delivery, and at such price or prices as Lender may deem commercially reasonable. To the extent permitted by law, Borrower hereby specifically waives all rights of redemption and any rights of stay or appraisal which it has or may have under any applicable law in effect from time to time. Any such public or private sales shall be held at such times and at such place(s) as Lender may determine. In case of the sale of all or any part of the Collateral on credit or for future delivery, the Collateral so sold may be retained by Lender until the selling price is paid by the purchaser, but Lender shall not incur any liability in case of the failure of such purchaser to pay for the Collateral and, in case of any such failure, such Collateral may be resold. Lender may, instead of exercising its power of sale, proceed to enforce its security interest in the Collateral by seeking a judgment or decree of a court of competent jurisdiction. Without limiting the generality of the foregoing, if an Event of Default is in effect,

(1) Subject to the rights of any third parties, Lender may license, or sublicense, whether general, special or otherwise, and whether on an exclusive or non-exclusive basis, any Copyrights, Patents or Trademarks included in the Collateral throughout the world for such term or terms, on such conditions and in such manner as Lender shall in its sole discretion determine;

(2) Lender may (without assuming any obligations or liability thereunder), at any time and from time to time, enforce (and shall have the exclusive right to enforce) against any licensee or sublicensee all rights and remedies of Borrower in, to and under any Copyright Licenses, Patent Licenses or Trademark Licenses and take or refrain from taking any action under any thereof, and Borrower hereby releases Lender from, and agrees to hold Lender free and harmless from and against any claims arising out of, any lawful action so taken or omitted to be taken with respect thereto other than claims arising out of Lender's gross negligence or willful misconduct; and

(3) Upon request by Lender, Borrower will execute and deliver to Lender a power of attorney, in form and substance reasonably satisfactory to Lender for the implementation of any lease, assignment, license, sublicense, grant of option, sale or other disposition of a Copyright, Patent or Trademark. In the event of any such disposition pursuant to this clause 3, Borrower shall supply its know-how and expertise relating to the products or services made or rendered in connection with Patents, the manufacture and sale of the products bearing Trademarks, and its customer lists and other records relating to such Copyrights, Patents or Trademarks and to the distribution of said products, to Lender.

7.4 Borrower's Obligations Upon Default. Upon the request of Lender after the occurrence and during the continuance of an Event of Default, Borrower will:

(a) Assemble and make available to Lender the Collateral at such place(s) as Lender shall reasonably designate, segregating all Collateral so that each item is capable of identification; and

(b) Subject to the rights of any lessor, permit Lender, by Lender's officers, employees, agents and representatives, to enter any premises where any Collateral is located, to take possession of the Collateral, to complete the processing, manufacture or repair of any Collateral, and to remove the Collateral, or to conduct any public or private sale of the Collateral, all without any liability of Lender for rent or other compensation for the use of Borrower's premises.

ARTICLE 8—SPECIAL COLLATERAL PROVISIONS

8.1 Compromise and Collection. Borrower and Lender recognize that setoffs, counterclaims, defenses and other claims may be asserted by obligors with respect to certain of the Rights to Payment; that certain of the Rights to Payment may be or become uncollectible in whole or in part; and that the expense and probability of success of litigating a disputed Right to Payment may exceed the amount that reasonably may be expected to be recovered with respect to such Right to Payment. Borrower hereby authorizes Lender, after and during the continuance of an Event of Default, to compromise with the obligor, accept in full payment of any Right to Payment such amount as Lender shall negotiate with the obligor, or abandon any Right to Payment. Any such action by Lender shall be considered commercially reasonable so long as Lender acts in good faith based on information known to it at the time it takes any such action.

8.2 Performance of Borrower's Obligations. Without having any obligation to do so, upon reasonable prior notice to Borrower, Lender may perform or pay any obligation which Borrower has agreed to perform or pay under this Agreement, including, without limitation, the payment or discharge of taxes or Liens levied or placed on or threatened against the Collateral. In so performing or paying, Lender shall determine the action to be taken and the amount necessary to discharge such obligations. Borrower shall reimburse Lender on demand for any amounts paid by Lender pursuant to this Section, which amounts shall constitute Obligations secured by the Collateral and shall bear interest from the date of demand at the Default Rate.

8.3 Power of Attorney. For the purpose of protecting and preserving the Collateral and Lender's rights under this Agreement, Borrower hereby irrevocably appoints Lender, with full power of substitution, as its attorney-in-fact with full power and authority, after the occurrence and during the continuance of an Event of Default, to do any act which Borrower is obligated to do hereunder; to exercise such rights with respect to the Collateral as Borrower might exercise; to use such Inventory, Equipment, Fixtures or other property as Borrower might use; to enter Borrower's premises; to give notice of Lender's security interest in, and to collect the Collateral; and before or after Default, to execute and file in Borrower's name any financing statements, amendments and continuation statements necessary or desirable to perfect or continue the perfection of Lender's security interests in the Collateral. Borrower hereby ratifies all that Lender shall lawfully do or cause to be done by virtue of this appointment.

8.4 Authorization for Lender to Take Certain Action. The power of attorney created in Section 8.3 is a power coupled with an interest and shall be irrevocable. The powers conferred on Lender hereunder are solely to protect its interests in the Collateral and shall not impose any duty upon Lender to exercise such powers. Lender shall be accountable only for amounts that it actually receives as a result of the exercise of such powers and in no event shall Lender or any of its directors, officers, employees, agents or representatives be responsible to Borrower for any act or failure to act, except for gross negligence or willful misconduct. After the occurrence and during the continuance of an Event of Default, Lender may exercise this power of attorney without notice to or assent of Borrower, in the name of Borrower, or in Lender's own name, from time to time in Lender's sole discretion and at Borrower's expense. To further carry out the terms of this Agreement, after the occurrence and during the continuance of an Event of Default, Lender may:

(a) Execute any statements or documents or take possession of, and endorse and collect and receive delivery or payment of, any checks, drafts, notes, acceptances or other instruments and documents constituting Collateral, or constituting the payment of amounts due and to become due or any performance to be rendered with respect to the Collateral.

(b) Sign and endorse any invoices, freight or express bills, bills of lading, storage or warehouse receipts; drafts, certificates and statements under any commercial or standby letter of credit relating to Collateral; assignments, verifications and notices in connection with Accounts; or any other documents relating to the Collateral, including without limitation the Records.

(c) Use or operate Collateral or any other property of Borrower for the purpose of preserving or liquidating Collateral.

(d) File any claim or take any other action or proceeding in any court of law or equity or as otherwise deemed appropriate by Lender for the purpose of collecting any and all monies due or securing any performance to be rendered with respect to the Collateral.

(e) Commence, prosecute or defend any suits, actions or proceedings or as otherwise deemed appropriate by Lender for the purpose of protecting or collecting the Collateral. In furtherance of this right, upon the occurrence and during the continuance of an Event of Default, Lender may apply for the appointment of a receiver or similar official to operate Borrower's business.

(f) Prepare, adjust, execute, deliver and receive payment under insurance claims, and collect and receive payment of and endorse any instrument in payment of loss or returned premiums or any other insurance refund or return, and apply such amounts at Lender's sole discretion, toward repayment of the Obligations or replacement of the Collateral.

8.5 Application of Proceeds. Any Proceeds and other monies or property received by Lender pursuant to the terms of this Agreement or any Loan Document may be applied by Lender first to the payment of expenses of collection, including without limitation reasonable attorneys' fees, and then to the payment of the Obligations in such order of application as Lender may elect.

8.6 Deficiency. If the Proceeds of any disposition of the Collateral are insufficient to cover all costs and expenses of such sale and the payment in full of all the Obligations, plus all other sums required to be expended or distributed by Lender, then Borrower shall be liable for any such deficiency.

8.7 Lender Transfer. Upon the transfer of all or any part of the Obligations, Lender may transfer all or part of the Collateral and shall be fully discharged thereafter from all liability and responsibility with respect to such Collateral so transferred, and the transferee shall be vested with all the rights and powers of Lender hereunder with respect to such Collateral so transferred, but with respect to any Collateral not so transferred, Lender shall retain all rights and powers hereby given.

8.8 Lender's Duties.

(a) Lender shall use reasonable care in the custody and preservation of any Collateral in its possession. Without limitation on other conduct which may be considered the exercise of reasonable care, Lender shall be deemed to have exercised reasonable care in the custody and preservation of such Collateral if such Collateral is accorded treatment substantially equal to that which Lender accords its own property, it being understood that Lender shall not have any responsibility for ascertaining or taking action with respect to calls, conversions, exchanges, maturities, declining value, tenders or other matters relative to any Collateral, regardless of whether Lender has or is deemed to have knowledge of such matters; or taking any necessary steps to preserve any rights against any Person with respect to any Collateral. Under no circumstances shall Lender be responsible for any injury or loss to the Collateral, or any part thereof, arising from any cause beyond the reasonable control of Lender.

(b) Lender may at any time deliver the Collateral or any part thereof to Borrower and the receipt of Borrower shall be a complete and full acquittance for the Collateral so delivered, and Lender shall thereafter be discharged from any liability or responsibility therefor.

(c) Neither Lender, nor any of its directors, officers, employees, agents, attorneys or any other person affiliated with or representing Lender shall be liable for any claims, demands, losses or damages, of any kind whatsoever, made, claimed, incurred or suffered by Borrower or any other party through the ordinary negligence of Lender, or any of its directors, officers, employees, agents, attorneys or any other person affiliated with or representing Lender.

8.9 Termination of Security Interests. Upon the payment in full of the Obligations and satisfaction of all Borrower's obligations under this Agreement and the other Loan Documents, and if Lender has no further obligations under its Commitment, the security interest granted hereby shall terminate and all rights to the Collateral shall revert to Borrower. Upon any such termination, the Lender shall, at Borrower's expense, execute and deliver to Borrower such documents as Borrower shall reasonably request to evidence such termination.

ARTICLE 9—GENERAL PROVISIONS

9.1 Notices. Any notice given by any party under any Loan Document shall be in writing and personally delivered, sent by overnight courier, or United States mail, postage prepaid, or sent by facsimile, or other authenticated message, charges prepaid, to the other party's or parties' addresses shown on the Supplement. Each party may change the address or facsimile number to which notices, requests and other communications are to be sent by giving written notice of such change to each other party. Notice given by hand delivery shall be deemed received on the date delivered; if sent by overnight courier, on the next Business Day after delivery to the courier service; if by first class mail, on the third Business Day after deposit in the U.S. Mail; and if by facsimile, on the date of transmission.

9.2 Binding Effect. The Loan Documents shall be binding upon and inure to the benefit of Borrower and Lender and their respective successors and assigns; provided, however, that Borrower may not assign or transfer Borrower's rights or obligations under any Loan Document. Lender reserves the right to sell, assign, transfer, negotiate or grant participations in all or any part of, or any interest in, Lender's rights and obligations under the Loan Documents. In connection with any of the foregoing, Lender may disclose all documents and information which Lender now or hereafter may have relating to the Loans, Borrower, or its business; provided that any person who receives such information shall have agreed in writing in advance to maintain the confidentiality of such information on terms reasonably acceptable to Borrower. It is the intention of the parties that, as a "venture capital operating company," Venture Lending & Leasing IV, LLC ("LLC"), the parent and sole owner of Lender., shall have the benefit of, and the power to independently exercise, those "management rights" provided in Section 5.3. To that end, the references to Lender in Sections 4.2(f), 5.1, 5.2, 5.3 and 5.9(a) hereof shall include LLC, and LLC shall have the right to exercise the advisory, inspection, information and other rights given to lender under those Sections independently of Lender. No amendment or modification of this Agreement shall alter or diminish LLC's rights under the preceding sentence without the consent of LLC.

9.3 No Waiver. Any waiver, consent or approval by Lender of any Event of Default or breach of any provision, condition, or covenant of any Loan Document must be in writing and shall be effective only to the extent set forth in writing. No waiver of any breach or default shall be deemed a waiver of any later breach or default of the same or any other provision of any Loan Document. No failure or delay on the part of Lender in exercising any power, right, or privilege under any Loan Document shall operate as a waiver thereof, and no single or partial exercise of any such power, right, or privilege shall preclude any further exercise thereof or the exercise of any other power, right or privilege. Lender has the right at its sole option to continue to accept interest and/or principal payments due under the Loan Documents after default, and such acceptance shall not constitute a waiver of said default or an extension of the Maturity Date unless Lender agrees otherwise in writing.

9.4 Rights Cumulative. All rights and remedies existing under the Loan Documents are cumulative to, and not exclusive of, any other rights or remedies available under contract or applicable law.

9.5 Unenforceable Provisions. Any provision of any Loan Document executed by Borrower which is prohibited or unenforceable in any jurisdiction, shall be so only as to such jurisdiction and only to the extent of such prohibition or unenforceability, but all the remaining provisions of any such Loan Document shall remain valid and enforceable.

9.6 Accounting Terms. Except as otherwise provided in this Agreement, accounting terms and financial covenants and information shall be determined and prepared in accordance with GAAP.

9.7 Indemnification; Exculpation. Borrower shall pay and protect, defend and indemnify Lender and Lender's employees, officers, directors, shareholders, affiliates, correspondents, agents and representatives (other than Lender, collectively "Agents") against, and hold Lender and each such Agent harmless from, all claims, actions, proceedings, liabilities, damages, losses, expenses (including, without limitation, attorneys' fees and costs) and other amounts incurred by Lender and each such Agent, arising from (i) the matters contemplated by this Agreement or any other Loan Documents, (ii) any dispute between Borrower and a third party, or (iii) any contention that Borrower has failed to comply with any law, rule, regulation, order or directive applicable to Borrower's business; **provided, however**, that this indemnification shall not apply to any of the foregoing incurred solely as the result of Lender's or any Agent's gross negligence or willful misconduct. This indemnification shall survive the payment and satisfaction of all of Borrower's Obligations to Lender.

9.8 Reimbursement. Borrower shall reimburse Lender for all costs and expenses, including without limitation reasonable attorneys' fees and disbursements expended or incurred by Lender in any arbitration, mediation, judicial reference, legal action or otherwise in connection with (a) the preparation and negotiation of the Loan Documents, (b) the amendment and enforcement of the Loan Documents, including without limitation during any workout, attempted workout, and/or in connection with the rendering of legal advice as to Lender's rights, remedies and obligations under the Loan Documents, (c) collecting any sum which becomes due Lender under any Loan Document, (d) any proceeding for declaratory relief, any counterclaim to any proceeding, or any appeal, or (e) the protection, preservation or enforcement of any rights of Lender. For the purposes of this section, attorneys' fees shall include, without limitation, fees incurred in connection with the following: (1) contempt proceedings; (2) discovery; (3) any motion, proceeding or other activity of any kind in connection with an Insolvency Proceeding; (4) garnishment, levy, and debtor and third party examinations; and (5) postjudgment motions and proceedings of any kind, including without limitation any activity taken to collect or enforce any judgment. All of the foregoing costs and expenses shall be payable upon demand by Lender, and if not paid within forty-five (45) days of presentation of invoices shall bear interest at the highest applicable Default Rate.

9.9 Execution in Counterparts. This Agreement may be executed in any number of counterparts which, when taken together, shall constitute but one agreement.

9.10 Entire Agreement. The Loan Documents are intended by the parties as the final expression of their agreement and therefore contain the entire agreement between the parties and supersede all prior understandings or agreements concerning the subject matter hereof. This Agreement may be amended only in a writing signed by Borrower and Lender.

9.11 Governing Law and Jurisdiction.

(a) THIS AGREEMENT AND THE LOAN DOCUMENTS SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF CALIFORNIA.

(b) ANY LEGAL ACTION OR PROCEEDING WITH RESPECT TO THIS AGREEMENT OR ANY OTHER LOAN DOCUMENT MAY BE BROUGHT IN THE COURTS OF THE STATE OF CALIFORNIA OR OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF CALIFORNIA, AND BY EXECUTION AND DELIVERY OF THIS AGREEMENT, EACH OF BORROWER AND LENDER CONSENTS, FOR ITSELF AND IN RESPECT OF ITS PROPERTY, TO THE NON-EXCLUSIVE JURISDICTION OF THOSE COURTS. EACH OF BORROWER AND LENDER IRREVOCABLY WAIVES ANY OBJECTION, INCLUDING ANY OBJECTION TO THE LAYING OF VENUE OR BASED ON THE GROUNDS OF FORUM NON CONVENIENS, WHICH IT MAY NOW OR HEREAFTER HAVE TO THE BRINGING OF ANY ACTION OR PROCEEDING IN SUCH JURISDICTION IN RESPECT OF THIS AGREEMENT OR ANY DOCUMENT RELATED HERETO. BORROWER AND LENDER EACH WAIVE PERSONAL SERVICE OF ANY SUMMONS, COMPLAINT OR OTHER PROCESS, WHICH MAY BE MADE BY ANY OTHER MEANS PERMITTED BY CALIFORNIA LAW.

9.12 Waiver of Jury Trial. BORROWER AND LENDER EACH WAIVES ITS RESPECTIVE RIGHTS TO A TRIAL BY JURY OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF OR RELATED TO THIS AGREEMENT, THE OTHER LOAN DOCUMENTS, OR THE TRANSACTIONS CONTEMPLATED HEREBY OR THEREBY, IN ANY ACTION, PROCEEDING OR OTHER LITIGATION OF ANY TYPE BROUGHT BY ANY OF THE PARTIES AGAINST ANY OTHER PARTY OR ANY PARTICIPANT OR ASSIGNEE, WHETHER WITH RESPECT TO CONTRACT CLAIMS, TORT CLAIMS, OR OTHERWISE. BORROWER AND LENDER EACH AGREES THAT ANY SUCH CLAIM OR CAUSE OF ACTION SHALL BE TRIED BY A COURT TRIAL WITHOUT A JURY. WITHOUT LIMITING THE FOREGOING, THE PARTIES FURTHER AGREE THAT THEIR RESPECTIVE RIGHT TO A TRIAL BY JURY IS WAIVED BY OPERATION OF THIS SECTION AS TO ANY ACTION, COUNTERCLAIM OR OTHER PROCEEDING WHICH SEEMS, IN WHOLE OR IN PART, TO CHALLENGE THE VALIDITY OR ENFORCEABILITY OF THIS AGREEMENT OR THE OTHER LOAN DOCUMENTS OR ANY PROVISION HEREOF OR THEREOF. THIS WAIVER SHALL APPLY TO ANY SUBSEQUENT AMENDMENTS, RENEWALS, SUPPLEMENTS OR MODIFICATIONS TO THIS AGREEMENT AND THE OTHER LOAN DOCUMENTS.

ARTICLE 10—DEFINITIONS

The definitions appearing in this Agreement or any Supplement shall be applicable to both the singular and plural forms of the defined terms:

"Account" means any "account," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest and, in any event, shall include, without limitation, all accounts receivable, book debts and other forms of obligations (other than forms of obligations evidenced by Chattel Paper, Documents or Instruments) now owned or hereafter received or acquired by or belonging or owing to Borrower (including, without limitation, under any trade name, style or division thereof) whether arising out of goods sold or services rendered by Borrower or from any other transaction, whether or not the same involves the sale of goods or services by Borrower (including, without limitation, any such obligation that may be characterized as an account or contract right under the UCC) and all of Borrower's rights in, to and under all purchase orders or receipts now owned or hereafter acquired by it for goods or services, and all of Borrower's rights to any goods represented by any of the foregoing (including, without limitation, unpaid seller's rights of rescission, replevin, reclamation and stoppage in transit and rights to returned, reclaimed or repossessed goods), and all monies due or to become due to Borrower under all purchase orders and contracts for the sale of goods or the performance of services or both by Borrower or in connection with any other transaction (whether or not yet earned by performance on the part of Borrower), now in existence or hereafter occurring, including, without limitation, the right to receive the proceeds of said purchase orders and contracts, and all collateral security and guarantees of any kind given by any Person with respect to any of the foregoing.

"Affiliate" means any Person which directly or indirectly controls, is controlled by, or is under common control with Borrower. "Control," "controlled by" and "under common control with" mean direct or indirect possession of the power to direct or cause the direction of management or policies (whether through ownership of voting securities, by contract or otherwise); provided, that control shall be conclusively presumed when any Person or affiliated group directly or indirectly owns five percent (5%) or more of the securities having ordinary voting power for the election of directors of a corporation.

"Agreement" means this Loan and Security Agreement and each Supplement thereto, as each may be amended or supplemented from time to time.

"Bankruptcy Code" means the Federal Bankruptcy Reform Act of 1978 (11 U.S.C. §101, et seq.), as amended.

"Basic Interest" means the fixed rate of interest payable on the outstanding balance of each Loan at the applicable Designated Rate.

"Borrowing Date" means the Business Day on which the proceeds of a Loan are disbursed by Lender.

"Borrowing Request" means a written request from Borrower in substantially the form of Exhibit "B" to the Supplement, requesting the funding of one or more Loans on a particular Borrowing Date.

"Business Day" means any day other than a Saturday, Sunday or other day on which commercial banks in New York City or San Francisco are authorized or required by law to close.

"**Chattel Paper"** means any "chattel paper," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Closing Date" means the date of this Agreement.

"Collateral" means all of Borrower's right, title and interest in and to the following property, whether now owned or hereafter acquired and wherever located: (a) all Receivables; (b) all Equipment; (c) all Fixtures; (d) all General Intangibles (subject to the exclusion described below with respect to Intellectual Property); (e) all Inventory; (f) all Investment Property; (g) all Deposit Accounts; (h) all other Goods and personal property of Borrower, whether tangible or intangible and whether now or hereafter owned or existing, leased, consigned by or to, or acquired by, Borrower and wherever located; (i) all Records; and (j) all Proceeds of each of the foregoing and all accessions to, substitutions and replacements for, and rents, profits and products of each of the foregoing; provided, however, that the foregoing "Collateral" shall not include Intellectual Property.

"Commitment" means the obligation of Lender to make Loans to Borrower up to the aggregate principal amount set forth in the Supplement.

"Copyright License" means any written agreement granting any right to use any Copyright or Copyright registration now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Copyrights" means all of the following now owned or hereafter acquired by Borrower or in which Borrower now hold or hereafter acquires any interest: (i) all copyrights, whether registered or unregistered, held pursuant to the laws of the United States, any State thereof or of any other country; (ii) all registrations, applications and recordings in the United States Copyright Office or in any similar office or agency of the United States, any State thereof or any other country; (iii) all continuations, renewals or extensions thereof; and (iv) any registrations to be issued under any pending applications.

“Default” means an event which with the giving of notice, passage of time, or both would constitute an Event of Default.

“Default Rate” is defined in Section 2.7.

“Deposit Accounts” means any “deposit accounts,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

“Designated Rate” means the rate of interest per annum described in the Supplement as being applicable to an outstanding Loan from time to time.

“Documents” means any “documents,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

“Environmental Laws” means all federal, state or local laws, statutes, common law duties, rules, regulations, ordinances and codes, together with all administrative orders, directed duties, requests, licenses, authorizations and permits of, and agreements with, any governmental authorities, in each case relating to environmental, health, or safety matters.

“Equipment” means any “equipment,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest and any and all additions, substitutions and replacements of any of the foregoing, wherever located, together with all attachments, components, parts, equipment and accessories installed thereon or affixed thereto.

“Event of Default” means any event described in Section 7.1.

“Fixtures” means any “fixtures,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

“GAAP” means generally accepted accounting principles and practices consistent with those principles and practices promulgated or adopted by the Financial Accounting Standards Board and the Board of the American Institute of Certified Public Accountants, their respective predecessors and successors. Each accounting term used but not otherwise expressly defined herein shall have the meaning given it by GAAP.

“General Intangibles” means any “general intangibles,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest and, in any event, shall include, without limitation, all right, title and interest that Borrower may now or hereafter have in or under any contract, all customer lists, Copyrights, Trademarks, Patents, websites, domain names, and all applications therefor and reissues, extensions, or renewals thereof, other rights to Intellectual Property, interests in partnerships, joint ventures and other business associations, Licenses, permits, trade secrets, proprietary or confidential information, inventions (whether or not patented or patentable), technical information, procedures, designs, knowledge, know-how, software, data bases, data, skill, expertise, recipes, experience, processes, models, drawings, materials and records, goodwill (including, without limitation, the goodwill associated with any Trademark, Trademark registration or Trademark licensed under any Trademark License), claims in or under insurance policies, including unearned premiums, uncertificated securities, money, cash or cash equivalents, deposit, checking and other bank accounts, rights to sue for past, present and future infringement of Copyrights, Trademarks and Patents, rights to receive tax refunds and other payments and rights of indemnification.

“Goods” means any “goods,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

“Indebtedness” of any Person means at any date, without duplication and without regard to whether matured or unmatured, absolute or contingent: (i) all obligations of such Person for borrowed money; (ii) all obligations of such Person evidenced by bonds, debentures, notes, or other similar instruments; (iii) all obligations of such Person to pay the deferred purchase price of property or services, except trade accounts payable arising in the ordinary course of business; (iv) all obligations of such Person as lessee under capital leases; (v) all obligations of such Person to reimburse or prepay any bank or other Person in respect of amounts paid under a letter of credit, banker’s acceptance, or similar instrument, whether drawn or undrawn; (vi) all obligations of such Person to purchase securities which arise out of or in connection with the sale of the same or substantially similar securities; (vii) all obligations of such Person to purchase, redeem, exchange, convert or otherwise acquire for value any capital stock of such Person or any warrants, rights or options to acquire such capital stock, now or hereafter outstanding, except to the extent that such obligations remain performable solely at the option of such Person; (viii) all obligations to repurchase assets previously sold (including any obligation to repurchase any accounts or chattel paper under any factoring, receivables purchase, or similar arrangement); (ix) obligations of such Person under interest rate swap, cap, collar or similar hedging arrangements; and (x) all obligations of others of any type described in clause (i) through clause (ix) above guaranteed by such Person.

"Insolvency Proceeding" means (a) any case, action or proceeding before any court or other governmental authority relating to bankruptcy, reorganization, insolvency, liquidation, receivership, dissolution, winding-up or relief of debtors, or (b) any general assignment for the benefit of creditors, composition, marshalling of assets for creditors, or other, similar arrangement in respect of its creditors generally or any substantial portion of its creditors, undertaken under U.S. Federal, state or foreign law, including the Bankruptcy Code.

"Instruments" means any "instrument," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Intellectual Property" means all Copyrights, Trademarks, Patents, Licenses, trade secrets, source codes, customer lists, proprietary or confidential information, inventions (whether or not patented or patentable), technical information, procedures, designs, knowledge, know-how, software, data bases, skill, expertise, experience, processes, models, drawings, materials, records and goodwill associated with the foregoing.

"Intellectual Property Security Agreement" means any Intellectual Property Security Agreement executed and delivered by Borrower in favor of Lender, as the same may be amended, supplemented, or restated from time to time.

"Inventory" means any "inventory," as such term is defined in the UCC, wherever located, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest, and, in any event, shall include, without limitation, all inventory, goods and other personal property that are held by or on behalf of Borrower for sale or lease or are furnished or are to be furnished under a contract of service or that constitute raw materials, work in process or materials used or consumed or to be used or consumed in Borrower's business, or the processing, packaging, promotion, delivery or shipping of the same, and all finished goods, whether or not the same is in transit or in the constructive, actual or exclusive possession of Borrower or is held by others for Borrower's account, including, without limitation, all goods covered by purchase orders and contracts with suppliers and all goods billed and held by suppliers and all such property first may be in the possession or custody of any carriers, forwarding agents, truckers, warehousemen, vendors, selling agents or other Persons.

"Investment Property" means any "investment property," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Letter of Credit Rights" means any "letter of credit rights," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest, including any right to payment under any letter of credit.

"License" means any Copyright License, Patent License, Trademark License or other license of rights or interests now held or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest and any renewals or extensions thereof.

"Lien" means any mortgage, deed of trust, pledge, hypothecation, assignment for security, security interest, encumbrance, levy, lien or charge of any kind, whether voluntarily incurred or arising by operation of law or otherwise, against any property, any conditional sale or other title retention agreement, any lease in the nature of a security interest, and the filing of any financing statement (other than a precautionary financing statement with respect to a lease that is not in the nature of a security interest) under the UCC or comparable law of any jurisdiction.

"Loan" means an extension of credit by Lender under this Agreement.

"Loan Documents" means, individually and collectively, this Loan and Security Agreement, each Supplement, each Note, the Intellectual Property Security Agreement, and any other security or pledge agreement(s), any Warrants issued by Borrower to Lender (or its designee) in connection with this Agreement, and all other contracts, instruments, addenda and documents executed in connection with this Agreement or the extensions of credit which are the subject of this Agreement.

"Material Adverse Effect" or "**Material Adverse Change**" means (a) a material adverse change in, or a material adverse effect upon, the operations, business, properties, or condition (financial or otherwise) of Borrower; (b) a material impairment of the ability of Borrower to perform under any Loan Document; or (c) a material adverse effect upon the legality, validity, binding effect or enforceability against Borrower of any Loan Document.

"Maturity Date" means, with regard to a Loan, the earlier of (i) its maturity by reason of acceleration, or (ii) its stated maturity date; and is the date on which payment of all outstanding principal, accrued interest, and the Terminal Payment with respect to such Loan is due.

"Note" means a promissory note substantially in the form attached to the Supplement as Exhibit "A", executed by Borrower evidencing each Loan.

"Obligations" means all debts, obligations and liabilities of Borrower to Lender currently existing or now or hereafter made, incurred or created under, pursuant to or in connection with this Agreement or any other Loan Document, whether voluntary or involuntary and however arising or evidenced, whether direct or acquired by Lender by assignment or succession, whether due or not due, absolute or contingent, liquidated or unliquidated, determined or undetermined, and whether Borrower may be liable individually or jointly, or whether recovery upon such debt may be or become barred by any statute of limitations or otherwise unenforceable; and all renewals, extensions and modifications thereof; and all attorneys' fees and costs incurred by Lender in connection with the collection and enforcement thereof as provided for in any Loan Document.

"Patent License" means any written agreement granting any right with respect to any invention on which a Patent is in existence now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Patents" means all of the following property now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest: (a) all letters patent of, or rights corresponding thereto in, the United States or any other county, all registrations and recordings thereof, and all applications for letters patent of, or rights corresponding thereto in, the United States or any other country, including, without limitation, registrations, recordings and applications in the United States Patent and Trademark Office or in any similar office or agency of the United States, any State thereof or any other country; (b) all reissues, continuations, continuations-in-part or extensions thereof; (c) all petty patents, divisionals, and patents of addition; and (d) all patents to be issued under any such applications.

"Permitted Lien" means

(a) Involuntary Liens which, in the aggregate, would not have a Material Adverse Effect and which in any event would not exceed, in the aggregate, the Threshold Amount;

(b) Liens for current taxes or other governmental or regulatory assessments which are not delinquent, or which are contested in good faith by the appropriate procedures and for which appropriate reserves are maintained;

(c) security interests on any property held or acquired by Borrower in the ordinary course of business securing Indebtedness incurred or assumed for the purpose of financing all or any part of the cost of acquiring such property; provided, that such Lien attaches solely to the property acquired with such Indebtedness and that the principal amount of such Indebtedness does not exceed one hundred percent (100%) of the cost of such property; and further provided, that such property is not equipment or other Collateral with respect to which a Loan has been made hereunder;

(d) Liens in favor of Lender;

(e) bankers' liens, rights of setoff and similar Liens incurred on deposits made in the ordinary course of business;

(f) materialmen's, mechanics', repairmen's, employees' or other like Liens arising in the ordinary course of business and which are not delinquent for more than 45 days or are being contested in good faith by appropriate proceedings;

(g) any judgment, attachment or similar Lien, unless the judgment it secures has not been discharged or execution thereof effectively stayed and bonded against pending appeal within 30 days of the entry thereof;

(h) exclusive and non-exclusive licenses of Intellectual Property; and

(i) Liens which have been approved by Lender in writing prior to the Closing Date and are set forth on the Schedule of "Permitted Liens" attached hereto.

"Person" means any individual, sole proprietorship, partnership, joint venture, trust, unincorporated organization, association, corporation, limited liability company, institution, public benefit corporation, other entity or government (whether federal, state, county, city, municipal, local, foreign, or otherwise, including any instrumentality, division, agency, body or department thereof).

"Proceeds" means "proceeds," as such term is defined in the UCC and, in any event, shall include, without limitation, (a) any and all Accounts, Chattel Paper, Instruments, cash or other forms of money or currency or other proceeds payable to Borrower from time to time in respect of the Collateral, (b) any and all proceeds of any insurance, indemnity, warranty or guaranty payable to Borrower from time to time with respect to any of the Collateral, (c) any and all payments (in any form whatsoever) made or due and payable to Borrower from time to time in connection with any requisition, confiscation, condemnation, seizure or forfeiture of all or any part of the Collateral by any governmental authority (or any Person acting under color of governmental authority), (d) any claim of Borrower against third parties (i) for past, present or future infringement of any Copyright, Patent or Patent License or (ii) for past, present or future infringement or dilution of any Trademark or Trademark License or for injury to the goodwill associated with any Trademark, Trademark registration or Trademark licensed under any Trademark License and (e) any and all other amounts from time to time paid or payable under or in connection with any of the Collateral.

"Qualified Public Offering" means the closing of a firmly underwritten public offering of Borrower's common stock with aggregate proceeds of not less than $20,000,000 (prior to underwriting expenses and commissions).

"Receivables" means all of Borrower's Accounts, Instruments, Documents, Chattel Paper, Supporting Obligations, and letters of credit and Letter of Credit Rights.

"Records" means all Borrower's computer programs, software, hardware, source codes and data processing information, all written documents, books, invoices, ledger sheets, financial information and statements, and all other writings concerning Borrower's business.

"Related Person" means any Affiliate of Borrower, or any officer, employee, director or equity security holder of Borrower or any Affiliate.

"Rights to Payment" means all Borrower's accounts, instruments, contract rights, documents, chattel paper and all other rights to payment, including, without limitation, the Accounts, all negotiable certificates of deposit and all rights to payment under any Patent License, any Trademark License, or any commercial or standby letter of credit.

"Security Documents" means this Loan and Security Agreement, the Supplement hereto, the Intellectual Property Security Agreement, and any and all account control agreements, collateral assignments, chattel mortgages, financing statements, amendments to any of the foregoing and other documents from time to time executed or filed to create, perfect or maintain the perfection of Lender's Liens on the Collateral.

"Supplement" means that certain supplement to the Loan and Security Agreement, as the same may be amended or restated from time to time, and any other supplements entered into between Borrower and Lender, as the same may be amended or restated from time to time.

"Supporting Obligations" means any "supporting obligations," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Terminal Payment" means, with respect to a Loan, an amount payable on the Maturity Date of such Loan in an amount equal to that percentage of the original principal amount of such Loan specified in the Supplement.

"Termination Date" has the meaning specified in the Supplement.

"Threshold Amount" has the meaning specified in the Supplement.

"Trademark License" means any written agreement granting any right to use any Trademark or Trademark registration now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Trademarks" means all of the following property now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest: (a) all trademarks, tradenames, corporate names, business names, trade styles, service marks, logos, other source or business identifiers, prints and labels on which any of the foregoing have appeared or appear, designs and general intangibles of like nature, now existing or hereafter adopted or acquired, all registrations and recordings thereof, and any applications in connection therewith, including, without limitation, registrations, recordings and applications in the United States Patent and Trademark Office or in any similar office or agency of the United States, any State thereof or any other country or any political subdivision thereof and (b) reissues, extensions or renewals thereof.

"UCC" means the Uniform Commercial Code as the same may, from time to time, be in effect in the State of California; provided, that in the event that, by reason of mandatory provisions of law, any or all of the attachment, perfection or priority of, or remedies with respect to, Lender's Lien on any Collateral is governed by the Uniform Commercial Code as enacted and in effect in a jurisdiction other than the State of California, the term "UCC" shall mean the Uniform Commercial Code as enacted and in effect in such other jurisdiction solely for purposes of the provisions thereof relating to such attachment, perfection, priority or remedies and for purposes of definitions related to such provisions. Unless otherwise defined herein, terms that are defined in the UCC and used herein shall have the meanings given to them in the UCC.

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

BORROWER:

ENTEROMEDICS INC.

By: /s/ Mark B. Knudson
Name: Mark Knudson
Title: President

LENDER:

VENTURE LENDING & LEASING IV, INC.

By: /s/ Salvador O. Gutierrez
Name: Salvador O. Gutierrez
Title: President

SUPPLEMENT
to the
Loan and Security Agreement
Dated as of December 1, 2004
between
EnteroMedics Inc. (“Borrower”)
and
Venture Lending & Leasing IV, Inc. (“Lender”)

This is a Supplement identified in the document entitled Loan and Security Agreement dated as of December 1, 2004, between Borrower and Lender (the **“Loan and Security Agreement”**). All capitalized terms used in this Supplement and not otherwise defined in this Supplement have the meanings ascribed to them in Section 10 of the Loan and Security Agreement, which is incorporated in its entirety into this Supplement. In the event of any inconsistency between the provisions of that document and this Supplement, this Supplement is controlling.

In addition to the provisions of the Loan and Security Agreement, the parties agree as follows:

Part 1.—Additional Definitions:

“Additional Growth Capital Loan” means any Loan requested by Borrower and funded by Lender under the Additional Growth Capital Loan Commitment for general corporate purposes of Borrower.

“Cash Equivalents” means, as of any date of determination, the following assets or rights of Borrower: (i) marketable direct obligations issued or unconditionally guaranteed by the United States government having maturities of not more than 12 months from the date of acquisition; and (ii) domestic certificates of deposit and time deposits having maturities of not more than 12 months from the date of acquisition, and overnight bank deposits, in each case issued by a commercial bank organized under the laws of the United States or any state thereof which at the time of acquisition are rated A-1 or better by Standard & Poor’s Corporation (or equivalent), and not subject to any offset rights in favor of such bank arising from any banking relationship with such bank.

“Commitment”: Subject to the terms and conditions set forth in the Loan and Security Agreement and this Supplement, Lender commits to make:

(i) Equipment Loans to Borrower up to the aggregate original principal amount of Two Hundred Fifty Thousand Dollars ($250,000) minus the aggregate original principal amount of the Soft Cost Loans (the **“Equipment Loan Commitment”**);

(ii) As a subfacility of the Equipment Loan Commitment, Soft Cost Loans to Borrower up to the aggregate original principal amount of Seventy Five Thousand Dollars ($75,000) (the **“Soft Cost Loan Commitment”**); provided, however, that in no event shall the aggregate original principal amount of all Soft Cost Loans and all Equipment Loans exceed Two Hundred Fifty Thousand Dollars ($250,000);

(iii) Growth Capital Loans to Borrower up to the aggregate original principal amount of Three Million Dollars ($3,000,000) (the **“Growth Capital Loan Commitment”**); and

(iv) Subject to subsequent written mutual agreement of Lender and Borrower, Additional Growth Capital Loans to Borrower up to the aggregate original principal amount of Five Million Dollars ($5,000,000) (the **“Additional Growth Capital Loan Commitment”**).

As used herein, the term **“Commitment”** shall mean the Equipment Loan Commitment, the Soft Cost Loan Commitment, the Growth Capital Loan Commitment, the Additional Growth Capital Loan Commitment or any combination of them or all of them, as the context requires. Equipment Loans, Soft Cost Loans, Growth Capital Loans and Additional Growth Capital Loans are sometimes referred to herein individually as a "**Loan**" or collectively as "**Loans**".

"Designated Rate": The Designated Rate means:

(i) *for each Equipment Loan*, a fixed rate of interest per annum equal to the Prime Rate as published on the Business Day on which Lender prepares the Note for such Equipment Loan following Borrower's submission of the Borrowing Request therefor, plus two and 23/1000 percent (2.023%); provided, however, that in no event shall the Designated Rate for an Equipment Loan be less than six and 523/1000 percent (6.523%);

(ii) *for each Soft Cost Loan*, a fixed rate of interest per annum equal to the Prime Rate as published on the Business Day on which Lender prepares the Note for such Soft Cost Loan following Borrower's submission of the Borrowing Request therefor, plus five and 46/100 percent (5.46%); provided, however, that in no event shall the Designated Rate for a Soft Cost Loan be less than nine and 96/100 percent (9.96%); and

(iii) *for each Growth Capital Loan and each Additional Growth Capital Loan*, a fixed rate of interest per annum equal to the Prime Rate as published on the Business Day on which Lender prepares the Note for such Loan following Borrower's submission of the Borrowing Request therefor, plus one and 99/100 percent (1.99%); provided, however, that in no event shall the Designated Rate for a Growth Capital Loan or an Additional Growth Capital Loan be less than six and 49/100 percent (6.49%).

"Eligible Equipment" means any new or used computer equipment, lab and shop equipment, test equipment and office equipment, and other standard hardware acceptable to Lender, and excluding any equipment constituting Soft Costs.

"Equipment Loan" means any Loan requested by Borrower and funded by Lender under the Equipment Loan Commitment to finance Borrower's acquisition or carrying of specific items of Eligible Equipment.

"Four Months' Expenses" means, as of any date of determination the aggregate dollar amount of operating and other expenses paid and accrued and cash expended (without duplication) by Borrower during the four calendar months most recently ended.

"Growth Capital Loan" means any Loan requested by Borrower and funded by Lender under the Growth Capital Loan Commitment for general corporate purposes of Borrower.

"Prime Rate" means the "prime rate" of interest, as published from time to time by The Wall Street Journal in the "Money Rates" section of its Western Edition newspaper.

"Soft Costs" means Borrower's costs of acquiring or licensing non-standard or custom equipment (not otherwise approved by Lender as Eligible Equipment), perpetual software license fees, tenant improvements at Borrower's primary business premises, and other items of personal property approved by Lender.

"Soft Cost Loan" means any Loan requested by Borrower and funded by Lender under the Soft Cost Loan Commitment to finance Borrower's acquisition or carrying of Soft Costs

"Terminal Payment": Each Equipment Loan, each Growth Capital Loan and each Additional Growth Capital Loan shall have a Terminal Payment equal to five percent (5%) of the original principal amount of such Loan. There shall be no Terminal Payment associated with Soft Cost Loans.

"Termination Date": The Termination Date is the earlier of:

(i) the date Lender may terminate making Loans or extending other credit pursuant to the rights of Lender under Article 7 of the Loan and Security Agreement, or (ii)(A) *with respect to the Equipment Loan Commitment, the Soft Cost Loan Commitment and the Growth Capital Loan Commitment*, June 30, 2005; and

(ii)(B) *with respect to the Additional Growth Capital Loan Commitment*, to be determined by Borrower and Lender.

"Threshold Amount" means Fifty Thousand Dollars ($50,000).

"Unrestricted Cash" means, as of any date of determination, Borrower's cash on hand and Cash Equivalents which are not subject to a Lien of any Person other than Lender.

Part 2.—Additional Covenants and Conditions:

1. Growth Capital Loan Commitment; Additional Growth Capital Loan Commitment; Use of Proceeds; Limitations on Loans.

(a) Growth Capital Loans. Subject to the terms and conditions of the Agreement, Lender agrees to make Growth Capital Loans to Borrower from time to time from the Closing Date up to and including the Termination Date in an aggregate original principal amount up to but not exceeding the then unfunded portion of the Growth Capital Loan Commitment**.** The proceeds of each Growth Capital Loan shall be used by Borrower for general corporate purposes.

(b) Additional Growth Capital Loans. Subject to the terms and conditions of the Agreement, Lender agrees to make Additional Growth Capital Loans to Borrower from time to time from the Closing Date up to and including the Termination Date in an aggregate original principal amount up to but not exceeding the then unfunded portion of the Additional Growth Capital Loan Commitment. The proceeds of each Additional Growth Capital Loan shall be used by Borrower for general corporate purposes subsequent to Borrower's Series C equity financing.

(c) Minimum Funding Amount. Except to the extent the remaining Growth Capital Loan Commitment or Additional Growth Capital Loan Commitment is a lesser amount, any Growth Capital Loans or Additional Growth Capital Loans requested by Borrower to be made on a single Business Day shall be for a minimum aggregate principal amount of Five Hundred Thousand Dollars ($500,000). Borrower shall not submit a Borrowing Request for Loans more frequently than once each calendar month, provided that a Borrowing Request may request more than one type of Loan.

(d) Repayment of Growth Capital Loans and Additional Growth Capital Loans. Principal of and interest on each Growth Capital Loan and each Additional Growth Capital Loan shall be payable as set forth in the Note (substantially in the form of Exhibit "A") evidencing such Loan, which Note, shall provide substantially as follows. Principal and interest at the Designated Rate shall be fully amortized over a period of 24 months in equal, monthly installments, commencing after an initial 6-month period of interest-only, monthly payments. In particular, on the Borrowing Date applicable to the Growth Capital Loan or Additional Growth Capital Loan evidenced by such Note, Borrower shall pay to Lender (i) interest only at a rate of 0.9166% per month, in advance, on the outstanding principal balance of the Loan evidenced by such Note, for the period from such Borrowing Date through the last day of the calendar month in which such Borrowing Date occurs, and (ii) a first (1^{st}) interest only installment at a rate of 0.9166% per month, in advance, on the outstanding principal balance of the Note for the ensuing month. Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall pay interest only at a rate of 0.9166% per month, in advance, on the outstanding principal balance of this Note for the ensuing month. Commencing on the first day of the seventh full calendar month after the Borrowing Date, and continuing on the first day of each consecutive calendar month thereafter, principal and interest at the Designated Rate shall be payable, in advance, in 24 equal consecutive installments in an amount sufficient to fully amortize the Loan(s) evidenced by such Note. Borrower shall pay the Terminal Payment on the date of the last amortization payment.

2. Equipment Loan Commitment; Use of Proceeds; Limitations on Loans.

(a) Equipment Loans. Subject to the terms and conditions of the Loan and Security Agreement and this Supplement, Lender agrees to make Equipment Loans to Borrower from time to time from the Closing Date up to and including the Termination Date in an aggregate original principal amount up to but not exceeding the lesser of (i) the then unfunded portion of the Equipment Loan Commitment, and (ii) an amount equal to 100% of the amount paid or payable by Borrower to a manufacturer, vendor or dealer who is not an Affiliate of Borrower for each item of Eligible Equipment being financed with the proceeds of such Equipment Loan as shown on an invoice therefor (excluding any commissions and any portion of the amount invoiced which relates to servicing or maintenance of the Eligible Equipment, delivery, freight and installation charges or sales taxes payable upon acquisition). Notwithstanding the foregoing, no item of Eligible Equipment shall be eligible to be financed with the proceeds of an Equipment Loan if such item was acquired or first placed in service by Borrower earlier than ninety (90) days prior to the Borrowing Date of such Equipment Loan; provided, however, that so long as the Borrowing Date of the initial Equipment Loan occurs within thirty (30) days of the Closing Date, Borrower may finance Eligible Equipment acquired or first placed in service from and after January 1, 2004, at Original Cost.

(b) Minimum Funding Amount. Except to the extent the remaining Equipment Loan Commitment is a lesser amount, any Equipment Loans requested by Borrower to be made on a single Business Day shall be for a minimum aggregate principal amount of Twenty Five Thousand Dollars ($25,000). Borrower shall not submit a Borrowing Request for Loans more frequently than once each calendar month, provided that a Borrowing Request may request more than one type of Loan.

(c) Repayment of Equipment Loans. Principal of and interest on each Equipment Loan shall be payable as set forth in the Note (substantially in the form of Exhibit "B") evidencing such Loan, which Note, shall provide substantially as follows. Principal and interest at the Designated Rate shall be fully amortized over a period of 30 months in equal, monthly installments, commencing after an initial 6-month period of interest-only, monthly payments. In particular, on the Borrowing Date applicable to the Equipment Loan evidenced by such Note, Borrower shall pay to Lender (i) interest only at a rate of 0.8333% per month, in advance, on the outstanding principal balance of the Loan evidenced by such Note, for the period from such Borrowing Date through the last day of the calendar month in which such Borrowing Date occurs, and (ii) a first (1^{st}) interest only installment at a rate of 0.8333% per month, in advance, on the outstanding principal balance of the Note for the ensuing month. Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall pay interest only at a rate of 0.8333% per month, in advance, on the outstanding principal balance of this Note for the ensuing month. Commencing on the first day of the seventh full calendar month after the Borrowing Date, and continuing on the first day of each consecutive calendar month thereafter, principal and interest at the Designated Rate shall be payable, in advance, in 30 equal consecutive installments in an amount sufficient to fully amortize the Loan(s) evidenced by such Note. Borrower shall pay the Terminal Payment on the date of the last amortization payment.

3. Soft Cost Loan Commitment; Use of Proceeds; Limitations on Loans.

(a) Soft Cost Loans. Subject to the terms and conditions of the Loan and Security Agreement and this Supplement, Lender agrees to make Soft Cost Loans to Borrower from time to time from the Closing Date up to and including the Termination Date in an aggregate original principal amount up to but not exceeding the lowest of (i) the then unfunded portion of the Equipment Loan Commitment, (ii) the then unfunded portion of the Soft Cost Loan Commitment and (ii) an amount equal to 100% of the amount paid or payable by Borrower to a manufacturer, vendor or dealer who is not an Affiliate of Borrower for each Soft Cost being financed with the proceeds of such Soft Cost Loan as shown on an invoice therefor (excluding any commissions and any portion of the amount invoiced which relates to servicing or maintenance of the Soft Cost, delivery, freight and installation charges or sales taxes payable upon acquisition). Notwithstanding the foregoing, no Soft Cost shall be eligible to be financed with the proceeds of a Soft Cost Loan if such item was expended, acquired or first placed in service by Borrower earlier than ninety (90) days prior to the Borrowing Date of such Soft Cost Loan; provided, however, that so long as the Borrowing Date of the initial Soft Cost Loan occurs within thirty (30) days of the Closing Date, Borrower may finance Soft Costs expendedm acquired or first placed in service from and after January 1, 2004, at Original Cost.

(b) Minimum Funding Amount. Except to the extent the remaining Soft Cost Loan Commitment is a lesser amount, any Soft Cost Loans requested by Borrower to be made on a single Business Day shall be for a minimum aggregate principal amount of Twenty Five Thousand Dollars ($25,000). Borrower shall not submit a Borrowing Request for Loans more frequently than once each calendar month, provided that a Borrowing Request may request more than one type of Loan.

(c) Repayment of Soft Cost Loans. Principal of and interest on each Soft Cost Loan shall be payable as set forth in the Note (substantially in the form of Exhibit "C") evidencing such Loan, which Note, shall provide substantially as follows. Principal and interest at the Designated Rate shall be fully amortized over a period of 30 months in equal, monthly installments, commencing after an initial 6-month period of interest-only, monthly payments. In particular, on the Borrowing Date applicable to the Soft Cost Loan evidenced by such Note, Borrower shall pay to Lender (i) interest only at a rate of 0.8333% per month, in advance, on the outstanding principal balance of the Loan evidenced by such Note, for the period from such Borrowing Date through the last day of the calendar month in which such Borrowing Date occurs, and (ii) a first (1st) interest only installment at a rate of 0.8333% per month, in advance, on the outstanding principal balance of the Note for the ensuing month. Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall pay interest only at a rate of 0.8333% per month, in advance, on the outstanding principal balance of this Note for the ensuing month. Commencing on the first day of the seventh full calendar month after the Borrowing Date, and continuing on the first day of each consecutive calendar month thereafter, principal and interest at the Designated Rate shall be payable, in advance, in 30 equal consecutive installments in an amount sufficient to fully amortize the Loan(s) evidenced by such Note.

4. Location of Eligible Equipment and Soft Costs. All Eligible Equipment and Soft Costs, if applicable, financed hereunder shall be located at all times at Borrower's principal place of business in Minneapolis, MN, or at such other places of business of Borrower located within the United States as may be consented to by Lender in writing.

5. Prepayment.

(a) Voluntary Prepayment. Except as set forth in Section 5(b) of this Part 2, no Loan may be voluntarily prepaid except as provided in this Section 5(a). Borrower may voluntarily prepay all, but not less than all, Loans in whole, but not in part, at any time by tendering to Lender cash payment in respect of such Loans in an amount equal to: (i) all accrued and unpaid Basic Interest on such Loans as of the date of prepayment; (ii) the Terminal Payments on such Loans; and (iii) an amount equal to the undiscounted, total amount of all installment payments of principal and Basic Interest that would have accrued and been payable from the date of prepayment through the stated Maturity Date of the Loans had such Loans remained outstanding and been paid in accordance with the terms of the related Notes.

(b) Prepayment of Growth Capital Loans at Book Value. So long as no Event of Default has occurred and is then continuing and provided that Borrower enters into a subsequent debt financing arrangement with Lender on terms and conditions substantially similar to the Growth Capital Loan Commitment (the **"New Facility"**), Borrower may voluntarily prepay all but, not less than all, Growth Capital Loans in whole, but not in part, within 60 days of the closing of the second tranche of Series B capital from Borrower's equity investors by tendering to Lender cash payment in respect of such Growth Capital Loans in an amount equal to the book value of such Growth Capital Loans as of the date of prepayment as reasonably determined by Lender; such cash payment to be tendered to Lender upon Borrower's and Lender's execution of a signed term sheet for the New Facility. By way of illustration and not of limitation, Exhibit "G" hereto sets forth an example of how the prepayment of Loans pursuant to this Section 5(b) is to be calculated, based upon the facts assumed therein for purposes of the illustration.

6. Subordination of Debt. During the term of the Loan and Security Agreement and until performance of all Obligations to Lender, Borrower shall not incur any Indebtedness for new borrowed money (except for Indebtedness permitted under Section 6.1 of the Loan and Security Agreement) after the date hereof unless the holder's right to repayment of such Indebtedness, the priority of any Lien securing the same, and the rights of the holder thereof to enforce remedies against Borrower following default have been made subordinate to the Liens of Lender and the prior payment of the Obligations to Lender under the Loan Documents pursuant to a written subordination agreement approved by Lender in its sole discretion in writing, which agreement may provide that regularly scheduled payments of accrued interest on such subordinated Indebtedness may be paid by Borrower and retained by the holder so long as no Event of Default has occurred.

7. Issuance of Warrants to Lender.

(a) As additional consideration for the making of the Commitments (other than the Additional Growth Capital Loan Commitment), Lender or its assignee has earned and shall have received, upon the execution hereof and as a condition to the initial Loan, a warrant instrument issued by Borrower in substantially the form attached hereto as Exhibit "E-1" (the **"Warrant"**), initially exercisable for Four Hundred Twelve Thousand Five Hundred Thirty Two (412,532) fully paid and nonassessable shares of the Borrower's Series B Preferred Stock at an initial exercise price of $0.4333 per share (the **"Stock Purchase Price"**); provided, however, that such initial number of shares of Series B Preferred Stock issuable under the Warrant at the Stock Purchase Price shall be increased automatically from time to time by that number of additional shares determined by dividing the product of (A) 0.055 and (B) the aggregate original principal amount of the Growth Capital Loans funded by Lender by the Stock Purchase Price. The Warrant shall be immediately vested and exercisable at any time and from time to time through June 30, 2012. The foregoing exercise price per share and number of shares issuable upon exercise of the Warrant shall also be subject to adjustment as provided in the Warrant. The Warrant shall include piggyback and S-3 registration rights, anti-dilution protections reasonably satisfactory to Lender and equivalent to those rights and protections granted to the holders of Borrower's Series B preferred stock, and shall remain exercisable beyond any public offering of Borrower's securities or merger transaction.

(b) Upon subsequent written mutual agreement of Lender and Borrower agreeing to the effectiveness of the Additional Growth Capital Loan Commitment, Lender or its assignee shall have earned and be entitled to receive, upon the execution thereof, a warrant instrument issued by Borrower in substantially the form attached hereto as Exhibit "E-2" (the **"Additional Warrant"**), initially exercisable for a number of shares of Borrower's Series C Preferred Stock at an initial exercise price per share equal to the lowest price per share paid by an investor for shares of Series C Preferred Stock (the **"Series C Stock Purchase Price"**), such number of shares having an aggregate exercise price of Two Hundred Seventy Five Thousand Dollars ($275,000); provided, however, that such initial number of shares of Series C Preferred Stock issuable under the Additional Warrant at the Series C Stock Purchase Price shall be increased automatically from time to time by that number of additional shares determined by dividing the product of (A) 0.055 and (B) the aggregate original principal amount of the Additional Growth Capital Loans funded by Lender by the Series C Stock Purchase Price. The Additional Warrant shall be immediately vested and exercisable at any time and from time to time through the date which is 7 years from the Termination Date of the Additional Growth Capital Loan Commitment. The foregoing exercise price per share and number of shares issuable upon exercise of the Additional Warrant shall also be subject to adjustment as provided in the Additional Warrant. The Additional Warrant shall include piggyback and S-3 registration rights, anti-dilution protections reasonably satisfactory to Lender and equivalent to those rights and protections granted to the holders of Borrower's Series C preferred stock, and shall remain exercisable beyond any public offering of Borrower's securities or merger transaction.

(c) Borrower acknowledges that Lender has assigned its rights to receive the Warrant and the Additional Warrant to its parent, Venture Lending & Leasing IV, LLC; in connection therewith, Borrower shall issue the Warrant and the Additional Warrant directly to Venture Lending & Leasing IV, LLC. Upon request of Borrower, Lender shall furnish to Borrower a copy of the agreement in which Lender assigned the Warrant and the Additional Warrant to Venture Lending & Leasing IV, LLC.

8. Lien on Intellectual Property. In reliance on Borrower's covenant in Section 6.2 of the Loan and Security Agreement to keep all of its Intellectual Property assets free and clear of Liens other than as set forth in Section 6.2, Lender has agreed initially to exclude Intellectual Property from the Collateral over which Borrower has granted to Lender a Lien to secure the Obligations. Borrower agrees that if at any time the ratio of its Unrestricted Cash to Four Months' Expenses is less than one-to-one (1:1), then the definition of Collateral in Article 10 of the Loan and Security Agreement shall be automatically and immediately, without any further action or writing required by the parties, amended to delete the final *proviso* thereof, such that all of Borrower's Intellectual Property then owned and thereafter arising or acquired becomes part of the Collateral for all purposes of the Loan and Security Agreement. In the event the definition of Collateral has been amended as set forth in this Section 8 and no Event of

Default has occurred and is then continuing, Borrower shall be able to continue to license, exclusively and non-exclusively, its Intellectual Property to other Persons in the ordinary course of its business, on terms consistent with industry practice, for fair consideration and with the consent of Borrower's Board of Directors. Borrower and Lender agree to execute and deliver, at Borrower's sole cost and expense, all documents and instruments necessary to perfect such Lien when it is created, including an Intellectual Property Security Agreement, substantially the form attached hereto as Exhibit "D". For clarity, the Intellectual Property Security Agreement will not be executed and delivered until such time as the Lender's security interest includes Intellectual Property in accordance with the terms of this Section 8. Lender agrees that if at any time after its security interest includes Intellectual Property the ratio of Borrower's Unrestricted Cash to Four Months' Expenses is greater than one-to-one (1:1) then the Lender's Lien as to that portion of the Collateral consisting of Intellectual Property shall be automatically and immediately, without any further action or writing required by the parties, released and the definition of Collateral in Article 10 of the Loan and Security Agreement shall be automatically and immediately, without any further action or writing required by the parties, amended to restate the final *proviso* thereof, such that the Collateral shall no longer include Borrower's Intellectual Property (subject to further amendment if at any time after such restatement the ratio of its Unrestricted Cash to Four Months' Expenses is less than one-to-one (1:1).

9. Forbearance of Exercise of Remedies Against Intellectual Property.

(a) Notwithstanding anything to the contrary contained in Article 7 and 8 of the Loan and Security Agreement or elsewhere in the Loan Documents, following the occurrence and during the continuance of an Event of Default, other than an Event of Default under Section 7.1(c) of the Loan and Security Agreement involving a voluntary Insolvency Proceeding or dissolution of Borrower or termination of Borrower's business, or an Event of Default under Section 7.1(f) or (h) of the Loan and Security Agreement, if at such time Lender has a Lien on Intellectual Property pursuant to Section 6 above, Lender agrees to forbear from selling, leasing, licensing or otherwise disposing of any Collateral comprising Intellectual Property for a period of up to sixty (60) days after the occurrence of such Event of Default (such period being referred to herein as a "Forbearance Period"), provided that at all times during the Forbearance Period:

(i) Borrower shall continue to have a duly constituted and acting board of directors, and executive management working on a full time basis for Borrower;

(ii) Borrower is able to demonstrate to the reasonable satisfaction of Lender that Borrower is exercising on a continuous and diligent basis reasonable commercial efforts to consummate a financing or other transaction that will enable it to satisfy and discharge its Obligations to Lender;

(iii) Borrower shall cooperate with Lender in its exercise of rights under Sections 5.3(a)(i), 5.3(b) and 5.9(a) of the Loan and Security Agreement;

(iv) No Insolvency Proceeding is commenced by or against Borrower; and

(v) No Person who holds or acquires a Lien on or against all or any material portion of Borrower's Intellectual Property actually exercises foreclosure or similar remedies against such property.

Subject to paragraph (b) below, upon the failure of Borrower to comply with any of the conditions described in clauses (i) through (v) above, the Forbearance Period shall immediately and automatically terminate and Lender may thereupon commence, continue and complete any exercise of its rights and remedies against Intellectual Property Collateral, all as provided in the Loan Documents and under applicable law.

(b) If during the Forbearance Period, Lender proposes or arranges a private or public sale of all or a material portion of the Intellectual Property Collateral (which sale shall not be consummated during the Forbearance Period), Lender shall give notice of such proposed sale to Borrower, including notice of the minimum price to be paid or bid in such sale. If Borrower's Board of Director determines in good faith that the proposed sale would not be commercially reasonable, then Borrower may, within ten (10) Business Days of receipt of the initial notice from Lender, deliver a written objection, following which the parties agree to meet promptly and to confer in good faith to resolve any disagreements as to value or the proposed sale. Unless the parties have otherwise agreed as a result of such meet-and-confer, Borrower shall obtain, at its sole expense, within sixty (60) days after the initial notice from Lender, a written appraisal of the orderly liquidation value of the Intellectual Property, prepared by a recognized, independent appraiser with experience evaluating similar types of property (in which event, the sixty (60)-day limitation on the Forbearance Period shall be extended if, and only as, necessary to afford Borrower the full sixty (60) days to obtain such appraisal). If such appraisal is not timely delivered, or if the value concluded by the independent appraisal is not more than one hundred twenty percent (120%) of the minimum price or bid in any transaction proposed by Lender for the same Intellectual Property Collateral, then Lender may proceed with the proposed transaction (but not sooner than one hundred twenty (120) days after the occurrence of an Event of Default unless Borrower approves otherwise) on price terms not materially more favorable to the transferee than originally proposed by Lender. If the value concluded by the independent appraisal is more than one hundred twenty percent (120%) of the minimum price or bid in any transaction proposed by Lender, then the sixty (60)-day limitation on the Forbearance Period (as may have been extended for the appraisal as aforesaid) shall be extended and the parties shall cooperate with one another to realize the higher valuation, provided that if the Forbearance Period (as so extended) terminates for any reason other than that set forth in clause (ii) of paragraph (a) above, Lender may thereupon commence, continue and complete any exercise of its rights and remedies against Intellectual Property Collateral, all as provided in the Loan Documents and under applicable law, and in all events, Lender shall be free to enforce such rights and remedies and complete one or more sales or other dispositions of the Intellectual Property after the earlier of (i) one hundred eighty (180) days after the occurrence of the Event of Default, or (ii) one hundred twenty (120) days after the delivery of the appraisal report to Borrower.

(c) At any time during the Forbearance Period, Lender will discontinue and forbear from enforcing its rights and remedies against the Collateral upon tender to Lender by Borrower or by another Person for its account all amounts payable under Section 5(a) of Part 2 hereunder.

10. Completion of Due Diligence; Payment and Disposition of Commitment Fee. As an additional condition precedent under Section 4.1 of the Loan and Security Agreement, Lender shall have completed to its satisfaction its due diligence review of Borrower's business and financial condition and prospects, and Lender's investment committee shall have approved the Commitment (other than the Additional Growth Capital Loan Commitment). If this condition is not satisfied, Lender shall refund to Borrower the Thirty Two Thousand Five Hundred Dollars ($32,500) commitment fee previously paid to Lender. Lender agrees that with respect to each Loan advanced (other than Additional Growth Capital Loans), on the Borrowing Date applicable to such Loan, Lender shall credit against the payments due from Borrower on such date in respect of such Loan an amount equal to the product of Thirty Two Thousand Five Hundred Dollars ($32,500) and a fraction the numerator of which is the principal amount of such Loan and the denominator of which is Three Million Two Hundred Fifty Thousand Dollars ($3,250,000), until the aggregate amount of such credits equals but does not exceed Thirty Two Thousand Five Hundred Dollars ($32,500).

11. Debits to Account for ACH Transfers. For purposes of Section 2.2 and 5.10 of the Loan and Security Agreement, Borrower's Primary Operating Account is:

Wells Fargo Bank
St. Paul, MN
Routing No.: xxxxx
Account No.: xxxxx
For Further Credit to: EnteroMedics Inc.

Loans will be advanced to the account specified above and payments will be automatically debited from the same account.

12. Documentation Fee Payment. As an additional condition precedent under Section 4.1 of the Loan and Security Agreement and pursuant to Section 9.8(a) thereof, on or prior to the initial Borrowing Date, Borrower shall pay to Lender Lender's reasonable and actual attorneys' fees, costs and expenses incurred and expended in connection with the preparation and negotiation of the Loan Documents, and shall reimburse Lender for Lender's out-of-pocket costs of perfecting its Liens against Collateral.

Part 3.—Additional Representations:

Borrower represents and warrants that as of the Closing Date and each Borrowing Date:

a) Its chief executive office is located at: 2800 Patton Road, St. Paul, MN 55113.

b) Its Equipment is located at: same as above.

c) Its Inventory is located at: same as above.

d) Its Records are located at: same as above.

e) In addition to its chief executive office, Borrower maintains offices or operates its business at the following locations: None.

f) Other than its full corporate name, Borrower has conducted business using the following trade names or fictitious business names: Beta Medical.

g) Borrower's Delaware state corporation I.D. number is 3832130.

h) Borrower's federal tax identification number is 48-1293684.

i) **Borrower's Other Deposit and Investment Accounts:** In addition to Borrower's Primary Operating Account at Wells Fargo Bank identified above, Borrower maintains to following other deposit and investment accounts:

Part 4.—Additional Loan Documents:

Form of Note for Growth Capital Loans	Exhibit "A-1"
Form of Note for Equipment Loans	Exhibit "A-2"
Form of Note for Soft Cost Loans	Exhibit "A-3"
Form of Borrowing Request	Exhibit "B"
Form of Compliance Certificate	Exhibit "C"
Form of Intellectual Property Security Agreement	Exhibit "D"
Forms of Warrants	Exhibits "E-1" and "E-2"
Form of Legal Opinion	Exhibit "F"

[*Signature page follows.*]

[Signature Page to Supplement to Loan and Security Agreement]

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

BORROWER:

ENTEROMEDICS INC.

By: /s/ Mark B. Knudson
Name: Mark Knudson
Title: President

Address for Notices:

Attn: Jim Kruse
2800 Patton Road
St. Paul, MN 55113
Fax #: 651-634-3212

LENDER:

VENTURE LENDING & LEASING IV, INC.

By: /s/ Salvador O. Gutierrez
Name: Salvador O. Gutierrez
Title: President

Address for Notices:

Attn: Chief Financial Officer
2010 North First Street, Suite 310
San Jose, California 95131
Fax #: (408) 436-8625

EXHIBIT "A-1"

FORM OF PROMISSORY NOTE
(Growth Capital Loans and Additional Growth Capital Loans)

[Note No. X-XXX]

$__________ __________ , 2004
San Jose, California

The undersigned ("Borrower") promises to pay to the order of VENTURE LENDING & LEASING IV, INC., a Maryland corporation ("Lender"), at its office at 2010 North First Street, Suite 310, San Jose, California 95131, or at such other place as Lender may designate in writing, in lawful money of the United States of America, the principal sum of____________________ Dollars ($__________), with Basic Interest thereon from the date hereof until maturity, whether scheduled or accelerated, at a fixed rate per annum equal to **[the Prime Rate (as defined in the Loan Agreement referred to below) as published on the Business Day on which Lender prepares this Note following Borrower's submission of the Borrowing Request therefor, plus 1.99% but not less than 6.49%)** (the "Designated Rate"), except as otherwise provided herein, according to the payment schedule described herein, and a Terminal Payment in the sum of **[5.00% of face amount of Loan]** Dollars ($__________) payable on the Maturity Date.

This Note is one of the Notes referred to in, and is entitled to all the benefits of, a Loan and Security Agreement dated as of December __, 2004, between Borrower and Lender (the "Loan Agreement"). Each capitalized term not otherwise defined herein shall have the meaning set forth in the Loan Agreement. The Loan Agreement contains provisions for the acceleration of the maturity of this Note upon the happening of certain stated events.

Principal of and interest on this Note shall be payable as follows:

On the Borrowing Date, Borrower shall pay (i) if the Borrowing Date is not the first day of the month, interest only at a rate per month equal to 0.9166%, in advance, on the outstanding principal balance of this Note for the period from the Borrowing Date through [**the last day of the same month]**; (ii) interest at a rate per month equal to 0.9166%, in advance, on the outstanding principal balance of this Note for the month of [**date of first regular interest only payment]**.

Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall make payments, in advance, of interest only at a rate per month equal to 0.9166% on the principal balance outstanding hereunder.

Commencing on the first day of the seventh full month after the Borrowing Date, and continuing on the first day of each consecutive month thereafter, principal and Basic Interest at the Designated Rate shall be payable, in advance, in twenty-four (24) equal consecutive installments of ____________________ Dollars ($__________) each. The Terminal Payment and unpaid expenses, fees, interest and principal amount shall be due and payable on ____________________ 200_.]

This Note may be voluntarily prepaid only as permitted under Section 5 of Part 2 of the Supplement to the Loan Agreement.

Any unpaid payments of principal or interest on this Note shall bear interest from their respective maturities, whether scheduled or accelerated, at a rate per annum equal to the Default Rate. Borrower shall pay such interest on demand.

Interest, charges and fees shall be calculated for actual days elapsed on the basis of a 360-day year, which results in higher interest, charge or fee payments than if a 365-day year were used. In no event shall Borrower be obligated to pay interest, charges or fees at a rate in excess of the highest rate permitted by applicable law from time to time in effect.

If Borrower is late in making any payment under this Note by more than five (5) Business Days, Borrower agrees to pay a "late charge" of five percent (5%) of the installment due, but not less than fifty dollars ($50.00) for any one such delinquent payment. This late charge may be charged by Lender for the purpose of defraying the expenses incidental to the handling of such delinquent amounts. Borrower acknowledges that such late charge represents a reasonable sum considering all of the circumstances existing on the date of this Note and represents a fair and reasonable estimate of the costs that will be sustained by Lender due to the failure of Borrower to make timely payments. Borrower further agrees that proof of actual damages would be costly and inconvenient. Such late charge shall be paid without prejudice to the right of Lender to collect any other amounts provided to be paid or to declare a default under this Note or any of the other Loan Documents or from exercising any other rights and remedies of Lender.

This Note shall be governed by, and construed in accordance with, the laws of the State of California, without regard to its conflict of laws provisions.

ENTEROMEDICS INC.

By: ____________________

Name: ____________________

Its: ____________________

EXHIBIT "A-2"

FORM OF PROMISSORY NOTE
(Equipment Loans)

[Note No. X-XXX]

$___________ ___________, 2004

San Jose, California

The undersigned ("Borrower") promises to pay to the order of VENTURE LENDING & LEASING IV, INC., a Maryland corporation ("Lender"), at its office at 2010 North First Street, Suite 310, San Jose, California 95131, or at such other place as Lender may designate in writing, in lawful money of the United States of America, the principal sum of ______________________Dollars ($___________), with Basic Interest thereon from the date hereof until maturity, whether scheduled or accelerated, at a fixed rate per annum equal to **[the Prime Rate (as defined in the Loan Agreement referred to below) as published on the Business Day on which Lender prepares this Note following Borrower's submission of the Borrowing Request therefor, plus 2.023% but not less than 6.523%)** (the "Designated Rate"), except as otherwise provided herein, according to the payment schedule described herein, and a Terminal Payment in the sum of **[5.00% of face amount of Loan]** Dollars ($___________) payable on the Maturity Date

This Note is one of the Notes referred to in, and is entitled to all the benefits of, a Loan and Security Agreement dated as of December __, 2004, between Borrower and Lender (the "Loan Agreement"). Each capitalized term not otherwise defined herein shall have the meaning set forth in the Loan Agreement. The Loan Agreement contains provisions for the acceleration of the maturity of this Note upon the happening of certain stated events.

Principal of and interest on this Note shall be payable as follows:

On the Borrowing Date, Borrower shall pay (i) if the Borrowing Date is not the first day of the month, interest only at a rate per month equal to 0.8333%, in advance, on the outstanding principal balance of this Note for the period from the Borrowing Date through [**the last day of the same month]**; (ii) interest at a rate per month equal to 0.8333%, in advance, on the outstanding principal balance of this Note for the month of [**date of first regular interest only payment]**.

Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall make payments, in advance, of interest only at a rate per month equal to 0.8333% on the principal balance outstanding hereunder.

Commencing on the first day of the seventh full month after the Borrowing Date, and continuing on the first day of each consecutive month thereafter, principal and Basic Interest at the Designated Rate shall be payable, in advance, in thirty (30) equal consecutive installments of ______________________ Dollars ($___________) each. The Terminal Payment and unpaid expenses, fees, interest and principal amount shall be due and payable on ______________________ 200_.]

This Note may be voluntarily prepaid only as permitted under Section 5 of Part 2 of the Supplement to the Loan Agreement.

Any unpaid payments of principal or interest on this Note shall bear interest from their respective maturities, whether scheduled or accelerated, at a rate per annum equal to the Default Rate. Borrower shall pay such interest on demand.

Interest, charges and fees shall be calculated for actual days elapsed on the basis of a 360-day year, which results in higher interest, charge or fee payments than if a 365-day year were used. In no event shall Borrower be obligated to pay interest, charges or fees at a rate in excess of the highest rate permitted by applicable law from time to time in effect.

If Borrower is late in making any payment under this Note by more than five (5) Business Days, Borrower agrees to pay a "late charge" of five percent (5%) of the installment due, but not less than fifty dollars ($50.00) for any one such delinquent payment. This late charge may be charged by Lender for the purpose of defraying the expenses incidental to the handling of such delinquent amounts. Borrower acknowledges that such late charge represents a reasonable sum considering all of the circumstances existing on the date of this Note and represents a fair and reasonable estimate of the costs that will be sustained by Lender due to the failure of Borrower to make timely payments. Borrower further agrees that proof of actual damages would be costly and inconvenient. Such late charge shall be paid without prejudice to the right of Lender to collect any other amounts provided to be paid or to declare a default under this Note or any of the other Loan Documents or from exercising any other rights and remedies of Lender.

This Note shall be governed by, and construed in accordance with, the laws of the State of California, without regard to its conflict of laws provisions.

ENTEROMEDICS INC.

By: ____________________
Name: ____________________
Its: ____________________

EXHIBIT “A-3”

FORM OF PROMISSORY NOTE
(Soft Cost Loans)

[Note No. X-XXX]

$__________ __________, 2004
San Jose, California

The undersigned (“Borrower”) promises to pay to the order of VENTURE LENDING & LEASING IV, INC., a Maryland corporation (“Lender”), at its office at 2010 North First Street, Suite 310, San Jose, California 95131, or at such other place as Lender may designate in writing, in lawful money of the United States of America, the principal sum of ____________________ Dollars ($__________), with Basic Interest thereon from the date hereof until maturity, whether scheduled or accelerated, at a fixed rate per annum equal to **[the Prime Rate (as defined in the Loan Agreement referred to below) as published on the Business Day on which Lender prepares this Note following Borrower’s submission of the Borrowing Request therefor, plus 5.46% but not less than 9.96%)** (the “Designated Rate”), except as otherwise provided herein, according to the payment schedule described herein.

This Note is one of the Notes referred to in, and is entitled to all the benefits of, a Loan and Security Agreement dated as of December __, 2004, between Borrower and Lender (the “Loan Agreement”). Each capitalized term not otherwise defined herein shall have the meaning set forth in the Loan Agreement. The Loan Agreement contains provisions for the acceleration of the maturity of this Note upon the happening of certain stated events.

Principal of and interest on this Note shall be payable as follows:

On the Borrowing Date, Borrower shall pay (i) if the Borrowing Date is not the first day of the month, interest only at a rate per month equal to 0.8333%, in advance, on the outstanding principal balance of this Note for the period from the Borrowing Date through [**the last day of the same month]**; (ii) interest at a rate per month equal to 0.8333%, in advance, on the outstanding principal balance of this Note for the month of __[**date of first regular interest only payment]**.

Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall make payments, in advance, of interest only at a rate per month equal to 0.8333% on the principal balance outstanding hereunder.

Commencing on the first day of the seventh full month after the Borrowing Date, and continuing on the first day of each consecutive month thereafter, principal and Basic Interest at the Designated Rate shall be payable, in advance, in thirty (30) equal consecutive installments of ____________________ Dollars ($__________) each.

This Note may be voluntarily prepaid only as permitted under Section 5 of Part 2 of the Supplement to the Loan Agreement.

Any unpaid payments of principal or interest on this Note shall bear interest from their respective maturities, whether scheduled or accelerated, at a rate per annum equal to the Default Rate. Borrower shall pay such interest on demand.

Interest, charges and fees shall be calculated for actual days elapsed on the basis of a 360-day year, which results in higher interest, charge or fee payments than if a 365-day year were used. In no event shall Borrower be obligated to pay interest, charges or fees at a rate in excess of the highest rate permitted by applicable law from time to time in effect.

If Borrower is late in making any payment under this Note by more than five (5) Business Days, Borrower agrees to pay a "late charge" of five percent (5%) of the installment due, but not less than fifty dollars ($50.00) for any one such delinquent payment. This late charge may be charged by Lender for the purpose of defraying the expenses incidental to the handling of such delinquent amounts. Borrower acknowledges that such late charge represents a reasonable sum considering all of the circumstances existing on the date of this Note and represents a fair and reasonable estimate of the costs that will be sustained by Lender due to the failure of Borrower to make timely payments. Borrower further agrees that proof of actual damages would be costly and inconvenient. Such late charge shall be paid without prejudice to the right of Lender to collect any other amounts provided to be paid or to declare a default under this Note or any of the other Loan Documents or from exercising any other rights and remedies of Lender.

This Note shall be governed by, and construed in accordance with, the laws of the State of California, without regard to its conflict of laws provisions.

ENTEROMEDICS INC.

By: ______________________

Name: ______________________

Its: ______________________

EXHIBIT "B"

FORM OF BORROWING REQUEST

[Date]

Venture Lending & Leasing IV, Inc.
2010 North First Street, Suite 310
San Jose, CA 95131

Re: EnteroMedics Inc.

Gentlemen:

Reference is made to the Loan and Security Agreement dated as of December __, 2004 (as amended from time to time, the "Loan Agreement", the capitalized terms used herein as defined therein), between Venture Lending & Leasing IV, Inc. and EnteroMedics Inc. (the "Company").

The undersigned is the ____________________ of the Company, and hereby requests on behalf of the Company a Loan under the Loan Agreement, and in that connection certifies as follows:

1. The type(s) of the proposed Loan is/are **[an Equipment Loan][a Soft Cost Loan][a Growth Capital Loan] [an Additional Growth Capital Loan].** The amount of the proposed Loan is ____________________ and __/100 Dollars ($). The Borrowing Date of the proposed Loan is __________, 200_.

2. **[If an Equipment Loan or Soft Cost Loan]** The Eligible Equipment and/or Soft Costs, as applicable, to be financed with the proceeds of the Loan are described, and are or will be located at the address(es) shown on the attached **Schedule 1** or amendment or supplement to **Schedule 1**, which is hereby incorporated by reference in and made a part of the Loan Agreement. The requested amount of the Loan does not exceed the aggregate of one hundred percent (100%) of the amount paid or payable by Company to a non-affiliated manufacturer, vendor or dealer for such items of Eligible Equipment and/or Soft Costs as shown on an invoice therefor. No item of Eligible Equipment or Soft Costs has been owned or was incurred by Company earlier than 90 days before the proposed Borrowing Date[; or January 1, 2004 with respect to the initial Loan only if funded within 30 days of the Closing Date]

3. As of this date, no Default or Event of Default has occurred and is continuing, or will result from the making of the proposed Loan, the representations and warranties of the Company contained in Article 3 of the Loan Agreement are true and correct in all material respects, and the conditions precedent described in Article 4 of the Loan Agreement have been met.

4. No event that has had or could reasonably be expected to have a Material Adverse Change has occurred.

5. The Company's most recent financial projections dated __________, as approved by the Company's Board of Directors on __________, are enclosed herewith unless such financial projections have been previously furnished to Lender.

The Company shall notify you promptly before the funding of the Loan if any of the matters to which I have certified above shall not be true and correct on the Borrowing Date.

Very truly yours,

EnteroMedics Inc.

Name: ________________________________
Title:*

* Must be executed by Borrower's Chief Financial Officer or other executive officer.

Schedule 1 to the Loan and Security Agreement

Description of Equipment and Soft Costs

Quantity	Article	Make	Year Mfg.	Model/Serial #	Location	üif Soft Cost

See attached continuation to Schedule 1

together with all improvements, replacements, accessions and additions thereto, wherever located, and all Proceeds thereof arising from the sale, lease, rental or other use or disposition of any such property, including all rights to payment with respect to insurance or condemnation, returned premiums, or any cause of action relating to any of the foregoing.

EXHIBIT "C"

COMPLIANCE CERTIFICATE

Venture Lending & Leasing IV, Inc.
2010 North First Street, Suite 310
San Jose, CA 95131

Re: EnteroMedics Inc.

Gentlemen:

Reference is made to the Loan and Security Agreement dated as of December __, 2004 (as the same have been and may be amended from time to time, the "Loan Agreement", the capitalized terms used herein as defined therein), between Venture Lending & Leasing IV, Inc. and EnteroMedics Inc. (the "Company").

The undersigned authorized representative of the Company hereby certifies that in accordance with the terms and conditions of the Loan Agreement, the Company is in complete compliance for the financial reporting period ending __________ with all required financial reporting and financial tests under the Loan Agreement, except as noted below. Attached herewith are the required documents supporting the foregoing certification. The undersigned further certifies that the accompanying financial statements have been prepared in accordance with Generally Accepted Accounting Principles (except for the omission of footnotes on the unaudited Interim Financial Statements), and are consistent from one period to the next, except as explained below.

Indicate compliance status by circling Yes/No under "Complies"

REPORTING REQUIREMENT	REQUIRED	COMPLIES
Interim Financial Statements	Monthly within 30 days	YES / NO
Audited Financial Statements	FYE within 180 days	YES / NO

Ratio of Unrestricted Cash to Four Months' Expenses:

(i) Unrestricted Cash as of ____: ____

(ii) Four Months' Expenses for the 4 months ended ____: ____

(iii) Ratio of (i) to (ii): __________ [*if less than 1:1, then Lien against IP springs*]

Date of most recent Board-approved
budget/plan __________

Submitted with Borrowing Request	YES / NO
Any change in budget/plan since prior Borrowing Request	YES / NO

ACCOUNT CONTROL AGREEMENTS

Pursuant to Section 6.11 of the Loan Agreement, Company represents and warrants that: (i) as of the date hereof, it maintains only those Deposit Accounts and investment/securities accounts set forth below; and (ii) a control agreement has been executed and delivered to Lender with respect to each such account *[Note: If the Company has established any new account(s) since the date of the last compliance certificate, please so indicate]*.

Deposit Accounts

	Name of Institution	Account Number	Control Agt. In place?	Complies	New Account
1.)			YES / NO	YES / NO	YES / NO

2.)			YES / NO	YES / NO	YES / NO
3.)			YES / NO	YES / NO	YES / NO
4.)			YES / NO	YES / NO	YES / NO

Investment Accounts

	Name of Institution	Account Number	Control Agt. In place?	Complies	New Account
1.)			YES / NO	YES / NO	YES / NO
2.)			YES / NO	YES / NO	YES / NO
3.)			YES / NO	YES / NO	YES / NO
4.)			YES / NO	YES / NO	YES / NO

EXPLANATIONS

Very truly yours,

ENTEROMEDICS INC.

Name: ______________________

Title:* ______________________

* Must be executed by Borrower's Chief Financial Officer or other executive officer.

EXHIBIT “D”

FORM OF INTELLECTUAL PROPERTY SECURITY AGREEMENT

EXHIBITS “E-1” and “E-2”

FORMS OF WARRANTS

EXHIBIT "F"

FORM OF LEGAL OPINION

EXHIBIT “G”

Illustration of prepayment calculation

AMENDMENT NO. 1
TO
SUPPLEMENT

This AMENDMENT NO. 1 TO SUPPLEMENT (this "Amendment") is made as of September 29, 2005, by and between ENTEROMEDICS INC., a Delaware corporation ("Borrower"), and VENTURE LENDING & LEASING IV, INC., a Maryland corporation ("Lender").

A. Borrower and Lender entered into that certain Loan and Security Agreement dated as of December 1, 2004 (the "Loan and Security Agreement"), together with a Supplement (the "Supplement") thereto of even date therewith (sometimes referred to together as the "Loan Agreement"), pursuant to which Lender agreed to make Equipment Loans, Soft Cost Loans, Growth Capital Loans and Additional Growth Capital Loans to Borrower up to the aggregate original principal amount of $8,250,000 on the terms and conditions set forth therein.

B. Borrower has requested that Lender modify the terms of the Growth Capital Loan Commitment and the Additional Growth Capital Loan Commitment (sometimes referred to together as the "Original Commitments"). Borrower has also requested that Lender make available an additional $750,000 commitment.

C. Lender is willing to modify the terms of the Original Commitments and provide an additional $750,000 commitment on the terms and subject to the conditions set forth in this Amendment.

D. Except where the context otherwise requires, or unless this Amendment otherwise provides, all words and expressions defined in the Loan and Security Agreement and the Supplement when used or referred to in this Amendment shall have the same meaning as those provided for in the Loan and Security Agreement and the Supplement.

NOW, THEREFORE, in consideration of the mutual obligations in this Amendment, the Loan and Security Agreement and Supplement, and for other good consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. Amendments to Supplement

1.1 Additional Defined Terms. The following defined terms are hereby added to Part 1 of the Supplement:

"Additional Equipment Loan" means any Loan requested by Borrower and funded by Lender under the Additional Equipment Loan Commitment to finance Borrower's acquisition or carrying of specific items of Eligible Equipment.

"Additional Soft Cost Loan" means any Loan requested by Borrower and funded by Lender under the Additional Soft Cost Loan Commitment to finance Borrower's acquisition or carrying of Soft Costs.

"Amendment" means that certain Amendment No. 1 to Supplement dated as of September 29, 2005 between Borrower and Lender.

2.2 Amendments to Certain Defined Terms. The following definitions under Part 1 of the Supplement are hereby amended and restated in their entirety as follows

"Commitment": Subject to the terms and conditions set forth in the Loan and Security Agreement and this Supplement, Lender commits to make::

(i) Equipment Loans to Borrower up to the aggregate original principal amount of Two Hundred Fifty Thousand Dollars ($250,000) minus the aggregate original principal amount of the Soft Cost Loans (the **"Equipment Loan Commitment"**);

(ii) As a subfacility of the Equipment Loan Commitment, Soft Cost Loans to Borrower up to the aggregate original principal amount of Seventy Five Thousand Dollars ($75,000) (the **"Soft Cost Loan Commitment"**); provided, however, that in no event shall the aggregate original principal amount of all Soft Cost Loans and all Equipment Loans exceed Two Hundred Fifty Thousand Dollars ($250,000);

(iii) Growth Capital Loans to Borrower up to the aggregate original principal amount of Three Million Dollars ($3,000,000) (the **"Growth Capital Loan Commitment"**);

(iv) Additional Growth Capital Loans to Borrower up to the aggregate original principal amount of Two Million Dollars ($2,000,000) (the **"Additional Growth Capital Loan Commitment"**);

(v) Additional Equipment Loans to Borrower up to the aggregate original principal amount of Five Hundred Thousand Dollars ($500,000) minus the aggregate original principal amount of the Additional Soft Cost Loans (the **"Additional Equipment Loan Commitment"**); and

(vi) As a subfacility of the Additional Equipment Loan Commitment, Additional Soft Cost Loans to Borrower up to the aggregate original principal amount of One Hundred Fifty Thousand Dollars ($150,000) (the **"Additional Soft Cost Loan Commitment"**); provided, however, that in no event shall the aggregate original principal amount of all Additional Soft Cost Loans and all Additional Equipment Loans exceed Five Hundred Thousand Dollars ($500,000).

As used herein, the term **"Commitment"** shall mean the Equipment Loan Commitment, the Soft Cost Loan Commitment, the Growth Capital Loan Commitment, the Additional Growth Capital Loan Commitment, the Additional Equipment Loan Commitment, the Additional Soft Cost Loan Commitment or any combination of them or all of them, as the context requires. Equipment Loans, Soft Cost Loans, Growth Capital Loans, Additional Growth Capital Loans, Additional Equipment Loans and Additional Soft Cost Loans are sometimes referred to herein individually as a "**Loan**" or collectively as "**Loans**".

"Designated Rate": The Designated Rate means:

(i) *for each Equipment Loan and each Additional Equipment Loan*, a fixed rate of interest per annum equal to the Prime Rate as published on the Business Day on which Lender prepares the Note for such Equipment Loan or Additional Equipment Loan, plus two and 23/1000 percent (2.023%); provided, however, that in no event shall the Designated Rate for an Equipment Loan or an Additional Equipment Loan be less than six and 523/1000 percent (6.523%);

(ii) *for each Soft Cost Loan and each Additional Soft Cost Loan*, a fixed rate of interest per annum equal to the Prime Rate as published on the Business Day on which Lender prepares the Note for such Soft Cost Loan or Additional Soft Cost Loan, plus five and 46/100 percent (5.46%); provided, however, that in no event shall the Designated Rate for a Soft Cost Loan or an Additional Soft Cost Loan be less than nine and 96/100 percent (9.96%); and

(iii) *for each Growth Capital Loan and each Additional Growth Capital Loan*, a fixed rate of interest per annum equal to the Prime Rate as published on the Business Day on which Lender prepares the Note for such Loan, plus one and 99/100 percent (1.99%); provided, however, that in no event shall the Designated Rate for a Growth Capital Loan or an Additional Growth Capital Loan be less than six and 49/100 percent (6.49%).

"Terminal Payment": Each Equipment Loan, each Additional Equipment Loan, each Growth Capital Loan and each Additional Growth Capital Loan shall have a Terminal Payment equal to five percent (5%) of the original principal amount of such Loan. There shall be no Terminal Payment associated with Soft Cost Loans and Additional Soft Cost Loans.

"Termination Date": The Termination Date is the earlier of:

(i) the date Lender may terminate making Loans or extending other credit pursuant to the rights of Lender under Article 7 of the Loan and Security Agreement, or

(ii)(A) *with respect to the Equipment Loan Commitment and the Soft Cost Loan Commitment*, June 30, 2005;

(ii)(B) *with respect to the Growth Capital Loan Commitment*, September 30, 2005; provided that such date shall be extended from September 30, 2005 to March 31, 2006 with respect to up to $500,000 of the Growth Capital Loan Commitment (assuming such Growth Capital Loan Commitment has not been fully funded as of September 30, 2005); and

(ii)(C) *with respect to the Additional Growth Capital Loan Commitment*, *the Additional Equipment Loan Commitment and the Additional Soft Cost Loan Commitment*, March 31, 2006.

2.3 Amendments to Provisions of Supplement.

(a) A new Section 2(a)(i) is added to Part 2 of the Supplement, immediately after Section 2(a), as follows:

2(a)(i) Additional Equipment Loans. Subject to the terms and conditions of the Loan and Security Agreement and the Supplement, Lender agrees to make Additional Equipment Loans to Borrower from time to time from the Closing Date up to and including the Termination Date in an aggregate original principal amount up to but not exceeding the lesser of (i) the then unfunded portion of the Additional Equipment Loan Commitment, and (ii) an amount equal to 100% of the amount paid or payable by Borrower to a manufacturer, vendor or dealer who is not an Affiliate of Borrower for each item of Eligible Equipment being financed with the proceeds of such Additional Equipment Loan as shown on an invoice therefor (excluding any commissions and any portion of the amount invoiced which relates to servicing or maintenance of the Eligible Equipment, delivery, freight and installation charges or sales taxes payable upon acquisition). Notwithstanding the foregoing, no item of Eligible Equipment shall be eligible to be financed with the proceeds of an Additional Equipment Loan if such item was acquired or first placed in service by Borrower earlier than ninety (90) days prior to the Borrowing Date of such Additional Equipment Loan; provided, however, that so long as the Borrowing Date of the initial Additional Equipment Loan occurs within thirty (30) days of the Closing Date, Borrower may finance Eligible Equipment acquired or first placed in service from and after January 1, 2005, at Original Cost.

(b) Section 2(b) of Part 2 of the Supplement is hereby amended and restated in its entirety as follows:

(b) Minimum Funding Amount. Except to the extent the remaining Equipment Loan Commitment or Additional Equipment Loan Commitment is a lesser amount, any Equipment Loans or Additional Equipment Loans requested by Borrower to be made on a single Business Day shall be for a minimum aggregate principal amount of Twenty Five Thousand Dollars ($25,000). Borrower shall not submit a Borrowing Request for Loans more frequently than once each calendar month, provided that a Borrowing Request may request more than one type of Loan.

(c) Section 2(c) of Part 2 of the Supplement is hereby amended and restated in its entirety as follows:

(c) Repayment of Equipment Loans and Additional Equipment Loans. Principal of and interest on each Equipment Loan and each Additional Equipment Loan shall be payable as set forth in the Note (substantially in the form of Exhibit "B") evidencing such Loan, which Note, shall provide substantially as follows. Principal and interest at the Designated Rate shall be fully amortized over a period of 30 months in equal, monthly installments, commencing after an initial 6-month period of interest-only, monthly payments. In particular, on the Borrowing Date applicable to the Equipment Loan or Additional Equipment Loan evidenced by such Note, Borrower shall pay to Lender (i) interest only at a rate of 0.8333% per month, in advance, on the outstanding principal balance of the Loan evidenced by such Note, for the period from such Borrowing Date through the last day of the calendar month in which such Borrowing Date occurs, and (ii) a first (1st) interest only installment at a rate of 0.8333% per month, in advance, on the outstanding principal balance of the Note for the ensuing month. Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall pay interest only at a rate of 0.8333% per month, in advance, on the outstanding principal balance of this Note for the ensuing month. Commencing on the first day of the seventh full calendar month after the Borrowing Date, and continuing on the first day of each consecutive calendar month thereafter, principal and interest at the Designated Rate shall be payable, in advance, in 30 equal consecutive installments in an amount sufficient to fully amortize the Loan(s) evidenced by such Note. Borrower shall pay the Terminal Payment on the date of the last amortization payment.

(d) A new Section 3(a)(i) is added to Part 2 of the Supplement, immediately after Section 3(a), as follows:

3(a)(i) Additional Soft Cost Loans. Subject to the terms and conditions of the Loan and Security Agreement and the Supplement, Lender agrees to make Additional Soft Cost Loans to Borrower from time to time from the Closing Date up to and including the Termination Date in an aggregate original principal amount up to but not exceeding the lowest of (i) the then unfunded portion of the Additional Equipment Loan Commitment, (ii) the then unfunded portion of the Additional Soft Cost Loan Commitment and (ii) an amount equal to 100% of the amount paid or payable by Borrower to a manufacturer, vendor or dealer who is not an Affiliate of Borrower for each Soft Cost being financed with the proceeds of such Additional Soft Cost Loan as shown on an invoice therefor (excluding any commissions and any portion of the amount invoiced which relates to servicing or maintenance of the Soft Cost, delivery, freight and installation charges or sales taxes payable upon acquisition). Notwithstanding the foregoing, no Soft Cost shall be eligible to be financed with the proceeds of an Additional Soft Cost Loan if such item was expended, acquired or first placed in service by Borrower earlier than ninety (90) days prior to the Borrowing Date of such Additional Soft Cost Loan; provided, however, that so long as the Borrowing Date of the initial Additional Soft Cost Loan occurs within thirty (30) days of the Closing Date, Borrower may finance Soft Costs expended, acquired or first placed in service from and after January 1, 2005, at Original Cost.

(e) Section 3(b) of Part 2 of the Supplement is hereby amended and restated in its entirety as follows:

(b) Minimum Funding Amount. Except to the extent the remaining Soft Cost Loan Commitment or Additional Soft Cost Loan Commitment is a lesser amount, any Soft Cost Loans or Additional Soft Cost Loans requested by Borrower to be made on a single Business Day shall be for a minimum aggregate principal amount of Twenty Five Thousand Dollars ($25,000). Borrower shall not submit a Borrowing Request for Loans more frequently than once each calendar month, provided that a Borrowing Request may request more than one type of Loan.

(f) Section 3(c) of Part 2 of the Supplement is hereby amended and restated in its entirety as follows:

(c) Repayment of Soft Cost Loans and Additional Soft Cost Loans. Principal of and interest on each Soft Cost Loan and each Additional Soft Cost Loans shall be payable as set forth in the Note (substantially in the form of Exhibit "C") evidencing such Loan, which Note, shall provide substantially as follows. Principal and interest at the Designated Rate shall be fully amortized over a period of 30 months in equal, monthly installments, commencing after an initial 6-month period of interest-only, monthly payments. In particular, on the Borrowing Date applicable to the Soft Cost Loan or the Additional Soft Cost Loan evidenced by such Note, Borrower shall pay to Lender (i) interest only at a rate of 0.8333% per month, in advance, on the outstanding principal balance of the Loan evidenced by such Note, for the period from such Borrowing Date through the last day of the calendar month in which such Borrowing Date occurs, and (ii) a first (1st) interest only installment at a rate of 0.8333% per month, in advance, on the outstanding principal balance of the Note for the ensuing month. Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall pay interest only at a rate of 0.8333% per month, in advance, on the outstanding principal balance of this Note for the ensuing month. Commencing on the first day of the seventh full calendar month after the Borrowing Date, and continuing on the first day of each consecutive calendar month thereafter, principal and interest at the Designated Rate shall be payable, in advance, in 30 equal consecutive installments in an amount sufficient to fully amortize the Loan(s) evidenced by such Note.

(g) Section 7(b) of Part 2 of the Supplement is hereby amended and restated in its entirety as follows:

(b) Intentionally Omitted.

(h) A new Section 7(d) is added to Part 2 of the Supplement, immediately after Section 7(c), as follows:

(d) Issuance of Warrant to Lender for Additional Commitments. As additional consideration for the making of the Additional Growth Capital Loan Commitment and Additional Equipment Loan Commitment, Lender has earned and is entitled to receive immediately upon the execution of the Amendment a warrant instrument issued by Borrower (the **"Preferred Stock Warrant"**) exercisable for a number of fully paid and nonassessable shares of the Borrower's preferred stock, such shares having an aggregate exercise price of $137,500 and an initial exercise price per share as set forth therein (the **"Warrant Stock Purchase Price"**); provided, however, that such initial number of shares of preferred stock issuable under the Preferred Stock Warrant at the Warrant Stock Purchase Price shall be increased automatically from time to time by that number of additional shares determined by dividing (A) the product of (x) 0.055 and (y) the aggregate original principal amount of the Additional Growth Capital Loans funded by Lender by (B) the Warrant Stock Purchase Price. The Preferred Stock Warrant shall be immediately vested and exercisable at any time and from time to time through March 31, 2013. The foregoing exercise price per share and number of shares issuable upon exercise of the Preferred Stock Warrant shall also be subject to adjustment as provided therein. The Preferred Stock Warrant shall include piggyback and S-3 registration rights, anti-dilution protections reasonably satisfactory to Lender and equivalent to those rights and protections granted to the holders of the series of preferred stock for which the Preferred Stock Warrant is exercisable, and shall remain exercisable beyond any public offering of Borrower's securities or merger transaction.

Borrower acknowledges that Lender has assigned its rights to receive the Preferred Stock Warrant to its parent, Venture Lending & Leasing IV, LLC; in connection therewith, Borrower shall issue the Preferred Stock Warrant directly to Venture Lending & Leasing IV, LLC. Upon request of Borrower, Lender shall furnish to Borrower a copy of the agreement in which Lender assigned the Preferred Stock Warrant to Venture Lending & Leasing IV, LLC.

(i) A new Section 10A is added to Part 2 of the Supplement, immediately after Section 10, as follows:

10A. Completion of Due Diligence for Additional Growth Capital Loan Commitment; Additional Equipment Loan Commitment and Additional Soft Cost Loan Commitment; Payment and Disposition of Commitment Fee associated with Additional Growth Capital Loans, Additional Equipment Loans and Additional Soft Cost Loans. As an additional condition precedent to the effectiveness of the Amendment, Lender shall have completed to its satisfaction its due diligence review of Borrower's business and financial condition and prospects, and Lender's investment committee shall have approved the Additional Growth Capital Loan Commitment, the Additional Equipment Loan Commitment and Additional Soft Cost Loan Commitment. If this condition is not satisfied, Lender shall refund to Borrower the Twenty Five Thousand Dollars ($25,000.00) commitment fee previously paid to Lender on account of the Additional Growth Capital Loan Commitment, the Additional Equipment Loan Commitment and

Additional Soft Cost Loan Commitment. Lender agrees that with respect to each Additional Growth Capital Loan, Additional Equipment Loan and Additional Soft Cost Loan advanced, on the Borrowing Date applicable to such Loan, Lender shall credit against the payments due from Borrower on such date in respect of such Loan an amount equal to the product of Twenty Five Thousand Dollars ($25,000.00) and a fraction the numerator of which is the principal amount of such Loan and the denominator of which is Two Million Five Hundred Thousand Dollars ($2,500,000.00), until the aggregate amount of such credits equals but does not exceed Twenty Five Thousand Dollars ($25,000.00).

(j) A new Section 13 is added to Part 2 of the Supplement, immediately after Section 12, as follows:

13. Collateralization of Corporate Credit Card Account. Notwithstanding anything to the contrary contained in the Loan and Security Agreement and Supplement, Lender agrees that Borrower may pledge a certificate of deposit in an amount not to exceed $50,000 to a commercial bank (**"Bank"**) in order to collateralize a corporate credit card program. Lender further agrees that: (i) Borrower's obligations to Bank under such corporate card program, not to exceed $50,000 in aggregate amount outstanding at any time, shall be permitted Indebtedness for all purposes of the Loan and Security Agreement; and (ii) the Liens in favor of Bank on the Credit Card Cash Collateral (hereinafter defined), securing the Indebtedness described in the preceding clause (i) shall be Permitted Liens for all purposes of the Loan and Security Agreement. **"Credit Card Cash Collateral"** means a certificate of deposit or time deposit account maintained at Bank in the principal amount of approximately $50,000 pledged by Borrower to Bank to secure Borrower's obligations to Bank under a corporate credit card program arranged by Bank for the account of Borrower.

(k) Exhibit A-1, the form of Promissory Note for Growth Capital Loans and Additional Growth Capital Loans, is hereby amended and restated in its entirety by as "Exhibit A-1" attached to this Amendment.

(l) Exhibit A-2, the form of Promissory Note for Equipment Loans, is hereby amended and restated in its entirety by as "Exhibit A-2" attached to this Amendment.

(m) Exhibit A-3, the form of Promissory Note for Soft Cost Loans, is hereby amended and restated in its entirety by as "Exhibit A-3" attached to this Amendment.

(n) Exhibit "B" to the Supplement, the form of Borrowing Request, is hereby amended and restated in its entirety by <u>Exhibit "B"</u> attached to this Amendment.

2. <u>Effectiveness of Amendment; Continued Effect of Original Agreement</u>.

2.1 <u>Continued Effect of Original Agreement</u>. All provisions of the Loan and Security Agreement, Supplement and other Loan Documents, except as modified by this Amendment, shall remain in full force and effect. This Amendment shall not operate as a waiver of any condition or obligation imposed on the parties under the Loan Documents.

2.2 Interpretation of Amendment. In the event of any conflict, inconsistency, or incongruity between any provision of this Amendment and any provision of the Loan Documents, the provisions of this Amendment shall govern and control.

2.3 Conditions to Effectiveness. This Amendment shall not be effective until each of the following conditions precedent has been fulfilled to the satisfaction of Lender:

(a) This Amendment and the Preferred Stock Warrant, substantially in the form attached hereto as Exhibit "C", shall have been duly executed and delivered by the respective parties hereto and, shall be in full force and effect and shall be in form and substance satisfactory to Lender.

(b) All action on the part of Borrower necessary for the valid execution, delivery and performance by Borrower of this Amendment and the Preferred Stock Warrant shall have been duly and effectively taken; and Lender shall have received a Secretary's Certificate executed by the Secretary of Borrower, which shall certify that attached thereto is a complete and correct copy of resolutions duly adopted by Borrower's Board of Directors, which resolutions have not been modified, amended, or rescinded in any respect and are in full force and effect as of the date hereof, and which resolutions authorize and ratify any actions previously, concurrently, or subsequently taken by Borrower with respect to the execution and performance of this Amendment and the matters contemplated herein.

(c) Lender shall have received a legal opinion of Borrower's counsel, substantially in the form attached hereto as Exhibit "D", covering the authority and enforceability of this Amendment and the Preferred Stock Warrant.

2.4 Borrower's Representations. Borrower hereby represents and warrants to Lender that: Borrower has full corporate power and authority to execute and deliver this Amendment, and to perform the obligations of its part to be performed thereunder and under the Loan Agreement and the Supplement as amended hereby; Borrower has taken all necessary action, corporate or otherwise, to authorize the execution and delivery of this Amendment and each of the documents described herein; no consent or approval of any person, no waiver of any lien or similar right, and no consent, license, approval or authorization of any governmental authority or agency is or will be required in connection with the execution or delivery by Borrower of this Amendment or the performance by Borrower of the Loan Agreement and the Supplement as amended hereby; and this Amendment and the Loan Agreement and the Supplement as amended hereby are, or upon delivery thereof to Lender will be, the legal, valid and binding obligations of Borrower, enforceable against Borrower in accordance with their respective terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization or similar laws affecting creditors' rights generally.

3. Miscellaneous.

3.1 Successors and Assigns. The terms and conditions of this Amendment shall inure to the benefit of and be binding upon the respective successors and assigns of the parties.

3.2 Governing Law. This Amendment shall be governed by and construed under the laws of the State of California as applied to agreements among California residents entered into and to be performed entirely within California, without regard to conflicts of law principles.

3.3 Amendments and Waivers. Any term of this Amendment may be amended and the observance of any term of this Amendment may be waived (either generally or in a particular instance and either retroactively or prospectively), only with the written consent of Borrower and Lender.

3.4 Severability. Whenever possible, each provision of this Amendment shall be interpreted in such manner as to be valid, legal, and enforceable under all applicable laws and regulations. If, however, any provision of this Amendment shall be invalid, illegal, or unenforceable under any such law or regulation in any jurisdiction, it shall, as to such jurisdiction, be deemed modified to conform to the minimum requirements of such law or regulation, or, if for any reason it is not deemed so modified, it shall be invalid, illegal, or unenforceable only to the extent of such invalidity, illegality, or limitation on enforceability without affecting the remaining provisions of this Amendment, or the validity, legality, or enforceability of such provision in any other jurisdiction.

3.5 Entire Agreement. This Amendment and the Loan Documents and the exhibits and schedules hereto and thereto constitute the full and entire understanding and agreement between the parties with regard to the subjects hereof and thereof.

3.6 Fees and Costs. All legal fees and costs incurred by Lender in connection with the preparation, negotiation and execution of this Amendment and the Preferred Stock Warrant shall be reimbursed by Borrower upon demand.

3.7 Counterparts. This Amendment may be executed in any number of counterparts, including counterparts transmitted by facsimile or electronic transmission, each of which shall be an original, but all of which together shall constitute one and the same instrument.

3.8 Further Assurances. Each party to this Amendment shall do and perform or cause to be done and performed all such further acts and things and shall execute and deliver all such other agreements, certificates, instruments and documents as the other party hereto may reasonably request in order to carry out the intent and accomplish the purposes of this Amendment and the consummation of the transactions contemplated hereby.

[Remainder of this page intentionally left blank.]

IN WITNESS WHEREOF, the parties have caused this Amendment No. 1 to Supplement to be duly executed as of the date and year first written above.

ENTEROMEDICS INC.

By: /s/ Mark B. Knudson
Name: Mark Knudson
Title: President

VENTURE LENDING & LEASING IV, INC.

By: /s/ Ronald W. Swenson
Name: Ronald W. Swenson
Title: Chief Executive Officer

EXHIBIT "A-1"

FORM OF PROMISSORY NOTE
(Growth Capital Loans and Additional Growth Capital Loans)

[Note No. X-XXX]

$__________ ______, 2004
San Jose, California

The undersigned ("Borrower") promises to pay to the order of VENTURE LENDING & LEASING IV, INC., a Maryland corporation ("Lender"), at its office at 2010 North First Street, Suite 310, San Jose, California 95131, or at such other place as Lender may designate in writing, in lawful money of the United States of America, the principal sum of ____________________ Dollars ($__________), with Basic Interest thereon from the date hereof until maturity, whether scheduled or accelerated, at a fixed rate per annum equal to **[the Prime Rate (as defined in the Loan Agreement referred to below) as published on the Business Day on which Lender prepares this Note following Borrower's submission of the Borrowing Request therefor, plus 1.99% but not less than 6.49%)** (the "Designated Rate"), except as otherwise provided herein, according to the payment schedule described herein, and a Terminal Payment in the sum of **[5.00% of face amount of Loan]** Dollars ($__________) payable on the Maturity Date.

This Note is one of the Notes referred to in, and is entitled to all the benefits of, a Loan and Security Agreement dated as of December 1, 2004, as amended by an Amendment No. 1 to Supplement dated as of September __, 2005, between Borrower and Lender (as the same have been and may be amended from time to time, the "Loan Agreement"). Each capitalized term not otherwise defined herein shall have the meaning set forth in the Loan Agreement. The Loan Agreement contains provisions for the acceleration of the maturity of this Note upon the happening of certain stated events.

Principal of and interest on this Note shall be payable as follows:

On the Borrowing Date, Borrower shall pay (i) if the Borrowing Date is not the first day of the month, interest only at a rate per month equal to 0.9166%, in advance, on the outstanding principal balance of this Note for the period from the Borrowing Date through [**the last day of the same month]**; (ii) interest at a rate per month equal to 0.9166%, in advance, on the outstanding principal balance of this Note for the month of ______ **[date of first regular interest only payment]**.

Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall make payments, in advance, of interest only at a rate per month equal to 0.9166% on the principal balance outstanding hereunder.

Commencing on the first day of the seventh full month after the Borrowing Date, and continuing on the first day of each consecutive month thereafter, principal and Basic Interest at the Designated Rate shall be payable, in advance, in twenty-four (24) equal consecutive installments of ____________________ Dollars ($__________) each. The Terminal Payment and unpaid expenses, fees, interest and principal amount shall be due and payable on ______ 200_.]

This Note may be voluntarily prepaid only as permitted under Section 5 of Part 2 of the Supplement to the Loan Agreement.

Any unpaid payments of principal or interest on this Note shall bear interest from their respective maturities, whether scheduled or accelerated, at a rate per annum equal to the Default Rate. Borrower shall pay such interest on demand.

Interest, charges and fees shall be calculated for actual days elapsed on the basis of a 360-day year, which results in higher interest, charge or fee payments than if a 365-day year were used. In no event shall Borrower be obligated to pay interest, charges or fees at a rate in excess of the highest rate permitted by applicable law from time to time in effect.

If Borrower is late in making any payment under this Note by more than five (5) Business Days, Borrower agrees to pay a “late charge” of five percent (5%) of the installment due, but not less than fifty dollars ($50.00) for any one such delinquent payment. This late charge may be charged by Lender for the purpose of defraying the expenses incidental to the handling of such delinquent amounts. Borrower acknowledges that such late charge represents a reasonable sum considering all of the circumstances existing on the date of this Note and represents a fair and reasonable estimate of the costs that will be sustained by Lender due to the failure of Borrower to make timely payments. Borrower further agrees that proof of actual damages would be costly and inconvenient. Such late charge shall be paid without prejudice to the right of Lender to collect any other amounts provided to be paid or to declare a default under this Note or any of the other Loan Documents or from exercising any other rights and remedies of Lender.

This Note shall be governed by, and construed in accordance with, the laws of the State of California, without regard to its conflict of laws provisions.

ENTEROMEDICS INC.

By: ________________________
Name: ________________________
Its: ________________________

EXHIBIT "A-2"

FORM OF PROMISSORY NOTE
(Equipment Loans and Additional Equipment Loans)

[Note No. X-XXX]

$__________ ______, 2004
San Jose, California

The undersigned ("Borrower") promises to pay to the order of VENTURE LENDING & LEASING IV, INC., a Maryland corporation ("Lender"), at its office at 2010 North First Street, Suite 310, San Jose, California 95131, or at such other place as Lender may designate in writing, in lawful money of the United States of America, the principal sum of ____________________ Dollars ($__________), with Basic Interest thereon from the date hereof until maturity, whether scheduled or accelerated, at a fixed rate per annum equal to **[the Prime Rate (as defined in the Loan Agreement referred to below) as published on the Business Day on which Lender prepares this Note following Borrower's submission of the Borrowing Request therefor, plus 2.023% but not less than 6.523%)** (the "Designated Rate"), except as otherwise provided herein, according to the payment schedule described herein, and a Terminal Payment in the sum of **[5.00% of face amount of Loan]** Dollars ($__________) payable on the Maturity Date

This Note is one of the Notes referred to in, and is entitled to all the benefits of, a Loan and Security Agreement dated as of December 1, 2004, as amended by an Amendment No. 1 to Supplement dated as of September __, 2005, between Borrower and Lender (as the same have been and may be amended from time to time, the "Loan Agreement"). The Loan Agreement contains provisions for the acceleration of the maturity of this Note upon the happening of certain stated events.

Principal of and interest on this Note shall be payable as follows:

On the Borrowing Date, Borrower shall pay (i) if the Borrowing Date is not the first day of the month, interest only at a rate per month equal to 0.8333%, in advance, on the outstanding principal balance of this Note for the period from the Borrowing Date through [**the last day of the same month]**; (ii) interest at a rate per month equal to 0.8333%, in advance, on the outstanding principal balance of this Note for the month of ______ [**date of first regular interest only payment]**.

Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall make payments, in advance, of interest only at a rate per month equal to 0.8333% on the principal balance outstanding hereunder.

Commencing on the first day of the seventh full month after the Borrowing Date, and continuing on the first day of each consecutive month thereafter, principal and Basic Interest at the Designated Rate shall be payable, in advance, in thirty (30) equal consecutive installments of ____________________ Dollars ($__________) each. The Terminal Payment and unpaid expenses, fees, interest and principal amount shall be due and payable on ______ 200_.]

This Note may be voluntarily prepaid only as permitted under Section 5 of Part 2 of the Supplement to the Loan Agreement.

Any unpaid payments of principal or interest on this Note shall bear interest from their respective maturities, whether scheduled or accelerated, at a rate per annum equal to the Default Rate. Borrower shall pay such interest on demand.

Interest, charges and fees shall be calculated for actual days elapsed on the basis of a 360-day year, which results in higher interest, charge or fee payments than if a 365-day year were used. In no event shall Borrower be obligated to pay interest, charges or fees at a rate in excess of the highest rate permitted by applicable law from time to time in effect.

If Borrower is late in making any payment under this Note by more than five (5) Business Days, Borrower agrees to pay a "late charge" of five percent (5%) of the installment due, but not less than fifty dollars ($50.00) for any one such delinquent payment. This late charge may be charged by Lender for the purpose of defraying the expenses incidental to the handling of such delinquent amounts. Borrower acknowledges that such late charge represents a reasonable sum considering all of the circumstances existing on the date of this Note and represents a fair and reasonable estimate of the costs that will be sustained by Lender due to the failure of Borrower to make timely payments. Borrower further agrees that proof of actual damages would be costly and inconvenient. Such late charge shall be paid without prejudice to the right of Lender to collect any other amounts provided to be paid or to declare a default under this Note or any of the other Loan Documents or from exercising any other rights and remedies of Lender.

This Note shall be governed by, and construed in accordance with, the laws of the State of California, without regard to its conflict of laws provisions.

ENTEROMEDICS INC.

By: ______________________________
Name: ______________________________
Its: ______________________________

EXHIBIT "A-3"

FORM OF PROMISSORY NOTE
(Soft Cost Loans and Additional Soft Cost Loans)

[Note No. X-XXX]

$__________ ______, 2004
San Jose, California

The undersigned ("Borrower") promises to pay to the order of VENTURE LENDING & LEASING IV, INC., a Maryland corporation ("Lender"), at its office at 2010 North First Street, Suite 310, San Jose, California 95131, or at such other place as Lender may designate in writing, in lawful money of the United States of America, the principal sum of ____________________ Dollars ($__________), with Basic Interest thereon from the date hereof until maturity, whether scheduled or accelerated, at a fixed rate per annum equal to **[the Prime Rate (as defined in the Loan Agreement referred to below) as published on the Business Day on which Lender prepares this Note following Borrower's submission of the Borrowing Request therefor, plus 5.46% but not less than 9.96%)** (the "Designated Rate"), except as otherwise provided herein, according to the payment schedule described herein.

This Note is one of the Notes referred to in, and is entitled to all the benefits of, a Loan and Security Agreement dated as of December 1, 2004, as amended by an Amendment No. 1 to Supplement dated as of September __, 2005, between Borrower and Lender (as the same have been and may be amended from time to time, the "Loan Agreement"). The Loan Agreement contains provisions for the acceleration of the maturity of this Note upon the happening of certain stated events.

Principal of and interest on this Note shall be payable as follows:

On the Borrowing Date, Borrower shall pay (i) if the Borrowing Date is not the first day of the month, interest only at a rate per month equal to 0.8333%, in advance, on the outstanding principal balance of this Note for the period from the Borrowing Date through [**the last day of the same month]**; (ii) interest at a rate per month equal to 0.8333%, in advance, on the outstanding principal balance of this Note for the month of ______ **[date of first regular interest only payment]**.

Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall make payments, in advance, of interest only at a rate per month equal to 0.8333% on the principal balance outstanding hereunder.

Commencing on the first day of the seventh full month after the Borrowing Date, and continuing on the first day of each consecutive month thereafter, principal and Basic Interest at the Designated Rate shall be payable, in advance, in thirty (30) equal consecutive installments of ____________________ Dollars ($__________) each.

This Note may be voluntarily prepaid only as permitted under Section 5 of Part 2 of the Supplement to the Loan Agreement.

Any unpaid payments of principal or interest on this Note shall bear interest from their respective maturities, whether scheduled or accelerated, at a rate per annum equal to the Default Rate. Borrower shall pay such interest on demand.

Interest, charges and fees shall be calculated for actual days elapsed on the basis of a 360-day year, which results in higher interest, charge or fee payments than if a 365-day year were used. In no event shall Borrower be obligated to pay interest, charges or fees at a rate in excess of the highest rate permitted by applicable law from time to time in effect.

If Borrower is late in making any payment under this Note by more than five (5) Business Days, Borrower agrees to pay a "late charge" of five percent (5%) of the installment due, but not less than fifty dollars ($50.00) for any one such delinquent payment. This late charge may be charged by Lender for the purpose of defraying the expenses incidental to the handling of such delinquent amounts. Borrower acknowledges that such late charge represents a reasonable sum considering all of the circumstances existing on the date of this Note and represents a fair and reasonable estimate of the costs that will be sustained by Lender due to the failure of Borrower to make timely payments. Borrower further agrees that proof of actual damages would be costly and inconvenient. Such late charge shall be paid without prejudice to the right of Lender to collect any other amounts provided to be paid or to declare a default under this Note or any of the other Loan Documents or from exercising any other rights and remedies of Lender.

This Note shall be governed by, and construed in accordance with, the laws of the State of California, without regard to its conflict of laws provisions.

ENTEROMEDICS INC.

By: ______________________________
Name: ____________________________
Its: ______________________________

EXHIBIT "B"

FORM OF BORROWING REQUEST

[Date]

Venture Lending & Leasing IV, Inc.
2010 North First Street, Suite 310
San Jose, CA 95131

Re: EnteroMedics Inc.

Gentlemen:

Reference is made to the Loan and Security Agreement dated as of December 1, 2004, as amended by an Amendment No. 1 to Supplement dated as of September __, 2005 (as the same have been and may be amended from time to time, the "Loan Agreement", the capitalized terms used herein as defined therein), between Venture Lending & Leasing IV, Inc. and EnteroMedics Inc. (the "Company").

The undersigned is the ____________________ of the Company, and hereby requests on behalf of the Company a Loan under the Loan Agreement, and in that connection certifies as follows:

1. The type(s) of the proposed Loan is/are **[an Equipment Loan][a Soft Cost Loan][a Growth Capital Loan] [an Additional Growth Capital Loan] [an Additional Equipment Loan][an Additional Soft Cost Loan].** The amount of the proposed Loan is ____________________ and _/100 Dollars ($__________). The Borrowing Date of the proposed Loan is ______, 200_.

2. **[If an Additional Equipment Loan or an Additional Soft Cost Loan]** The Eligible Equipment and/or Soft Costs, as applicable, to be financed with the proceeds of the Loan are described, and are or will be located at the address(es) shown on the attached **Schedule 1** or amendment or supplement to **Schedule 1**, which is hereby incorporated by reference in and made a part of the Loan Agreement. The requested amount of the Loan does not exceed the aggregate of one hundred percent (100%) of the amount paid or payable by Company to a non-affiliated manufacturer, vendor or dealer for such items of Eligible Equipment and/or Soft Costs as shown on an invoice therefor. No item of Eligible Equipment or Soft Costs has been owned or was incurred by Company earlier than 90 days before the proposed Borrowing Date[; or January 1, 2005 with respect to the initial Loan only if funded within 30 days of the Closing Date]

3. As of this date, no Default or Event of Default has occurred and is continuing, or will result from the making of the proposed Loan, the representations and warranties of the Company contained in Article 3 of the Loan Agreement are true and correct in all material respects, and the conditions precedent described in Article 4 of the Loan Agreement have been met.

4. No event that has had or could reasonably be expected to have a Material Adverse Change has occurred.

5. The Company's most recent financial projections dated __________, as approved by the Company's Board of Directors on __________, are enclosed herewith unless such financial projections have been previously furnished to Lender.

The Company shall notify you promptly before the funding of the Loan if any of the matters to which I have certified above shall not be true and correct on the Borrowing Date.

Very truly yours,

EnteroMedics Inc.

Name: ________________________________
Title:*

* Must be executed by Borrower's Chief Financial Officer or other executive officer.

Schedule 1 to the Loan and Security Agreement

Description of Equipment and Soft Costs

Quantity	Article	Make	Year Mfg.	Model/ Serial #	Location	üif Soft Cost

See attached continuation to Schedule 1

together with all improvements, replacements, accessions and additions thereto, wherever located, and all Proceeds thereof arising from the sale, lease, rental or other use or disposition of any such property, including all rights to payment with respect to insurance or condemnation, returned premiums, or any cause of action relating to any of the foregoing.

EXHIBIT “C”

FORM OF PREFERRED STOCK WARRANT

EXHIBIT “D”

FORM OF LEGAL OPINION

EXHIBIT 10.6

LOAN AND SECURITY AGREEMENT

Dated as of May 17, 2007

between

ENTEROMEDICS INC.,
a Delaware corporation,

as “Borrower”,

and

VENTURE LENDING & LEASING IV, INC.,
a Maryland corporation,
and
VENTURE LENDING & LEASING V, INC.,
a Maryland corporation,

each, as “Lender”

LOAN AND SECURITY AGREEMENT

The Borrower and each of Venture Lending & Leasing IV, Inc. ("VLL4") and Venture Lending & Leasing V, Inc. ("VLL5") have entered or anticipate entering into one or more transactions pursuant to which each Lender severally and not jointly agrees to make available to Borrower a loan facility governed by the terms and conditions set forth in this document and one or more Supplements executed by Borrower and Lender which incorporate this document by reference. Each Supplement constitutes a supplement to and forms part of this document, and will be read and construed as one with this document, so that this document and the Supplement constitute a single agreement between the parties (collectively referred to as this "Agreement").

Accordingly, the parties agree as follows:

ARTICLE 1—INTERPRETATION

1.1 Definitions. The terms defined in Article 10 and in the Supplement will have the meanings therein specified for purposes of this Agreement.

1.2 Inconsistency. In the event of any inconsistency between the provisions of any Supplement and this document, the provisions of the Supplement will be controlling for the purpose of all relevant transactions.

1.3 Several Obligations of Lender. The parties are entering into this single Agreement for convenience, and this Agreement is and shall be interpreted for all purposes as separate and distinct agreements between Borrower and VLL4, on the one hand, and Borrower and VLL5, on the other hand, and nothing in this Agreement shall be deemed a joint venture, partnership or other association between VLL4 and VLL5. Each reference in this Agreement to "Lender" shall mean and refer to each of VLL4 and VLL5, singly and independent of one another. Without limiting the generality of the foregoing, the Commitment, covenants and other obligations of "Lender" under this Agreement are several and not joint obligations of VLL4 and VLL5, and all rights and remedies of "Lender" under this Agreement may be exercised by VLL4 and/or VLL5 independently of one another.

ARTICLE 2 —THE COMMITMENT AND LOANS

2.1 The Commitment. Subject to the terms and conditions of this Agreement, Lender agrees to make term loans to Borrower from time to time from the Closing Date and to, but not including, the Termination Date in an aggregate principal amount not exceeding the Commitment. The Commitment is not a revolving credit commitment, and Borrower does not have the right to repay and reborrow hereunder. Each Loan requested by Borrower to be made on a single Business Day shall be for a minimum principal amount set forth in the Supplement, except to the extent the remaining Commitment is a lesser amount.

2.2 Notes Evidencing Loans; Repayment. Each Loan shall be evidenced by a separate Note payable to the order of Lender, in the total principal amount of the Loan. Principal and interest of each Loan shall be payable at the times set forth in the Note and regularly scheduled payments thereof and each Terminal Payment shall be effected by automatic debit of the appropriate funds from Borrower's Primary Operating Account as specified in the Supplement hereto.

2.3 Procedures for Borrowing.

(a) Borrower shall give Lender, at least five (5) Business Days' prior to a proposed Borrowing Date, written notice of any request for borrowing hereunder (a "Borrowing Request"). Each Borrowing Request shall be in substantially the form of Exhibit "B" to the Supplement, shall be executed by a responsible executive or financial officer of Borrower, and shall state how much is requested, and shall be accompanied by such other information and documentation as Lender may reasonably request.

(b) No later than 1:00 p.m. Pacific Standard Time on the Borrowing Date, if Borrower has satisfied the conditions precedent in Article 4, Lender shall make the Loan available to Borrower in immediately available funds.

2.4 Interest. Except as otherwise specified in the applicable Note, Basic Interest on the outstanding principal balance of each Loan shall accrue daily at the Designated Rate from the Borrowing Date until the Maturity Date. If the outstanding principal balance of such Loan is not paid on the Maturity Date, interest shall accrue at the Default Rate until paid in full, as further set forth herein.

2.5 Terminal Payment. Except as otherwise provided in the Supplement, Borrower shall pay the Terminal Payment with respect to each Loan on the Maturity Date of such Loan.

2.6 Interest Rate Calculation. Basic Interest, along with charges and fees under this Agreement and any Loan Document, shall be calculated for actual days elapsed on the basis of a 360-day year, which results in higher interest, charge or fee payments than if a 365-day year were used. In no event shall Borrower be obligated to pay Lender interest, charges or fees at a rate in excess of the highest rate permitted by applicable law from time to time in effect.

2.7 Default Interest. Any unpaid payments of principal or interest or the Terminal Payment with respect to any Loan shall bear interest from their respective maturities, whether scheduled or accelerated, at the Designated Rate for such Loan plus five percent (5.00%) per annum, until paid in full, whether before or after judgment (the "Default Rate"). Borrower shall pay such interest on demand.

2.8 Late Charges. If Borrower is late in making any payment of principal or interest or Terminal Payment under this Agreement by more than five (5) days, Borrower agrees to pay a late charge of five percent (5%) of the installment due, but not less than fifty dollars ($50.00) for any one such delinquent payment. This late charge may be charged by Lender for the purpose of defraying the expenses incidental to the handling of such delinquent amounts. Borrower acknowledges that such late charge represents a reasonable sum considering all of the circumstances existing on the date of this Agreement and represents a fair and reasonable estimate of the costs that will be sustained by Lender due to the failure of Borrower to make timely payments. Borrower further agrees that proof of actual damages would be costly and inconvenient. Such late charge shall be paid without prejudice to the right of Lender to collect any other amounts provided to be paid or to declare a default under this Agreement or any of the other Loan Documents or from exercising any other rights and remedies of Lender.

2.9 Lender's Records. Principal, Basic Interest, Terminal Payments and all other sums owed under any Loan Document shall be evidenced by entries in records maintained by Lender for such purpose. Each payment on and any other credits with respect to principal, Basic Interest, Terminal Payments and all other sums outstanding under any Loan Document shall be evidenced by entries in such records. Absent manifest error, Lender's records shall be conclusive evidence thereof.

2.10 Grant of Security Interests; Filing of Financing Statements.

(a) To secure the timely payment and performance of all of Borrower's Obligations to Lender, Borrower hereby grants to Lender continuing security interests in all of the Collateral. In connection with the foregoing, Borrower authorizes Lender to prepare and file any financing statements describing the Collateral without otherwise obtaining the Borrower's signature or consent with respect to the filing of such financing statements.

(b) Borrower is and shall remain absolutely and unconditionally liable for the performance of its obligations under the Loan Documents, including, without limitation, any deficiency by reason of the failure of the Collateral to satisfy all amounts due Lender under any of the Loan Documents.

(c) All Collateral pledged by Borrower under this Agreement and any Supplement shall secure the timely payment and performance of all Obligations under this Agreement, the Notes and the other Loan Documents. Except as expressly provided in this Agreement, no Collateral pledged under this Agreement or any Supplement shall be released until such time as all Obligations under this Agreement and the other Loan Documents have been satisfied and paid in full.

ARTICLE 3—REPRESENTATIONS AND WARRANTIES

Borrower represents and warrants that, except as set forth in the Supplement or any schedule of exceptions executed by the parties, as of the Closing Date and each Borrowing Date:

3.1 Due Organization. Borrower is a corporation duly organized and validly existing in good standing under the laws of the jurisdiction of its incorporation, and is duly qualified to conduct business and is in good standing in each other jurisdiction in which its business is conducted or its properties are located, except where the failure to be so qualified would not reasonably be expected to have a Material Adverse Effect.

3.2 Authorization, Validity and Enforceability. The execution, delivery and performance of all Loan Documents executed by Borrower are within Borrower's powers, have been duly authorized, and are not in conflict with Borrower's articles or certificate of incorporation or by-laws, or the terms of any charter or other organizational document of Borrower, as amended from time to time; and all such Loan Documents constitute valid and binding obligations of Borrower, enforceable in accordance with their terms (except as may be limited by bankruptcy, insolvency and similar laws affecting the enforcement of creditors' rights in general, and subject to general principles of equity).

3.3 Compliance with Applicable Laws. Borrower has complied with all licensing, permit and fictitious name requirements necessary to lawfully conduct the business in which it is engaged, and to any sales, leases or the furnishing of services by Borrower, including without limitation those requiring consumer or other disclosures, the noncompliance with which would have a Material Adverse Effect.

3.4 No Conflict. The execution, delivery, and performance by Borrower of all Loan Documents are not in conflict with any law, rule, regulation, order or directive, or any indenture, agreement, or undertaking to which Borrower is a party or by which Borrower may be bound or affected. Without limiting the generality of the foregoing, the issuance of the Warrant to Lender (or its designee) and the grant of registration rights in connection therewith do not violate any agreement or instrument by which Borrower is bound or require the consent of any holders of Borrower's securities other than consents which have been obtained prior to the Closing Date.

3.5 No Litigation, Claims or Proceedings. There is no litigation, tax claim, proceeding or dispute pending, or, to the knowledge of Borrower, threatened against or affecting Borrower, its property or the conduct of its business.

3.6 Correctness of Financial Statements. Borrower's financial statements which have been delivered to Lender fairly and accurately reflect Borrower's financial condition in accordance with GAAP as of the latest date of such financial statements; and, since that date there has been no Material Adverse Change.

3.7 No Subsidiaries. Borrower is not a majority owner of or in a control relationship with any other business entity.

3.8 Environmental Matters. To its knowledge after reasonable inquiry, Borrower has concluded that Borrower is in compliance with Environmental Laws, except to the extent a failure to be in such compliance could not reasonably be expected to have a Material Adverse Effect.

3.9 No Event of Default. No Default or Event of Default has occurred and is continuing.

3.10 Full Disclosure. None of the representations or warranties made by Borrower in the Loan Documents as of the date such representations and warranties are made or deemed made, and none of the statements contained in any exhibit, report, statement or certificate furnished by or on behalf of Borrower in connection with the Loan Documents (including disclosure materials delivered by or on behalf of Borrower to Lender prior to the Closing Date or pursuant to Section 5.2 hereof), contains any untrue statement of a material fact or omits any material fact required to be stated therein or necessary to make the statements made therein, in light of the circumstances under which they are made, not misleading as of the time when made or delivered.

3.11 Specific Representations Regarding Collateral.

(a) Title. Except for the security interests created by this Agreement and Permitted Liens, (i) Borrower is and will be the unconditional legal and beneficial owner of the Collateral, and (ii) the Collateral is genuine and subject to no Liens, rights or defenses of others. There exist no prior assignments or encumbrances of record with the U.S. Patent and Trademark Office or Copyright Office affecting any Collateral in favor of any third party.

(b) Rights to Payment. The names of the obligors, amount owing to Borrower, due dates and all other information with respect to the Rights to Payment are and will be correctly stated in all material respects in all Records relating to the Rights to Payment. Borrower further represents and warrants, to its knowledge, that each Person appearing to be obligated on a Right to Payment has authority and capacity to contract and is bound as it appears to be.

(c) Location of Collateral. Borrower's chief executive office, Inventory, Records, Equipment, and any other offices or places of business are located at the address(es) shown on the Supplement.

(d) Business Names. Other than its full corporate name, Borrower has not conducted business using any trade names or fictitious business names except as shown on the Supplement.

3.12 Copyrights, Patents, Trademarks and Licenses.

(a) Borrower owns or is licensed or otherwise has the right to use all of the patents, trademarks, service marks, trade names, copyrights, contractual franchises, authorizations and other similar rights that are reasonably necessary for the operation of its business, without conflict with the rights of any other Person.

(b) To Borrower’s knowledge, no slogan or other advertising device, product, process, method, substance, part or other material now employed, or now contemplated to be employed, by Borrower infringes upon any rights held by any other Person.

(c) No claim or litigation regarding any of the foregoing is pending or, to Borrower’s knowledge, threatened, and no patent, invention, device, application, principle or any statute, law, rule, regulation, standard or code is pending or proposed which, in either case, could reasonably be expected to have a Material Adverse Effect.

3.13 Survival. The representations and warranties of Borrower as set forth in this Agreement survive the execution and delivery of this Agreement.

ARTICLE 4—CONDITIONS PRECEDENT

4.1 Conditions to First Loan. The obligation of Lender to make its first Loan hereunder is, in addition to the conditions precedent specified in Section 4.2 and in any Supplement, subject to the fulfillment of the following conditions and to the receipt by Lender of the documents described below, duly executed and in form and substance satisfactory to Lender and its counsel:

(a) Resolutions. A certified copy of the resolutions of the Board of Directors of Borrower authorizing the execution, delivery and performance by Borrower of the Loan Documents.

(b) Incumbency and Signatures. A certificate of the secretary of Borrower certifying the names of the officer or officers of Borrower authorized to sign the Loan Documents, together with a sample of the true signature of each such officer.

(c) Legal Opinion. The opinion of legal counsel for Borrower as to such matters as Lender may reasonably request, including the matters covered by Sections 3.1, 3.2, 3.4 and 3.5 hereof.

(d) Articles and By-Laws. Certified copies of the Articles or Certificate of Incorporation and By-Laws of Borrower, as amended through the Closing Date.

(e) This Agreement. A counterpart of this Agreement and an initial Supplement, with all schedules completed and attached thereto, and disclosing such information as is acceptable to Lender.

(f) Financing Statements. Filing copies (or other evidence of filing satisfactory to Lender and its counsel) of such UCC financing statements, collateral assignments, account control agreements, and termination statements, with respect to the Collateral as Lender shall request.

(g) Insurance Certificates. Insurance certificates showing Lender as loss payee and as additional insured.

(h) Lien Searches. UCC lien, judgment, bankruptcy and tax lien searches of Borrower from such jurisdictions or offices as Lender may reasonably request, all as of a date reasonably satisfactory to Lender and its counsel.

(i) Good Standing Certificate. A Certificate of status or good standing of Borrower as of a date acceptable to Lender from the jurisdiction of Borrower’s organization and any foreign jurisdictions where Borrower is qualified to do business.

(j) Warrant(s). One or more warrants issued by Borrower to Lender (or its designee) exercisable for such number, type and class of shares of Borrower’s capital stock, and for an initial exercise price as is specified in the Supplement.

(k) Other Documents. Such other documents and instruments as Lender may reasonably request to effectuate the intents and purposes of this Agreement.

4.2 Conditions to All Loans. The obligation of Lender to make its initial Loan and each subsequent Loan is subject to the following further conditions precedent that:

(a) No Default. No Default or Event of Default has occurred and is continuing or will result from the making of any such Loan, and the representations and warranties of Borrower contained in Article 3 of this Agreement and Part 3 of the Supplement are true and correct as of the Borrowing Date of such Loan.

(b) No Material Adverse Change. No event has occurred that has had or could reasonably be expected to have a Material Adverse Change.

(c) Borrowing Request. Borrower shall have delivered to Lender a Borrowing Request for such Loan.

(d) Note. Borrower shall have delivered an executed Note evidencing such Loan, substantially in the form of Exhibit “A” attached to the Supplement.

(e) Supplemental Lien Filings. Borrower shall have executed and delivered such amendments or supplements to this Agreement and additional Security Documents, financing statements and third party waivers as Lender may reasonably request in connection with the proposed Loan, in order to create, protect or perfect or to maintain the perfection of Lender’s Liens on the Collateral.

(f) VCOC Limitation. Lender shall not be obligated to make any Loan under its Commitment if at the time of or after giving effect to the proposed Loan Lender would no longer qualify as: (A) a “venture capital operating company” under U.S. Department of Labor Regulations Section 2510.3-101(d), Title 29 of the Code of Federal Regulations, as amended; and (B) a “business development company” under the provisions of federal Investment Company Act of 1940, as amended; and (C) a “regulated investment company” under the provisions of the Internal Revenue Code of 1986, as amended.

(g) Financial Projections. Borrower shall have delivered to Lender Borrower’s business plan and/or financial projections or forecasts as most recently approved by Borrower’s Board of Directors.

ARTICLE 5—AFFIRMATIVE COVENANTS

During the term of this Agreement and until its performance of all Obligations, Borrower will:

5.1 Notice to Lender. Promptly give written notice to Lender of:

(a) Any litigation or administrative or regulatory proceeding affecting Borrower where the amount claimed against Borrower is at the Threshold Amount or more, or where the granting of the relief requested could have a Material Adverse Effect; or of the acquisition by Borrower of any commercial tort claim, including brief details of such claim and such other information as Lender may reasonably request to enable Lender to better perfect its Lien in such commercial tort claim as Collateral.

(b) Any substantial dispute which may exist between Borrower or any governmental or regulatory authority.

(c) The occurrence of any Default or any Event of Default.

(d) Any change in the location of any of Borrower’s places of business or Collateral at least thirty (30) days in advance of such change, or of the establishment of any new, or the discontinuance of any existing, place of business.

(e) Any dispute or default by Borrower or any other party under any joint venture, partnering, distribution, cross-licensing, strategic alliance, collaborative research or manufacturing, license or similar agreement which could reasonably be expected to have a Material Adverse Effect.

(f) Any other matter which has resulted or might reasonably result in a Material Adverse Change.

5.2 Financial Statements. Deliver to Lender or cause to be delivered to Lender, in form and detail satisfactory to Lender the following financial and other information, which Borrower warrants shall be accurate and complete in all material respects:

(a) Monthly Financial Statements. As soon as available but no later than thirty (30) days after the end of each month, Borrower’s balance sheet as of the end of such period, and Borrower’s income statement for such period and for that portion of Borrower’s financial reporting year ending with such period, prepared in accordance with GAAP and attested by a responsible financial officer of Borrower as being complete and correct and fairly presenting Borrower’s financial condition and the results of Borrower’s operations. After a Qualified Public Offering, the foregoing interim financial statements shall be delivered no later than 45 days after each fiscal quarter and for the quarter-annual fiscal period then ended.

(b) Year-End Financial Statements. As soon as available but no later than one hundred eighty (180) days after and as of the end of each financial reporting year, a complete copy of Borrower's audit report, which shall include balance sheet, income statement, statement of changes in equity and statement of cash flows for such year, prepared in accordance with GAAP and certified by an independent certified public accountant selected by Borrower and satisfactory to Lender (the "Accountant"). The Accountant's certification shall not be qualified or limited due to a restricted or limited examination by the Accountant of any material portion of Borrower's records or otherwise.

(c) Compliance Certificates. Simultaneously with the delivery of each set of financial statements referred to in paragraphs (a) and (b) above, a certificate of the chief financial officer of Borrower substantially in the form of Exhibit "C" to the Supplement (i) setting forth in reasonable detail any calculations required to establish whether Borrower is in compliance with any financial covenants or tests set forth in the Supplement, and (ii) stating whether any Default or Event of Default exists on the date of such certificate, and if so, setting forth the details thereof and the action which Borrower is taking or proposes to take with respect thereto.

(d) Government Required Reports; Press Releases. Promptly after sending, issuing, making available, or filing, copies of all statements released to any news media for publication, all reports, proxy statements, and financial statements that Borrower sends or makes available to its stockholders, and, not later than five (5) days after actual filing or the date such filing was first due, all registration statements and reports that Borrower files or is required to file with the Securities and Exchange Commission, or any other governmental or regulatory authority.

(e) Other Information. Such other statements, lists of property and accounts, budgets, forecasts, reports, information regarding equity financings that are consummated after the Closing Date or other information as Lender may from time to time reasonably request.

5.3 Managerial Assistance from Lender. At no cost to Borrower, permit Lender to substantially participate in, and substantially influence the conduct of management of Borrower through the exercise of "management rights," as that term is defined in 29 C.F.R. § 2510.3-101(d), including without limitation the following rights:

(a) Borrower agrees that (i) it will make its officers, directors, employees and affiliates available at such times as Lender may reasonably request for Lender to consult with and advise as to the conduct of Borrower's business, its equipment and financing plans, and its financial condition and prospects, (ii) Lender shall have the right to inspect Borrower's books, records, facilities and properties at reasonable times during normal business hours on reasonable advance notice, and (iii) Lender shall be entitled to recommend prospective candidates for election or nomination for election to Borrower's Board of Directors but Borrower shall not be bound by such recommendations, it being the intention of the parties that Lender shall be entitled through such rights, *inter alia*, to furnish "significant managerial assistance", as defined in Section 2(a)(47) of the Investment Company Act of 1940, to Borrower.

(b) Without limiting the generality of (a) above, if Lender reasonably believes that financial or other developments affecting Borrower have impaired or are likely to impair Borrower's ability to perform its obligations under this Agreement, permit Lender reasonable access to Borrower's management and/or Board of Directors and opportunity to present Lender's views with respect to such developments.

Lender shall cooperate with Borrower to ensure that the exercise of Lender's rights shall not disrupt the business of Borrower. The rights enumerated above shall not be construed as giving Lender control over Borrower's management or policies.

5.4 Existence. Maintain and preserve Borrower's existence, present form of business, and all rights and privileges necessary or desirable in the normal course of its business; and keep all Borrower's property in good working order and condition, ordinary wear and tear excepted.

5.5 Insurance. Obtain and keep in force insurance in such amounts and types as is usual in the type of business conducted by Borrower, with insurance carriers having a policyholder rating of not less than "A" and financial category rating of Class VII in "Best's Insurance Guide," unless otherwise approved by Lender. Such insurance policies must be in form and substance satisfactory to Lender, and shall list Lender as an additional insured or loss payee, as applicable, on endorsement(s) in form reasonably acceptable to Lender. Borrower shall furnish to Lender such endorsements, and upon Lender's request, copies of any or all such policies.

5.6 Accounting Records. Maintain adequate books, accounts and records, and prepare all financial statements in accordance with GAAP, and in compliance with the regulations of any governmental or regulatory authority having jurisdiction over Borrower or Borrower's business; and permit employees or agents of Lender at such reasonable times as Lender may request, at Borrower's expense, to inspect Borrower's properties, and to examine, and make copies and memoranda of Borrower's books, accounts and records.

5.7 Compliance With Laws. Comply with all laws (including Environmental Laws), rules, regulations applicable to, and all orders and directives of any governmental or regulatory authority having jurisdiction over, Borrower or Borrower's business, and with all material agreements to which Borrower is a party, except where the failure to so comply would not have a Material Adverse Effect.

5.8 Taxes and Other Liabilities. Pay all Borrower's Indebtedness when due; pay all taxes and other governmental or regulatory assessments before delinquency or before any penalty attaches thereto, except as may be contested in good faith by the appropriate procedures and for which Borrower shall maintain appropriate reserves; and timely file all required tax returns.

5.9 Special Collateral Covenants.

(a) Maintenance of Collateral; Inspection. Do all things reasonably necessary to maintain, preserve, protect and keep all Collateral in good working order and salable condition, ordinary wear and tear excepted, deal with the Collateral in all ways as are considered good practice by owners of like property, and use the Collateral lawfully and, to the extent applicable, only as permitted by Borrower's insurance policies. Maintain, or cause to be maintained, complete and accurate Records relating to the Collateral. Upon reasonable prior notice at reasonable times during normal business hours, Borrower hereby authorizes Lender's officers, employees, representatives and agents to inspect the Collateral and to discuss the Collateral and the Records relating thereto with Borrower's officers and employees, and, in the case of any Right to Payment, with any Person which is or may be obligated thereon.

(b) Financing Statements and Other Actions. Execute and deliver to Lender all financing statements, notices and other documents (including, without limitation, any filings with the United States Patent and Trademark Office) from time to time reasonably requested by Lender to maintain a first perfected security interest in the Collateral in favor of Lender; perform such other acts, and execute and deliver to Lender such additional conveyances, assignments, agreements and instruments, as Lender may at any time request in connection with the administration and enforcement of this Agreement or Lender's rights, powers and remedies hereunder.

(c) Liens. Not create, incur, assume or permit to exist any Lien or grant any other Person a negative pledge on any Collateral, except Permitted Liens.

(d) Documents of Title. Not sign or authorize the signing of any financing statement or other document naming Borrower as debtor or obligor, or acquiesce or cooperate in the issuance of any bill of lading, warehouse receipt or other document or instrument of title with respect to any Collateral, except those negotiated to Lender, or those naming Lender as secured party.

(e) Change in Location or Name. Without at least 30 days' prior written notice to Lender: (a) not relocate any Collateral or Records, its chief executive office, or establish a place of business at a location other than as specified in the Supplement; and (b) not change its name, mailing address, location of Collateral, jurisdiction of incorporation or its legal structure.

(f) Decals, Markings. At the request of Lender, firmly affix a decal, stencil or other marking to designated items of Equipment, indicating thereon the security interest of Lender.

(g) Agreement With Real Property Owner/Landlord. Obtain and maintain such acknowledgments, consents, waivers and agreements from the owner, lienholder, mortgagee and landlord with respect to any real property on which Equipment is located as Lender may require, all in form and substance satisfactory to Lender. Lender hereby waives the requirement of this Section 5.9(g) with respect to Borrower's principal place of business in St. Paul, Minnesota leased and occupied by Borrower as of the Closing Date based on Borrower's representation that such lease does not give the lessor an interest in the Equipment located at such place of business.

(h) Certain Agreements on Rights to Payment. Other than in the ordinary course of business, not make any material discount, credit, rebate or other reduction in the original amount owing on a Right to Payment or accept in satisfaction of a Right to Payment less than the original amount thereof.

5.10 Authorization for Automated Clearinghouse Funds Transfer. (i) Authorize Lender to initiate debit entries to Borrower's Primary Operating Account, specified in the Supplement attached hereto, through Automated Clearinghouse ("ACH") transfers, in order to satisfy regularly scheduled payments of principal, interest and Terminal Payments; (ii) provide Lender at least thirty (30) days notice of any change in Borrower's Primary Operating Account; and (iii) grant Lender any additional authorizations necessary to begin ACH debits from a new account which becomes the Primary Operating Account.

ARTICLE 6—NEGATIVE COVENANTS

During the term of this Agreement and until the performance of all Obligations, Borrower will not:

6.1 Indebtedness. Be indebted for borrowed money, the deferred purchase price of property, or leases which would be capitalized in accordance with GAAP; or become liable as a surety, guarantor, accommodation party or otherwise for or upon the obligation of any other Person, except:

(a) Indebtedness incurred for the acquisition of supplies or inventory on normal trade credit;

(b) Indebtedness incurred for customer trade payable and other vendor-based operating leases;

(c) Indebtedness incurred pursuant to one or more transactions permitted under Section 6.4;

(d) Indebtedness of Borrower under this Agreement;

(e) Indebtedness of Borrower under the VLL4 Loan Agreement;

(f) Indebtedness incurred in accordance with Section 4 of Part 2 of the Supplement;

(g) Indebtedness to a commercial bank (**"Bank"**) under a corporate card program not to exceed Fifty Thousand Dollars ($50,000) in aggregate amount outstanding at any time; and

(h) Any Indebtedness approved by Lender prior to the Closing Date and set forth on Schedule 6.1.

6.2 Liens. Create, incur, assume or permit to exist any Lien, or grant any other Person a negative pledge, on any of Borrower's property, except Permitted Liens. Without limiting the generality of the foregoing, and as a material inducement to the Lenders' making of the Commitment and entering into the Loan Documents, Borrower agrees that it shall not assign, mortgage, pledge, grant a security interest in, or encumber any of Borrower's Intellectual Property, or enter into any agreement, document, instrument or other arrangement (except with or in favor of Lenders) with any Person which directly or indirectly prohibits or has the effect of prohibiting Borrower from assigning, mortgaging, pledging, granting a security interest in or upon, or encumbering any of Borrower's Intellectual Property, except as is otherwise permitted in Section 6.5(i) of this Agreement and clause (h) of the definition of "Permitted Lien" herein.

6.3 Dividends. Except after a Qualified Public Offering, pay any dividends or purchase, redeem or otherwise acquire or make any other distribution with respect to any of Borrower's capital stock, except (a) dividends or other distributions solely of capital stock of Borrower, and (b) so long as no Event of Default has occurred and is continuing, repurchases of stock from employees upon termination of employment under reverse vesting or similar repurchase plans not to exceed $100,000 in any calendar year.

6.4 Changes/Mergers. Liquidate or dissolve; or enter into any consolidation, merger or other combination in which the stockholders of the Borrower immediately prior to the first such transaction own less than 50% of the voting stock of the Borrower immediately after giving effect to such transaction or related series of such transactions, except that Borrower may consolidate or merge so long as: (A) the entity that results from such merger or consolidation (the "Surviving Entity") shall have executed and delivered to Lender an agreement in form and substance reasonably satisfactory to Lender, containing an assumption by the Surviving Entity of the due and punctual payment and performance of all Obligations and performance and observance of each covenant and condition of Borrower in the Loan Documents; (B) all such obligations of the Surviving Entity to Lender shall be guaranteed by any entity that directly or indirectly owns or controls more than 50% of the voting stock of the Surviving Entity; (C) immediately after giving effect to such merger or consolidation, no Event of Default or, event which with the lapse of time or giving of notice or both, would result in an Event of Default shall have occurred and be continuing; and (D) the credit risk to Lender, in its sole discretion, of the Surviving Entity shall not be increased. In determining whether the proposed merger or consolidation would result in an increased credit risk, Lender may consider, among other things, changes in Borrower's management team, employee base, access to equity markets, venture capital support, financial position and/or disposition of intellectual property rights which may reasonably be anticipated as a result of the transaction.

6.5 Sales of Assets. Sell, transfer, lease, license or otherwise dispose of (a "Transfer") any of Borrower's assets except (i) exclusive and non-exclusive licenses of Intellectual Property in the ordinary course of business consistent with industry practice; (ii) Transfers of worn-out, obsolete or surplus property (each as determined by the Borrower in its reasonable judgment); (iii) Transfers of Inventory; (iv) Transfers constituting Permitted Liens; (v) Transfers permitted in Section 6.6 hereunder; and (vi) Transfers of assets (other than Intellectual Property) for fair consideration and in the ordinary course of its business.

6.6 Loans/Investments. Make or suffer to exist any loans, guaranties, advances, or investments, except:

(a) Accounts receivable in the ordinary course of Borrower's business;

(b) Investments in domestic certificates of deposit issued by, and other domestic investments with, financial institutions organized under the laws of the United States or a state thereof, having at least One Hundred Million Dollars ($100,000,000) in capital and a rating of at least "investment grade" or "A" by Moody's or any successor rating agency;

(c) Investments in marketable obligations of the United States of America and in open market commercial paper given the highest credit rating by a national credit agency and maturing not more than one year from the creation thereof;

(d) Temporary advances to cover incidental expenses to be incurred in the ordinary course of business;

(e) Investments in joint ventures, strategic alliances, licensing and similar arrangements customary in Borrower's industry and which do not require Borrower to assume or otherwise become liable for the obligations of any third party not directly related to or arising out of such arrangement or, without the prior written consent of Lender, require Borrower to transfer ownership of non-cash assets to such joint venture or other entity; and

(f) Investments in wholly-owned subsidiaries of the Borrower.

6.7 Transactions With Related Persons. Directly or indirectly enter into any transaction with or for the benefit of a Related Person on terms more favorable to the Related Person than would have been obtainable in an "arms' length" dealing.

6.8 Other Business. Engage in any material line of business other than the business Borrower conducts as of the Closing Date.

6.9 Financial Covenants. Fail to comply with any financial covenants or tests set forth in the Supplement.

6.10 Compliance. Become an "investment company" or controlled by an "investment company," within the meaning of the Investment Company Act of 1940, or become principally engaged in, or undertake as one of its important activities, the business of extending credit for the purpose of purchasing or carrying margin stock, or use the proceeds of any Loan for such purpose. Fail to meet the minimum funding requirements of ERISA, permit a Reportable Event or Prohibited Transaction, as defined in ERISA, to occur, fail to comply with the Federal Fair Labor Standards Act or violate any law or regulation, which violation could have a Material Adverse Effect or a material adverse effect on the Collateral or the priority of Lender's Lien on the Collateral, or permit any of its subsidiaries to do any of the foregoing.

6.11 Other Deposit and Securities Accounts. Maintain any deposit accounts or accounts holding securities owned by Borrower except (i) Deposit Accounts and investment/securities accounts as set forth in the Supplement, and (ii) other Deposit Accounts and securities/investment accounts, in each case, with respect to which Borrower and Lender shall have taken such action as Lender reasonably deems necessary to obtain a perfected first security interest therein. Notwithstanding anything contained herein to the contrary, including the Borrower's grant of a security interest in Section 2.10(a), Lender agrees that, in the event the Lender instructs any depositary bank to (i) deliver funds to the Lender or (ii) not to permit the Borrower to withdraw funds from any Deposit Account, the Borrower may withdraw, for a period not to exceed 30 days commencing on the date

Lender delivers such instructions, an amount in the Deposit Accounts not to exceed $250,000 for the purpose of meeting Borrower's then current payroll obligations or, with Lender's consent, other outstanding obligations of Borrower, and that any such withdrawal shall be free and clear of any interest of the Lender in such funds. The Lender shall provide instruction to such depositary bank in order to permit the Borrower to make such withdrawal.

ARTICLE 7—EVENTS OF DEFAULT

7.1 Events of Default; Acceleration. Upon the occurrence and during the continuation of any Default, the obligation of Lender to make any additional Loan shall be suspended. The occurrence of any of the following (each, an "Event of Default") shall terminate any obligation of Lender to make any additional Loan; and shall, at the option of Lender (1) make all sums of Basic Interest and principal, all Terminal Payments, and any Obligations and other amounts owing under any Loan Documents immediately due and payable without notice of default, presentment or demand for payment, protest or notice of nonpayment or dishonor or any other notices or demands, and (2) give Lender the right to exercise any other right or remedy provided by contract or applicable law:

(a) Borrower shall fail to pay any principal, interest or Terminal Payment under this Agreement or any Note, or fail to pay any fees or other charges when due under any Loan Document, and such failure continues for three (3) Business Days or more after the same first becomes due; or an Event of Default as defined in any other Loan Document shall have occurred.

(b) Any representation or warranty made, or financial statement, certificate or other document provided, by Borrower under any Loan Document shall prove to have been false or misleading in any material respect when made or deemed made herein.

(c) Borrower shall fail to pay its debts generally as they become due or shall commence any Insolvency Proceeding with respect to itself; an involuntary Insolvency Proceeding shall be filed against Borrower, or a custodian, receiver, trustee, assignee for the benefit of creditors, or other similar official, shall be appointed to take possession, custody or control of the properties of Borrower, and such involuntary Insolvency Proceeding, petition or appointment is acquiesced to by Borrower or is not dismissed within sixty (60) days; or the dissolution or termination of the business of Borrower; or Borrower shall take any corporate action for the purpose of effecting, approving, or consenting to any of the foregoing.

(d) Borrower shall be in default beyond any applicable period of grace or cure under any other agreement involving the borrowing of money, the purchase of property, the advance of credit or any other monetary liability of any kind to Lender or to any Person which results in the acceleration of payment of such obligation in an amount in excess of the Threshold Amount.

(e) Any governmental or regulatory authority shall take any judicial or administrative action, or any defined benefit pension plan maintained by Borrower shall have any unfunded liabilities, any of which, in the reasonable judgment of Lender, might have a Material Adverse Effect.

(f) Except as permitted in Section 6.4, any sale, transfer or other disposition of all or a substantial or material part of the assets of Borrower, including without limitation to any trust or similar entity, shall occur.

(g) Any judgment(s) singly or in the aggregate in excess of the Threshold Amount shall be entered against Borrower which remain unsatisfied, unvacated or unstayed pending appeal for thirty (30) or more days after entry thereof.

(h) At any time prior to the initial sale of Borrower's equity securities to the public pursuant to a registration statement filed under the Securities Act of 1933, as amended, any Person or two or more Persons (other than any "Excluded Person" as defined below) acting in concert shall have acquired (in a single transaction or series of related transactions occurring within a six-month period) beneficial ownership (within the meaning of Rule 13d-3 of the Securities and Exchange Commission) of outstanding shares of voting stock of Borrower representing fifty percent (50%) or more of the voting power of all shares of Borrower's voting stock that are outstanding immediately after such acquisition. As used in this paragraph (h), "Excluded Person" means: (i) any Person who is a stockholder of Borrower as of the Closing Date; (ii) a venture capital firm or similar investment fund or institution; (iii) any Strategic Partner of Borrower, or (iv) an affiliate of any Person described in clause (i), (ii) or (iii). For purposes of this Section 7.1(h), "Strategic Partner" means any Person who either prior to first acquiring equity securities of Borrower has an existing contractual relationship with Borrower for the joint development or sharing of, or similar arrangement relating to, Borrower's technology or products, or enters into such a contractual relationship at the time of acquiring Borrower's securities.

(i) Borrower shall fail to perform or observe any covenant contained in Article 6 of this Agreement.

(j) Borrower shall fail to perform or observe any covenant contained in Section 5.9 of this Agreement.

(k) Borrower shall fail to perform or observe any covenant contained in this Agreement or any other Loan Document (other than a covenant which is dealt with specifically elsewhere in this Article 7) and, if capable of being cured, the breach of such covenant is not cured within 30 days after the sooner to occur of Borrower's receipt of notice of such breach from Lender or the date on which such breach first becomes known to any officer of Borrower; provided, however that if such breach is not capable of being cured within such 30-day period and Borrower timely notifies Lender of such fact and Borrower diligently pursues such cure, then the cure period shall be extended to the date requested in Borrower's notice but in no event more than 90 days from the initial breach; provided, further, that such additional 60-day opportunity to cure shall not apply in the case of any failure to perform or observe any covenant which has been the subject of a prior failure within the preceding 180 days or which is a willful and knowing breach by Borrower.

7.2 Remedies Upon Default. Upon the occurrence and during the continuance of an Event of Default, Lender shall be entitled to, at its option, exercise any or all of the rights and remedies available to a secured party under the UCC or any other applicable law, and exercise any or all of its rights and remedies provided for in this Agreement and in any other Loan Document. The obligations of Borrower under this Agreement shall continue to be effective or be reinstated, as the case may be, if at any time any payment of any Obligations is rescinded or must otherwise be returned by Lender upon, on account of, or in connection with, the insolvency, bankruptcy or reorganization of Borrower or otherwise, all as though such payment had not been made.

7.3 Sale of Collateral. Upon the occurrence and during the continuance of an Event of Default, Lender may sell all or any part of the Collateral, at public or private sales, to itself, a wholesaler, retailer or investor, for cash, upon credit or for future delivery, and at such price or prices as Lender may deem commercially reasonable. To the extent permitted by law, Borrower hereby specifically waives all rights of redemption and any rights of stay or appraisal which it has or may have under any applicable law in effect from time to time. Any such public or private sales shall be held at such times and at such place(s) as Lender may determine. In case of the sale of all or any part of the Collateral on credit or for future delivery, the Collateral so sold may be retained by Lender until the selling price is paid by the purchaser, but Lender shall not incur any liability in case of the failure of such purchaser to pay for the Collateral and, in case of any such failure, such Collateral may be resold. Lender may, instead of exercising its power of sale, proceed to enforce its security interest in the Collateral by seeking a judgment or decree of a court of competent jurisdiction. Without limiting the generality of the foregoing, if an Event of Default is in effect,

(1) Subject to the rights of any third parties, Lender may license, or sublicense, whether general, special or otherwise, and whether on an exclusive or non-exclusive basis, any Copyrights, Patents or Trademarks included in the Collateral throughout the world for such term or terms, on such conditions and in such manner as Lender shall in its sole discretion determine;

(2) Lender may (without assuming any obligations or liability thereunder), at any time and from time to time, enforce (and shall have the exclusive right to enforce) against any licensee or sublicensee all rights and remedies of Borrower in, to and under any Copyright Licenses, Patent Licenses or Trademark Licenses and take or refrain from taking any action under any thereof, and Borrower hereby releases Lender from, and agrees to hold Lender free and harmless from and against any claims arising out of, any lawful action so taken or omitted to be taken with respect thereto other than claims arising out of Lender's gross negligence or willful misconduct; and

(3) Upon request by Lender, Borrower will execute and deliver to Lender a power of attorney, in form and substance reasonably satisfactory to Lender for the implementation of any lease, assignment, license, sublicense, grant of option, sale or other disposition of a Copyright, Patent or Trademark. In the event of any such disposition pursuant to this clause 3, Borrower shall supply its know-how and expertise relating to the products or services made or rendered in connection with Patents, the manufacture and sale of the products bearing Trademarks, and its customer lists and other records relating to such Copyrights, Patents or Trademarks and to the distribution of said products, to Lender.

7.4 Borrower's Obligations Upon Default. Upon the request of Lender after the occurrence and during the continuance of an Event of Default, Borrower will:

(a) Assemble and make available to Lender the Collateral at such place(s) as Lender shall reasonably designate, segregating all Collateral so that each item is capable of identification; and

(b) Subject to the rights of any lessor, permit Lender, by Lender's officers, employees, agents and representatives, to enter any premises where any Collateral is located, to take possession of the Collateral, to complete the processing, manufacture or repair of any Collateral, and to remove the Collateral, or to conduct any public or private sale of the Collateral, all without any liability of Lender for rent or other compensation for the use of Borrower's premises.

ARTICLE 8—SPECIAL COLLATERAL PROVISIONS

8.1 Compromise and Collection. Borrower and Lender recognize that setoffs, counterclaims, defenses and other claims may be asserted by obligors with respect to certain of the Rights to Payment; that certain of the Rights to Payment may be or become uncollectible in whole or in part; and that the expense and probability of success of litigating a disputed Right to Payment may exceed the amount that reasonably may be expected to be recovered with respect to such Right to Payment. Borrower hereby authorizes Lender, after and during the continuance of an Event of Default, to compromise with the obligor, accept in full payment of any Right to Payment such amount as Lender shall negotiate with the obligor, or abandon any Right to Payment. Any such action by Lender shall be considered commercially reasonable so long as Lender acts in good faith based on information known to it at the time it takes any such action.

8.2 Performance of Borrower's Obligations. Without having any obligation to do so, upon reasonable prior notice to Borrower, Lender may perform or pay any obligation which Borrower has agreed to perform or pay under this Agreement, including, without limitation, the payment or discharge of taxes or Liens levied or placed on or threatened against the Collateral. In so performing or paying, Lender shall determine the action to be taken and the amount necessary to discharge such obligations. Borrower shall reimburse Lender on demand for any amounts paid by Lender pursuant to this Section, which amounts shall constitute Obligations secured by the Collateral and shall bear interest from the date of demand at the Default Rate.

8.3 Power of Attorney. For the purpose of protecting and preserving the Collateral and Lender's rights under this Agreement, Borrower hereby irrevocably appoints Lender, with full power of substitution, as its attorney-in-fact with full power and authority, after the occurrence and during the continuance of an Event of Default, to do any act which Borrower is obligated to do hereunder; to exercise such rights with respect to the Collateral as Borrower might exercise; to use such Inventory, Equipment, Fixtures or other property as Borrower might use; to enter Borrower's premises; to give notice of Lender's security interest in, and to collect the Collateral; and before or after Default, to execute and file in Borrower's name any financing statements, amendments and continuation statements necessary or desirable to perfect or continue the perfection of Lender's security interests in the Collateral. Borrower hereby ratifies all that Lender shall lawfully do or cause to be done by virtue of this appointment.

8.4 Authorization for Lender to Take Certain Action. The power of attorney created in Section 8.3 is a power coupled with an interest and shall be irrevocable. The powers conferred on Lender hereunder are solely to protect its interests in the Collateral and shall not impose any duty upon Lender to exercise such powers. Lender shall be accountable only for amounts that it actually receives as a result of the exercise of such powers and in no event shall Lender or any of its directors, officers, employees, agents or representatives be responsible to Borrower for any act or failure to act, except for gross negligence or willful misconduct. After the occurrence and during the continuance of an Event of Default, Lender may exercise this power of attorney without notice to or assent of Borrower, in the name of Borrower, or in Lender's own name, from time to time in Lender's sole discretion and at Borrower's expense. To further carry out the terms of this Agreement, after the occurrence and during the continuance of an Event of Default, Lender may:

(a) Execute any statements or documents or take possession of, and endorse and collect and receive delivery or payment of, any checks, drafts, notes, acceptances or other instruments and documents constituting Collateral, or constituting the payment of amounts due and to become due or any performance to be rendered with respect to the Collateral.

(b) Sign and endorse any invoices, freight or express bills, bills of lading, storage or warehouse receipts; drafts, certificates and statements under any commercial or standby letter of credit relating to Collateral; assignments, verifications and notices in connection with Accounts; or any other documents relating to the Collateral, including without limitation the Records.

(c) Use or operate Collateral or any other property of Borrower for the purpose of preserving or liquidating Collateral.

(d) File any claim or take any other action or proceeding in any court of law or equity or as otherwise deemed appropriate by Lender for the purpose of collecting any and all monies due or securing any performance to be rendered with respect to the Collateral.

(e) Commence, prosecute or defend any suits, actions or proceedings or as otherwise deemed appropriate by Lender for the purpose of protecting or collecting the Collateral. In furtherance of this right, upon the occurrence and during the continuance of an Event of Default, Lender may apply for the appointment of a receiver or similar official to operate Borrower's business.

(f) Prepare, adjust, execute, deliver and receive payment under insurance claims, and collect and receive payment of and endorse any instrument in payment of loss or returned premiums or any other insurance refund or return, and apply such amounts at Lender's sole discretion, toward repayment of the Obligations or replacement of the Collateral.

8.5 Application of Proceeds. Any Proceeds and other monies or property received by Lender pursuant to the terms of this Agreement or any Loan Document may be applied by Lender first to the payment of expenses of collection, including without limitation reasonable attorneys' fees, and then to the payment of the Obligations in such order of application as Lender may elect.

8.6 Deficiency. If the Proceeds of any disposition of the Collateral are insufficient to cover all costs and expenses of such sale and the payment in full of all the Obligations, plus all other sums required to be expended or distributed by Lender, then Borrower shall be liable for any such deficiency.

8.7 Lender Transfer. Upon the transfer of all or any part of the Obligations, Lender may transfer all or part of the Collateral and shall be fully discharged thereafter from all liability and responsibility with respect to such Collateral so transferred, and the transferee shall be vested with all the rights and powers of Lender hereunder with respect to such Collateral so transferred, but with respect to any Collateral not so transferred, Lender shall retain all rights and powers hereby given.

8.8 Lender's Duties.

(a) Lender shall use reasonable care in the custody and preservation of any Collateral in its possession. Without limitation on other conduct which may be considered the exercise of reasonable care, Lender shall be deemed to have exercised reasonable care in the custody and preservation of such Collateral if such Collateral is accorded treatment substantially equal to that which Lender accords its own property, it being understood that Lender shall not have any responsibility for ascertaining or taking action with respect to calls, conversions, exchanges, maturities, declining value, tenders or other matters relative to any Collateral, regardless of whether Lender has or is deemed to have knowledge of such matters; or taking any necessary steps to preserve any rights against any Person with respect to any Collateral. Under no circumstances shall Lender be responsible for any injury or loss to the Collateral, or any part thereof, arising from any cause beyond the reasonable control of Lender.

(b) Lender may at any time deliver the Collateral or any part thereof to Borrower and the receipt of Borrower shall be a complete and full acquittance for the Collateral so delivered, and Lender shall thereafter be discharged from any liability or responsibility therefor.

(c) Neither Lender, nor any of its directors, officers, employees, agents, attorneys or any other person affiliated with or representing Lender shall be liable for any claims, demands, losses or damages, of any kind whatsoever, made, claimed, incurred or suffered by Borrower or any other party through the ordinary negligence of Lender, or any of its directors, officers, employees, agents, attorneys or any other person affiliated with or representing Lender.

8.9 Termination of Security Interests. Upon the payment in full of the Obligations and satisfaction of all Borrower's obligations under this Agreement and the other Loan Documents, and if Lender has no further obligations under its Commitment, the security interest granted hereby shall terminate and all rights to the

Collateral shall revert to Borrower. Upon any such termination, the Lender shall, at Borrower's expense, execute and deliver to Borrower such documents as Borrower shall reasonably request to evidence such termination.

ARTICLE 9—GENERAL PROVISIONS

9.1 Notices. Any notice given by any party under any Loan Document shall be in writing and personally delivered, sent by overnight courier, or United States mail, postage prepaid, or sent by facsimile, or other authenticated message, charges prepaid, to the other party's or parties' addresses shown on the Supplement. Each party may change the address or facsimile number to which notices, requests and other communications are to be sent by giving written notice of such change to each other party. Notice given by hand delivery shall be deemed received on the date delivered; if sent by overnight courier, on the next Business Day after delivery to the courier service; if by first class mail, on the third Business Day after deposit in the U.S. Mail; and if by facsimile, on the date of transmission.

9.2 Binding Effect. The Loan Documents shall be binding upon and inure to the benefit of Borrower and Lender and their respective successors and assigns; provided, however, that Borrower may not assign or transfer Borrower's rights or obligations under any Loan Document. Lender reserves the right to sell, assign, transfer, negotiate or grant participations in all or any part of, or any interest in, Lender's rights and obligations under the Loan Documents. In connection with any of the foregoing, Lender may disclose all documents and information which Lender now or hereafter may have relating to the Loans, Borrower, or its business; provided that any person who receives such information shall have agreed in writing in advance to maintain the confidentiality of such information on terms reasonably acceptable to Borrower. It is the intention of the parties that, as a "venture capital operating company," each of Venture Lending & Leasing IV, LLC (the parent and sole owner of VLL4), and Venture Lending & Leasing V, LLC (the parent and sole owner of VLL5) (together, "LLC") shall have the benefit of, and the power to independently exercise, those "management rights" provided to Lender in Section 5.3. To that end, the references to Lender in Sections 4.2(f), 5.1, 5.2, 5.3 and 5.9(a) hereof shall include LLC, and LLC shall have the right to exercise the advisory, inspection, information and other rights given to lender under those Sections independently of Lender. No amendment or modification of this Agreement shall alter or diminish LLC's rights under the preceding sentence without the consent of LLC.

9.3 No Waiver. Any waiver, consent or approval by Lender of any Event of Default or breach of any provision, condition, or covenant of any Loan Document must be in writing and shall be effective only to the extent set forth in writing. No waiver of any breach or default shall be deemed a waiver of any later breach or default of the same or any other provision of any Loan Document. No failure or delay on the part of Lender in exercising any power, right, or privilege under any Loan Document shall operate as a waiver thereof, and no single or partial exercise of any such power, right, or privilege shall preclude any further exercise thereof or the exercise of any other power, right or privilege. Lender has the right at its sole option to continue to accept interest and/or principal payments due under the Loan Documents after default, and such acceptance shall not constitute a waiver of said default or an extension of the Maturity Date unless Lender agrees otherwise in writing.

9.4 Rights Cumulative. All rights and remedies existing under the Loan Documents are cumulative to, and not exclusive of, any other rights or remedies available under contract or applicable law.

9.5 Unenforceable Provisions. Any provision of any Loan Document executed by Borrower which is prohibited or unenforceable in any jurisdiction, shall be so only as to such jurisdiction and only to the extent of such prohibition or unenforceability, but all the remaining provisions of any such Loan Document shall remain valid and enforceable.

9.6 Accounting Terms. Except as otherwise provided in this Agreement, accounting terms and financial covenants and information shall be determined and prepared in accordance with GAAP.

9.7 Indemnification; Exculpation. Borrower shall pay and protect, defend and indemnify Lender and Lender's employees, officers, directors, shareholders, affiliates, correspondents, agents and representatives (other than Lender, collectively "Agents") against, and hold Lender and each such Agent harmless from, all claims, actions, proceedings, liabilities, damages, losses, expenses (including, without limitation, attorneys' fees and costs) and other amounts incurred by Lender and each such Agent, arising from (i) the matters contemplated by this Agreement or any other Loan Documents, (ii) any dispute between Borrower and a third party, or (iii) any contention that Borrower has failed to comply with any law, rule, regulation, order or directive applicable to Borrower's business; **provided, however**, that this indemnification shall not apply to any of the foregoing incurred solely as the result of Lender's or any Agent's gross negligence or willful misconduct. This indemnification shall survive the payment and satisfaction of all of Borrower's Obligations to Lender.

9.8 Reimbursement. Borrower shall reimburse Lender for all costs and expenses, including without limitation reasonable attorneys' fees and disbursements expended or incurred by Lender in any arbitration, mediation, judicial reference, legal action or otherwise in connection with (a) the preparation and negotiation of the Loan Documents, (b) the amendment and enforcement of the Loan Documents, including without limitation during any workout, attempted workout, and/or in connection with the rendering of legal advice as to Lender's rights, remedies and obligations under the Loan Documents, (c) collecting any sum which becomes due Lender under any Loan Document, (d) any proceeding for declaratory relief, any counterclaim to any proceeding, or any appeal, or (e) the protection, preservation or enforcement of any rights of Lender. For the purposes of this section, attorneys' fees shall include, without limitation, fees incurred in connection with the following: (1) contempt proceedings; (2) discovery; (3) any motion, proceeding or other activity of any kind in connection with an Insolvency Proceeding; (4) garnishment, levy, and debtor and third party examinations; and (5) postjudgment motions and proceedings of any kind, including without limitation any activity taken to collect or enforce any judgment. All of the foregoing costs and expenses shall be payable upon demand by Lender, and if not paid within forty-five (45) days of presentation of invoices shall bear interest at the highest applicable Default Rate.

9.9 Execution in Counterparts. This Agreement may be executed in any number of counterparts which, when taken together, shall constitute but one agreement.

9.10 Entire Agreement. The Loan Documents are intended by the parties as the final expression of their agreement and therefore contain the entire agreement between the parties and supersede all prior understandings or agreements concerning the subject matter hereof. This Agreement may be amended only in a writing signed by Borrower and Lender.

9.11 Governing Law and Jurisdiction.

(a) THIS AGREEMENT AND THE LOAN DOCUMENTS SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF CALIFORNIA.

(b) ANY LEGAL ACTION OR PROCEEDING WITH RESPECT TO THIS AGREEMENT OR ANY OTHER LOAN DOCUMENT MAY BE BROUGHT IN THE COURTS OF THE STATE OF CALIFORNIA OR OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF CALIFORNIA, AND BY EXECUTION AND DELIVERY OF THIS AGREEMENT, EACH OF BORROWER AND LENDER CONSENTS, FOR ITSELF AND IN RESPECT OF ITS PROPERTY, TO THE NON-EXCLUSIVE JURISDICTION OF THOSE COURTS. EACH OF BORROWER AND LENDER IRREVOCABLY WAIVES ANY OBJECTION, INCLUDING ANY OBJECTION TO THE LAYING OF VENUE OR BASED ON THE GROUNDS OF FORUM NON CONVENIENS, WHICH IT MAY NOW OR HEREAFTER HAVE TO THE BRINGING OF ANY ACTION OR PROCEEDING IN SUCH JURISDICTION IN RESPECT OF THIS AGREEMENT OR ANY DOCUMENT RELATED HERETO. BORROWER AND LENDER EACH WAIVE PERSONAL SERVICE OF ANY SUMMONS, COMPLAINT OR OTHER PROCESS, WHICH MAY BE MADE BY ANY OTHER MEANS PERMITTED BY CALIFORNIA LAW.

9.12 Waiver of Jury Trial. BORROWER AND LENDER EACH WAIVES ITS RESPECTIVE RIGHTS TO A TRIAL BY JURY OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF OR RELATED TO THIS AGREEMENT, THE OTHER LOAN DOCUMENTS, OR THE TRANSACTIONS CONTEMPLATED HEREBY OR THEREBY, IN ANY ACTION, PROCEEDING OR OTHER LITIGATION OF ANY TYPE BROUGHT BY ANY OF THE PARTIES AGAINST ANY OTHER PARTY OR ANY PARTICIPANT OR ASSIGNEE, WHETHER WITH RESPECT TO CONTRACT CLAIMS, TORT CLAIMS, OR OTHERWISE. BORROWER AND LENDER EACH AGREES THAT ANY SUCH CLAIM OR CAUSE OF ACTION SHALL BE TRIED BY A COURT TRIAL WITHOUT A JURY. WITHOUT LIMITING THE FOREGOING, THE PARTIES FURTHER AGREE THAT THEIR RESPECTIVE RIGHT TO A TRIAL BY JURY IS WAIVED BY OPERATION OF THIS SECTION AS

TO ANY ACTION, COUNTERCLAIM OR OTHER PROCEEDING WHICH SEEMS, IN WHOLE OR IN PART, TO CHALLENGE THE VALIDITY OR ENFORCEABILITY OF THIS AGREEMENT OR THE OTHER LOAN DOCUMENTS OR ANY PROVISION HEREOF OR THEREOF. THIS WAIVER SHALL APPLY TO ANY SUBSEQUENT AMENDMENTS, RENEWALS, SUPPLEMENTS OR MODIFICATIONS TO THIS AGREEMENT AND THE OTHER LOAN DOCUMENTS.

ARTICLE 10—DEFINITIONS

The definitions appearing in this Agreement or any Supplement shall be applicable to both the singular and plural forms of the defined terms:

"Account" means any "account," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest and, in any event, shall include, without limitation, all accounts receivable, book debts and other forms of obligations (other than forms of obligations evidenced by Chattel Paper, Documents or Instruments) now owned or hereafter received or acquired by or belonging or owing to Borrower (including, without limitation, under any trade name, style or division thereof) whether arising out of goods sold or services rendered by Borrower or from any other transaction, whether or not the same involves the sale of goods or services by Borrower (including, without limitation, any such obligation that may be characterized as an account or contract right under the UCC) and all of Borrower's rights in, to and under all purchase orders or receipts now owned or hereafter acquired by it for goods or services, and all of Borrower's rights to any goods represented by any of the foregoing (including, without limitation, unpaid seller's rights of rescission, replevin, reclamation and stoppage in transit and rights to returned, reclaimed or repossessed goods), and all monies due or to become due to Borrower under all purchase orders and contracts for the sale of goods or the performance of services or both by Borrower or in connection with any other transaction (whether or not yet earned by performance on the part of Borrower), now in existence or hereafter occurring, including, without limitation, the right to receive the proceeds of said purchase orders and contracts, and all collateral security and guarantees of any kind given by any Person with respect to any of the foregoing.

"Affiliate" means any Person which directly or indirectly controls, is controlled by, or is under common control with Borrower. "Control," "controlled by" and "under common control with" mean direct or indirect possession of the power to direct or cause the direction of management or policies (whether through ownership of voting securities, by contract or otherwise); provided, that control shall be conclusively presumed when any Person or affiliated group directly or indirectly owns five percent (5%) or more of the securities having ordinary voting power for the election of directors of a corporation.

"Agreement" means this Loan and Security Agreement and each Supplement thereto, as each may be amended or supplemented from time to time.

"Bankruptcy Code" means the Federal Bankruptcy Reform Act of 1978 (11 U.S.C. §101, et seq.), as amended.

"Basic Interest" means the fixed rate of interest payable on the outstanding balance of each Loan at the applicable Designated Rate.

"Borrowing Date" means the Business Day on which the proceeds of a Loan are disbursed by Lender.

"Borrowing Request" means a written request from Borrower in substantially the form of Exhibit "B" to the Supplement, requesting the funding of one or more Loans on a particular Borrowing Date.

"Business Day" means any day other than a Saturday, Sunday or other day on which commercial banks in New York City or San Francisco are authorized or required by law to close.

"**Chattel Paper"** means any "chattel paper," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Closing Date" means the date of this Agreement.

"Collateral" means all of Borrower's right, title and interest in and to the following property, whether now owned or hereafter acquired and wherever located: (a) all Receivables; (b) all Equipment; (c) all Fixtures; (d) all General Intangibles (subject to the exclusion described below with respect to Intellectual Property); (e) all Inventory; (f) all Investment Property; (g) all Deposit Accounts; (h) all other Goods and personal property of Borrower, whether tangible or intangible and whether now or hereafter owned or existing, leased, consigned by or to, or acquired by, Borrower and wherever located; (i) all

Records; and (j) all Proceeds of each of the foregoing and all accessions to, substitutions and replacements for, and rents, profits and products of each of the foregoing; provided, however, that the foregoing "Collateral" shall not include Intellectual Property.

"Commitment" means the obligation of Lender to make Loans to Borrower up to the aggregate principal amount set forth in the Supplement.

"Copyright License" means any written agreement granting any right to use any Copyright or Copyright registration now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Copyrights" means all of the following now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest: (i) all copyrights, whether registered or unregistered, held pursuant to the laws of the United States, any State thereof or of any other country; (ii) all registrations, applications and recordings in the United States Copyright Office or in any similar office or agency of the United States, any State thereof or any other country; (iii) all continuations, renewals or extensions thereof; and (iv) any registrations to be issued under any pending applications.

"Default" means an event which with the giving of notice, passage of time, or both would constitute an Event of Default.

"Default Rate" is defined in Section 2.7.

"Deposit Accounts" means any "deposit accounts," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Designated Rate" means the rate of interest per annum described in the Supplement as being applicable to an outstanding Loan from time to time.

"Documents" means any "documents," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"Environmental Laws" means all federal, state or local laws, statutes, common law duties, rules, regulations, ordinances and codes, together with all administrative orders, directed duties, requests, licenses, authorizations and permits of, and agreements with, any governmental authorities, in each case relating to environmental, health, or safety matters.

"Equipment" means any "equipment," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest and any and all additions, substitutions and replacements of any of the foregoing, wherever located, together with all attachments, components, parts, equipment and accessories installed thereon or affixed thereto.

"Event of Default" means any event described in Section 7.1.

"Fixtures" means any "fixtures," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

"GAAP" means generally accepted accounting principles and practices consistent with those principles and practices promulgated or adopted by the Financial Accounting Standards Board and the Board of the American Institute of Certified Public Accountants, their respective predecessors and successors. Each accounting term used but not otherwise expressly defined herein shall have the meaning given it by GAAP.

"General Intangibles" means any "general intangibles," as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest and, in any event, shall include, without limitation, all right, title and interest that Borrower may now or hereafter have in or under any contract, all customer lists, Copyrights, Trademarks, Patents, websites, domain names, and all applications therefor and reissues, extensions, or renewals thereof, other rights to Intellectual Property, interests in partnerships, joint ventures and other business associations, Licenses, permits, trade secrets, proprietary or confidential information, inventions (whether or not patented or patentable), technical information, procedures, designs, knowledge, know-how, software, data bases, data, skill, expertise, recipes, experience, processes, models, drawings, materials and records, goodwill (including, without limitation, the goodwill associated with any Trademark, Trademark registration or Trademark licensed under any Trademark License), claims in or under insurance policies, including unearned premiums, uncertificated securities, money, cash or cash equivalents, deposit, checking and other bank accounts, rights to sue for past, present and future infringement of Copyrights, Trademarks and Patents, rights to receive tax refunds and other payments and rights of indemnification.

“Goods” means any “goods,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

“Indebtedness” of any Person means at any date, without duplication and without regard to whether matured or unmatured, absolute or contingent: (i) all obligations of such Person for borrowed money; (ii) all obligations of such Person evidenced by bonds, debentures, notes, or other similar instruments; (iii) all obligations of such Person to pay the deferred purchase price of property or services, except trade accounts payable arising in the ordinary course of business; (iv) all obligations of such Person as lessee under capital leases; (v) all obligations of such Person to reimburse or prepay any bank or other Person in respect of amounts paid under a letter of credit, banker’s acceptance, or similar instrument, whether drawn or undrawn; (vi) all obligations of such Person to purchase securities which arise out of or in connection with the sale of the same or substantially similar securities; (vii) all obligations of such Person to purchase, redeem, exchange, convert or otherwise acquire for value any capital stock of such Person or any warrants, rights or options to acquire such capital stock, now or hereafter outstanding, except to the extent that such obligations remain performable solely at the option of such Person; (viii) all obligations to repurchase assets previously sold (including any obligation to repurchase any accounts or chattel paper under any factoring, receivables purchase, or similar arrangement); (ix) obligations of such Person under interest rate swap, cap, collar or similar hedging arrangements; and (x) all obligations of others of any type described in clause (i) through clause (ix) above guaranteed by such Person.

“Insolvency Proceeding” means (a) any case, action or proceeding before any court or other governmental authority relating to bankruptcy, reorganization, insolvency, liquidation, receivership, dissolution, winding-up or relief of debtors, or (b) any general assignment for the benefit of creditors, composition, marshalling of assets for creditors, or other, similar arrangement in respect of its creditors generally or any substantial portion of its creditors, undertaken under U.S. Federal, state or foreign law, including the Bankruptcy Code.

“Instruments” means any “instrument,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

“Intellectual Property” means all Copyrights, Trademarks, Patents, Licenses, trade secrets, source codes, customer lists, proprietary or confidential information, inventions (whether or not patented or patentable), technical information, procedures, designs, knowledge, know-how, software, data bases, skill, expertise, experience, processes, models, drawings, materials, records and goodwill associated with the foregoing.

“Intellectual Property Security Agreement” means any Intellectual Property Security Agreement executed and delivered by Borrower in favor of Lender, as the same may be amended, supplemented, or restated from time to time.

“Inventory” means any “inventory,” as such term is defined in the UCC, wherever located, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest, and, in any event, shall include, without limitation, all inventory, goods and other personal property that are held by or on behalf of Borrower for sale or lease or are furnished or are to be furnished under a contract of service or that constitute raw materials, work in process or materials used or consumed or to be used or consumed in Borrower’s business, or the processing, packaging, promotion, delivery or shipping of the same, and all finished goods, whether or not the same is in transit or in the constructive, actual or exclusive possession of Borrower or is held by others for Borrower’s account, including, without limitation, all goods covered by purchase orders and contracts with suppliers and all goods billed and held by suppliers and all such property first may be in the possession or custody of any carriers, forwarding agents, truckers, warehousemen, vendors, selling agents or other Persons.

“Investment Property” means any “investment property,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

“Letter of Credit Rights” means any “letter of credit rights,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest, including any right to payment under any letter of credit.

“License” means any Copyright License, Patent License, Trademark License or other license of rights or interests now held or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest and any renewals or extensions thereof.

“Lien” means any mortgage, deed of trust, pledge, hypothecation, assignment for security, security interest, encumbrance, levy, lien or charge of any kind, whether voluntarily incurred or arising by operation of law or otherwise, against any property, any conditional sale or other title retention agreement, any lease in the nature of a security interest, and the filing of any financing statement (other than a precautionary financing statement with respect to a lease that is not in the nature of a security interest) under the UCC or comparable law of any jurisdiction.

“Loan” means an extension of credit by Lender under this Agreement.

“Loan Documents” means, individually and collectively, this Loan and Security Agreement, each Supplement, each Note, the Intellectual Property Security Agreement, and any other security or pledge agreement(s), any Warrants issued by Borrower to Lender (or its designee) in connection with this Agreement, and all other contracts, instruments, addenda and documents executed in connection with this Agreement or the extensions of credit which are the subject of this Agreement.

“Material Adverse Effect” or “**Material Adverse Change**” means (a) a material adverse change in, or a material adverse effect upon, the operations, business, properties, or condition (financial or otherwise) of Borrower; (b) a material impairment of the ability of Borrower to perform under any Loan Document; or (c) a material adverse effect upon the legality, validity, binding effect or enforceability against Borrower of any Loan Document.

“Maturity Date” means, with regard to a Loan, the earlier of (i) its maturity by reason of acceleration, or (ii) its stated maturity date; and is the date on which payment of all outstanding principal, accrued interest, and the Terminal Payment with respect to such Loan is due.

“Note” means a promissory note substantially in the form attached to the Supplement as Exhibit “A”, executed by Borrower evidencing each Loan.

“Obligations” means all debts, obligations and liabilities of Borrower to Lender currently existing or now or hereafter made, incurred or created under, pursuant to or in connection with (i) this Agreement or any other Loan Document and (ii) the VLL4 Loan Agreement, in each case,, whether voluntary or involuntary and however arising or evidenced, whether direct or acquired by Lender by assignment or succession, whether due or not due, absolute or contingent, liquidated or unliquidated, determined or undetermined, and whether Borrower may be liable individually or jointly, or whether recovery upon such debt may be or become barred by any statute of limitations or otherwise unenforceable; and all renewals, extensions and modifications thereof; and all attorneys’ fees and costs incurred by Lender in connection with the collection and enforcement thereof as provided for in any Loan Document.

“Patent License” means any written agreement granting any right with respect to any invention on which a Patent is in existence now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

“Patents” means all of the following property now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest: (a) all letters patent of, or rights corresponding thereto in, the United States or any other country, all registrations and recordings thereof, and all applications for letters patent of, or rights corresponding thereto in, the United States or any other country, including, without limitation, registrations, recordings and applications in the United States Patent and Trademark Office or in any similar office or agency of the United States, any State thereof or any other country; (b) all reissues, continuations, continuations-in-part or extensions thereof; (c) all petty patents, divisionals, and patents of addition; and (d) all patents to be issued under any such applications.

“Permitted Lien” means

(a) Involuntary Liens which, in the aggregate, would not have a Material Adverse Effect and which in any event would not exceed, in the aggregate, the Threshold Amount;

(b) Liens for current taxes or other governmental or regulatory assessments which are not delinquent, or which are contested in good faith by the appropriate procedures and for which appropriate reserves are maintained;

(c) security interests on any property held or acquired by Borrower in the ordinary course of business securing Indebtedness incurred or assumed for the purpose of financing all or any part of the cost of acquiring such property; provided, that such Lien attaches solely to the property acquired with such Indebtedness and that the principal amount of such Indebtedness does not exceed one hundred percent (100%) of the cost of such property;

(d) Liens in favor of Lender;

(e) bankers' liens, rights of setoff and similar Liens incurred on deposits made in the ordinary course of business;

(f) materialmen's, mechanics', repairmen's, employees' or other like Liens arising in the ordinary course of business and which are not delinquent for more than 45 days or are being contested in good faith by appropriate proceedings;

(g) any judgment, attachment or similar Lien, unless the judgment it secures has not been discharged or execution thereof effectively stayed and bonded against pending appeal within 30 days of the entry thereof;

(h) exclusive and non-exclusive licenses of Intellectual Property;

(i) Liens which have been approved by Lender in writing prior to the Closing Date and are set forth on the Schedule of "Permitted Liens" attached hereto;

(j) Liens in favor of VLL4 granted pursuant to the VLL4 Loan Agreement;

(k) Liens securing Indebtedness permitted under Section 6.1(f) hereof; and

(l) Liens in favor of Bank (as defined in Section 6.1(g)) on the Credit Card Cash Collateral (hereinafter defined), securing the Indebtedness permitted under Section 6.1(g) hereof. **"Credit Card Cash Collateral"** means a certificate of deposit or time deposit account maintained at Bank in the principal amount of approximately $50,000 pledged by Borrower to Bank to secure Borrower's obligations to Bank under a corporate credit card program arranged by Bank for the account of Borrower.

"Person" means any individual, sole proprietorship, partnership, joint venture, trust, unincorporated organization, association, corporation, limited liability company, institution, public benefit corporation, other entity or government (whether federal, state, county, city, municipal, local, foreign, or otherwise, including any instrumentality, division, agency, body or department thereof).

"Proceeds" means "proceeds," as such term is defined in the UCC and, in any event, shall include, without limitation, (a) any and all Accounts, Chattel Paper, Instruments, cash or other forms of money or currency or other proceeds payable to Borrower from time to time in respect of the Collateral, (b) any and all proceeds of any insurance, indemnity, warranty or guaranty payable to Borrower from time to time with respect to any of the Collateral, (c) any and all payments (in any form whatsoever) made or due and payable to Borrower from time to time in connection with any requisition, confiscation, condemnation, seizure or forfeiture of all or any part of the Collateral by any governmental authority (or any Person acting under color of governmental authority), (d) any claim of Borrower against third parties (i) for past, present or future infringement of any Copyright, Patent or Patent License or (ii) for past, present or future infringement or dilution of any Trademark or Trademark License or for injury to the goodwill associated with any Trademark, Trademark registration or Trademark licensed under any Trademark License and (e) any and all other amounts from time to time paid or payable under or in connection with any of the Collateral.

"Qualified Public Offering" means the closing of a firmly underwritten public offering of Borrower's common stock with aggregate proceeds of not less than $20,000,000 (prior to underwriting expenses and commissions).

"Receivables" means all of Borrower's Accounts, Instruments, Documents, Chattel Paper, Supporting Obligations, and letters of credit and Letter of Credit Rights.

"Records" means all Borrower's computer programs, software, hardware, source codes and data processing information, all written documents, books, invoices, ledger sheets, financial information and statements, and all other writings concerning Borrower's business.

"Related Person" means any Affiliate of Borrower, or any officer, employee, director or equity security holder of Borrower or any Affiliate.

“Rights to Payment” means all Borrower’s accounts, instruments, contract rights, documents, chattel paper and all other rights to payment, including, without limitation, the Accounts, all negotiable certificates of deposit and all rights to payment under any Patent License, any Trademark License, or any commercial or standby letter of credit.

“Security Documents” means this Loan and Security Agreement, the Supplement hereto, the Intellectual Property Security Agreement, and any and all account control agreements, collateral assignments, chattel mortgages, financing statements, amendments to any of the foregoing and other documents from time to time executed or filed to create, perfect or maintain the perfection of Lender’s Liens on the Collateral.

“Supplement” means that certain supplement to the Loan and Security Agreement, as the same may be amended or restated from time to time, and any other supplements entered into between Borrower and Lender, as the same may be amended or restated from time to time.

“Supporting Obligations” means any “supporting obligations,” as such term is defined in the UCC, now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

“Terminal Payment” means, with respect to a Loan, an amount payable on the Maturity Date of such Loan in an amount equal to that percentage of the original principal amount of such Loan specified in the Supplement.

“Termination Date” has the meaning specified in the Supplement.

“Threshold Amount” has the meaning specified in the Supplement.

“Trademark License” means any written agreement granting any right to use any Trademark or Trademark registration now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest.

“Trademarks” means all of the following property now owned or hereafter acquired by Borrower or in which Borrower now holds or hereafter acquires any interest: (a) all trademarks, tradenames, corporate names, business names, trade styles, service marks, logos, other source or business identifiers, prints and labels on which any of the foregoing have appeared or appear, designs and general intangibles of like nature, now existing or hereafter adopted or acquired, all registrations and recordings thereof, and any applications in connection therewith, including, without limitation, registrations, recordings and applications in the United States Patent and Trademark Office or in any similar office or agency of the United States, any State thereof or any other country or any political subdivision thereof and (b) reissues, extensions or renewals thereof.

“UCC” means the Uniform Commercial Code as the same may, from time to time, be in effect in the State of California; provided, that in the event that, by reason of mandatory provisions of law, any or all of the attachment, perfection or priority of, or remedies with respect to, Lender’s Lien on any Collateral is governed by the Uniform Commercial Code as enacted and in effect in a jurisdiction other than the State of California, the term “UCC” shall mean the Uniform Commercial Code as enacted and in effect in such other jurisdiction solely for purposes of the provisions thereof relating to such attachment, perfection, priority or remedies and for purposes of definitions related to such provisions. Unless otherwise defined herein, terms that are defined in the UCC and used herein shall have the meanings given to them in the UCC.

“VLL4 Loan Agreement” means, collectively, that certain Loan and Security Agreement dated as of December 1, 2004, between Borrower and VLL4, together with all of the “Loan Documents” (as such term is defined therein).

[Signature page follows]

[Signature page to Loan and Security Agreement]

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

BORROWER:

ENTEROMEDICS INC.

By: /s/ Mark B. Knudson

Name: Mark B. Knudson

Title: President & CEO

LENDER:

VENTURE LENDING & LEASING IV, INC.

By: /s/ Ronald W. Swenson

Name: Ronald W. Swenson

Title: CEO

LENDER:

VENTURE LENDING & LEASING V, INC.

By: /s/ Ronald W. Swenson

Name: Ronald W. Swenson

Title: CEO

[Schedules to Loan and Security Agreement follow]

Schedule 6.1 – Indebtedness

None.

Schedule of Permitted Liens

None.

SUPPLEMENT
to the
Loan and Security Agreement
Dated as of May 17, 2007
between
EnteroMedics Inc. (“Borrower”)
and
Venture Lending & Leasing IV, Inc. (“VLL4”)
and
Venture Lending & Leasing V, Inc. (“VLL5”)
(each of VLL4 and VLL5, as “Lender”)

This is a Supplement identified in the document entitled Loan and Security Agreement dated as of May 17, 2007, between Borrower and Lender (the **“Loan and Security Agreement”**). All capitalized terms used in this Supplement and not otherwise defined in this Supplement have the meanings ascribed to them in Section 10 of the Loan and Security Agreement, which is incorporated in its entirety into this Supplement. In the event of any inconsistency between the provisions of that document and this Supplement, this Supplement is controlling.

The parties are entering into this single Supplement to the Loan and Security Agreement for convenience, and this Supplement is and shall be interpreted for all purposes as separate and distinct agreements between Borrower and VLL4, on the one hand, and Borrower and VLL5, on the other hand, and nothing in this Supplement shall be deemed a joint venture, partnership or other association between VLL4 and VLL5. Each reference in this Supplement to “Lender” shall mean and refer to each of VLL4 and VLL5, singly and independent of one another. Without limiting the generality of the foregoing, the Commitment, covenants and other obligations of “Lender” under the Loan and Security Agreement, as supplemented hereby, are several and not joint obligations of VLL4 and VLL5, and all rights and remedies of “Lender” under the Loan and Security Agreement, as supplemented hereby, may be exercised by VLL4 and/or VLL5 independently of one another.

In addition to the provisions of the Loan and Security Agreement, the parties agree as follows:

Part 1.—Additional Definitions:

“Commitment” means, as the context may require, the VLL4 Commitment or the VLL5 Commitment. Each Lender’s Commitment is several and not joint with the Commitment of the other Lender.

“Cash Equivalents” means, as of any date of determination, the following assets or rights of Borrower: (i) marketable direct obligations issued or unconditionally guaranteed by the United States government having maturities of not more than 12 months from the date of acquisition; and (ii) domestic certificates of deposit and time deposits having maturities of not more than 12 months from the date of acquisition, and overnight bank deposits, in each case issued by a commercial bank organized under the laws of the United States or any state thereof which at the time of acquisition are rated A-1 or better by Standard & Poor’s Corporation (or equivalent), and not subject to any offset rights in favor of such bank arising from any banking relationship with such bank.

“Designated Rate” means, for each Growth Capital Loan, a fixed rate of interest per annum equal to the Prime Rate as published on the Business Day on which Lender prepares the Note for such Loan following Borrower’s submission of the Borrowing Request therefor, plus two percent (2.00%); provided, however, that in no event shall the Designated Rate for a Growth Capital Loan be less than ten and one-quarter of one percent (10.25%).

“Four Months’ Expenses” means, as of any date of determination the aggregate dollar amount of operating and other expenses paid and accrued and cash expended (without duplication) by Borrower during the four calendar months most recently ended.

“Growth Capital Loan” means any Loan requested by Borrower and funded by Lender under its Commitment for general corporate purposes of Borrower. Growth Capital Loans are sometimes referred to herein individually as a **“Loan”** or collectively as **“Loans”**.

“Interest-Only Rate”: The Interest-Only Rate for each Growth Capital Loan shall be a fixed rate of interest per annum equal to the Prime Rate as published on the Business Day on which Lender prepares the Note for such Loan, plus four and 23/100 percent (4.23%); provided, however, that in no event shall the Interest-Only Rate for a Growth Capital Loan be less than twelve and 48/100 percent (12.48%).

“Prime Rate” means the “prime rate” of interest, as published from time to time by The Wall Street Journal in the “Money Rates” section of its Western Edition newspaper.

“Terminal Payment”: Each Growth Capital Loan shall have a Terminal Payment equal to three and one-tenth of one percent (3.1%) of the original principal amount of such Loan.

“Termination Date”: The Termination Date is the earlier of: (i) the date Lender may terminate making Loans or extending other credit pursuant to the rights of Lender under Article 7 of the Loan and Security Agreement, or (ii)(A) *with respect to the First Tranche of the Commitment*, May 25, 2007; and (B) *with respect to the Second Tranche of the Commitment*, August 31, 2007.

“Threshold Amount” means Fifty Thousand Dollars ($50,000).

“Unrestricted Cash” means, as of any date of determination, Borrower’s cash on hand and Cash Equivalents which are not subject to a Lien of any Person other than Lender.

“VLL4 Commitment”: Subject to the terms and conditions set forth in the Loan and Security Agreement and this Supplement, VLL4 commits to make Growth Capital Loans to Borrower up to the aggregate original principal amount of Five Million Dollars ($5,000,000) for general corporate purposes. The VLL4 Commitment shall be divided into two equal tranches in the amount of Two Million Five Hundred Thousand Dollars ($2,500,000) each, which shall be referred to herein as the “**First Tranche**” and the “**Second Tranche**”, respectively, of the VLL4 Commitment.

“VLL5 Commitment”: Subject to the terms and conditions set forth in the Loan and Security Agreement and this Supplement, VLL5 commits to make Growth Capital Loans to Borrower up to the aggregate original principal amount of Five Million Dollars ($5,000,000) for general corporate purposes. The VLL5 Commitment shall be divided into two equal tranches in the amount of Two Million Five Hundred Thousand Dollars ($2,500,000) each, which shall be referred to herein as the “**First Tranche**” and the “**Second Tranche**”, respectively, of the VLL5 Commitment.

Part 2.—Additional Covenants and Conditions:

1. Commitment; Use of Proceeds; Limitations on Loans.

(a) Growth Capital Loans. Subject to the terms and conditions of the Loan and Security Agreement and this Supplement, Lender agrees to make Growth Capital Loans to Borrower from time to time from the Closing Date up to and including the applicable Termination Date in an aggregate original principal amount up to but not exceeding the then unfunded portion of Lender’s Commitment. Borrowing Request(s) for Growth Capital Loans shall be applied first to the First Tranche of Lender’s Commitment until either (i) the First Tranche has been fully utilized or (ii) the Termination Date of the First Tranche has occurred; then such Borrowing Request(s) for Growth Capital Loans shall be applied against the Second Tranche of Lender's Commitment until either (i) the Second Tranche has been fully utilized or (ii) the Termination Date of the Second Tranche has occurred. The proceeds of each Growth Capital Loan shall be used by Borrower for general corporate purposes.

(b) Minimum Funding Amount. Except to the extent the remaining Commitment is a lesser amount, any Growth Capital Loans requested by Borrower to be made on a single Business Day shall be for a minimum aggregate principal amount of Two Million Five Hundred Thousand Dollars ($2,500,000). Borrower shall not submit a Borrowing Request for Loans more frequently than once each calendar month.

(c) Repayment of Growth Capital Loans. Principal of and interest on each Growth Capital Loan shall be payable as set forth in a Note (substantially in the form of Exhibit "A" hereto) evidencing such Loan, which Note shall provide substantially as follows: principal and interest at the Designated Rate shall be fully amortized over a period of 30 months in equal, monthly installments, commencing after an initial 6-month period of interest-only, monthly payments. In particular, on the Borrowing Date applicable to the Growth Capital Loan evidenced by such Note, Borrower shall pay to Lender (i) *if the Borrowing Date is not the first day of the month* interest only at the Interest-Only Rate, in advance, on the outstanding principal balance of the Loan evidenced by such Note, for the period from such Borrowing Date through the last day of the calendar month in which such Borrowing Date occurs, and (ii) a first (1st) interest only installment at the Interest-Only Rate, in advance, on the outstanding principal balance of the Note for the ensuing month. Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall pay interest only at the Interest-Only Rate, in advance, on the outstanding principal balance of this Note for the ensuing month. Commencing on the first day of the seventh full calendar month after the Borrowing Date, and continuing on the first day of each consecutive calendar month thereafter, principal and interest at the Designated Rate shall be payable, in advance, in 30 equal consecutive installments in an amount sufficient to fully amortize the Loan evidenced by such Note. Borrower shall pay the Terminal Payment on the date of the last amortization payment.

2. Voluntary Prepayment. No Loan may be voluntarily prepaid except as provided in this Section 2. Borrower may voluntarily prepay all, but not less than all, Loans in whole, but not in part, at any time by tendering to Lender cash payment in respect of such Loans in an amount equal to: (i) all accrued and unpaid Basic Interest on such Loans as of the date of prepayment; (ii) the Terminal Payments on such Loans; and (iii) an amount equal to the undiscounted, total amount of all installment payments of principal and Basic Interest that would have accrued and been payable from the date of prepayment through the stated Maturity Date of the Loans had such Loans remained outstanding and been paid in accordance with the terms of the related Notes.

3. Subordination of Debt. During the term of the Loan and Security Agreement and until performance of all Obligations to Lender, Borrower shall not incur any Indebtedness for new borrowed money (except for Indebtedness permitted under Section 6.1 of the Loan and Security Agreement) after the date hereof unless approved by Lender and where the holder's right to repayment of such Indebtedness, the priority of any Lien securing the same, and the rights of the holder thereof to enforce remedies against Borrower following default have been made subordinate to the Liens of Lender and the prior payment of the Obligations to Lender under the Loan Documents pursuant to a written subordination agreement approved by Lender in its sole discretion in writing, which agreement may provide that regularly scheduled payments of accrued interest on such subordinated Indebtedness may be paid by Borrower and retained by the holder so long as no Event of Default has occurred.

4. Issuance of Warrants.

(a) As additional consideration for the making of its Commitment, VLL4 or its assignee has earned and shall have received, upon the execution hereof and as a condition to the initial Loan, a warrant instrument issued by Borrower (the **"VLL4 Warrant"**), initially exercisable for 309,231 fully paid and nonassessable shares of Borrower's Series C Preferred Stock at an initial exercise price of $0.8893 per share (the **"Stock Purchase Price"**); provided, however, that such initial number of shares of Series C Preferred Stock issuable under the VLL4 Warrant at the Stock Purchase Price shall be increased automatically from time to time by that number of additional shares determined by dividing (i) the product of (A) 0.055 and (B) the aggregate original principal amount of the Growth Capital Loans funded by VLL4 by (ii) the Stock Purchase Price.

(b) As additional consideration for the making of its Commitment, VLL5 or its assignee has earned and shall have received, upon the execution hereof and as a condition to the initial Loan, a warrant instrument issued by Borrower (the **"VLL5 Warrant"** and together with the VLL4 Warrant, the **"Warrants"**), initially exercisable for 309,231 fully paid and nonassessable shares of Borrower's Series C Preferred Stock at an initial exercise price per share equal to the Stock Purchase Price; provided, however, that such initial number of shares of Series C Preferred Stock issuable under the VLL5 Warrant at the Stock Purchase Price shall be increased automatically from time to time by that number of additional shares determined by dividing (i) the product of (A) 0.055 and (B) the aggregate original principal amount of the Growth Capital Loans funded by VLL5 by (ii) the Stock Purchase Price.

(c) The Warrants shall be in substantially the form attached hereto as Exhibit "E" and immediately vested and exercisable at any time and from time to time through August 31, 2014. The foregoing exercise price per share and number of shares issuable upon exercise of the Warrants shall also be subject to adjustment as provided in the Warrants. The Warrants shall include piggyback and S-3 registration rights, anti-dilution protections reasonably satisfactory to Lender and equivalent to those rights and protections granted to the holders of Borrower's Series C Preferred Stock, and shall remain exercisable beyond any public offering of Borrower's securities or merger transaction. Borrower acknowledges that: (i) VLL4 has assigned its rights to receive the VLL4 Warrant to its parent, Venture Lending & Leasing IV, LLC; and (ii) VLL5 has assigned its rights to receive the VLL5 Warrant to its parent, Venture Lending & Leasing V, LLC. In connection therewith, Borrower shall issue the VLL4 Warrant directly to Venture Lending & Leasing IV, LLC, and Borrower shall issue the VLL5 Warrant directly to Venture Lending & Leasing V, LLC. Upon request of Borrower, Lender shall furnish to Borrower a copy of the agreement in which Lender assigned its Warrant to its parent.

5. Lien on Intellectual Property. In reliance on Borrower's covenant in Section 6.2 of the Loan and Security Agreement to keep all of its Intellectual Property assets free and clear of Liens other than as set forth in Section 6.2, Lender has agreed initially to exclude Intellectual Property from the Collateral over which Borrower has granted to Lender a Lien to secure the Obligations. Borrower agrees that if at any time the ratio of its Unrestricted Cash to Four Months' Expenses is less than one-to-one (1:1), then the definition of Collateral in Article 10 of the Loan and Security Agreement shall be automatically and immediately, without any further action or writing required by the parties, amended to delete the final *proviso* thereof, such that all of Borrower's Intellectual Property then owned and thereafter arising or acquired becomes part of the Collateral for all purposes of the Loan and Security Agreement. In the event the definition of Collateral has been amended as set forth in this Section 5 and no Event of Default has occurred and is then continuing, Borrower shall be able to continue to license, exclusively and non-exclusively, its Intellectual Property to other Persons in the ordinary course of its business, on terms consistent with industry practice, for fair consideration and with the consent of Borrower's Board of Directors. Borrower and Lender agree to execute and deliver, at Borrower's sole cost and expense, all documents and instruments necessary to perfect such Lien when it is created, including an Intellectual Property Security Agreement, substantially the form attached hereto as Exhibit "D". For clarity, the Intellectual Property Security Agreement will not be executed and delivered until such time as the Lender's security interest includes Intellectual Property in accordance with the terms of this Section 5. Lender agrees that if at any time after its security interest includes Intellectual Property the ratio of Borrower's Unrestricted Cash to Four Months' Expenses is greater than one-to-one (1:1) then the Lender's Lien as to that portion of the Collateral consisting of Intellectual Property shall be automatically and immediately, without any further action or writing required by the parties, released and the definition of Collateral in Article 10 of the Loan and Security Agreement shall be automatically and immediately, without any further action or writing required by the parties, amended to restate the final *proviso* thereof, such that the Collateral shall no longer include Borrower's Intellectual Property (subject to further amendment if at any time after such restatement the ratio of its Unrestricted Cash to Four Months' Expenses is less than one-to-one (1:1)).

6. Forbearance of Exercise of Remedies Against Intellectual Property.

(a) Notwithstanding anything to the contrary contained in Article 7 and 8 of the Loan and Security Agreement or elsewhere in the Loan Documents, following the occurrence and during the continuance of an Event of Default, other than an Event of Default under Section 7.1(c) of the Loan and Security Agreement involving a voluntary Insolvency Proceeding or dissolution of Borrower or termination of Borrower's business, or an Event of Default under Section 7.1(f) or (h) of the Loan and Security Agreement, if at such time Lender has a Lien on Intellectual Property pursuant to Section 5 above, Lender agrees to forbear from selling, leasing, licensing or otherwise disposing of any Collateral comprising Intellectual Property for a period of up to sixty (60) days after the occurrence of such Event of Default (such period being referred to herein as a "Forbearance Period"), provided that at all times during the Forbearance Period:

(i) Borrower shall continue to have a duly constituted and acting board of directors, and executive management working on a full time basis for Borrower;

(ii) Borrower is able to demonstrate to the reasonable satisfaction of Lender that Borrower is exercising on a continuous and diligent basis reasonable commercial efforts to consummate a financing or other transaction that will enable it to satisfy and discharge its Obligations to Lender;

(iii) Borrower shall cooperate with Lender in its exercise of rights under Sections 5.3(a)(i), 5.3(b) and 5.9(a) of the Loan and Security Agreement;

(iv) No Insolvency Proceeding is commenced by or against Borrower; and

(v) No Person who holds or acquires a Lien on or against all or any material portion of Borrower's Intellectual Property actually exercises foreclosure or similar remedies against such property.

Subject to paragraph (b) below, upon the failure of Borrower to comply with any of the conditions described in clauses (i) through (v) above, the Forbearance Period shall immediately and automatically terminate and Lender may thereupon commence, continue and complete any exercise of its rights and remedies against Intellectual Property Collateral, all as provided in the Loan Documents and under applicable law.

(b) If during the Forbearance Period, Lender proposes or arranges a private or public sale of all or a material portion of the Intellectual Property Collateral (which sale shall not be consummated during the Forbearance Period), Lender shall give notice of such proposed sale to Borrower, including notice of the minimum price to be paid or bid in such sale. If Borrower's Board of Director determines in good faith that the proposed sale would not be commercially reasonable, then Borrower may, within ten (10) Business Days of receipt of the initial notice from Lender, deliver a written objection, following which the parties agree to meet promptly and to confer in good faith to resolve any disagreements as to value or the proposed sale. Unless the parties have otherwise agreed as a result of such meet-and-confer, Borrower shall obtain, at its sole expense, within sixty (60) days after the initial notice from Lender, a written appraisal of the orderly liquidation value of the Intellectual Property, prepared by a recognized, independent appraiser with experience evaluating similar types of property (in which event, the sixty (60)-day limitation on the Forbearance Period shall be extended if, and only as, necessary to afford Borrower the full sixty (60) days to obtain such appraisal). If such appraisal is not timely delivered, or if the value concluded by the independent appraisal is not more than one hundred twenty percent (120%) of the minimum price or bid in any transaction proposed by Lender for the same Intellectual Property Collateral, then Lender may proceed with the proposed transaction (but not sooner than one hundred twenty (120) days after the occurrence of an Event of Default unless Borrower approves otherwise) on price terms not materially more favorable to the transferee than originally proposed by Lender. If the value concluded by the independent appraisal is more than one hundred twenty percent (120%) of the minimum price or bid in any transaction proposed by Lender, then the sixty (60)-day limitation on the Forbearance Period (as may have been extended for the appraisal as aforesaid) shall be extended and the parties shall cooperate with one another to realize the higher valuation, provided that if the Forbearance Period (as so extended) terminates for any reason other than that set forth in clause (ii) of paragraph (a) above, Lender may thereupon commence, continue and complete any exercise of its rights and remedies against Intellectual Property

Collateral, all as provided in the Loan Documents and under applicable law, and in all events, Lender shall be free to enforce such rights and remedies and complete one or more sales or other dispositions of the Intellectual Property after the earlier of (i) one hundred eighty (180) days after the occurrence of the Event of Default, or (ii) one hundred twenty (120) days after the delivery of the appraisal report to Borrower.

(c) At any time during the Forbearance Period, Lender will discontinue and forbear from enforcing its rights and remedies against the Collateral upon tender to Lender by Borrower or by another Person for its account all amounts payable under Section 2 of Part 2 hereunder.

7. Completion of Due Diligence; Payment and Disposition of Commitment Fee. As an additional condition precedent under Section 4.1 of the Loan and Security Agreement, Lender shall have completed to its satisfaction its due diligence review of Borrower's business and financial condition and prospects, and Lender's investment committee shall have approved its Commitment. If this condition is not satisfied, the One Hundred Thousand Dollars ($100,000) commitment fee (the **"Commitment Fee"**) previously paid by Borrower shall be refunded. Each Lender agrees that with respect to each Growth Capital Loan advanced by it under its Commitment, on the Borrowing Date applicable to such Loan, such Lender shall credit against the payments due from Borrower on such date in respect of such Loan an amount equal to the product of Fifty Thousand Dollars ($50,000) and a fraction the numerator of which is the principal amount of such Loan and the denominator of which is Five Million Dollars ($5,000,000), until the aggregate amount of such credits by such Lender equals but does not exceed Fifty Thousand Dollars ($50,000). Except as set forth in this section, the Commitment Fee is not refundable.

8. Debits to Account for ACH Transfers. For purposes of Section 2.2 and 5.10 of the Loan and Security Agreement, Borrower's Primary Operating Account is:

Wells Fargo Bank
430 N. Wabasha St., Suite 302, St. Paul, MN 55101
Routing No.: xxxxx
Account No.: xxxxx
For Further Credit to: EnteroMedics Inc.
Contact: Charlie Roehl
Phone: 651-205-9658
Email: Charles.Roehl@wellsfargo.com

Loans will be advanced to the account specified above and payments will be automatically debited from the same account.

9. Documentation Fee Payment. Pursuant to Section 9.8(a) of the Loan and Security Agreement, Borrower shall pay to Lender, on demand, Lender's reasonable and actual attorneys' fees, costs and expenses incurred and expended in connection with the preparation and negotiation of the Loan Documents, and shall reimburse Lender for Lender's out-of-pocket costs of perfecting its Liens against Collateral.

<u>Part 3.—Additional Representations</u>:

Borrower represents and warrants that as of the Closing Date and each Borrowing Date:

a) Its chief executive office is located at: 2800 Patton Road, St. Paul, MN 55113.

b) Its Equipment is located at: same as above.

c) Its Inventory is located at: same as above.

d) Its Records are located at: same as above.

e) In addition to its chief executive office, Borrower maintains offices or operates its business at the following locations: None.

f) Other than its full corporate name, Borrower has conducted business using the following trade names or fictitious business names: Beta Medical.

g) Borrower's Delaware state corporation I.D. number is 3832130.

h) Borrower's federal tax identification number is 48-1293684.

i) **Borrower's Other Deposit and Investment Accounts:** In addition to Borrower's Primary Operating Account at Wells Fargo Bank identified above, Borrower maintains to following other deposit and investment accounts:

1. Institution: Wells Fargo Institutional Brokerage & Sales
   Address: 608 Second Avenue North, 10th Floor, Minneapolis, MN 55479-0145
   Account Type: securities
   Account No.: xxxxx
   Contact: Shale Nyberg
   Phone: 612-667-4659
   Email: shale.a.nyberg@wellsfargo.com

2. Institution: Silicon Valley Bank Asset Management
   Address: 185 Berry Street, Lobby 1, Suite 3000, San Francisco, CA 94107
   Account type: securities
   Account No.: xxxxx
   Contact: Sonia Calvo
   Phone: 415-512-4267
   Email: scalvo@svb.com

Part 4.—Additional Loan Documents:

Form of Note	Exhibit "A"
Form of Borrowing Request	Exhibit "B"
Form of Compliance Certificate	Exhibit "C"
Form of Intellectual Property Security Agreement	Exhibit "D"
Form of Warrant	Exhibit "E"
Form of Legal Opinion	Exhibit "F"

[*Signature page follows.*]

[Signature Page to Supplement to Loan and Security Agreement]

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

BORROWER:

ENTEROMEDICS INC.

By: /s/ Mark B. Knudson
Name: Mark B. Knudson
Title: President & CEO

Address for Notices:

Attn: Mark B. Knudson
2800 Patton Road
St. Paul, MN 55113
Fax #: 651-789-2758

LENDER:

VENTURE LENDING & LEASING IV, INC.

By: /s/ Ronald W. Swenson
Name: Ronald W. Swenson
Title: CEO

Address for Notices:

Attn: Chief Financial Officer
2010 North First Street, Suite 310
San Jose, California 95131
Fax #: (408) 436-8625

LENDER:

VENTURE LENDING & LEASING V, INC.

By: /s/ Ronald W. Swenson
Name: Ronald W. Swenson
Title: CEO

Address for Notices:

Attn: Chief Financial Officer
2010 North First Street, Suite 310
San Jose, California 95131
Fax #: (408) 436-8625

EXHIBIT "A"

FORM OF PROMISSORY NOTE
(Growth Capital Loans)

[Note No. X-XXX**]**

$______ ___________, 2004
San Jose, California

The undersigned ("Borrower") promises to pay to the order of VENTURE LENDING & LEASING **[IV/V]**, INC., a Maryland corporation ("Lender"), at its office at 2010 North First Street, Suite 310, San Jose, California 95131, or at such other place as Lender may designate in writing, in lawful money of the United States of America, the principal sum of ___________ Dollars ($______), with Basic Interest thereon from the date hereof until maturity, whether scheduled or accelerated, at a fixed rate per annum equal to **[the Prime Rate (as defined in the Loan Agreement referred to below) as published on the Business Day on which Lender prepares this Note following Borrower's submission of the Borrowing Request therefor, plus 2.00% but not less than 10.25%)** (the "Designated Rate"), except as otherwise provided herein, according to the payment schedule described herein, and a Terminal Payment in the sum of **[3.10% of face amount of Loan]** Dollars ($______) payable on the Maturity Date.

This Note is one of the Notes referred to in, and is entitled to all the benefits of, a Loan and Security Agreement dated as of May __, 2007, between Borrower and Lender (as amended, restated and supplemented from time to time, the "Loan Agreement"). Each capitalized term not otherwise defined herein shall have the meaning set forth in the Loan Agreement. The Loan Agreement contains provisions for the acceleration of the maturity of this Note upon the happening of certain stated events.

Principal of and interest on this Note shall be payable as follows:

On the Borrowing Date, Borrower shall pay **[***if the Borrowing Date is not the first day of the month* interest at a rate equal to **[the Prime Rate as published on the Business Day on which Lender prepares this Note plus 4.23%, but in no event less than 12.48%]**, in advance, on the outstanding principal balance of this Note for the period from the Borrowing Date through __**[the last day of the same month]**____; and (ii)**]** interest only at a rate equal to **[the Prime Rate as published on the Business Day on which Lender prepares this Note plus 4.23%, but in no event less than 12.48%]** (the "Interest-Only Rate") in advance, on the outstanding principal balance of this Note in the amount of $______ for the month of **[date of first regular interest only payment]**.

Commencing on the first day of the second full month after the Borrowing Date, and continuing on the first day of the third through the sixth full months after the Borrowing Date, Borrower shall make payments, in advance, of interest only at the Interest-Only Rate on the principal balance outstanding hereunder in the amount of $______ each.

Commencing on the first day of the seventh full month after the Borrowing Date, and continuing on the first day of each consecutive month thereafter, principal and Basic Interest at the Designated Rate shall be payable, in advance, in thirty (30) equal consecutive installments of ___________ Dollars ($______) each. The Terminal Payment and unpaid expenses, fees, interest and principal amount shall be due and payable on ___________ 200__.]

This Note may be voluntarily prepaid only as permitted under Section 2 of Part 2 of the Supplement to the Loan Agreement.

Any unpaid payments of principal or interest on this Note shall bear interest from their respective maturities, whether scheduled or accelerated, at a rate per annum equal to the Default Rate. Borrower shall pay such interest on demand.

Interest, charges and fees shall be calculated for actual days elapsed on the basis of a 360-day year, which results in higher interest, charge or fee payments than if a 365-day year were used. In no event shall Borrower be obligated to pay interest, charges or fees at a rate in excess of the highest rate permitted by applicable law from time to time in effect.

If Borrower is late in making any payment under this Note by more than five (5) Business Days, Borrower agrees to pay a "late charge" of five percent (5%) of the installment due, but not less than fifty dollars ($50.00) for any one such delinquent payment. This late charge may be charged by Lender for the purpose of defraying the expenses incidental to the handling of such delinquent amounts. Borrower acknowledges that such late charge represents a reasonable sum considering all of the circumstances existing on the date of this Note and represents a fair and reasonable estimate of the costs that will be sustained by Lender due to the failure of Borrower to make timely payments. Borrower further agrees that proof of actual damages would be costly and inconvenient. Such late charge shall be paid without prejudice to the right of Lender to collect any other amounts provided to be paid or to declare a default under this Note or any of the other Loan Documents or from exercising any other rights and remedies of Lender.

This Note shall be governed by, and construed in accordance with, the laws of the State of California, without regard to its conflict of laws provisions.

ENTEROMEDICS INC.

By: ______________________________
Name: ______________________________
Its: ______________________________

EXHIBIT "B"

FORM OF BORROWING REQUEST

[Date]

Venture Lending & Leasing **[IV/V]**, Inc.
2010 North First Street, Suite 310
San Jose, CA 95131

Re: EnteroMedics Inc.

Ladies and Gentlemen:

Reference is made to the Loan and Security Agreement dated as of May __, 2007 (as amended, restated and supplemented from time to time, the "Loan Agreement", the capitalized terms used herein as defined therein), between Venture Lending & Leasing **[IV/V]**, Inc. ("Lender") and EnteroMedics Inc. (the "Company").

The undersigned is the __________ of the Company, and hereby requests on behalf of the Company a Loan under the Loan Agreement, and in that connection certifies as follows:

1. The amount of the proposed Loan is __________ and __/100 Dollars ($______). The Borrowing Date of the proposed Loan is __________, 200__.

2. As of this date, no Default or Event of Default has occurred and is continuing, or will result from the making of the proposed Loan, the representations and warranties of the Company contained in Article 3 of the Loan Agreement are true and correct in all material respects, and the conditions precedent described in Article 4 of the Loan Agreement have been met.

3. No event that has had or could reasonably be expected to have a Material Adverse Change has occurred.

4. The Company's most recent financial projections dated __________, as approved by the Company's Board of Directors on __________, are enclosed herewith unless such financial projections have been previously furnished to Lender.

The Company shall notify you promptly before the funding of the Loan if any of the matters to which I have certified above shall not be true and correct on the Borrowing Date.

Very truly yours,

EnteroMedics Inc.

Name: ______________________________
Title:* ______________________________

* Must be executed by Company's Chief Financial Officer or other executive officer.

EXHIBIT "C"

COMPLIANCE CERTIFICATE

Venture Lending & Leasing **[IV/V]**, Inc.
2010 North First Street, Suite 310
San Jose, CA 95131

Re: EnteroMedics Inc.

Ladies and Gentlemen:

Reference is made to the Loan and Security Agreement dated as of May __, 2007 (as amended, restated and supplemented from time to time, the "Loan Agreement", the capitalized terms used herein as defined therein), between Venture Lending & Leasing **[IV/V]**, Inc. and EnteroMedics Inc. (the "Company").

The undersigned authorized representative of the Company hereby certifies that in accordance with the terms and conditions of the Loan Agreement, (i) no Event of Default has occurred and is continuing as of the date hereof, and (ii) the Company is in complete compliance for the financial reporting period ending __________ with all required financial reporting and financial tests under the Loan Agreement, except as noted below. Attached herewith are the required documents supporting the foregoing certification. The undersigned further certifies that the accompanying financial statements have been prepared in accordance with Generally Accepted Accounting Principles (except for the omission of footnotes on the unaudited Interim Financial Statements), and are consistent from one period to the next, except as explained below.

Indicate compliance status by circling Yes/No under "Complies"

REPORTING REQUIREMENT	REQUIRED	COMPLIES
Interim Financial Statements	Monthly within 30 days	YES / NO
Audited Financial Statements	FYE within 180 days	YES / NO

Ratio of Unrestricted Cash to Four Months' Expenses:

(i) Unrestricted Cash as of ______: ______

(ii) Four Months' Expenses for the 4 months ended ______: ______

(iii) Ratio of (i) to (ii): ______ [*if less than 1:1, then Lien against IP springs*]

Date of most recent Board-approved budget/plan __________

Any change in budget/plan since version most recently delivered to Lender YES* / NO

* if "YES" then please attach

ACCOUNT CONTROL AGREEMENTS

Pursuant to Section 6.11 of the Loan Agreement, Company represents and warrants that: (i) as of the date hereof, it maintains only those Deposit Accounts and investment/securities accounts set forth below; and (ii) a control agreement has been executed and delivered to Lender with respect to each such account *[Note: If the Company has established any new account(s) since the date of the last compliance certificate, please so indicate]*.

Deposit Accounts

	Name of Institution	Account Number	Control Agt. In place?	Complies	New Account
1.)			YES / NO	YES / NO	YES / NO
2.)			YES / NO	YES / NO	YES / NO
3.)			YES / NO	YES / NO	YES / NO
4.)			YES / NO	YES / NO	YES / NO

Investment Accounts

	Name of Institution	Account Number	Control Agt. In place?	Complies	New Account
1.)			YES / NO	YES / NO	YES / NO
2.)			YES / NO	YES / NO	YES / NO
3.)			YES / NO	YES / NO	YES / NO
4.)			YES / NO	YES / NO	YES / NO

EXPLANATIONS

____

____

____

____

Please provide the following information regarding the Company's financing:

Date of Last Round Raised: ___________

Has there been any new financing since the last Compliance Certificate submitted? YES /NO

If "YES" please complete information below and attach a copy of the Capitalization Table

Date Closed: ___________ Series: ___________ Per Share Price: $______

Amount Raised: ____ Post Money Valuation: ____

Any stock splits since date of last report? YES /NO

If yes, please provide any information on stock splits which would affect valuation:

____

Any dividends since date of last report? YES / NO

If yes, please provide any information on dividends which would affect valuation:

Any unusual terms? (ie. Anti-dilution, multiple preference, etc.)

If yes, please explain:

Very truly yours,

ENTEROMEDICS INC.

Name: ____________________
Title:* ____________________

* Must be executed by Company's Financial Officer or other executive officer.

EXHIBIT “D”

FORM OF INTELLECTUAL PROPERTY SECURITY AGREEMENT

EXHIBIT “E”

FORM OF WARRANT

EXHIBIT “F”

FORM OF LEGAL OPINION

ENTEROMEDICS INC.
EXECUTIVE EMPLOYMENT AGREEMENT

This Employment Agreement ("Agreement") is made and entered on June 22, 2005 ("Agreement Date") between EnteroMedics Inc. ("Company"), a Delaware corporation with its principal place of business at 2800 Patton Road, St. Paul, Minnesota 55113, and Mark B. Knudson ("Employee"), a Minnesota resident, whose address is 1309 West Royal Oaks Drive, Shoreview, Minnesota 55126, for the purpose of setting forth the terms and conditions of Employee's employment by the Company.

RECITALS

WHEREAS, Employee possesses certain skills, talents, contacts, judgment and knowledge of the business of Company;

WHEREAS, Employee is currently employed by the Company as its Chief Executive Officer and President, and Company desires to have the continued benefit of Employee's employment in such capacities, and Employee desires to continue to serve in such capacities, pursuant to the terms and conditions set forth in this Agreement; and

WHEREAS, Employee understands that such continued employment is expressly conditioned on execution of this Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of Employee's continued employment with Company and the foregoing premises, the mutual covenants set forth below and other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, Company and Employee agree as follows:

ARTICLE I: EMPLOYMENT, TERM, AND DUTIES

1.1 **Employment**. Company hereby employs Employee as Chief Executive Officer and President, and Employee accepts such employment and agrees to perform services for Company pursuant to the terms and conditions set forth in this Agreement.

1.2 **Term.** The term ("Term") of this Agreement shall commence on the Agreement Date and, unless earlier terminated in accordance with Article III of this Agreement, shall terminate two years from the Agreement Date; provided, however, the term of this Agreement shall automatically renew for successive one year terms thereafter unless prior to ninety (90) days of the expiration of the initial Term or any additional Terms, either party provides written notice to the other of its or his desire to terminate this Agreement.

1.3 **Position and Duties**.

1.3.1 **Service with Company.** During the Term, Employee agrees to perform such duties and responsibilities as are assigned to him from time to time by the Company's Board of Directors ("Board").

1.3.2 **Performance of Duties.** During the Term, Employee agrees to serve Company in an Executive capacity as President and Chief Executive Officer and shall perform such duties as are customarily associated with these current titles and as required by the Company's Board of Directors.

ARTICLE II. COMPENSATION, BENEFITS AND EXPENSES

2.1 **Base Salary**. Subject to the provisions of Article III of this Agreement, during the Term, Company shall pay Employee a Base Salary not less than $300,000 per year or such higher annual rate as may from time to time be approved by the Board. Such Base Salary shall be paid in substantially equal regular periodic payments, less deductions and withholdings, in accordance with Company's regular payroll procedures, policies and practices as such may be modified from time to time. The Base Salary shall be reviewed by the Board annually for potential adjustment on the basis of performance and Employee shall be eligible, at Company's sole discretion, for annual salary increases consistent with Company's procedures, policies and practices. If Employee's Base Salary is increased from time to time during the Term, the increased amount shall become the Base Salary for the remainder of the Term and any extensions of the Term and for as long thereafter as required pursuant to Article III as applicable, subject to any subsequent increases.

2.2 **Incentive Compensation.** In addition to Base Salary, Company shall make Employee eligible for such cash and equity pursuant to Company's Incentive Compensation Plan, if any, as may be applicable and adopted by Company. Payment of incentive compensation will be subject to Employee achieving certain objectives set annually by Employee and the Compensation Committee of the Board, with the target amount of any cash incentive compensation for any calendar year to be approved by the Compensation Committee of the Board, which in no event shall exceed 30% of Employee's base salary in effect from time to time. Employee and the Compensation Committee will meet and review the objectives set by the Compensation Committee for the upcoming calendar year prior to July 15 for the 2005 calendar year and, for each year thereafter, prior to March 31 of such year.

2.3 **Participation in Benefits.** During the Term of Employee's employment by Company, Employee shall be entitled to participate in the employee benefits offered generally by Company to its employees, to the extent that Employee's position, tenure, salary, health and other qualifications make Employee eligible to participate. Without limiting the foregoing, Employee shall be eligible to participate in any pension plan, or group life, health or accident insurance or any such other plan or policy that may presently be in effect or that may hereafter be adopted by the Company for the benefit of its employees and corporate officers generally. Employee is eligible to receive six weeks of Paid Time Off ("PTO") on an annual basis subject to Company's PTO policy. PTO includes all forms of personal leave including vacation and sick leave. Employee's participation in such benefits shall be subject to the terms of the applicable plans, as the same may be amended from time to time. Company does not guarantee the adoption or continuance of any particular employee benefit during Employee's employment, and nothing in this Agreement is intended to, or shall in any way restrict the right of Company, to amend, modify or terminate any of its benefits during the Term of this Agreement.

ARTICLE III: TERMINATION AND COMPENSATION FOLLOWING TERMINATION

3.1 **Termination**. Subject to the respective continuing obligations of the parties under this Agreement, this Agreement and Employee's employment hereunder may be terminated prior to the end of the Term (the "Separation Date") under the following circumstances:

3.1.1 **Termination By Mutual Agreement**. By mutual written agreement of the parties at any time.

3.1.2 **Termination By Employee's Death**. In the event of Employee's death.

3.1.3 **Termination By Employee's Disability.** In the event Employee becomes Disabled. For purposes of this Agreement, "Disabled" or "Disability" means the incapacity or inability of Employee, whether due to accident, sickness or otherwise (with the exception of the illegal use of drugs), as determined by a medical doctor acceptable to Company and confirmed in writing by such doctor, to perform the essential functions of Employee's position under this Agreement, with or without reasonable accommodation (provided that no accommodation that imposes undue hardship on Company will be required) for an aggregate of ninety (90) days during any period of one hundred eighty (180) consecutive days, or such longer period as may be required under applicable law.

3.1.4 **Termination By Company For Cause**. Company may terminate this Agreement and Employee's employment for Cause at any time after providing written notice to Employee. For purposes of this Agreement, "Cause" means: (a) willful breach of Employee's duties to Company or willful breach of this Agreement; (b) conviction of any felony or any crime involving fraud, dishonesty, or moral turpitude; (c) participation in any fraud against or affecting Company or any subsidiary, affiliate, customer, supplier, client, agent, or employee thereof; or (d) any other act Company determines constitutes gross or willful misconduct detrimental to Company including, but not limited to, unethical practices, dishonesty, disloyalty, or any other acts harmful to Company; provided, however that a for Cause termination pursuant to clause (a), if susceptible of cure, shall not become effective unless Employee fails to cure such failure to perform or breach within thirty (30) days after his receipt of written notice from Company, such notice to describe such failure to perform or breach and identify what reasonable actions shall be required to cure such failure to perform or breach.

3.1.5 **Termination By Employee Without Good Reason**. The Employee may terminate Employee's employment under this Agreement at any time for any reason or no reason with thirty (30) days written notice.

3.1.6 **Termination By Company Without Cause**. Company may terminate Employee's employment under this Agreement at any time for any reason or no reason with 30 days written notice including following a Change in Control as defined in Employee's applicable EnteroMedics Inc. Incentive Stock Option Agreement(s) or Non-Incentive Stock Option Agreement(s) ("Employee's Stock Option Agreements") as the case may be, except that no notice shall be required for a termination without Cause following a Change in Control. A termination of this Agreement and employee's employment pursuant to the operation of the provisions of Section 1.2 of this Agreement shall be deemed a termination by Company without Cause.

3.1.7 **Termination By Employee For Good Reason**. Employee may terminate Employee's employment pursuant to this Agreement for Good Reason. For purposes of this Agreement, "Good Reason" means: (a) at any time, the assignment by Company to Employee of employment duties, functions or responsibilities that are significantly different from, and result in a substantial diminution of, Employee's duties, functions or responsibilities; or (b) at any time, a requirement that Employee be based at any office or location more than 25 miles from Employee's primary work location prior to the date of this Agreement.

3.2 **Compensation Following Termination Prior to End of the Term**. In the event that Employee's employment pursuant to this Agreement is terminated prior to the end of the Term, Employee shall be entitled to the following compensation and benefits upon such termination:

3.2.1 **Payment of Base of Salary.** In the event that Employee's employment is terminated pursuant to any subsection of Section 3.1 of this Agreement, Company shall, within 14 calendar days following the Separation Date, pay to Employee, Employee's spouse or Employee's estate, as the case may be, any amounts due to Employee for Base Salary through the Separation Date.

In the event of a termination pursuant to Section 3.1.5 (by Employee without Good Reason), upon receiving Employee's notice, Company has the option, at its discretion (a) to continue to engage Employee's services through the 30 day notice period until the Separation Date, or (b) terminate the use of Employee's services during the 30 day notice period prior to the Separation Date but treat Employee as if he were providing services through the 30 day notice period until the Separation Date for purposes of determining Employee's compensation due him pursuant to this Section 3.2.1.

3.2.2 **Payment of Incentive Compensation.** In the event that Employee's employment is terminated prior to the expiration of the Term pursuant to subsections 3.1.1; 3.1.2; 3.1.3; 3.1.6; or 3.1.7 of Section 3.1 of this Agreement, Company shall, within 14 calendar days following the Separation Date, also pay to Employee, Employee's spouse or Employee's estate, as the case may be, any amounts due to Employee for unpaid and pro rata amounts to which Employee is entitled as of the Separation Date pursuant to Section 2.2 of this Agreement.

3.2.3 **Payment of Severance for Termination By Company Without Cause or By Employee for Good Reason**. In the event that Employee's employment is terminated prior to the expiration of the Term pursuant to subsection 3.1.6 (By Company Without Cause) or 3.1.7 (By Employee for Good Reason) and provided Employee has executed a written release to Company in substantially the same form attached hereto as Exhibit A and the rescission period specified therein has expired, Company shall also continue to pay, as severance pay, Employee's Base Salary at the rate in effect on the Separation Date, for a period of 12 months following the Separation Date. Such payments will be at usual and customary pay intervals of Employer and will be subject to all appropriate deductions and withholdings.

Additionally, pursuant to the terms and conditions set forth in Employee's applicable Stock Option Agreements with Company, Company agrees that, notwithstanding anything to the contrary set forth in such Stock Option Agreements or Company's Stock Incentive Plan, as may be amended from time to time, during the five-year period following the Separation Date, Employee shall be permitted to exercise immediately all Options granted to Employee that have vested as of the Separation Date and those Options that would have vested within one year of the Separation Date had Employee's employment with Company not terminated. The parties hereto agree and acknowledge that, with respect to any Options previously granted to Employee that were intended by the parties to be treated as "incentive stock options" within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, such Options, to the extent they may be exercised by Employee more than 90 days following the Separation Date shall be treated as non-qualified Options, notwithstanding any provision in Employee's Stock Option Agreements to the contrary.

In the event that a Change in Control occurs, and Employee is not terminated, the vesting schedule of Options held by Employee shall accelerate such that on the date the Change of Control is completed 50% of any unvested shares of Employee shall immediately vest and shall be exercisable during the five-year period following the Separation Date notwithstanding anything to the contrary set forth in Employee's applicable Stock Option Agreements with the Company or Company's Stock Incentive Plan; provided, however, that if, in connection with the consummation of the transaction resulting in the Change in Control, Employee receives a cash payment with respect to each Option equal to the difference or "spread" between (i) the per share amount paid to holders of Common Stock in such transaction and (ii) the per share exercise price under the applicable option agreement, his Options shall be cancelled upon the consummation of the Change in Control in exchange for such cash payment.

In the event that a Change in Control occurs, and Employee is terminated, the vesting schedule of Options held by Employee shall accelerate such that on the date the Change of Control is completed 100% of any unvested shares of Employee shall immediately vest and shall be exercisable during the five-year period following the Separation Date notwithstanding anything to the contrary set forth in Employee's applicable Stock Option Agreements with the Company or Company's Stock Incentive Plan; provided, however, that if, in connection with the consummation of the transaction resulting in the Change in Control, Employee receives a cash payment with respect to each Option equal to the difference or "spread" between (i) the per share amount paid to holders of Common Stock in such transaction and (ii) the per share exercise price under the applicable option agreement, his Options shall be cancelled upon the consummation of the Change in Control in exchange for such cash payment.

3.2.4 **General Provision Regarding Treatment of Options.** Except as otherwise specified in Sections 3.2.3 of this Agreement, the terms of the Stock Incentive Plan and Employee's Stock Option Agreements, as applicable, shall govern the treatment of Employee's Options following the Separation Date.

3.3 **<u>Benefits Following Termination Prior to the End of the Term</u>.** In the event that Employee's employment is terminated pursuant to subsections 3.1.2; 3.1.3; 3.1.6; or 3.1.7 of Section 3.1 of this Agreement, Employee shall, at no cost to Employee, be entitled to continue to participate in Company-provided medical, dental, and life insurance programs for a period of

12 months following the Separation Date irrespective of any then pre-existing health conditions of Employee or his spouse provided, however, that, if this Agreement is terminated as a result of Employee's death, Employee's then current spouse shall be entitled to continue to participate in Company-provided medical and dental insurance programs for one year after Employee's death irrespective of any then pre-existing health conditions, unless, in each case, such continued participation is prohibited by any applicable laws or would otherwise jeopardize the tax qualified status of any such programs. If Company is prohibited by applicable law or would otherwise jeopardize the tax qualified status of any medical, dental, or life insurance plan and as a result Company terminates coverage, it shall promptly reimburse Employee (or Employee's spouse as the case may be) for the cost of obtaining comparable third party coverage irrespective of any then preexisting health conditions of Employee and/or his spouse.

Except as otherwise provided in this Section 3.3, the benefits to which Employee (or, as applicable, Employee's spouse or estate) may be entitled upon termination pursuant to the plans and policies of Company specified Article II of this Agreement shall be determined and paid in accordance with such plans and policies.

3.4 **Surrender of Records and Property**. Upon termination of Employee's employment with Company, Employee shall deliver promptly to Company all Confidential Information as defined in Section 4.1 and all Company property including, but not necessarily limited to records, manuals, books, blank forms, documents, letters, memoranda, business plans, minutes, notes, notebooks, reports, computer disks, computer software, computer programs (including source code, object code, on-line files, documentation, testing materials and plans and reports), computer print-outs, member or customer lists, credit cards, keys, identification, products, access cards, designs, drawings, sketches, devices, specifications, formulae, data, tables or calculations or copies thereof, and all other tangible or intangible property relating in any way to the business of Company that are the property of Company or any subsidiary or affiliate, if any, or which relate in any way to the business, products, practices or techniques of Company or any subsidiary or affiliate.

ARTICLE IV. CONFIDENTIAL INFORMATION

4.1 **Definition.** For purposes of this Agreement, "Confidential Information" means any information that is not generally known to the public or to other persons who can obtain economic value from its disclosure or use; information which derives independent economic benefit from not being known to such persons; and information about the activities or business of Company that is not generally known to others engaged in similar business or activities, its products, services, finances, trade secrets, contracts, patents filed or pending, the techniques used in completing customer projects, research and development, data and information, processes, designs, engineering, marketing plans or techniques, organization or operation. The foregoing list is intended to be illustrative rather than comprehensive. Additionally, the term "confidential information" shall mean any confidential information as that term is defined in any agreement Employer may have with its customers or other third parties from time to time.

4.2 **Nondisclosure**. During the term of this Agreement or at any time thereafter, Employee agrees not to disclose Confidential information to any other third party or company, other than in connection with Employee's employment with Company, or use such information, directly or indirectly, for any purpose whatsoever, without the prior written consent of Company.

ARTICLE V. INVENTIONS

5.1 **Disclosure and Assignment of Inventions and Other Works**. During the term of this Agreement and for one year following the Separation Date, Employee shall promptly disclose to Company in writing all ideas, improvements and discoveries, whether or not such are patentable or copyrightable, and whether or not in writing or reduced to practice ("Inventions") and any writings, drawings, diagrams, charts, tables, databases, software (in object or source code and recorded on any medium), and any other works of authorship, whether or not such are copyrightable ("Works of Authorship") that are conceived, made, discovered, written or created by Employee alone or jointly with any person, group or entity, whether during the normal hours of his employment at Company or on Employee's own time. Employee hereby assigns all rights to all such Inventions and Works of Authorship to Company. Employee shall give Company all the assistance it reasonably requires for Company to perfect, protect, and use its rights to such Inventions and Works of Authorship. Employee shall sign all such documents, take all such actions and supply all such information that Company considers necessary or desirable to transfer or record the transfer of Company's entire right, title and interest in such Inventions and Works of Authorship and to enable Company to obtain exclusive patent, copyright, or other legal protection for Inventions and Works of Authorship anywhere in the world, provided Company shall bear all reasonable expenses of Employee in rendering such cooperation.

5.2 **Notice and Acknowledgement**. In accordance with Minnesota Statute § 181.78, the foregoing Section 5.1 does not require Employee to assign or offer to assign to Company any of Employee's rights in an Invention that Employee developed entirely on Employee's own time without using Company's equipment, supplies, facilities or trade secret information, and (1) that does not relate directly to Company's business or to Company's actual or demonstrably anticipated research or development, or (2) that does not result from any work performed by Employee for Company. To the extent a provision in this Agreement purports to require Employee to assign Inventions otherwise excluded by this paragraph, the provision is against the public policy of the State of Minnesota and is unenforceable. By signing this Agreement, Employee acknowledges receipt of the notification required by Minnesota Statute § 181.78.

ARTICLE VI. NONCOMPETITION AND NONSOLICITATION

6.1 **Agreement Not to Compete**. During the Term of Employee's employment by Company, and for a period of 12 consecutive months from the date of termination of such employment for whatever reason (whether occasioned by Employee or Company), Employee shall not, directly or indirectly, in any place in the world, render services to any conflicting organization, or engage in competition with Company, in any manner or capacity, nor direct any other individual or business enterprise to engage in competition with Company in any manner or capacity, (*e.g.*, as an advisor, principal, agent, partner, officer, director, stockholder of more than 1% of the outstanding shares of the capital stock of a publicly traded company, employee, member of any association or limited liability company or otherwise) on any products competitive with Company's existing products, any products competitive with Company's announced products or any products competitive with Company's pending products that have not yet been announced but which Employee has, or should have, actual or constructive knowledge. For the purposes of this Section, “conflicting organization” shall be defined as any person, corporation or entity that competes with any product, process or service, in existence or under development, of Company pertaining to implantable medical devices to treat obesity or devices to apply signals to a vagus nerve to treat a gastrointestinal disorder (*e.g.*, obesity, pancreatitis or irritable bowel syndrome).

6.2 **Agreement Not to Solicit**. Employee hereby acknowledges that the Company’s customers constitute vital and valuable aspects of its business on a worldwide basis. In recognition of that fact, for a period of one (1) year following the termination of this Agreement for any reason whatsoever, Employee shall not solicit, or assist anyone else in the solicitation of, any of the Company’s then-current customers to terminate their respective relationships with the Company and to become customers of any enterprise with which Employee may then be associated, affiliated or connected.

6.3 **Agreement Not to Recruit**. Employee hereby acknowledges that the Company’s employees, consultants and other contractors constitute vital and valuable aspects of its business and missions on a worldwide basis. In recognition of that fact, for a period of one (1) year following the termination of this Agreement for any reason whatsoever, Employee shall not solicit, or assist anyone else in the solicitation of, any of the Company’s then-current employees, consultants or other contractors to terminate their respective relationships with the Company and to become employees, consultants or contractors by any enterprise with which Employee may then be associated, affiliated or connected.

ARTICLE VII: MISCELLANEOUS PROVISIONS

7.1 **Company Remedies**. Employee acknowledges and agrees that the restrictions and agreements contained in this Agreement are reasonable and necessary to protect the legitimate interests of Company, that the services to be rendered by Employee are of a special, unique and extraordinary character, that it would be difficult to replace such services and that any violation of Articles IV, V or VI of this Agreement would be highly injurious to Company, that Employee’s violation of any of Articles IV, V or VI of this Agreement would cause Employer irreparable harm that would not be adequately compensated by monetary damages and that the remedy at law for any breach of any of the provisions of Articles IV, V and VI will be inadequate. Accordingly, Employee specifically agrees that Company shall be entitled, in addition to any remedy at law, to preliminary and permanent injunctive relief and specific performance for any actual or threatened violation of this Agreement and to enforce the provisions of Articles IV, V and VI of this Agreement.

7.2 **Assignment**. This Agreement shall not be assignable, in whole or in part, by Employee without the written consent of Company and any purported or attempted assignment or transfer of this Agreement or any of Employee’s duties, responsibilities or obligations hereunder shall be void. This Agreement is binding upon Employee, Employee’s heirs and personal representatives. This Agreement shall inure to the benefit of and be binding upon Company and its successors and assigns. Notwithstanding the foregoing, Company may, without the consent of Employee, assign its rights and obligations under this Agreement to any business entity that has become the successor to Company in the event of a sale, merger, liquidation or similar transaction. After any such assignment by Company, Company shall be discharged from all further liability hereunder and such successor assignee shall thereafter be deemed to be Company for the purposes of all provisions of this Agreement.

7.3 **Notices**. All notices, requests, demands and other communications under this Agreement shall be in writing, shall be deemed to have been duly given on the date of service if personally served on the parties to whom notice is to be given, or on the third day after mailing if mailed to the parties to whom notice is given, whether by first class, registered, or certified mail, and properly addressed as follows:

If to the Company, at:	EnteroMedics Inc. 2800 Patton Road St. Paul, Minnesota 55113
If to Employee, at:	Mark Knudson 1309 West Royal Oaks Drive Shoreview, Minnesota 55126

Any party may change the address for the purpose of this Section by giving the other written notice of the new address in the manner set forth above.

7.4 **Governing Law**. The validity, interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of Minnesota, without regard to conflicts of laws principles thereof.

7.5 **Arbitration.** The parties irrevocably consent that any litigation commenced or arising in connection with the interpretation or enforcement of this Agreement that has not been settled through negotiation within a period of thirty (30) days after the date on which either party shall first have notified the other party in writing of the existence of a dispute shall be settled by final and binding arbitration under the then-applicable Commercial Arbitration Rules of the American Arbitration Association ("AAA"). Any such arbitration shall be conducted by one (1) neutral arbitrator appointed by mutual agreement of the parties or, failing such agreement, in accordance with the AAA Rules. The arbitrator shall be an experienced attorney with a background in employment law. Any arbitration shall be conducted in Minneapolis, Minnesota. An arbitration award may be enforced in any court of competent jurisdiction. Notwithstanding any contrary provision in the AAA Rules, the following additional procedures and rules shall apply to any such arbitration:

(A) Each party shall have the right to request from the arbitrator, and the arbitrator shall order upon good cause shown, reasonable and limited pre-hearing discovery, including (1) exchange of witness lists, (2) depositions under oath of named witnesses at a mutually convenient location, (3) written interrogatories, and (4) document requests;

(B) Upon conclusion of the pre-hearing discovery, the arbitrator shall promptly hold a hearing upon the evidence to be adduced by the parties and shall promptly render a written opinion and award;

(C) The arbitrator may award damages or injunctive relief consistent with the terms of this Agreement but may not award or assess punitive damages against either party; and

(D) Each party shall bear his or its own costs and expenses of the arbitration and one-half (1/2) of the fees and costs of the arbitrator, subject to the power of the arbitrator, in his or her sole discretion, to award all such reasonable costs, expenses and attorneys' fees to the prevailing party.

7.6 **Construction**. Notwithstanding the general rules of construction, both Company and Employee acknowledge that both parties were given an equal opportunity to negotiate the terms and conditions contained in this Agreement, and agree that the identity of the drafter of this Agreement is not relevant to any interpretation of the terms and conditions of this Agreement.

7.7 **Severability**. In the event any provision of this Agreement (or portion thereof) shall be held illegal or invalid for any reason, said illegality or invalidity shall not in any way affect the legality or validity of any other provision of this Agreement. To the extent any provision (or portion thereof) of this Agreement shall be determined to be invalid or unenforceable in any jurisdiction, such provision (or portion thereof) shall be deemed to be deleted from this Agreement as to such jurisdiction only, and the validity and enforceability of the remainder of such provision and of this Agreement shall be unaffected.

7.8 **Entire Agreement**. This Agreement is the final, complete and exclusive agreement of the parties and sets forth the entire agreement between Company and Employee with respect to Employee's employment by Company, and there are no undertakings, covenants or commitments other than as set forth herein. The Agreement may not be altered or amended, except by a writing executed by Employee and a member of the Board. This Agreement supersedes, terminates, replaces and supplants any and all prior understandings or agreements between the parties relating in any way to the hiring or employment of Employee by Company.

7.9 **Survival**. The parties expressly acknowledge and agree that the provisions of this Agreement that by their express or implied terms extend beyond the expiration of this Agreement or the termination of Employee's employment under this Agreement, shall continue in full force and effect, notwithstanding Employee's termination of employment under this Agreement or the expiration of this Agreement.

7.10 **Waivers**. No failure on the part of either party to exercise, and no delay in exercising, any right or remedy under this Agreement shall operate as a waiver thereof; nor shall any single or partial exercise of any right or remedy under this Agreement preclude any other or further exercise thereof or the exercise of any other right or remedy granted hereby or by any related document or by law.

7.11 **Attorneys' Fees.** Upon receipt by Company of a statement for legal services from the attorneys representing Employee, Company shall reimburse Employee or pay on behalf of Employee the reasonable and necessary attorneys' fees and associated expenses incurred by Employee in connection with the negotiation of this Agreement.

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

EnteroMedics Inc.

By /s/ Carl Goldfischer
Its Director

/s/ Mark B. Knudson
Mark B. Knudson

EXHIBIT A

GENERAL RELEASE

This General Release is made and entered into as of the __ day of __________, __________ , by Mark B. Knudson(“Employee”).

WHEREAS, EnteroMedics Inc. (“Company”) and Employee are parties to an Employment Agreement dated __________;

WHEREAS, Employee intends to settle any and all claims that Employee has or may have against Company as a result of Employee’s employment with Company and the cessation of Employee’s employment with Company; and

WHEREAS, Under the terms of the Employment Agreement, which Employee agrees are fair and reasonable, Employee agreed to enter into this General Release as a condition precedent to the severance arrangements described in Article III of the Employment Agreement.

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

1. **Release**. For the consideration expressed in the Employment Agreement, Employee does hereby fully and completely release and waive any and all claims, complaints, causes of action, demands, suits and damages, of any kind or character, which Employee has or may have against the Released Parties, as hereinafter defined, arising out of any acts, omissions, conduct, decisions, behavior or events occurring up through the date of Employee’s signature on this General Release, including Employee’s employment with Company and the cessation of that employment. For purposes of this General Release, “Released Parties” means collectively Company, its predecessors, successors, assigns, parents, affiliates, subsidiaries, related companies, officers, directors, shareholders, agents, servants, employees and insurers, and each and all thereof.

Employee understands and accepts that Employee’s release of claims includes any and all possible discrimination claims, including, but not limited to, claims based upon: Title VII of the Federal Civil Rights Act of 1964, as amended; the Age Discrimination in Employment Act; the Americans with Disabilities Act; the Equal Pay Act; the Fair Labor Standards Act; the Employee Retirement Income Security Act; the Minnesota Human Rights Act; Minn. Stat. §181.81; or any other federal, state or local statute, ordinance or law. Employee also understands that Employee is giving up all other claims, including those grounded in contract or tort theories, including, but not limited to: wrongful discharge; violation of Minn. Stat. §176.82; breach of contract; tortious interference with contractual relations; promissory estoppel; breach of the implied covenant of good faith and fair dealing; breach of express or implied promise; breach of manuals or other policies; assault; battery; fraud; false imprisonment; invasion of privacy; intentional or negligent misrepresentation; defamation, including libel, slander, discharge defamation and self-publication defamation; discharge in violation of public policy; whistleblower; intentional or negligent infliction of emotional distress; or any other theory, whether legal or equitable.

Employee further understands that Employee is releasing, and does hereby release, any claims for damages, by charge or otherwise, whether brought by Employee or on Employee's behalf by any other party, governmental or otherwise, and agrees not to institute any claims for damages via administrative or legal proceedings against any of the Released Parties. Employee also waives and releases any and all rights to money damages or other legal relief awarded by any governmental agency related to any charge or other claim against any of the Released Parties.

This General Release does not apply to any post-termination claim that Employee may have for benefits under the provisions of any employee benefit plan maintained by Company.

Employee's release of claims shall not apply to any claims Employee might have to indemnification under Minnesota Statute §302A.521, any other applicable statute or regulation or Company's by-laws.

2. **Rescission**. Employee has been informed of Employee's right to rescind this General Release by written notice to Company within fifteen (15) calendar days after the execution of this General Release. Employee has been informed and understands that any such rescission must be in writing and delivered to Company by hand or sent by mail within the 15-day time period. If delivered by mail, the rescission must be: (1) postmarked within the applicable period and (2) sent by certified mail, return receipt requested.

Employee understands that Company will have no obligations under the Employment Agreement in the event a notice of rescission by Employee is timely delivered, and, in the event Employee rescinds this General Release, Employee agrees to repay to Company any payments made to Employee or benefits conferred upon him pursuant to Article III of the Employment Agreement prior to the date of rescission.

3. **Acceptance Period; Advice of Counsel**. The terms of this General Release will be open for acceptance by Employee for a period of 21 days during which time Employee may consider whether or not to accept this General Release. Employee agrees that changes to this General Release, whether material or immaterial, will not restart this acceptance period. Employee is hereby advised to seek the advice of an attorney regarding this General Release.

4. **Binding Agreement**. This General Release shall be binding upon, and inure to the benefit of, Employee and Company and their respective successors and permitted assigns.

5. **Representation**. Employee hereby acknowledges and states that Employee has read this General Release. Employee further represents that this General Release is written in language that is understandable to Employee, that Employee fully appreciates the meaning of its terms, and that Employee enters into this General Release freely and voluntarily.

IN WITNESS WHEREOF, Employee, after due consideration, has authorized, executed and delivered this General Release all as of the date first written.

____

Mark B. Knudson

EXHIBIT 10.9

ENTEROMEDICS INC.
EXECUTIVE EMPLOYMENT AGREEMENT

This Employment Agreement ("Agreement") is made and entered on May 21, 2007 ("Agreement Date") between EnteroMedics Inc. ("Company"), a Delaware corporation with its principal place of business at 2800 Patton Road, St. Paul, Minnesota 55113, and Greg Lea ("Employee"), a Minnesota resident, whose address is 26321 607th Street, Mantorville, MN 55955, for the purpose of setting forth the terms and conditions of Employee's employment by the Company.

RECITALS

WHEREAS, Employee possesses certain skills, talents, contacts, judgment and knowledge of the business of Company;

WHEREAS, Employee is currently employed by the Company as Senior Vice President desires to have the continued benefit of Employee's employment in such capacities, and Employee desires to continue to serve in such capacities, pursuant to the terms and conditions set forth in this Agreement; and

WHEREAS, Employee understands that such continued employment is expressly conditioned on execution of this Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of Employee's continued employment with Company and the foregoing premises, the mutual covenants set forth below and other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, Company and Employee agree as follows:

ARTICLE I: EMPLOYMENT, TERM, AND DUTIES

1.1 **Employment**. Company hereby employs Employee as Senior Vice President and Employee accepts such employment and agrees to perform services for Company pursuant to the terms and conditions set forth in this Agreement.

1.2 **Term**. The term ("Term") of this Agreement shall commence on the Agreement Date and, unless earlier terminated in accordance with Article III of this Agreement, shall terminate one year from the Agreement Date; provided, however, the term of this Agreement shall automatically renew for successive one year terms thereafter unless prior to ninety (90) days of the expiration of the initial Term or any additional Terms, either party provides written notice to the other of its or his desire to terminate this Agreement.

1.3 **Position and Duties**.

1.3.1 **Service with Company.** During the Term, Employee agrees to perform such duties and responsibilities as are assigned to him from time to time by the CEO and Company's

Board of Directors (“Board”) which currently encompasses Quality Systems, Regulatory and Clinical Affairs.

1.3.2 **Performance of Duties.** During the Term, Employee agrees to serve Company in an Executive capacity as Senior Vice President and shall perform such duties as are required by the CEO and Company’s Board of Directors.

ARTICLE II. COMPENSATION, BENEFITS AND EXPENSES

2.1 **Base Salary**. Subject to the provisions of Article III of this Agreement, during the Term, Company shall pay Employee a Base Salary not less than $230,000 per year or such higher annual rate as may from time to time be approved by the Board. Such Base Salary shall be paid in substantially equal regular periodic payments, less deductions and withholdings, in accordance with Company’s regular payroll procedures, policies and practices as such may be modified from time to time. The Base Salary shall be reviewed by the compensation committee of the Board annually for potential adjustment on the basis of performance and Employee shall be eligible, at Company’s sole discretion, for annual salary increases consistent with Company’s procedures, policies and practices. If Employee’s Base Salary is increased from time to time during the Term, the increased amount shall become the Base Salary for the remainder of the Term and any extensions of the Term and for as long thereafter as required pursuant to Article III as applicable, subject to any subsequent increases.

2.2 **Incentive Compensation.** In addition to Base Salary, Company shall make Employee eligible for such cash and equity pursuant to Company’s Incentive Compensation Plan, if any, as may be applicable and adopted by Company. Payment of incentive compensation will be subject to Employee achieving certain objectives set annually by Employee and the Compensation Committee of the Board, with the target amount of any cash incentive compensation for any calendar year to be approved by the Compensation Committee of the Board, which in no event shall exceed 25% of Employee’s base salary in effect from time to time. Employee and the CEO will meet and review the objectives set by the CEO for the upcoming calendar year prior to March 31 of each year.

2.3 **Participation in Benefits.** During the Term of Employee’s employment by Company, Employee shall be entitled to participate in the employee benefits offered generally by Company to its employees, to the extent that Employee’s position, tenure, salary, health and other qualifications make Employee eligible to participate. Without limiting the foregoing, Employee shall be eligible to participate in any pension plan, or group life, health or accident insurance or any such other plan or policy that may presently be in effect or that may hereafter be adopted by the Company for the benefit of its employees and corporate officers generally. Employee is eligible to receive six weeks of Paid Time Off (“PTO”) on an annual basis subject to Company’s PTO policy. PTO includes all forms of personal leave including vacation and sick leave. Employee’s participation in such benefits shall be subject to the terms of the applicable plans, as the same may be amended from time to time. Company does not guarantee the adoption or continuance of any particular employee benefit during Employee’s employment, and nothing in this Agreement is intended to, or shall in any way restrict the right of Company, to amend, modify or terminate any of its benefits during the Term of this Agreement.

ARTICLE III: TERMINATION AND COMPENSATION FOLLOWING TERMINATION

3.1 **Termination**. Subject to the respective continuing obligations of the parties under this Agreement, this Agreement and Employee’s employment hereunder may be terminated prior to the end of the Term (the “Separation Date”) under the following circumstances:

3.1.1 **Termination By Mutual Agreement**. By mutual written agreement of the parties at any time.

3.1.2 **Termination By Employee’s Death**. In the event of Employee’s death.

3.1.3 **Termination By Employee’s Disability.** In the event Employee becomes Disabled. For purposes of this Agreement, “Disabled” or “Disability” means the incapacity or inability of Employee, whether due to accident, sickness or otherwise (with the exception of the illegal use of drugs), as determined by a medical doctor acceptable to Company and confirmed in writing by such doctor, to perform the essential functions of Employee’s position under this Agreement, with or without reasonable accommodation (provided that no accommodation that imposes undue hardship on Company will be required) for an aggregate of ninety (90) days during any period of one hundred eighty (180) consecutive days, or such longer period as may be required under applicable law.

3.1.4 **Termination By Company For Cause**. Company may terminate this Agreement and Employee’s employment for Cause at any time after providing written notice to Employee. For purposes of this Agreement, “Cause” means: (a) willful breach of Employee’s duties to Company or willful breach of this Agreement; (b) conviction of any felony or any crime involving fraud, dishonesty, or moral turpitude; (c) participation in any fraud against or affecting Company or any subsidiary, affiliate, customer, supplier, client, agent, or employee thereof; or (d) any other act Company determines constitutes gross or willful misconduct detrimental to Company including, but not limited to, unethical practices, dishonesty, disloyalty, or any other acts harmful to Company; provided, however that a for Cause termination pursuant to clause (a), if susceptible of cure, shall not become effective unless Employee fails to cure such failure to perform or breach within thirty (30) days after his receipt of written notice from Company, such notice to describe such failure to perform or breach and identify what reasonable actions shall be required to cure such failure to perform or breach.

3.1.5 **Termination By Employee Without Good Reason**. The Employee may terminate Employee’s employment under this Agreement at any time for any reason or no reason with thirty (30) days written notice.

3.1.6 **Termination By Company Without Cause**. Company may terminate Employee’s employment under this Agreement at any time for any reason or no reason with 30 days written notice including following a Change in Control as defined in Employee’s applicable Company Incentive Stock Option Agreement(s) or Non-Incentive Stock Option Agreement(s) (“Employee’s Stock Option Agreements”) as the case may be, except that no notice shall be required for a termination without Cause following a Change in Control. A termination of this

Agreement and employee's employment pursuant to the operation of the provisions of Section 1.2 of this Agreement shall be deemed a termination by Company without Cause.

3.1.7 **Termination By Employee For Good Reason.** Employee may terminate Employee's employment pursuant to this Agreement for Good Reason. For purposes of this Agreement, "Good Reason" means: (a) at any time, the assignment by Company to Employee of employment duties, functions or responsibilities that are significantly different from, and result in a substantial diminution of, Employee's duties, functions or responsibilities; or (b) at any time, a requirement that Employee be based at any office or location more than 25 miles from Employee's primary work location prior to the date of this Agreement.

3.2 **Compensation Following Termination Prior to End of the Term.** In the event that Employee's employment pursuant to this Agreement is terminated prior to the end of the Term, Employee shall be entitled to the following compensation and benefits upon such termination:

3.2.1 **Payment of Base of Salary.** In the event that Employee's employment is terminated pursuant to any subsection of Section 3.1 of this Agreement, Company shall, within 14 calendar days following the Separation Date, pay to Employee, Employee's spouse or Employee's estate, as the case may be, any amounts due to Employee for Base Salary through the Separation Date.

In the event of a termination pursuant to Section 3.1.5 (by Employee without Good Reason), upon receiving Employee's notice, Company has the option, at its discretion (a) to continue to engage Employee's services through the 30 day notice period until the Separation Date, or (b) terminate the use of Employee's services during the 30 day notice period prior to the Separation Date but treat Employee as if he were providing services through the 30 day notice period until the Separation Date for purposes of determining Employee's compensation due him pursuant to this Section 3.2.1.

3.2.2 **Payment of Incentive Compensation.** In the event that Employee's employment is terminated prior to the expiration of the Term pursuant to subsections 3.1.1; 3.1.2; 3.1.3; 3.1.6; or 3.1.7 of Section 3.1 of this Agreement, Company shall, within 14 calendar days following the Separation Date, also pay to Employee, Employee's spouse or Employee's estate, as the case may be, any amounts due to Employee for unpaid and pro rata amounts to which Employee is entitled as of the Separation Date pursuant to Section 2.2 of this Agreement.

3.2.3 **Payment of Severance for Termination By Company Without Cause or By Employee for Good Reason**. In the event that Employee's employment is terminated prior to the expiration of the Term pursuant to subsection 3.1.6 (By Company Without Cause) or 3.1.7 (By Employee for Good Reason) and provided Employee has executed a written release to Company in substantially the same form attached hereto as Exhibit A and the rescission period specified therein has expired, Company shall also continue to pay, as severance pay, Employee's Base Salary at the rate in effect on the Separation Date, for a period of 6 months following the Separation Date. Such payments will be at usual and customary pay intervals of Employer and will be subject to all appropriate deductions and withholdings.

Additionally, pursuant to the terms and conditions set forth in Employee's applicable Stock Option Agreements with Company, Company agrees that, notwithstanding anything to the contrary set forth in such Stock Option Agreements or Company's Stock Incentive Plan, as may be amended from time to time, during the five-year period following the Separation Date, Employee shall be permitted to exercise immediately all Options granted to Employee that have vested as of the Separation Date and those Options that would have vested within one year of the Separation Date had Employee's employment with Company not terminated. The parties hereto agree and acknowledge that, with respect to any Options previously granted to Employee that were intended by the parties to be treated as "incentive stock options" within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, such Options, to the extent they may be exercised by Employee more than 90 days following the Separation Date shall be treated as non-qualified Options, notwithstanding any provision in Employee's Stock Option Agreements to the contrary.

In the event that a Change in Control occurs, and Employee is not terminated, the vesting schedule of Options held by Employee shall accelerate such that on the date the Change of Control is completed 50% of any unvested shares of Employee shall immediately vest and shall be exercisable during the five-year period following the Separation Date notwithstanding anything to the contrary set forth in Employee's applicable Stock Option Agreements with the Company or Company's Stock Incentive Plan; provided, however, that if, in connection with the consummation of the transaction resulting in the Change in Control, Employee receives a cash payment with respect to each Option equal to the difference or "spread" between (i) the per share amount paid to holders of Common Stock in such transaction and (ii) the per share exercise price under the applicable option agreement, his Options shall be cancelled upon the consummation of the Change in Control in exchange for such cash payment.

In the event that a Change in Control occurs, and Employee is terminated, the vesting schedule of Options held by Employee shall accelerate such that on the date the Change of Control is completed 100% of any unvested shares of Employee shall immediately vest and shall be exercisable during the five-year period following the Separation Date notwithstanding anything to the contrary set forth in Employee's applicable Stock Option Agreements with the Company or Company's Stock Incentive Plan; provided, however, that if, in connection with the consummation of the transaction resulting in the Change in Control, Employee receives a cash payment with respect to each Option equal to the difference or "spread" between (i) the per share amount paid to holders of Common Stock in such transaction and (ii) the per share exercise price under the applicable option agreement, his Options shall be cancelled upon the consummation of the Change in Control in exchange for such cash payment.

3.2.4 **General Provision Regarding Treatment of Options.** Except as otherwise specified in Sections 3.2.3 of this Agreement, the terms of the Stock Incentive Plan and Employee's Stock Option Agreements, as applicable, shall govern the treatment of Employee's Options following the Separation Date.

3.3 **Benefits Following Termination Prior to the End of the Term.** In the event that Employee's employment is terminated pursuant to subsections 3.1.2; 3.1.3; 3.1.6; or 3.1.7 of Section 3.1 of this Agreement, Employee shall, at no cost to Employee, be entitled to continue to participate in Company-provided medical, dental, and life insurance programs for a period of

6 months following the Separation Date irrespective of any then pre-existing health conditions of Employee or his spouse provided, however, that, if this Agreement is terminated as a result of Employee's death, Employee's then current spouse shall be entitled to continue to participate in Company-provided medical and dental insurance programs for one year after Employee's death irrespective of any then pre-existing health conditions, unless, in each case, such continued participation is prohibited by any applicable laws or would otherwise jeopardize the tax qualified status of any such programs. If Company is prohibited by applicable law or would otherwise jeopardize the tax qualified status of any medical, dental, or life insurance plan and as a result Company terminates coverage, it shall promptly reimburse Employee (or Employee's spouse as the case may be) for the cost of obtaining comparable third party coverage irrespective of any then preexisting health conditions of Employee and/or his spouse.

Except as otherwise provided in this Section 3.3, the benefits to which Employee (or, as applicable, Employee's spouse or estate) may be entitled upon termination pursuant to the plans and policies of Company specified Article II of this Agreement shall be determined and paid in accordance with such plans and policies.

3.4 **Surrender of Records and Property**. Upon termination of Employee's employment with Company, Employee shall deliver promptly to Company all Confidential Information as defined in Section 4.1 and all Company property including, but not necessarily limited to records, manuals, books, blank forms, documents, letters, memoranda, business plans, minutes, notes, notebooks, reports, computer disks, computer software, computer programs (including source code, object code, on-line files, documentation, testing materials and plans and reports), computer print-outs, member or customer lists, credit cards, keys, identification, products, access cards, designs, drawings, sketches, devices, specifications, formulae, data, tables or calculations or copies thereof, and all other tangible or intangible property relating in any way to the business of Company that are the property of Company or any subsidiary or affiliate, if any, or which relate in any way to the business, products, practices or techniques of Company or any subsidiary or affiliate.

ARTICLE IV. CONFIDENTIAL INFORMATION

4.1 **Definition.** For purposes of this Agreement, "Confidential Information" means any information that is not generally known to the public or to other persons who can obtain economic value from its disclosure or use; information which derives independent economic benefit from not being known to such persons; and information about the activities or business of Company that is not generally known to others engaged in similar business or activities, its products, services, finances, trade secrets, contracts, patents filed or pending, the techniques used in completing customer projects, research and development, data and information, processes, designs, engineering, marketing plans or techniques, organization or operation. The foregoing list is intended to be illustrative rather than comprehensive. Additionally, the term "confidential information" shall mean any confidential information as that term is defined in any agreement Employer may have with its customers or other third parties from time to time.

4.2 **Nondisclosure**. During the term of this Agreement or at any time thereafter, Employee agrees not to disclose Confidential information to any other third party or company, other than in connection with Employee's employment with Company, or use such information, directly or indirectly, for any purpose whatsoever, without the prior written consent of Company.

ARTICLE V. INVENTIONS

5.1 **Disclosure and Assignment of Inventions and Other Works**. During the term of this Agreement and for one year following the Separation Date, Employee shall promptly disclose to Company in writing all ideas, improvements and discoveries, whether or not such are patentable or copyrightable, and whether or not in writing or reduced to practice ("Inventions") and any writings, drawings, diagrams, charts, tables, databases, software (in object or source code and recorded on any medium), and any other works of authorship, whether or not such are copyrightable ("Works of Authorship") that are conceived, made, discovered, written or created by Employee alone or jointly with any person, group or entity, whether during the normal hours of his employment at Company or on Employee's own time. Employee hereby assigns all rights to all such Inventions and Works of Authorship to Company. Employee shall give Company all the assistance it reasonably requires for Company to perfect, protect, and use its rights to such Inventions and Works of Authorship. Employee shall sign all such documents, take all such actions and supply all such information that Company considers necessary or desirable to transfer or record the transfer of Company's entire right, title and interest in such Inventions and Works of Authorship and to enable Company to obtain exclusive patent, copyright, or other legal protection for Inventions and Works of Authorship anywhere in the world, provided Company shall bear all reasonable expenses of Employee in rendering such cooperation.

5.2 **Notice and Acknowledgement**. In accordance with Minnesota Statute § 181.78, the foregoing Section 5.1 does not require Employee to assign or offer to assign to Company any of Employee's rights in an Invention that Employee developed entirely on Employee's own time without using Company's equipment, supplies, facilities or trade secret information, and (1) that does not relate directly to Company's business or to Company's actual or demonstrably anticipated research or development, or (2) that does not result from any work performed by Employee for Company. For the purpose of this Section, "Company's business" shall be defined as development pertaining to implantable medical devices to treat obesity or devices to apply signals to a vagus nerve to treat a gastrointestinal disorder (e.g., obesity, pancreatitis or irritable bowel syndrome).

To the extent a provision in this Agreement purports to require Employee to assign Inventions otherwise excluded by this paragraph, the provision is against the public policy of the State of Minnesota and is unenforceable. By signing this Agreement, Employee acknowledges receipt of the notification required by Minnesota Statute § 181.78.

ARTICLE VI. NONCOMPETITION AND NONSOLICITATION

6.1 **Agreement Not to Compete**. During the Term of Employee's employment by Company, and for a period of 12 consecutive months from the date of termination of such employment for whatever reason (whether occasioned by Employee or Company), Employee shall not, directly or indirectly, in any place in the world, render services to any conflicting organization, or engage in competition with Company, in any manner or capacity, nor direct any other individual or business enterprise to engage in competition with Company in any manner or

capacity, (*e.g.*, as an advisor, principal, agent, partner, officer, director, stockholder of more than 1% of the outstanding shares of the capital stock of a publicly traded company, employee, member of any association or limited liability company or otherwise) on any products competitive with Company's existing products, any products competitive with Company's announced products or any products competitive with Company's pending products that have not yet been announced but which Employee has, or should have, actual or constructive knowledge. For the purposes of this Section, "conflicting organization" shall be defined as any person, corporation or entity that competes with any product, process or service, in existence or under development, of Company pertaining to implantable medical devices to treat obesity or devices to apply signals to a vagus nerve to treat a gastrointestinal disorder (*e.g.*, obesity, pancreatitis or irritable bowel syndrome).

6.2 **<u>Agreement Not to Solicit</u>**. Employee hereby acknowledges that the Company's customers constitute vital and valuable aspects of its business on a worldwide basis. In recognition of that fact, for a period of one (1) year following the termination of this Agreement for any reason whatsoever, Employee shall not solicit, or assist anyone else in the solicitation of, any of the Company's then-current customers to terminate their respective relationships with the Company and to become customers of any enterprise with which Employee may then be associated, affiliated or connected.

6.3 **<u>Agreement Not to Recruit</u>**. Employee hereby acknowledges that the Company's employees, consultants and other contractors constitute vital and valuable aspects of its business and missions on a worldwide basis. In recognition of that fact, for a period of one (1) year following the termination of this Agreement for any reason whatsoever, Employee shall not solicit, or assist anyone else in the solicitation of, any of the Company's then-current employees, consultants and other contractors to terminate their respective relationships with the Company and to become employees, consultants and other contractors of any enterprise with which Employee may then be associated, affiliated or connected.

ARTICLE VII: MISCELLANEOUS PROVISIONS

7.1 **<u>Company Remedies</u>**. Employee acknowledges and agrees that the restrictions and agreements contained in this Agreement are reasonable and necessary to protect the legitimate interests of Company, that the services to be rendered by Employee are of a special, unique and extraordinary character, that it would be difficult to replace such services and that any violation of Articles IV, V or VI of this Agreement would be highly injurious to Company, that Employee's violation of any of Articles IV, V or VI of this Agreement would cause Employer irreparable harm that would not be adequately compensated by monetary damages and that the remedy at law for any breach of any of the provisions of Articles IV, V and VI will be inadequate. Accordingly, Employee specifically agrees that Company shall be entitled, in addition to any remedy at law, to preliminary and permanent injunctive relief and specific performance for any actual or threatened violation of this Agreement and to enforce the provisions of Articles IV, V and VI of this Agreement.

7.2 **<u>Assignment</u>**. This Agreement shall not be assignable, in whole or in part, by Employee without the written consent of Company and any purported or attempted assignment or transfer of this Agreement or any of Employee's duties, responsibilities or obligations hereunder shall be

void. This Agreement is binding upon Employee, Employee's heirs and personal representatives. This Agreement shall inure to the benefit of and be binding upon Company and its successors and assigns. Notwithstanding the foregoing, Company may, without the consent of Employee, assign its rights and obligations under this Agreement to any business entity that has become the successor to Company in the event of a sale, merger, liquidation or similar transaction. After any such assignment by Company, Company shall be discharged from all further liability hereunder and such successor assignee shall thereafter be deemed to be Company for the purposes of all provisions of this Agreement.

7.3 **Notices.** All notices, requests, demands and other communications under this Agreement shall be in writing, shall be deemed to have been duly given on the date of service if personally served on the parties to whom notice is to be given, or on the third day after mailing if mailed to the parties to whom notice is given, whether by first class, registered, or certified mail, and properly addressed as follows:

If to the Company, at:	EnteroMedics Inc. 2800 Patton Road St. Paul, MN 55113
If to Employee, at:	26321 607th Street Mantorville, MN 55955

Any party may change the address for the purpose of this Section by giving the other written notice of the new address in the manner set forth above.

7.4 **Governing Law.** The validity, interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of Minnesota, without regard to conflicts of laws principles thereof.

7.5 **Arbitration.** The parties irrevocably consent that any litigation commenced or arising in connection with the interpretation or enforcement of this Agreement that has not been settled through negotiation within a period of thirty (30) days after the date on which either party shall first have notified the other party in writing of the existence of a dispute shall be settled by final and binding arbitration under the then-applicable Commercial Arbitration Rules of the American Arbitration Association ("AAA"). Any such arbitration shall be conducted by one (1) neutral arbitrator appointed by mutual agreement of the parties or, failing such agreement, in accordance with the AAA Rules. The arbitrator shall be an experienced attorney with a background in employment law. Any arbitration shall be conducted in Minneapolis, Minnesota. An arbitration award may be enforced in any court of competent jurisdiction. Notwithstanding any contrary provision in the AAA Rules, the following additional procedures and rules shall apply to any such arbitration:

(A) Each party shall have the right to request from the arbitrator, and the arbitrator shall order upon good cause shown, reasonable and limited pre-hearing discovery, including (1) exchange of witness lists, (2) depositions under oath of named witnesses at a mutually convenient location, (3) written interrogatories, and (4) document requests;

(B) Upon conclusion of the pre-hearing discovery, the arbitrator shall promptly hold a hearing upon the evidence to be adduced by the parties and shall promptly render a written opinion and award;

(C) The arbitrator may award damages or injunctive relief consistent with the terms of this Agreement but may not award or assess punitive damages against either party; and

(D) Each party shall bear his or its own costs and expenses of the arbitration and one-half (1/2) of the fees and costs of the arbitrator, subject to the power of the arbitrator, in his or her sole discretion, to award all such reasonable costs, expenses and attorneys' fees to the prevailing party.

7.6 **Construction.** Notwithstanding the general rules of construction, both Company and Employee acknowledge that both parties were given an equal opportunity to negotiate the terms and conditions contained in this Agreement, and agree that the identity of the drafter of this Agreement is not relevant to any interpretation of the terms and conditions of this Agreement.

7.7 **Severability.** In the event any provision of this Agreement (or portion thereof) shall be held illegal or invalid for any reason, said illegality or invalidity shall not in any way affect the legality or validity of any other provision of this Agreement. To the extent any provision (or portion thereof) of this Agreement shall be determined to be invalid or unenforceable in any jurisdiction, such provision (or portion thereof) shall be deemed to be deleted from this Agreement as to such jurisdiction only, and the validity and enforceability of the remainder of such provision and of this Agreement shall be unaffected.

7.8 **Entire Agreement.** This Agreement is the final, complete and exclusive agreement of the parties and sets forth the entire agreement between Company and Employee with respect to Employee's employment by Company, and there are no undertakings, covenants or commitments other than as set forth herein. The Agreement may not be altered or amended, except by a writing executed by Employee and a member of the Board. This Agreement supersedes, terminates, replaces and supplants any and all prior understandings or agreements between the parties relating in any way to the hiring or employment of Employee by Company.

7.9 **Survival.** The parties expressly acknowledge and agree that the provisions of this Agreement that by their express or implied terms extend beyond the expiration of this Agreement or the termination of Employee's employment under this Agreement, shall continue in full force and effect, notwithstanding Employee's termination of employment under this Agreement or the expiration of this Agreement.

7.10 **Waivers.** No failure on the part of either party to exercise, and no delay in exercising, any right or remedy under this Agreement shall operate as a waiver thereof; nor shall any single or partial exercise of any right or remedy under this Agreement preclude any other or further exercise thereof or the exercise of any other right or remedy granted hereby or by any related document or by law.

7.11 **Attorneys' Fees**. Upon receipt by Company of a statement for legal services from the attorneys representing Employee, Company shall reimburse Employee or pay on behalf of Employee the reasonable and necessary attorneys' fees and associated expenses incurred by Employee in connection with the negotiation of this Agreement.

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

ENTEROMEDICS INC.	**EMPLOYEE**
By: /S/ MARK B. KNUDSON	By: /S/ GREG LEA
Mark B. Knudson Its: President and CEO	Greg Lea
Date: May 21, 2007	Date: May 21, 2007

EXHIBIT A

GENERAL RELEASE

This General Release is made and entered into as of the ______ day of ____________ , ______ , by Employee ("Employee").

WHEREAS, EnteroMedics Inc. ("Company") and Employee are parties to an Employment Agreement dated ____________ ;

WHEREAS, Employee intends to settle any and all claims that Employee has or may have against Company as a result of Employee's employment with Company and the cessation of Employee's employment with Company; and

WHEREAS, Under the terms of the Employment Agreement, which Employee agrees are fair and reasonable, Employee agreed to enter into this General Release as a condition precedent to the severance arrangements described in Article III of the Employment Agreement.

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

1. **Release**. For the consideration expressed in the Employment Agreement, Employee does hereby fully and completely release and waive any and all claims, complaints, causes of action, demands, suits and damages, of any kind or character, which Employee has or may have against the Released Parties, as hereinafter defined, arising out of any acts, omissions, conduct, decisions, behavior or events occurring up through the date of Employee's signature on this General Release, including Employee's employment with Company and the cessation of that employment. For purposes of this General Release, "Released Parties" means collectively Company, its predecessors, successors, assigns, parents, affiliates, subsidiaries, related companies, officers, directors, shareholders, agents, servants, employees and insurers, and each and all thereof.

Employee understands and accepts that Employee's release of claims includes any and all possible discrimination claims, including, but not limited to, claims based upon: Title VII of the Federal Civil Rights Act of 1964, as amended; the Age Discrimination in Employment Act; the Americans with Disabilities Act; the Equal Pay Act; the Fair Labor Standards Act; the Employee Retirement Income Security Act; the Minnesota Human Rights Act; Minn. Stat. §181.81; or any other federal, state or local statute, ordinance or law. Employee also understands that Employee is giving up all other claims, including those grounded in contract or tort theories, including, but not limited to: wrongful discharge; violation of Minn. Stat. §176.82; breach of contract; tortious interference with contractual relations; promissory estoppel; breach of the implied covenant of good faith and fair dealing; breach of express or implied promise; breach of manuals or other policies; assault; battery; fraud; false imprisonment; invasion of privacy; intentional or negligent misrepresentation; defamation, including libel, slander, discharge defamation and self-publication defamation; discharge in violation of public policy; whistleblower; intentional or negligent infliction of emotional distress; or any other theory, whether legal or equitable.

Employee further understands that Employee is releasing, and does hereby release, any claims for damages, by charge or otherwise, whether brought by Employee or on Employee's behalf by any other party, governmental or otherwise, and agrees not to institute any claims for damages via administrative or legal proceedings against any of the Released Parties. Employee also waives and releases any and all rights to money damages or other legal relief awarded by any governmental agency related to any charge or other claim against any of the Released Parties.

This General Release does not apply to any post-termination claim that Employee may have for benefits under the provisions of any employee benefit plan maintained by Company.

Employee's release of claims shall not apply to any claims Employee might have to indemnification under Minnesota Statute §302A.521, any other applicable statute or regulation or Company's by-laws.

2. **Rescission**. Employee has been informed of Employee's right to rescind this General Release by written notice to Company within fifteen (15) calendar days after the execution of this General Release. Employee has been informed and understands that any such rescission must be in writing and delivered to Company by hand or sent by mail within the 15-day time period. If delivered by mail, the rescission must be: (1) postmarked within the applicable period and (2) sent by certified mail, return receipt requested.

Employee understands that Company will have no obligations under the Employment Agreement in the event a notice of rescission by Employee is timely delivered, and, in the event Employee rescinds this General Release, Employee agrees to repay to Company any payments made to Employee or benefits conferred upon him pursuant to Article III of the Employment Agreement prior to the date of rescission.

3. **Acceptance Period; Advice of Counsel**. The terms of this General Release will be open for acceptance by Employee for a period of 21 days during which time Employee may consider whether or not to accept this General Release. Employee agrees that changes to this General Release, whether material or immaterial, will not restart this acceptance period. Employee is hereby advised to seek the advice of an attorney regarding this General Release.

4. **Binding Agreement**. This General Release shall be binding upon, and inure to the benefit of, Employee and Company and their respective successors and permitted assigns.

5. **Representation**. Employee hereby acknowledges and states that Employee has read this General Release. Employee further represents that this General Release is written in language that is understandable to Employee, that Employee fully appreciates the meaning of its terms, and that Employee enters into this General Release freely and voluntarily.

IN WITNESS WHEREOF, Employee, after due consideration, has authorized, executed and delivered this General Release all as of the date first written.

Employee: ______________________________

ENTEROMEDICS INC.
EXECUTIVE EMPLOYMENT AGREEMENT

This Employment Agreement ("Agreement") is made and entered on February 9, 2007 ("Agreement Date") between EnteroMedics Inc. ("Company"), a Delaware corporation with its principal place of business at 2800 Patton Road, St. Paul, Minnesota 55113, and Adrianus Donders ("Employee"), a Minnesota resident, whose address is 15089 Crane Street NW, Andover, Minnesota 55304, for the purpose of setting forth the terms and conditions of Employee's employment by the Company.

RECITALS

WHEREAS, Employee possesses certain skills, talents, contacts, judgment and knowledge of the business of Company;

WHEREAS, Employee is currently employed by the Company as its Senior Vice President Operations desires to have the continued benefit of Employee's employment in such capacities, and Employee desires to continue to serve in such capacities, pursuant to the terms and conditions set forth in this Agreement; and

WHEREAS, Employee understands that such continued employment is expressly conditioned on execution of this Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of Employee's continued employment with Company and the foregoing premises, the mutual covenants set forth below and other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, Company and Employee agree as follows:

ARTICLE I: EMPLOYMENT, TERM, AND DUTIES

1.1 **Employment.** Company hereby employs Employee as Senior Vice President Operations, and Employee accepts such employment and agrees to perform services for Company pursuant to the terms and conditions set forth in this Agreement.

1.2 **Term.** The term ("Term") of this Agreement shall commence on the Agreement Date and, unless earlier terminated in accordance with Article III of this Agreement, shall terminate one year from the Agreement Date; provided, however, the term of this Agreement shall automatically renew for successive one year terms thereafter unless prior to ninety (90) days of the expiration of the initial Term or any additional Terms, either party provides written notice to the other of its or his desire to terminate this Agreement.

1.3 **Position and Duties**.

1.3.1 **Service with Company.** During the Term, Employee agrees to perform such duties and responsibilities as are assigned to him from time to time by the Company's Board of Directors ("Board").

1.3.2 **Performance of Duties.** During the Term, Employee agrees to serve Company in an Executive capacity as Senior Vice President Operations and shall perform such duties as are customarily associated with these current titles and as required by the Company's Board of Directors.

ARTICLE II. COMPENSATION, BENEFITS AND EXPENSES

2.1 **Base Salary.** Subject to the provisions of Article III of this Agreement, during the Term, Company shall pay Employee a Base Salary not less than $235,000 per year or such higher annual rate as may from time to time be approved by the Board. Such Base Salary shall be paid in substantially equal regular periodic payments, less deductions and withholdings, in accordance with Company's regular payroll procedures, policies and practices as such may be modified from time to time. The Base Salary shall be reviewed by the Board annually for potential adjustment on the basis of performance and Employee shall be eligible, at Company's sole discretion, for annual salary increases consistent with Company's procedures, policies and practices. If Employee's Base Salary is increased from time to time during the Term, the increased amount shall become the Base Salary for the remainder of the Term and any extensions of the Term and for as long thereafter as required pursuant to Article III as applicable, subject to any subsequent increases.

2.2 **Incentive Compensation.** In addition to Base Salary, Company shall make Employee eligible for such cash and equity pursuant to Company's Incentive Compensation Plan, if any, as may be applicable and adopted by Company. Payment of incentive compensation will be subject to Employee achieving certain objectives set annually by Employee and the CEO, with the target amount of any cash incentive compensation for any calendar year to be approved by the Compensation Committee of the Board, which in no event shall exceed 25% of Employee's base salary in effect from time to time. Employee and the CEO will meet and review the objectives set by the CEO for the upcoming calendar year prior to March 31 of each year.

2.3 **Participation in Benefits.** During the Term of Employee's employment by Company, Employee shall be entitled to participate in the employee benefits offered generally by Company to its employees, to the extent that Employee's position, tenure, salary, health and other qualifications make Employee eligible to participate. Without limiting the foregoing, Employee shall be eligible to participate in any pension plan, or group life, health or accident insurance or any such other plan or policy that may presently be in effect or that may hereafter be adopted by the Company for the benefit of its employees and corporate officers generally. Employee is eligible to receive six weeks of Paid Time Off ("PTO") on an annual basis subject to Company's PTO policy. PTO includes all forms of personal leave including vacation and sick leave. Employee's participation in such benefits shall be subject to the terms of the applicable plans, as the same may be amended from time to time. Company does not guarantee the adoption or continuance of any particular employee benefit during Employee's employment, and nothing in this Agreement is intended to, or shall in any way restrict the right of Company, to amend, modify or terminate any of its benefits during the Term of this Agreement.

ARTICLE III: TERMINATION AND COMPENSATION FOLLOWING TERMINATION

3.1 **Termination**. Subject to the respective continuing obligations of the parties under this Agreement, this Agreement and Employee's employment hereunder may be terminated prior to the end of the Term (the "Separation Date") under the following circumstances:

3.1.1 **Termination By Mutual Agreement**. By mutual written agreement of the parties at any time.

3.1.2 **Termination By Employee's Death**. In the event of Employee's death.

3.1.3 **Termination By Employee's Disability**. In the event Employee becomes Disabled. For purposes of this Agreement, "Disabled" or "Disability" means the incapacity or inability of Employee, whether due to accident, sickness or otherwise (with the exception of the illegal use of drugs), as determined by a medical doctor acceptable to Company and confirmed in writing by such doctor, to perform the essential functions of Employee's position under this Agreement, with or without reasonable accommodation (provided that no accommodation that imposes undue hardship on Company will be required) for an aggregate of ninety (90) days during any period of one hundred eighty (180) consecutive days, or such longer period as may be required under applicable law.

3.1.4 **Termination By Company For Cause**. Company may terminate this Agreement and Employee's employment for Cause at any time after providing written notice to Employee. For purposes of this Agreement, "Cause" means: (a) willful breach of Employee's duties to Company or willful breach of this Agreement; (b) conviction of any felony or any crime involving fraud, dishonesty, or moral turpitude; (c) participation in any fraud against or affecting Company or any subsidiary, affiliate, customer, supplier, client, agent, or employee thereof; or (d) any other act Company determines constitutes gross or willful misconduct detrimental to Company including, but not limited to, unethical practices, dishonesty, disloyalty, or any other acts harmful to Company; provided, however that a for Cause termination pursuant to clause (a), if susceptible of cure, shall not become effective unless Employee fails to cure such failure to perform or breach within thirty (30) days after his receipt of written notice from Company, such notice to describe such failure to perform or breach and identify what reasonable actions shall be required to cure such failure to perform or breach.

3.1.5 **Termination By Employee Without Good Reason**. The Employee may terminate Employee's employment under this Agreement at any time for any reason or no reason with thirty (30) days written notice.

3.1.6 **Termination By Company Without Cause**. Company may terminate Employee's employment under this Agreement at any time for any reason or no reason with 30 days written notice including following a Change in Control as defined in Employee's applicable Sample Company Inc. Incentive Stock Option Agreement(s) or Non-Incentive Stock Option Agreement(s) ("Employee's Stock Option Agreements") as the case may be, except that no notice shall be required for a termination without Cause following a Change in Control. A termination of this Agreement and employee's employment pursuant to the operation of the provisions of Section 1.2 of this Agreement shall be deemed a termination by Company without Cause.

3.1.7 **Termination By Employee For Good Reason**. Employee may terminate Employee's employment pursuant to this Agreement for Good Reason. For purposes of this Agreement, "Good Reason" means: (a) at any time, the assignment by Company to Employee of employment duties, functions or responsibilities that are significantly different from, and result in a substantial diminution of, Employee's duties, functions or responsibilities; or (b) at any time, a requirement that Employee be based at any office or location more than 25 miles from Employee's primary work location prior to the date of this Agreement.

3.2 **Compensation Following Termination Prior to End of the Term**. In the event that Employee's employment pursuant to this Agreement is terminated prior to the end of the Term, Employee shall be entitled to the following compensation and benefits upon such termination:

3.2.1 **Payment of Base of Salary.** In the event that Employee's employment is terminated pursuant to any subsection of Section 3.1 of this Agreement, Company shall, within 14 calendar days following the Separation Date, pay to Employee, Employee's spouse or Employee's estate, as the case may be, any amounts due to Employee for Base Salary through the Separation Date.

In the event of a termination pursuant to Section 3.1.5 (by Employee without Good Reason), upon receiving Employee's notice, Company has the option, at its discretion (a) to continue to engage Employee's services through the 30 day notice period until the Separation Date, or (b) terminate the use of Employee's services during the 30 day notice period prior to the Separation Date but treat Employee as if he were providing services through the 30 day notice period until the Separation Date for purposes of determining Employee's compensation due him pursuant to this Section 3.2.1.

3.2.2 **Payment of Incentive Compensation.** In the event that Employee's employment is terminated prior to the expiration of the Term pursuant to subsections 3.1.1; 3.1.2; 3.1.3; 3.1.6; or 3.1.7 of Section 3.1 of this Agreement, Company shall, within 14 calendar days following the Separation Date, also pay to Employee, Employee's spouse or Employee's estate, as the case may be, any amounts due to Employee for unpaid and pro rata amounts to which Employee is entitled as of the Separation Date pursuant to Section 2.2 of this Agreement.

3.2.3 **Payment of Severance for Termination By Company Without Cause or By Employee for Good Reason**. In the event that Employee's employment is terminated prior to the expiration of the Term pursuant to subsection 3.1.6 (By Company Without Cause) or 3.1.7 (By Employee for Good Reason) and provided Employee has executed a written release to Company in substantially the same form attached hereto as Exhibit A and the rescission period specified therein has expired, Company shall also continue to pay, as severance pay, Employee's Base Salary at the rate in effect on the Separation Date, for a period of 6 months following the Separation Date. Such payments will be at usual and customary pay intervals of Employer and will be subject to all appropriate deductions and withholdings.

Additionally, pursuant to the terms and conditions set forth in Employee's applicable Stock Option Agreements with Company, Company agrees that, notwithstanding anything to the contrary set forth in such Stock Option Agreements or Company's Stock Incentive Plan, as may be amended from time to time, during the five-year period following the Separation Date, Employee shall be permitted to exercise immediately all Options granted to Employee that have vested as of the Separation Date and those Options that would have vested within one year of the Separation Date had Employee's employment with Company not terminated. The parties hereto agree and acknowledge that, with respect to any Options previously granted to Employee that were intended by the parties to be treated as "incentive stock options" within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, such Options, to the extent they may be exercised by Employee more than 90 days following the Separation Date shall be treated as non-qualified Options, notwithstanding any provision in Employee's Stock Option Agreements to the contrary.

In the event that a Change in Control occurs, and Employee is not terminated, the vesting schedule of Options held by Employee shall accelerate such that on the date the Change of Control is completed 50% of any unvested shares of Employee shall immediately vest and shall be exercisable during the five-year period following the Separation Date notwithstanding anything to the contrary set forth in Employee's applicable Stock Option Agreements with the Company or Company's Stock Incentive Plan; provided, however, that if, in connection with the consummation of the transaction resulting in the Change in Control, Employee receives a cash payment with respect to each Option equal to the difference or "spread" between (i) the per share amount paid to holders of Common Stock in such transaction and (ii) the per share exercise price under the applicable option agreement, his Options shall be cancelled upon the consummation of the Change in Control in exchange for such cash payment.

In the event that a Change in Control occurs, and Employee is terminated, the vesting schedule of Options held by Employee shall accelerate such that on the date the Change of Control is completed 100% of any unvested shares of Employee shall immediately vest and shall be exercisable during the five-year period following the Separation Date notwithstanding anything to the contrary set forth in Employee's applicable Stock Option Agreements with the Company or Company's Stock Incentive Plan; provided, however, that if, in connection with the consummation of the transaction resulting in the Change in Control, Employee receives a cash payment with respect to each Option equal to the difference or "spread" between (i) the per share amount paid to holders of Common Stock in such transaction and (ii) the per share exercise price under the applicable option agreement, his Options shall be cancelled upon the consummation of the Change in Control in exchange for such cash payment.

3.2.4 **General Provision Regarding Treatment of Options.** Except as otherwise specified in Sections 3.2.3 of this Agreement, the terms of the Stock Incentive Plan and Employee's Stock Option Agreements, as applicable, shall govern the treatment of Employee's Options following the Separation Date.

3.3 **Benefits Following Termination Prior to the End of the Term.** In the event that Employee's employment is terminated pursuant to subsections 3.1.2; 3.1.3; 3.1.6; or 3.1.7 of Section 3.1 of this Agreement, Employee shall, at no cost to Employee, be entitled to continue to participate in Company-provided medical, dental, and life insurance programs for a period of

6 months following the Separation Date irrespective of any then pre-existing health conditions of Employee or his spouse provided, however, that, if this Agreement is terminated as a result of Employee's death, Employee's then current spouse shall be entitled to continue to participate in Company-provided medical and dental insurance programs for one year after Employee's death irrespective of any then pre-existing health conditions, unless, in each case, such continued participation is prohibited by any applicable laws or would otherwise jeopardize the tax qualified status of any such programs. If Company is prohibited by applicable law or would otherwise jeopardize the tax qualified status of any medical, dental, or life insurance plan and as a result Company terminates coverage, it shall promptly reimburse Employee (or Employee's spouse as the case may be) for the cost of obtaining comparable third party coverage irrespective of any then preexisting health conditions of Employee and/or his spouse.

Except as otherwise provided in this Section 3.3, the benefits to which Employee (or, as applicable, Employee's spouse or estate) may be entitled upon termination pursuant to the plans and policies of Company specified Article II of this Agreement shall be determined and paid in accordance with such plans and policies.

3.4 **Surrender of Records and Property**. Upon termination of Employee's employment with Company, Employee shall deliver promptly to Company all Confidential Information as defined in Section 4.1 and all Company property including, but not necessarily limited to records, manuals, books, blank forms, documents, letters, memoranda, business plans, minutes, notes, notebooks, reports, computer disks, computer software, computer programs (including source code, object code, on-line files, documentation, testing materials and plans and reports), computer print-outs, member or customer lists, credit cards, keys, identification, products, access cards, designs, drawings, sketches, devices, specifications, formulae, data, tables or calculations or copies thereof, and all other tangible or intangible property relating in any way to the business of Company that are the property of Company or any subsidiary or affiliate, if any, or which relate in any way to the business, products, practices or techniques of Company or any subsidiary or affiliate.

ARTICLE IV. CONFIDENTIAL INFORMATION

4.1 **Definition.** For purposes of this Agreement, "Confidential Information" means any information that is not generally known to the public or to other persons who can obtain economic value from its disclosure or use; information which derives independent economic benefit from not being known to such persons; and information about the activities or business of Company that is not generally known to others engaged in similar business or activities, its products, services, finances, trade secrets, contracts, patents filed or pending, the techniques used in completing customer projects, research and development, data and information, processes, designs, engineering, marketing plans or techniques, organization or operation. The foregoing list is intended to be illustrative rather than comprehensive. Additionally, the term "confidential information" shall mean any confidential information as that term is defined in any agreement Employer may have with its customers or other third parties from time to time.

4.2 **Nondisclosure**. During the term of this Agreement or at any time thereafter, Employee agrees not to disclose Confidential information to any other third party or company, other than in connection with Employee's employment with Company, or use such information, directly or indirectly, for any purpose whatsoever, without the prior written consent of Company.

ARTICLE V. INVENTIONS

5.1 **Disclosure and Assignment of Inventions and Other Works**. During the term of this Agreement and for one year following the Separation Date, Employee shall promptly disclose to Company in writing all ideas, improvements and discoveries, whether or not such are patentable or copyrightable, and whether or not in writing or reduced to practice (“Inventions”) and any writings, drawings, diagrams, charts, tables, databases, software (in object or source code and recorded on any medium), and any other works of authorship, whether or not such are copyrightable (“Works of Authorship”) that are conceived, made, discovered, written or created by Employee alone or jointly with any person, group or entity, whether during the normal hours of his employment at Company or on Employee’s own time. Employee hereby assigns all rights to all such Inventions and Works of Authorship to Company. Employee shall give Company all the assistance it reasonably requires for Company to perfect, protect, and use its rights to such Inventions and Works of Authorship. Employee shall sign all such documents, take all such actions and supply all such information that Company considers necessary or desirable to transfer or record the transfer of Company’s entire right, title and interest in such Inventions and Works of Authorship and to enable Company to obtain exclusive patent, copyright, or other legal protection for Inventions and Works of Authorship anywhere in the world, provided Company shall bear all reasonable expenses of Employee in rendering such cooperation.

5.2 **Notice and Acknowledgement**. In accordance with Minnesota Statute § 181.78, the foregoing Section 5.1 does not require Employee to assign or offer to assign to Company any of Employee’s rights in an Invention that Employee developed entirely on Employee’s own time without using Company’s equipment, supplies, facilities or trade secret information, and (1) that does not relate directly to Company’s business or to Company’s actual or demonstrably anticipated research or development, or (2) that does not result from any work performed by Employee for Company. For the purposes of this Section, “Company’s business” shall be defined as development pertaining to implantable medical devices to treat obesity or devices to apply signals to a vagus nerve to treat a gastrointestinal disorder (e.g., obesity, pancreatitis or irritable bowel syndrome).

To the extent a provision in this Agreement purports to require Employee to assign Inventions otherwise excluded by this paragraph, the provision is against the public policy of the State of Minnesota and is unenforceable. By signing this Agreement, Employee acknowledges receipt of the notification required by Minnesota Statute § 181.78.

ARTICLE VI. NONCOMPETITION AND NONSOLICITATION

6.1 **Agreement Not to Compete**. During the Term of Employee’s employment by Company, and for a period of 12 consecutive months from the date of termination of such employment for whatever reason (whether occasioned by Employee or Company), Employee shall not, directly or indirectly, in any place in the world, render services to any conflicting organization, or engage in competition with Company, in any manner or capacity, nor direct any other individual or business enterprise to engage in competition with Company in any manner or

capacity, (*e.g.*, as an advisor, principal, agent, partner, officer, director, stockholder of more than 1% of the outstanding shares of the capital stock of a publicly traded company, employee, member of any association or limited liability company or otherwise) on any products competitive with Company's existing products, any products competitive with Company's announced products or any products competitive with Company's pending products that have not yet been announced but which Employee has, or should have, actual or constructive knowledge. For the purposes of this Section, "conflicting organization" shall be defined as any person, corporation or entity that competes with any product, process or service, in existence or under development, of Company pertaining to implantable medical devices to treat obesity or devices to apply signals to a vagus nerve to treat a gastrointestinal disorder (*e.g.*, obesity, pancreatitis or irritable bowel syndrome).

6.2 **Agreement Not to Solicit**. Employee hereby acknowledges that the Company's customers constitute vital and valuable aspects of its business on a worldwide basis. In recognition of that fact, for a period of one (1) year following the termination of this Agreement for any reason whatsoever, Employee shall not solicit, or assist anyone else in the solicitation of, any of the Company's then-current customers to terminate their respective relationships with the Company and to become customers of any enterprise with which Employee may then be associated, affiliated or connected.

6.3 **Agreement Not to Recruit**. Employee hereby acknowledges that the Company's employees, consultants and other contractors constitute vital and valuable aspects of its business and missions on a worldwide basis. In recognition of that fact, for a period of one (1) year following the termination of this Agreement for any reason whatsoever, Employee shall not solicit, or assist anyone else in the solicitation of, any of the Company's then-current employees, consultants or other contractors to terminate their respective relationships with the Company and to become employees, consultants or contractors by any enterprise with which Employee may then be associated, affiliated or connected.

ARTICLE VII: MISCELLANEOUS PROVISIONS

7.1 **Company Remedies**. Employee acknowledges and agrees that the restrictions and agreements contained in this Agreement are reasonable and necessary to protect the legitimate interests of Company, that the services to be rendered by Employee are of a special, unique and extraordinary character, that it would be difficult to replace such services and that any violation of Articles IV, V or VI of this Agreement would be highly injurious to Company, that Employee's violation of any of Articles IV, V or VI of this Agreement would cause Employer irreparable harm that would not be adequately compensated by monetary damages and that the remedy at law for any breach of any of the provisions of Articles IV, V and VI will be inadequate. Accordingly, Employee specifically agrees that Company shall be entitled, in addition to any remedy at law, to preliminary and permanent injunctive relief and specific performance for any actual or threatened violation of this Agreement and to enforce the provisions of Articles IV, V and VI of this Agreement.

7.2 **Assignment**. This Agreement shall not be assignable, in whole or in part, by Employee without the written consent of Company and any purported or attempted assignment or transfer of this Agreement or any of Employee's duties, responsibilities or obligations hereunder shall be

void. This Agreement is binding upon Employee, Employee's heirs and personal representatives. This Agreement shall inure to the benefit of and be binding upon Company and its successors and assigns. Notwithstanding the foregoing, Company may, without the consent of Employee, assign its rights and obligations under this Agreement to any business entity that has become the successor to Company in the event of a sale, merger, liquidation or similar transaction. After any such assignment by Company, Company shall be discharged from all further liability hereunder and such successor assignee shall thereafter be deemed to be Company for the purposes of all provisions of this Agreement.

7.3 **Notices**. All notices, requests, demands and other communications under this Agreement shall be in writing, shall be deemed to have been duly given on the date of service if personally served on the parties to whom notice is to be given, or on the third day after mailing if mailed to the parties to whom notice is given, whether by first class, registered, or certified mail, and properly addressed as follows:

If to the Company, at:	EnteroMedics Inc. 2800 Patton Road St. Paul, MN 55113
If to Employee, at:	15089 Crane Street NW Andover, Minnesota 55304

Any party may change the address for the purpose of this Section by giving the other written notice of the new address in the manner set forth above.

7.4 **Governing Law.** The validity, interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of Minnesota, without regard to conflicts of laws principles thereof.

7.5 **Arbitration.** The parties irrevocably consent that any litigation commenced or arising in connection with the interpretation or enforcement of this Agreement that has not been settled through negotiation within a period of thirty (30) days after the date on which either party shall first have notified the other party in writing of the existence of a dispute shall be settled by final and binding arbitration under the then-applicable Commercial Arbitration Rules of the American Arbitration Association ("AAA"). Any such arbitration shall be conducted by one (1) neutral arbitrator appointed by mutual agreement of the parties or, failing such agreement, in accordance with the AAA Rules. The arbitrator shall be an experienced attorney with a background in employment law. Any arbitration shall be conducted in Minneapolis, Minnesota. An arbitration award may be enforced in any court of competent jurisdiction. Notwithstanding any contrary provision in the AAA Rules, the following additional procedures and rules shall apply to any such arbitration:

(A) Each party shall have the right to request from the arbitrator, and the arbitrator shall order upon good cause shown, reasonable and limited pre-hearing discovery, including (1) exchange of witness lists, (2) depositions under oath of named witnesses at a mutually convenient location, (3) written interrogatories, and (4) document requests;

(B) Upon conclusion of the pre-hearing discovery, the arbitrator shall promptly hold a hearing upon the evidence to be adduced by the parties and shall promptly render a written opinion and award;

(C) The arbitrator may award damages or injunctive relief consistent with the terms of this Agreement but may not award or assess punitive damages against either party; and

(D) Each party shall bear his or its own costs and expenses of the arbitration and one- half (1/2) of the fees and costs of the arbitrator, subject to the power of the arbitrator, in his or her sole discretion, to award all such reasonable costs, expenses and attorneys’ fees to the prevailing party.

7.6 **Construction.** Notwithstanding the general rules of construction, both Company and Employee acknowledge that both parties were given an equal opportunity to negotiate the terms and conditions contained in this Agreement, and agree that the identity of the drafter of this Agreement is not relevant to any interpretation of the terms and conditions of this Agreement.

7.7 **Severability.** In the event any provision of this Agreement (or portion thereof) shall be held illegal or invalid for any reason, said illegality or invalidity shall not in any way affect the legality or validity of any other provision of this Agreement. To the extent any provision (or portion thereof) of this Agreement shall be determined to be invalid or unenforceable in any jurisdiction, such provision (or portion thereof) shall be deemed to be deleted from this Agreement as to such jurisdiction only, and the validity and enforceability of the remainder of such provision and of this Agreement shall be unaffected.

7.8 **Entire Agreement.** This Agreement is the final, complete and exclusive agreement of the parties and sets forth the entire agreement between Company and Employee with respect to Employee’s employment by Company, and there are no undertakings, covenants or commitments other than as set forth herein. The Agreement may not be altered or amended, except by a writing executed by Employee and a member of the Board. This Agreement supersedes, terminates, replaces and supplants any and all prior understandings or agreements between the parties relating in any way to the hiring or employment of Employee by Company.

7.9 **Survival.** The parties expressly acknowledge and agree that the provisions of this Agreement that by their express or implied terms extend beyond the expiration of this Agreement or the termination of Employee’s employment under this Agreement, shall continue in full force and effect, notwithstanding Employee’s termination of employment under this Agreement or the expiration of this Agreement.

7.10 **Waivers.** No failure on the part of either party to exercise, and no delay in exercising, any right or remedy under this Agreement shall operate as a waiver thereof; nor shall any single or partial exercise of any right or remedy under this Agreement preclude any other or further exercise thereof or the exercise of any other right or remedy granted hereby or by any related document or by law.

7.11 **Attorneys' Fees.** Upon receipt by Company of a statement for legal services from the attorneys representing Employee, Company shall reimburse Employee or pay on behalf of Employee the reasonable and necessary attorneys' fees and associated expenses incurred by Employee in connection with the negotiation of this Agreement.

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

ENTEROMEDICS INC.	**EMPLOYEE**
By: /s/ Mark B. Knudson	By: /s/ Adrianus Donders
Mark B. Knudson	Adrianus Donders
Its: President and CEO	
Date: February 9, 2007	Date:

EXHIBIT A

GENERAL RELEASE

This General Release is made and entered into as of the __ day of ______, __ by Employee("Employee").

WHEREAS, EnteroMedics Inc. ("Company") and Employee are parties to an Employment Agreement dated __________;

WHEREAS, Employee intends to settle any and all claims that Employee has or may have against Company as a result of Employee's employment with Company and the cessation of Employee's employment with Company; and

WHEREAS, Under the terms of the Employment Agreement, which Employee agrees are fair and reasonable, Employee agreed to enter into this General Release as a condition precedent to the severance arrangements described in Article III of the Employment Agreement.

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

1. **Release**. For the consideration expressed in the Employment Agreement, Employee does hereby fully and completely release and waive any and all claims, complaints, causes of action, demands, suits and damages, of any kind or character, which Employee has or may have against the Released Parties, as hereinafter defined, arising out of any acts, omissions, conduct, decisions, behavior or events occurring up through the date of Employee's signature on this General Release, including Employee's employment with Company and the cessation of that employment. For purposes of this General Release, "Released Parties" means collectively Company, its predecessors, successors, assigns, parents, affiliates, subsidiaries, related companies, officers, directors, shareholders, agents, servants, employees and insurers, and each and all thereof.

Employee understands and accepts that Employee's release of claims includes any and all possible discrimination claims, including, but not limited to, claims based upon: Title VII of the Federal Civil Rights Act of 1964, as amended; the Age Discrimination in Employment Act; the Americans with Disabilities Act; the Equal Pay Act; the Fair Labor Standards Act; the Employee Retirement Income Security Act; the Minnesota Human Rights Act; Minn. Stat. §181.81; or any other federal, state or local statute, ordinance or law. Employee also understands that Employee is giving up all other claims, including those grounded in contract or tort theories, including, but not limited to: wrongful discharge; violation of Minn. Stat. §176.82; breach of contract; tortious interference with contractual relations; promissory estoppel; breach of the implied covenant of good faith and fair dealing; breach of express or implied promise; breach of manuals or other policies; assault; battery; fraud; false imprisonment; invasion of privacy; intentional or negligent misrepresentation; defamation, including libel, slander, discharge defamation and self-publication defamation; discharge in violation of public policy; whistleblower; intentional or negligent infliction of emotional distress; or any other theory, whether legal or equitable.

Employee further understands that Employee is releasing, and does hereby release, any claims for damages, by charge or otherwise, whether brought by Employee or on Employee's behalf by any other party, governmental or otherwise, and agrees not to institute any claims for damages via administrative or legal proceedings against any of the Released Parties. Employee also waives and releases any and all rights to money damages or other legal relief awarded by any governmental agency related to any charge or other claim against any of the Released Parties.

This General Release does not apply to any post-termination claim that Employee may have for benefits under the provisions of any employee benefit plan maintained by Company.

Employee's release of claims shall not apply to any claims Employee might have to indemnification under Minnesota Statute §302A.521, any other applicable statute or regulation or Company's by-laws.

2. **Rescission**. Employee has been informed of Employee's right to rescind this General Release by written notice to Company within fifteen (15) calendar days after the execution of this General Release. Employee has been informed and understands that any such rescission must be in writing and delivered to Company by hand or sent by mail within the 15-day time period. If delivered by mail, the rescission must be: (1) postmarked within the applicable period and (2) sent by certified mail, return receipt requested.

Employee understands that Company will have no obligations under the Employment Agreement in the event a notice of rescission by Employee is timely delivered, and, in the event Employee rescinds this General Release, Employee agrees to repay to Company any payments made to Employee or benefits conferred upon him pursuant to Article III of the Employment Agreement prior to the date of rescission.

3. **Acceptance Period; Advice of Counsel**. The terms of this General Release will be open for acceptance by Employee for a period of 21 days during which time Employee may consider whether or not to accept this General Release. Employee agrees that changes to this General Release, whether material or immaterial, will not restart this acceptance period. Employee is hereby advised to seek the advice of an attorney regarding this General Release.

4. **Binding Agreement**. This General Release shall be binding upon, and inure to the benefit of, Employee and Company and their respective successors and permitted assigns.

5. **Representation**. Employee hereby acknowledges and states that Employee has read this General Release. Employee further represents that this General Release is written in language that is understandable to Employee, that Employee fully appreciates the meaning of its terms, and that Employee enters into this General Release freely and voluntarily.

IN WITNESS WHEREOF, Employee, after due consideration, has authorized, executed and delivered this General Release all as of the date first written.

____

Adrianus Donders

____

Date

EXHIBIT 10.11

ENTEROMEDICS INC.
EXECUTIVE EMPLOYMENT AGREEMENT

This Employment Agreement (“Agreement”) is made and entered on May 16, 2007 (“Agreement Date”) between EnteroMedics Inc. (“Company”), a Delaware corporation with its principal place of business at 2800 Patton Road, St. Paul, Minnesota 55113, and Russell Felkey (“Employee”), a Minnesota resident, whose address is 15227 Highland Bluff, Minnetonka, MN 55345, for the purpose of setting forth the terms and conditions of Employee’s employment by the Company.

RECITALS

WHEREAS, Employee possesses certain skills, talents, contacts, judgment and knowledge of the business of Company;

WHEREAS, Employee is currently employed by the Company as Senior Vice President desires to have the continued benefit of Employee’s employment in such capacities, and Employee desires to continue to serve in such capacities, pursuant to the terms and conditions set forth in this Agreement; and

WHEREAS, Employee understands that such continued employment is expressly conditioned on execution of this Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of Employee’s continued employment with Company and the foregoing premises, the mutual covenants set forth below and other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, Company and Employee agree as follows:

ARTICLE I: EMPLOYMENT, TERM, AND DUTIES

1.1 **Employment.** Company hereby employs Employee as Senior Vice President and Employee accepts such employment and agrees to perform services for Company pursuant to the terms and conditions set forth in this Agreement.

1.2 **Term.** The term (“Term”) of this Agreement shall commence on the Agreement Date and, unless earlier terminated in accordance with Article III of this Agreement, shall terminate one year from the Agreement Date; provided, however, the term of this Agreement shall automatically renew for successive one year terms thereafter unless prior to ninety (90) days of the expiration of the initial Term or any additional Terms, either party provides written notice to the other of its or his desire to terminate this Agreement.

1.3 **Position and Duties.**

1.3.1 **Service with Company.** During the Term, Employee agrees to perform such duties and responsibilities as are assigned to him from time to time by the CEO and Company’s

Board of Directors ("Board") which currently encompasses Quality Systems, Regulatory and Clinical Affairs.

1.3.2 **Performance of Duties.** During the Term, Employee agrees to serve Company in an Executive capacity as Senior Vice President and shall perform such duties as are required by the CEO and Company's Board of Directors.

ARTICLE II. COMPENSATION, BENEFITS AND EXPENSES

2.1 **Base Salary.** Subject to the provisions of Article III of this Agreement, during the Term, Company shall pay Employee a Base Salary not less than $230,000 per year or such higher annual rate as may from time to time be approved by the Board. Such Base Salary shall be paid in substantially equal regular periodic payments, less deductions and withholdings, in accordance with Company's regular payroll procedures, policies and practices as such may be modified from time to time. The Base Salary shall be reviewed by the compensation committee of the Board annually for potential adjustment on the basis of performance and Employee shall be eligible, at Company's sole discretion, for annual salary increases consistent with Company's procedures, policies and practices. If Employee's Base Salary is increased from time to time during the Term, the increased amount shall become the Base Salary for the remainder of the Term and any extensions of the Term and for as long thereafter as required pursuant to Article III as applicable, subject to any subsequent increases.

2.2 **Incentive Compensation.** In addition to Base Salary, Company shall make Employee eligible for such cash and equity pursuant to Company's Incentive Compensation Plan, if any, as may be applicable and adopted by Company. Payment of incentive compensation will be subject to Employee achieving certain objectives set annually by Employee and the Compensation Committee of the Board, with the target amount of any cash incentive compensation for any calendar year to be approved by the Compensation Committee of the Board, which in no event shall exceed 25% of Employee's base salary in effect from time to time. Employee and the CEO will meet and review the objectives set by the CEO for the upcoming calendar year prior to March 31 of each year.

2.3 **Participation in Benefits.** During the Term of Employee's employment by Company, Employee shall be entitled to participate in the employee benefits offered generally by Company to its employees, to the extent that Employee's position, tenure, salary, health and other qualifications make Employee eligible to participate. Without limiting the foregoing, Employee shall be eligible to participate in any pension plan, or group life, health or accident insurance or any such other plan or policy that may presently be in effect or that may hereafter be adopted by the Company for the benefit of its employees and corporate officers generally. Employee is eligible to receive six weeks of Paid Time Off ("PTO") on an annual basis subject to Company's PTO policy. PTO includes all forms of personal leave including vacation and sick leave. Employee's participation in such benefits shall be subject to the terms of the applicable plans, as the same may be amended from time to time. Company does not guarantee the adoption or continuance of any particular employee benefit during Employee's employment, and nothing in this Agreement is intended to, or shall in any way restrict the right of Company, to amend, modify or terminate any of its benefits during the Term of this Agreement.

ARTICLE III: TERMINATION AND COMPENSATION FOLLOWING TERMINATION

3.1 **Termination**. Subject to the respective continuing obligations of the parties under this Agreement, this Agreement and Employee's employment hereunder may be terminated prior to the end of the Term (the "Separation Date") under the following circumstances:

3.1.1 **Termination By Mutual Agreement**. By mutual written agreement of the parties at any time.

3.1.2 **Termination By Employee's Death**. In the event of Employee's death.

3.1.3 **Termination By Employee's Disability**. In the event Employee becomes Disabled. For purposes of this Agreement, "Disabled" or "Disability" means the incapacity or inability of Employee, whether due to accident, sickness or otherwise (with the exception of the illegal use of drugs), as determined by a medical doctor acceptable to Company and confirmed in writing by such doctor, to perform the essential functions of Employee's position under this Agreement, with or without reasonable accommodation (provided that no accommodation that imposes undue hardship on Company will be required) for an aggregate of ninety (90) days during any period of one hundred eighty (180) consecutive days, or such longer period as may be required under applicable law.

3.1.4 **Termination By Company For Cause**. Company may terminate this Agreement and Employee's employment for Cause at any time after providing written notice to Employee. For purposes of this Agreement, "Cause" means: (a) willful breach of Employee's duties to Company or willful breach of this Agreement; (b) conviction of any felony or any crime involving fraud, dishonesty, or moral turpitude; (c) participation in any fraud against or affecting Company or any subsidiary, affiliate, customer, supplier, client, agent, or employee thereof; or (d) any other act Company determines constitutes gross or willful misconduct detrimental to Company including, but not limited to, unethical practices, dishonesty, disloyalty, or any other acts harmful to Company; provided, however that a for Cause termination pursuant to clause (a), if susceptible of cure, shall not become effective unless Employee fails to cure such failure to perform or breach within thirty (30) days after his receipt of written notice from Company, such notice to describe such failure to perform or breach and identify what reasonable actions shall be required to cure such failure to perform or breach.

3.1.5 **Termination By Employee Without Good Reason**. The Employee may terminate Employee's employment under this Agreement at any time for any reason or no reason with thirty (30) days written notice.

3.1.6 **Termination By Company Without Cause**. Company may terminate Employee's employment under this Agreement at any time for any reason or no reason with 30 days written notice including following a Change in Control as defined in Employee's applicable Company Incentive Stock Option Agreement(s) or Non-Incentive Stock Option Agreement(s) ("Employee's Stock Option Agreements") as the case may be, except that no notice shall be required for a termination without Cause following a Change in Control. A termination of this

Agreement and employee's employment pursuant to the operation of the provisions of Section 1.2 of this Agreement shall be deemed a termination by Company without Cause.

3.1.7 **Termination By Employee For Good Reason**. Employee may terminate Employee's employment pursuant to this Agreement for Good Reason. For purposes of this Agreement, "Good Reason" means: (a) at any time, the assignment by Company to Employee of employment duties, functions or responsibilities that are significantly different from, and result in a substantial diminution of, Employee's duties, functions or responsibilities; or (b) at any time, a requirement that Employee be based at any office or location more than 25 miles from Employee's primary work location prior to the date of this Agreement.

3.2 **Compensation Following Termination Prior to End of the Term**. In the event that Employee's employment pursuant to this Agreement is terminated prior to the end of the Term, Employee shall be entitled to the following compensation and benefits upon such termination:

3.2.1 **Payment of Base of Salary.** In the event that Employee's employment is terminated pursuant to any subsection of Section 3.1 of this Agreement, Company shall, within 14 calendar days following the Separation Date, pay to Employee, Employee's spouse or Employee's estate, as the case may be, any amounts due to Employee for Base Salary through the Separation Date.

In the event of a termination pursuant to Section 3.1.5 (by Employee without Good Reason), upon receiving Employee's notice, Company has the option, at its discretion (a) to continue to engage Employee's services through the 30 day notice period until the Separation Date, or (b) terminate the use of Employee's services during the 30 day notice period prior to the Separation Date but treat Employee as if he were providing services through the 30 day notice period until the Separation Date for purposes of determining Employee's compensation due him pursuant to this Section 3.2.1.

3.2.2 **Payment of Incentive Compensation.** In the event that Employee's employment is terminated prior to the expiration of the Term pursuant to subsections 3.1.1; 3.1.2; 3.1.3; 3.1.6; or 3.1.7 of Section 3.1 of this Agreement, Company shall, within 14 calendar days following the Separation Date, also pay to Employee, Employee's spouse or Employee's estate, as the case may be, any amounts due to Employee for unpaid and pro rata amounts to which Employee is entitled as of the Separation Date pursuant to Section 2.2 of this Agreement.

3.2.3 **Payment of Severance for Termination By Company Without Cause or By Employee for Good Reason**. In the event that Employee's employment is terminated prior to the expiration of the Term pursuant to subsection 3.1.6 (By Company Without Cause) or 3.1.7 (By Employee for Good Reason) and provided Employee has executed a written release to Company in substantially the same form attached hereto as Exhibit A and the rescission period specified therein has expired, Company shall also continue to pay, as severance pay, Employee's Base Salary at the rate in effect on the Separation Date, for a period of 6 months following the Separation Date. Such payments will be at usual and customary pay intervals of Employer and will be subject to all appropriate deductions and withholdings.

Additionally, pursuant to the terms and conditions set forth in Employee's applicable Stock Option Agreements with Company, Company agrees that, notwithstanding anything to the contrary set forth in such Stock Option Agreements or Company's Stock Incentive Plan, as may be amended from time to time, during the five-year period following the Separation Date, Employee shall be permitted to exercise immediately all Options granted to Employee that have vested as of the Separation Date and those Options that would have vested within one year of the Separation Date had Employee's employment with Company not terminated. The parties hereto agree and acknowledge that, with respect to any Options previously granted to Employee that were intended by the parties to be treated as "incentive stock options" within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, such Options, to the extent they may be exercised by Employee more than 90 days following the Separation Date shall be treated as non-qualified Options, notwithstanding any provision in Employee's Stock Option Agreements to the contrary.

In the event that a Change in Control occurs, and Employee is not terminated, the vesting schedule of Options held by Employee shall accelerate such that on the date the Change of Control is completed 50% of any unvested shares of Employee shall immediately vest and shall be exercisable during the five-year period following the Separation Date notwithstanding anything to the contrary set forth in Employee's applicable Stock Option Agreements with the Company or Company's Stock Incentive Plan; provided, however, that if, in connection with the consummation of the transaction resulting in the Change in Control, Employee receives a cash payment with respect to each Option equal to the difference or "spread" between (i) the per share amount paid to holders of Common Stock in such transaction and (ii) the per share exercise price under the applicable option agreement, his Options shall be cancelled upon the consummation of the Change in Control in exchange for such cash payment.

In the event that a Change in Control occurs, and Employee is terminated, the vesting schedule of Options held by Employee shall accelerate such that on the date the Change of Control is completed 100% of any unvested shares of Employee shall immediately vest and shall be exercisable during the five-year period following the Separation Date notwithstanding anything to the contrary set forth in Employee's applicable Stock Option Agreements with the Company or Company's Stock Incentive Plan; provided, however, that if, in connection with the consummation of the transaction resulting in the Change in Control, Employee receives a cash payment with respect to each Option equal to the difference or "spread" between (i) the per share amount paid to holders of Common Stock in such transaction and (ii) the per share exercise price under the applicable option agreement, his Options shall be cancelled upon the consummation of the Change in Control in exchange for such cash payment.

3.2.4 **General Provision Regarding Treatment of Options.** Except as otherwise specified in Sections 3.2.3 of this Agreement, the terms of the Stock Incentive Plan and Employee's Stock Option Agreements, as applicable, shall govern the treatment of Employee's Options following the Separation Date.

3.3 **<u>Benefits Following Termination Prior to the End of the Term</u>.** In the event that Employee's employment is terminated pursuant to subsections 3.1.2; 3.1.3; 3.1.6; or 3.1.7 of Section 3.1 of this Agreement, Employee shall, at no cost to Employee, be entitled to continue to participate in Company-provided medical, dental, and life insurance programs for a period of

6 months following the Separation Date irrespective of any then pre-existing health conditions of Employee or his spouse provided, however, that, if this Agreement is terminated as a result of Employee's death, Employee's then current spouse shall be entitled to continue to participate in Company-provided medical and dental insurance programs for one year after Employee's death irrespective of any then pre-existing health conditions, unless, in each case, such continued participation is prohibited by any applicable laws or would otherwise jeopardize the tax qualified status of any such programs. If Company is prohibited by applicable law or would otherwise jeopardize the tax qualified status of any medical, dental, or life insurance plan and as a result Company terminates coverage, it shall promptly reimburse Employee (or Employee's spouse as the case may be) for the cost of obtaining comparable third party coverage irrespective of any then preexisting health conditions of Employee and/or his spouse.

Except as otherwise provided in this Section 3.3, the benefits to which Employee (or, as applicable, Employee's spouse or estate) may be entitled upon termination pursuant to the plans and policies of Company specified Article II of this Agreement shall be determined and paid in accordance with such plans and policies.

3.4 **Surrender of Records and Property**. Upon termination of Employee's employment with Company, Employee shall deliver promptly to Company all Confidential Information as defined in Section 4.1 and all Company property including, but not necessarily limited to records, manuals, books, blank forms, documents, letters, memoranda, business plans, minutes, notes, notebooks, reports, computer disks, computer software, computer programs (including source code, object code, on-line files, documentation, testing materials and plans and reports), computer print-outs, member or customer lists, credit cards, keys, identification, products, access cards, designs, drawings, sketches, devices, specifications, formulae, data, tables or calculations or copies thereof, and all other tangible or intangible property relating in any way to the business of Company that are the property of Company or any subsidiary or affiliate, if any, or which relate in any way to the business, products, practices or techniques of Company or any subsidiary or affiliate.

ARTICLE IV. CONFIDENTIAL INFORMATION

4.1 **Definition.** For purposes of this Agreement, "Confidential Information" means any information that is not generally known to the public or to other persons who can obtain economic value from its disclosure or use; information which derives independent economic benefit from not being known to such persons; and information about the activities or business of Company that is not generally known to others engaged in similar business or activities, its products, services, finances, trade secrets, contracts, patents filed or pending, the techniques used in completing customer projects, research and development, data and information, processes, designs, engineering, marketing plans or techniques, organization or operation. The foregoing list is intended to be illustrative rather than comprehensive. Additionally, the term "confidential information" shall mean any confidential information as that term is defined in any agreement Employer may have with its customers or other third parties from time to time.

4.2 **Nondisclosure**. During the term of this Agreement or at any time thereafter, Employee agrees not to disclose Confidential information to any other third party or company, other than in connection with Employee's employment with Company, or use such information, directly or indirectly, for any purpose whatsoever, without the prior written consent of Company.

ARTICLE V. INVENTIONS

5.1 **Disclosure and Assignment of Inventions and Other Works.** During the term of this Agreement and for one year following the Separation Date, Employee shall promptly disclose to Company in writing all ideas, improvements and discoveries, whether or not such are patentable or copyrightable, and whether or not in writing or reduced to practice ("Inventions") and any writings, drawings, diagrams, charts, tables, databases, software (in object or source code and recorded on any medium), and any other works of authorship, whether or not such are copyrightable ("Works of Authorship") that are conceived, made, discovered, written or created by Employee alone or jointly with any person, group or entity, whether during the normal hours of his employment at Company or on Employee's own time. Employee hereby assigns all rights to all such Inventions and Works of Authorship to Company. Employee shall give Company all the assistance it reasonably requires for Company to perfect, protect, and use its rights to such Inventions and Works of Authorship. Employee shall sign all such documents, take all such actions and supply all such information that Company considers necessary or desirable to transfer or record the transfer of Company's entire right, title and interest in such Inventions and Works of Authorship and to enable Company to obtain exclusive patent, copyright, or other legal protection for Inventions and Works of Authorship anywhere in the world, provided Company shall bear all reasonable expenses of Employee in rendering such cooperation.

5.2 **Notice and Acknowledgement**. In accordance with Minnesota Statute § 181.78, the foregoing Section 5.1 does not require Employee to assign or offer to assign to Company any of Employee's rights in an Invention that Employee developed entirely on Employee's own time without using Company's equipment, supplies, facilities or trade secret information, and (1) that does not relate directly to Company's business or to Company's actual or demonstrably anticipated research or development, or (2) that does not result from any work performed by Employee for Company. For the purpose of this Section, "Company's business" shall be defined as development pertaining to implantable medical devices to treat obesity or devices to apply signals to a vagus nerve to treat a gastrointestinal disorder (e.g., obesity, pancreatitis or irritable bowel syndrome).

To the extent a provision in this Agreement purports to require Employee to assign Inventions otherwise excluded by this paragraph, the provision is against the public policy of the State of Minnesota and is unenforceable. By signing this Agreement, Employee acknowledges receipt of the notification required by Minnesota Statute § 181.78.

ARTICLE VI. NONCOMPETITION AND NONSOLICITATION

6.1 **Agreement Not to Compete**. During the Term of Employee's employment by Company, and for a period of 12 consecutive months from the date of termination of such employment for whatever reason (whether occasioned by Employee or Company), Employee shall not, directly or indirectly, in any place in the world, render services to any conflicting organization, or engage in competition with Company, in any manner or capacity, nor direct any other individual or business enterprise to engage in competition with Company in any manner or

capacity, (*e.g.*, as an advisor, principal, agent, partner, officer, director, stockholder of more than 1% of the outstanding shares of the capital stock of a publicly traded company, employee, member of any association or limited liability company or otherwise) on any products competitive with Company's existing products, any products competitive with Company's announced products or any products competitive with Company's pending products that have not yet been announced but which Employee has, or should have, actual or constructive knowledge. For the purposes of this Section, "conflicting organization" shall be defined as any person, corporation or entity that competes with any product, process or service, in existence or under development, of Company pertaining to implantable medical devices to treat obesity or devices to apply signals to a vagus nerve to treat a gastrointestinal disorder (*e.g.*, obesity, pancreatitis or irritable bowel syndrome).

6.2 **Agreement Not to Solicit**. Employee hereby acknowledges that the Company's customers constitute vital and valuable aspects of its business on a worldwide basis. In recognition of that fact, for a period of one (1) year following the termination of this Agreement for any reason whatsoever, Employee shall not solicit, or assist anyone else in the solicitation of, any of the Company's then-current customers to terminate their respective relationships with the Company and to become customers of any enterprise with which Employee may then be associated, affiliated or connected.

6.3 **Agreement Not to Recruit**. Employee hereby acknowledges that the Company's employees, consultants and other contractors constitute vital and valuable aspects of its business and missions on a worldwide basis. In recognition of that fact, for a period of one (1) year following the termination of this Agreement for any reason whatsoever, Employee shall not solicit, or assist anyone else in the solicitation of, any of the Company's then-current employees, consultants and other contractors to terminate their respective relationships with the Company and to become employees, consultants and other contractors of any enterprise with which Employee may then be associated, affiliated or connected.

ARTICLE VII: MISCELLANEOUS PROVISIONS

7.1 **Company Remedies**. Employee acknowledges and agrees that the restrictions and agreements contained in this Agreement are reasonable and necessary to protect the legitimate interests of Company, that the services to be rendered by Employee are of a special, unique and extraordinary character, that it would be difficult to replace such services and that any violation of Articles IV, V or VI of this Agreement would be highly injurious to Company, that Employee's violation of any of Articles IV, V or VI of this Agreement would cause Employer irreparable harm that would not be adequately compensated by monetary damages and that the remedy at law for any breach of any of the provisions of Articles IV, V and VI will be inadequate. Accordingly, Employee specifically agrees that Company shall be entitled, in addition to any remedy at law, to preliminary and permanent injunctive relief and specific performance for any actual or threatened violation of this Agreement and to enforce the provisions of Articles IV, V and VI of this Agreement.

7.2 **Assignment**. This Agreement shall not be assignable, in whole or in part, by Employee without the written consent of Company and any purported or attempted assignment or transfer of this Agreement or any of Employee's duties, responsibilities or obligations hereunder shall be

void. This Agreement is binding upon Employee, Employee's heirs and personal representatives. This Agreement shall inure to the benefit of and be binding upon Company and its successors and assigns. Notwithstanding the foregoing, Company may, without the consent of Employee, assign its rights and obligations under this Agreement to any business entity that has become the successor to Company in the event of a sale, merger, liquidation or similar transaction. After any such assignment by Company, Company shall be discharged from all further liability hereunder and such successor assignee shall thereafter be deemed to be Company for the purposes of all provisions of this Agreement.

7.3 **Notices**. All notices, requests, demands and other communications under this Agreement shall be in writing, shall be deemed to have been duly given on the date of service if personally served on the parties to whom notice is to be given, or on the third day after mailing if mailed to the parties to whom notice is given, whether by first class, registered, or certified mail, and properly addressed as follows:

If to the Company, at:	EnteroMedics Inc. 2800 Patton Road St. Paul, MN 55113
If to Employee, at:	15227 Highland Bluff Minnetonka, MN 55345

Any party may change the address for the purpose of this Section by giving the other written notice of the new address in the manner set forth above.

7.4 **Governing Law**. The validity, interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of Minnesota, without regard to conflicts of laws principles thereof.

7.5 **Arbitration.** The parties irrevocably consent that any litigation commenced or arising in connection with the interpretation or enforcement of this Agreement that has not been settled through negotiation within a period of thirty (30) days after the date on which either party shall first have notified the other party in writing of the existence of a dispute shall be settled by final and binding arbitration under the then-applicable Commercial Arbitration Rules of the American Arbitration Association ("AAA"). Any such arbitration shall be conducted by one (1) neutral arbitrator appointed by mutual agreement of the parties or, failing such agreement, in accordance with the AAA Rules. The arbitrator shall be an experienced attorney with a background in employment law. Any arbitration shall be conducted in Minneapolis, Minnesota. An arbitration award may be enforced in any court of competent jurisdiction. Notwithstanding any contrary provision in the AAA Rules, the following additional procedures and rules shall apply to any such arbitration:

(A) Each party shall have the right to request from the arbitrator, and the arbitrator shall order upon good cause shown, reasonable and limited pre-hearing discovery, including (1) exchange of witness lists, (2) depositions under oath of named witnesses at a mutually convenient location, (3) written interrogatories, and (4) document requests;

(B) Upon conclusion of the pre-hearing discovery, the arbitrator shall promptly hold a hearing upon the evidence to be adduced by the parties and shall promptly render a written opinion and award;

(C) The arbitrator may award damages or injunctive relief consistent with the terms of this Agreement but may not award or assess punitive damages against either party; and

(D) Each party shall bear his or its own costs and expenses of the arbitration and one- half (1/2) of the fees and costs of the arbitrator, subject to the power of the arbitrator, in his or her sole discretion, to award all such reasonable costs, expenses and attorneys' fees to the prevailing party.

7.6 **Construction**. Notwithstanding the general rules of construction, both Company and Employee acknowledge that both parties were given an equal opportunity to negotiate the terms and conditions contained in this Agreement, and agree that the identity of the drafter of this Agreement is not relevant to any interpretation of the terms and conditions of this Agreement.

7.7 **Severability**. In the event any provision of this Agreement (or portion thereof) shall be held illegal or invalid for any reason, said illegality or invalidity shall not in any way affect the legality or validity of any other provision of this Agreement. To the extent any provision (or portion thereof) of this Agreement shall be determined to be invalid or unenforceable in any jurisdiction, such provision (or portion thereof) shall be deemed to be deleted from this Agreement as to such jurisdiction only, and the validity and enforceability of the remainder of such provision and of this Agreement shall be unaffected.

7.8 **Entire Agreement**. This Agreement is the final, complete and exclusive agreement of the parties and sets forth the entire agreement between Company and Employee with respect to Employee's employment by Company, and there are no undertakings, covenants or commitments other than as set forth herein. The Agreement may not be altered or amended, except by a writing executed by Employee and a member of the Board. This Agreement supersedes, terminates, replaces and supplants any and all prior understandings or agreements between the parties relating in any way to the hiring or employment of Employee by Company.

7.9 **Survival**. The parties expressly acknowledge and agree that the provisions of this Agreement that by their express or implied terms extend beyond the expiration of this Agreement or the termination of Employee's employment under this Agreement, shall continue in full force and effect, notwithstanding Employee's termination of employment under this Agreement or the expiration of this Agreement.

7.10 **Waivers**. No failure on the part of either party to exercise, and no delay in exercising, any right or remedy under this Agreement shall operate as a waiver thereof; nor shall any single or partial exercise of any right or remedy under this Agreement preclude any other or further exercise thereof or the exercise of any other right or remedy granted hereby or by any related document or by law.

7.11 **Attorneys' Fees.** Upon receipt by Company of a statement for legal services from the attorneys representing Employee, Company shall reimburse Employee or pay on behalf of Employee the reasonable and necessary attorneys' fees and associated expenses incurred by Employee in connection with the negotiation of this Agreement.

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

ENTEROMEDICS INC.		**EMPLOYEE**	
By:	/s/ Mark B. Knudson	By:	/s/ Russell Felkey
	Mark B. Knudson		Russell Felkey
	Its: President and CEO		
Date:	May 16, 2007	Date:	May 16, 2007

EXHIBIT A

GENERAL RELEASE

This General Release is made and entered into as of the ______ day of ___________, __, by Employee("Employee").

WHEREAS, EnteroMedics Inc. ("Company") and Employee are parties to an Employment Agreement dated ___________;

WHEREAS, Employee intends to settle any and all claims that Employee has or may have against Company as a result of Employee's employment with Company and the cessation of Employee's employment with Company; and

WHEREAS, Under the terms of the Employment Agreement, which Employee agrees are fair and reasonable, Employee agreed to enter into this General Release as a condition precedent to the severance arrangements described in Article III of the Employment Agreement.

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

1. **Release**. For the consideration expressed in the Employment Agreement, Employee does hereby fully and completely release and waive any and all claims, complaints, causes of action, demands, suits and damages, of any kind or character, which Employee has or may have against the Released Parties, as hereinafter defined, arising out of any acts, omissions, conduct, decisions, behavior or events occurring up through the date of Employee's signature on this General Release, including Employee's employment with Company and the cessation of that employment. For purposes of this General Release, "Released Parties" means collectively Company, its predecessors, successors, assigns, parents, affiliates, subsidiaries, related companies, officers, directors, shareholders, agents, servants, employees and insurers, and each and all thereof.

Employee understands and accepts that Employee's release of claims includes any and all possible discrimination claims, including, but not limited to, claims based upon: Title VII of the Federal Civil Rights Act of 1964, as amended; the Age Discrimination in Employment Act; the Americans with Disabilities Act; the Equal Pay Act; the Fair Labor Standards Act; the Employee Retirement Income Security Act; the Minnesota Human Rights Act; Minn. Stat. §181.81; or any other federal, state or local statute, ordinance or law. Employee also understands that Employee is giving up all other claims, including those grounded in contract or tort theories, including, but not limited to: wrongful discharge; violation of Minn. Stat. §176.82; breach of contract; tortious interference with contractual relations; promissory estoppel; breach of the implied covenant of good faith and fair dealing; breach of express or implied promise; breach of manuals or other policies; assault; battery; fraud; false imprisonment; invasion of privacy; intentional or negligent misrepresentation; defamation, including libel, slander, discharge defamation and self-publication defamation; discharge in violation of public policy; whistleblower; intentional or negligent infliction of emotional distress; or any other theory, whether legal or equitable.

Employee further understands that Employee is releasing, and does hereby release, any claims for damages, by charge or otherwise, whether brought by Employee or on Employee's behalf by any other party, governmental or otherwise, and agrees not to institute any claims for damages via administrative or legal proceedings against any of the Released Parties. Employee also waives and releases any and all rights to money damages or other legal relief awarded by any governmental agency related to any charge or other claim against any of the Released Parties.

This General Release does not apply to any post-termination claim that Employee may have for benefits under the provisions of any employee benefit plan maintained by Company.

Employee's release of claims shall not apply to any claims Employee might have to indemnification under Minnesota Statute §302A.521, any other applicable statute or regulation or Company's by-laws.

2. **Rescission**. Employee has been informed of Employee's right to rescind this General Release by written notice to Company within fifteen (15) calendar days after the execution of this General Release. Employee has been informed and understands that any such rescission must be in writing and delivered to Company by hand or sent by mail within the 15-day time period. If delivered by mail, the rescission must be: (1) postmarked within the applicable period and (2) sent by certified mail, return receipt requested.

Employee understands that Company will have no obligations under the Employment Agreement in the event a notice of rescission by Employee is timely delivered, and, in the event Employee rescinds this General Release, Employee agrees to repay to Company any payments made to Employee or benefits conferred upon him pursuant to Article III of the Employment Agreement prior to the date of rescission.

3. **Acceptance Period; Advice of Counsel**. The terms of this General Release will be open for acceptance by Employee for a period of 21 days during which time Employee may consider whether or not to accept this General Release. Employee agrees that changes to this General Release, whether material or immaterial, will not restart this acceptance period. Employee is hereby advised to seek the advice of an attorney regarding this General Release.

4. **Binding Agreement**. This General Release shall be binding upon, and inure to the benefit of, Employee and Company and their respective successors and permitted assigns.

5. **Representation**. Employee hereby acknowledges and states that Employee has read this General Release. Employee further represents that this General Release is written in language that is understandable to Employee, that Employee fully appreciates the meaning of its terms, and that Employee enters into this General Release freely and voluntarily.

IN WITNESS WHEREOF, Employee, after due consideration, has authorized, executed and delivered this General Release all as of the date first written.

Employee:______________________________

ENTEROMEDICS INC.
2003 STOCK INCENTIVE PLAN

Section 1. Purpose.

The purpose of the EnteroMedics Inc. 2003 Stock Incentive Plan (the “Plan”) is to aid in attracting and retaining employees, management personnel and other personnel and members of the Board of Directors who are not also employees (“Non-Employee Directors”) of EnteroMedics (the “Company”) capable of assuring the future success of the Company, to offer such personnel and Non-Employee Directors incentives to put forth maximum efforts for the success of the Company’s business and to afford such personnel and Non-Employee Directors an opportunity to acquire a proprietary interest in the Company.

Section 2. Definitions.

As used in the Plan, the following terms shall have the meanings set forth below:

(a) “Affiliate” shall mean (i) any entity that, directly or indirectly through one or more intermediaries, is controlled by the Company and (ii) any entity in which the Company has a significant equity interest, in each case as determined by the Committee.

(b) “Award” shall mean any Option, Stock Appreciation Right, Restricted Stock, Restricted Stock Unit, Performance Award, Dividend Equivalent, Other Stock Grant or Other Stock-Based Award granted under the Plan.

(c) “Award Agreement” shall mean any written agreement, contract or other instrument or document evidencing any Award granted under the Plan.

(d) “Code” shall mean the Internal Revenue Code of 1986, as amended from time to time, and any regulations promulgated thereunder.

(e) “Committee” shall mean either the Board of Directors of the Company or a committee of the Board of Directors appointed by the Board of Directors to administer the Plan.

(f) “Company” shall mean EnteroMedics Inc., a Delaware corporation, and any successor corporation.

(g) “Dividend Equivalent” shall mean any right granted under Section 6(e) of the Plan.

(h) “Eligible Person” shall mean any employee, officer, consultant, independent contractor or Non-Employee Director providing services to the Company or any Affiliate whom the Committee determines to be an Eligible Person.

(i) “Fair Market Value” shall mean, with respect to any property (including, without limitation, any Shares or other securities), the fair market value of such property determined by such methods or procedures as shall be established from time to time by the Committee. Notwithstanding the foregoing, unless otherwise determined by the Committee, the Fair Market Value of Shares on a given date for purposes of the Plan shall not be less than (i) the closing price as reported for composite transactions, if the Shares are then listed on a national securities exchange, (ii) the last sale price, if the Shares are then quoted on the Nasdaq National Market or (iii) the average of the closing representative bid and asked prices of the Shares in all other cases, on the date as of which fair market value is being determined. If on a given date the Shares are not traded in an established securities market, the Committee shall make a good faith attempt to satisfy the requirements of this clause and in connection therewith shall take such action as it deems necessary or advisable.

(j) “Incentive Stock Option” shall mean an option granted under Section 6(a) of the Plan that is intended to meet the requirements of Section 422 of the Code or any successor provision.

(k) “Non-Qualified Stock Option” shall mean an option granted under Section 6(a) of the Plan that is not intended to be an Incentive Stock Option.

(l) “Option” shall mean an Incentive Stock Option or a Non-Qualified Stock Option.

(m) “Other Stock Grant” shall mean any right granted under Section 6(f) of the Plan.

(n) “Other Stock-Based Award” shall mean any right granted under Section 6(g) of the Plan.

(o) “Participant” shall mean an Eligible Person designated to be granted an Award under the Plan.

(p) “Performance Award” shall mean any right granted under Section 6(d) of the Plan.

(q) “Person” shall mean any individual, corporation, partnership, association or trust.

(r) “Plan” shall mean the EnteroMedics Inc. 2003 Stock Incentive Plan, as amended from time to time.

(s) “Restricted Stock” shall mean any Shares granted under Section 6(c) of the Plan.

(t) “Restricted Stock Unit” shall mean any unit granted under Section 6(c) of the Plan evidencing the right to receive a Share (or a cash payment equal to the Fair Market Value of a Share) at some future date.

(u) “Shares” shall mean shares of Common Stock, $0.01 par value, of the Company or such other securities or property as may become subject to Awards pursuant to an adjustment made under Section 4(c) of the Plan.

(v) “Stock Appreciation Right” shall mean any right granted under Section 6(b) of the Plan.

Section 3. Administration.

(a) Power and Authority of the Committee. The Plan shall be administered by the Committee. Subject to the express provisions of the Plan and to applicable law, the Committee shall have full power and authority to: (i) designate Participants; (ii) determine the type or types of Awards to be granted to each Participant under the Plan; (iii) determine the number of Shares to be covered by (or with respect to which payments, rights or other matters are to be calculated in connection with) each Award; (iv) determine the terms and conditions of any Award or Award Agreement; (v) amend the terms and conditions of any Award or Award Agreement and accelerate the exercisability of Options or the lapse of restrictions relating to Restricted Stock, Restricted Stock Units or other Awards; (vi) determine whether, to what extent and under what circumstances Awards may be exercised in cash, Shares, other securities, other Awards or other property, or canceled, forfeited or suspended; (vii) determine whether, to what extent and under what circumstances cash, Shares, other securities, other Awards, other property and other amounts payable with respect to an Award under the Plan shall be deferred either automatically or at the election of the holder thereof or the Committee; (viii) interpret and administer the Plan and any instrument or agreement relating to, or Award made under, the Plan; (ix) establish, amend, suspend or waive such rules and regulations and appoint such agents as it shall deem appropriate for the proper administration of the Plan; and (x) make any other determination and take any other action that the Committee deems necessary or desirable for the administration of the Plan. Unless otherwise expressly provided in the Plan, all designations, determinations, interpretations and other decisions under or with respect to the Plan or any Award shall be within the sole discretion of the Committee, may be made at any time and shall be final, conclusive and binding upon any Participant, any holder or beneficiary of any Award.

(b) Delegation. The Committee may delegate its powers and duties under the Plan to one or more officers of the Company or any Affiliate or a committee of such officers, subject to such terms, conditions and limitations as the Committee may establish in its sole discretion.

Section 4. Shares Available for Awards.

(a) Shares Available. Subject to adjustment as provided in Section 4(c), the aggregate number of Shares that may be issued under all Awards under the Plan shall be 21,724,838. If any Shares covered by an Award or to which an Award relates are not purchased or are forfeited, or if an Award otherwise terminates without delivery of any Shares, then the number of Shares counted against the aggregate number of Shares available under the Plan with respect to such Award, to the extent of any such forfeiture or termination, shall again be available for granting Awards under the Plan. Notwithstanding the foregoing, the number of Shares available for granting Incentive Stock Options under the Plan shall not exceed 21,724,838, subject to adjustment as provided in the Plan and Section 422 or 424 of the Code or any successor provision.

(b) Accounting for Awards. For purposes of this Section 4, if an Award entitles the holder thereof to receive or purchase Shares, the number of Shares covered by such Award or to which such Award relates shall be counted on the date of grant of such Award against the aggregate number of Shares available for granting Awards under the Plan.

(c) Adjustments. In the event that the Committee shall determine that any dividend or other distribution (whether in the form of cash, Shares, other securities or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase or exchange of Shares or other securities of the Company, issuance of warrants or other rights to purchase Shares or other securities of the Company or other similar corporate transaction or event affects the Shares such that an adjustment is determined by the Committee to be appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan, then the Committee shall, in such manner as it may deem equitable, adjust any or all of (i) the number and type of Shares (or other securities or other property) that thereafter may be made the subject of Awards, (ii) the number and type of Shares (or other securities or other property) subject to outstanding Awards and (iii) the purchase or exercise price with respect to any Award; provided, however, that the number of Shares covered by any Award or to which such Award relates shall always be a whole number.

Section 5. Eligibility.

Any Eligible Person of the Company or any Affiliate, shall be eligible to be designated a Participant. In determining which Eligible Persons shall receive an Award and the terms of any Award, the Committee may take into account the nature of the services rendered by the respective Eligible Persons, their present and potential contributions to the success of the Company or such other factors as the Committee, in its discretion, shall deem relevant. Notwithstanding the foregoing, an Incentive Stock Option may only be granted to full or part-time employees (which term as used herein includes, without limitation, officers and directors who are also employees), and an Incentive Stock Option shall not be granted to an employee of an Affiliate unless such Affiliate is also a “subsidiary corporation” of the Company within the meaning of Section 424(f) of the Code or any successor provision.

Section 6. Awards.

(a) Options. The Committee is hereby authorized to grant Options to Participants with the following terms and conditions and with such additional terms and conditions not inconsistent with the provisions of the Plan as the Committee shall determine:

(i) Exercise Price. The purchase price per Share purchasable under an Option shall be determined by the Committee; provided, however, that the purchase price of an Incentive Stock Option shall not be less than 100% of the Fair Market Value of a Share on the date of grant of such Option.

(ii) Option Term. The term of each Option shall be fixed by the Committee; provided, however, that the term of an Incentive Stock Option may not extend more than ten years from the date of grant of such Incentive Stock Option.

(iii) Time and Method of Exercise. The Committee shall determine the time or times at which an Option may be exercised in whole or in part and the method or methods by which, and the form or forms (including, without limitation, cash, Shares, other securities, other Awards or other property, or any combination thereof, having a Fair Market Value on the exercise date equal to the relevant exercise price, which terms shall be set forth in the Award Agreement) in which payment of the exercise price with respect thereto may be made or deemed to have been made.

(iv) Ten Percent Shareholder Rule. Notwithstanding any other provision in the Plan, if at the time an Option is otherwise to be granted pursuant to the Plan to a Participant who owns, directly or indirectly (within the meaning of Section 424(d) of the Code), Common Stock of the Company possessing more than 10% of the total combined voting power of all classes of stock of the Company or its parent or any subsidiary, then any Incentive Stock Option to be granted to such Participant pursuant to the Plan shall satisfy the requirements of Section 422(c)(5) of the Code, and the exercise price of such Option shall be not less than 110% of the Fair Market Value of the Shares covered, and such Option by its terms shall not be exercisable after the expiration of five years from the date such Option is granted.

(b) Stock Appreciation Rights. The Committee is hereby authorized to grant Stock Appreciation Rights to Participants subject to the terms of the Plan and any applicable Award Agreement. A Stock Appreciation Right granted under the Plan shall confer on the holder thereof a right to receive upon exercise thereof the excess of (i) the Fair Market Value of one Share on the date of exercise (or, if the Committee shall so determine, at any time during a specified period before or after the date of exercise) over (ii) the grant price of the Stock Appreciation Right as specified by the Committee, which price shall not be less than 100% of the Fair Market Value of one Share on the date of grant of the Stock Appreciation Right. Subject to the terms of the Plan and any applicable Award Agreement, the grant price, term, methods of exercise, dates of exercise, methods of settlement and any other terms and conditions of any Stock Appreciation Right shall be as determined by the Committee. The Committee may impose such conditions or restrictions on the exercise of any Stock Appreciation Right as it may deem appropriate.

(c) Restricted Stock and Restricted Stock Units. The Committee is hereby authorized to grant Restricted Stock and Restricted Stock Units to Participants with the following terms and conditions and with such additional terms and conditions not inconsistent with the provisions of the Plan as the Committee shall determine:

(i) Restrictions. Shares of Restricted Stock and Restricted Stock Units shall be subject to such restrictions as the Committee may impose (including, without limitation, a waiver by the Participant of the right to vote or to receive any dividend or other right or property with respect thereto), which restrictions may lapse separately or in combination at such time or times, in such installments or otherwise as the Committee may deem appropriate.

(ii) Stock Certificates. Any Restricted Stock shall be registered in the name of the Participant and shall bear an appropriate legend referring to the terms, conditions and restrictions applicable to such Restricted Stock. In the case of Restricted Stock Units, no Shares shall be issued at the time such Awards are granted.

(iii) Forfeiture. Except as otherwise determined by the Committee, upon termination of employment (as determined under criteria established by the Committee) during the applicable restriction period, all Shares of Restricted Stock and all Restricted Stock Units at such time subject to restriction shall be forfeited and reacquired by the Company at the original purchase price; provided, however, that the Committee may, when it finds that a waiver would be in the best interest of the Company, waive in whole or in part any or all remaining restrictions with respect to Shares of Restricted Stock or Restricted Stock Units. Upon the lapse or waiver of restrictions and the restricted period relating to Restricted Stock Units evidencing the right to receive Shares, such Shares shall be issued and delivered to the holders of the Restricted Stock Units.

(d) Performance Awards. The Committee is hereby authorized to grant Performance Awards to Participants subject to the terms of the Plan and any applicable Award Agreement. A Performance Award granted under the Plan (i) may be denominated or payable in cash, Shares (including, without limitation, Restricted Stock and Restricted Stock Units), other securities, other Awards or other property and (ii) shall confer on the holder thereof the right to receive payments, in whole or in part, upon the achievement of such performance goals during such performance periods as the Committee shall establish. Subject to the terms of the Plan and any applicable Award Agreement, the performance goals to be achieved during any performance period, the length of any performance period, the amount of any Performance Award granted, the amount of any payment or transfer to be made pursuant to any Performance Award and any other terms and conditions of any Performance Award shall be determined by the Committee.

(e) Dividend Equivalents. The Committee is hereby authorized to grant Dividend Equivalents to Participants, subject to the terms of the Plan and any applicable Award Agreement, under which such Participants shall be entitled to receive payments (in cash, Shares, other securities, other Awards or other property as determined in the discretion of the Committee) equivalent to the amount of cash dividends paid by the Company to holders of Shares with respect to a number of Shares determined by the Committee.

(f) Other Stock Grants. The Committee is hereby authorized, subject to the terms of the Plan and any applicable Award Agreement, to grant to Participants Shares without restrictions thereon as are deemed by the Committee to be consistent with the purpose of the Plan.

(g) Other Stock-Based Awards. The Committee is hereby authorized to grant to Participants subject to the terms of the Plan and any applicable Award Agreement, such other Awards that are denominated or payable in, valued in whole or in part by reference to, or otherwise based on or related to, Shares (including, without limitation, securities convertible into Shares), as are deemed by the Committee to be consistent with the purpose of the Plan. Shares or other securities delivered pursuant to a purchase right granted under this Section 6(g) shall be purchased for such consideration, which may be paid by such method or methods and in such form or forms (including, without limitation, cash, Shares, other securities, other Awards or other property or any combination thereof), as the Committee shall determine.

(h) General.

(i) No Cash Consideration for Awards. Awards shall be granted for no cash consideration or for such minimal cash consideration as may be required by applicable law.

(ii) Awards May Be Granted Separately or Together. Awards may, in the discretion of the Committee, be granted either alone or in addition to, in tandem with or in substitution for any other Award or any award granted under any plan of the Company or any Affiliate other than the Plan. Awards granted in addition to or in tandem with other Awards or in addition to or in tandem with awards granted under any such other plan of the Company or any Affiliate may be granted either at the same time as or at a different time from the grant of such other Awards or awards.

(iii) Forms of Payment under Awards. Subject to the terms of the Plan and of any applicable Award Agreement, payments or transfers to be made by the Company or an Affiliate upon the grant, exercise or payment of an Award may be made in such form or forms as the Committee shall determine (including, without limitation, cash, Shares, other securities, other Awards or other property or any combination thereof), and may be made in a single payment or transfer, in installments or on a deferred basis, in each case in accordance with rules and procedures established by the Committee. Such rules and procedures may include, without limitation, provisions for the payment or crediting of reasonable interest on installment or deferred payments or the grant or crediting of Dividend Equivalents with respect to installment or deferred payments.

(iv) Limits on Transfer of Awards. No Award (other than Other Stock Grants) and no right under any such Award shall be transferable by a Participant otherwise than by will or by the laws of descent and distribution; provided, however, that, with the approval of the Committee, a Participant may, in the manner established by the Committee, transfer Options (other than Incentive Stock Options) or designate a beneficiary or beneficiaries to exercise the rights of the Participant and receive any property distributable with respect to any Award upon the death of the Participant. Each Award or right under any Award shall be exercisable during the Participant's lifetime only by the Participant or, if permissible under applicable law, by the Participant's guardian or legal representative. No Award or right under any such Award may be pledged, alienated, attached or otherwise encumbered, and any purported pledge, alienation, attachment or encumbrance thereof shall be void and unenforceable against the Company or any Affiliate.

(v) Term of Awards. The term of each Award shall be for such period as may be determined by the Committee.

(vi) Restrictions; Securities Exchange Listing. All Shares or other securities delivered under the Plan pursuant to any Award or the exercise thereof shall be subject to such restrictions as the Committee may deem advisable under the Plan, and to any applicable federal or state securities laws and regulatory requirements. The Committee may cause appropriate entries to be made or legends to be affixed to reflect such restrictions. If the Shares or other securities are listed on a securities exchange, the Company shall not be required to deliver any Shares or other securities covered by an Award until such Shares or other securities have been listed on such securities exchange.

Section 7. Amendment and Termination; Adjustments.

Except to the extent prohibited by applicable law and unless otherwise expressly provided in an Award Agreement or in the Plan:

(a) Amendments to the Plan. The Board of Directors of the Company may amend, alter, suspend, discontinue or terminate the Plan; provided, however, that, notwithstanding any other provision of the Plan or any Award Agreement, without the approval of the shareholders of the Company, no such amendment, alteration, suspension, discontinuation or termination shall be made that, absent such approval:

(i) if a class of the Company's securities is then listed on a securities exchange, would cause Rule 16b-3 or the provisions of Section 162(m)(4)(c) of the Code to become unavailable with respect to the Plan;

(ii) would violate the rules or regulations of the Nasdaq National Market, any other securities exchange or the National Association of Securities Dealers, Inc. that are applicable to the Company; or

(iii) would cause the Company to be unable, under the Code, to grant Incentive Stock Options under the Plan.

(b) Amendments to Awards. The Committee may waive any conditions of or rights of the Company under any outstanding Award, prospectively or retroactively. The Committee may not amend, alter, suspend, discontinue or terminate any outstanding Award, prospectively or retroactively, without the consent of the Participant or holder or beneficiary thereof, except as otherwise herein provided or in the Award Agreement.

(c) Correction of Defects, Omissions and Inconsistencies. The Committee may correct any defect, supply any omission or reconcile any inconsistency in the Plan or any Award in the manner and to the extent it shall deem desirable to carry the Plan into effect.

Section 8. Income Tax Withholding; Tax Bonuses.

(a) Withholding. In order to comply with all applicable federal or state income tax laws or regulations, the Company may take such action as it deems appropriate to ensure that all applicable federal or state payroll, withholding, income or other taxes, which are the sole and absolute responsibility of a Participant are withheld or collected from such Participant. In order to assist a Participant in paying all or a portion of the federal and state taxes to be withheld or collected upon exercise or receipt of (or the lapse of restrictions relating to) an Award, the Committee, in its discretion and subject to such additional terms and conditions as it may adopt, may permit the Participant to satisfy such tax obligation by (i) electing to have the Company withhold a portion of the Shares otherwise to be delivered upon exercise or receipt of (or the lapse of restrictions relating to) such Award with a Fair Market Value equal to the amount of such taxes or (ii) electing to deliver to the Company Shares other than Shares issuable upon exercise or receipt of (or the lapse of restrictions relating to) such Award with a Fair Market Value equal to the amount of such taxes. The election, if any, must be made on or before the date that the amount of tax to be withheld is determined.

(b) Tax Bonuses. The Committee, in its discretion, shall have the authority, at the time of grant of any Award under this Plan or at any time thereafter, to approve cash bonuses to designated Participants to be paid upon their exercise or receipt of (or the lapse of restrictions relating to) Awards in order to provide funds to pay all or a portion of federal and state taxes due as a result of such exercise or receipt (or the lapse of such restrictions). The Committee shall have full authority in its discretion to determine the amount of any such tax bonus.

Section 9. General Provisions.

(a) No Rights to Awards. No Eligible Person, Participant or other Person shall have any claim to be granted any Award under the Plan, and there is no obligation for uniformity of treatment of Eligible Persons, Participants or holders or beneficiaries of Awards under the Plan. The terms and conditions of Awards need not be the same with respect to any Participant or with respect to different Participants.

(b) Award Agreements. No Participant will have rights under an Award granted to such Participant unless and until an Award Agreement shall have been duly executed on behalf of the Company and, if requested by the Company, signed by the Participant.

(c) No Limit on Other Compensation Arrangements. Nothing contained in the Plan shall prevent the Company or any Affiliate from adopting or continuing in effect other or additional compensation arrangements, and such arrangements may be either generally applicable or applicable only in specific cases.

(d) No Right to Employment. The grant of an Award shall not be construed as giving a Participant the right to be retained in the employ of the Company or any Affiliate, nor will it affect in any way the right of the Company or an Affiliate to terminate such employment at any time, with or without cause. In addition, the Company or an Affiliate may at any time dismiss a Participant from employment free from any liability or any claim under the Plan, unless otherwise expressly provided in the Plan or in any Award Agreement.

(e) Governing Law. The validity, construction and effect of the Plan or any Award, and any rules and regulations relating to the Plan or any Award, shall be determined in accordance with the laws of the State of Minnesota.

(f) Severability. If any provision of the Plan or any Award is or becomes or is deemed to be invalid, illegal or unenforceable in any jurisdiction or would disqualify the Plan or any Award under any law deemed applicable by the Committee, such provision shall be construed or deemed amended to conform to applicable laws, or if it cannot be so construed or deemed amended without, in the determination of the Committee, materially altering the purpose or intent of the Plan or the Award, such provision shall be stricken as to such jurisdiction or Award, and the remainder of the Plan or any such Award shall remain in full force and effect.

(g) No Trust or Fund Created. Neither the Plan nor any Award shall create or be construed to create a trust or separate fund of any kind or a fiduciary relationship between the Company or any Affiliate and a Participant or any other Person. To the extent that any Person acquires a right to receive payments from the Company or any Affiliate pursuant to an Award, such right shall be no greater than the right of any unsecured general creditor of the Company or any Affiliate.

(h) No Fractional Shares. No fractional Shares shall be issued or delivered pursuant to the Plan or any Award, and the Committee shall determine whether cash shall be paid in lieu of any fractional Shares or whether such fractional Shares or any rights thereto shall be canceled, terminated or otherwise eliminated.

(i) Headings. Headings are given to the Sections and subsections of the Plan solely as a convenience to facilitate reference. Such headings shall not be deemed in any way material or relevant to the construction or interpretation of the Plan or any provision thereof.

(j) Other Benefits. No compensation or benefit awarded to or realized by any Participant under the Plan shall be included for the purpose of computing such Participant's compensation under any compensation-based retirement, disability, or similar plan of the Company unless required by law or otherwise provided by such other plan.

Section 10. Effective Date of the Plan.

The Plan shall be effective as of the date of its approval and adoption by the Company's shareholders. If the Company's shareholders do not approve the Plan, the Plan shall be null and void.

Section 11. Term of the Plan.

Awards shall only be granted under the Plan during a 10-year period beginning on the effective date of the Plan. However, unless otherwise expressly provided in the Plan or in an applicable Award Agreement, any Award theretofore granted may extend beyond the end of such 10-year period, and the authority of the Committee provided for hereunder with respect to the Plan and any Awards, and the authority of the Board of Directors of the Company to amend the Plan and to waive any conditions or rights of the Company under any Award pursuant to 7(b) hereof, shall extend beyond the termination of the Plan.

EXHIBIT 10.13

Grant ID XXXXX

ENTEROMEDICS INC.
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 $.01 per share (the “Common Stock”), of the Company at the price of $__________ per Share on the terms and conditions set forth herein. It is understood and agreed that such price is not less than 100% of the fair market value of each such Share on the date of this Agreement. The Option is 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”).

2. Duration and Exerciseability. 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 and may be exercised by Optionee in cumulative installments as follows:

On or after each of the following dates	Shares as to which the Option is exercisable
XXXXX, XXXX	
Each subsequent month for 35 months	
36th subsequent month	

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 shall cease to be employed by the Company or its subsidiaries, 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 three months after such termination of employment 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 shall cease to be employed by the Company or its subsidiaries by reason of Optionee's gross and willful misconduct during the course of his/her employment 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 while employed by the Company or its subsidiaries, or within three months after termination of his/her employment with the Company for any reason other than gross and willful misconduct, or if Optionee's employment with the Company 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 employment 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 his/her employment, if earlier) or termination of Optionee's employment because of disability and subject to the condition that the Option shall not be exercisable after the expiration of its term.

(d) With respect to the Option and any other incentive stock option granted to Optionee, Optionee understands that to the extent that the aggregate fair market value (determined as of the date of the Option and each other such incentive stock option) of the shares of Common Stock issuable upon exercise of the Option and all other incentive stock options which become exercisable for the first time by Optionee during any calendar year exceeds $100,000, then, in accordance with Section 422(d) of the Code, the portion of the Option and any such other incentive stock options that exceed $100,000 shall be treated as options that do not qualify as incentive stock options.

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. Miscellaneous.

(a) The Option is issued pursuant to the Plan and is subject to its terms. In the event that any of the terms of this Option conflict or are inconsistent in any respect with the 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 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.

(d) Subject to Section 6 of this Agreement, if Optionee shall dispose of any of the Shares acquired upon exercise of the Option within two years from the date hereof or within one year after exercise of the Option, then, in order to provide the Company with the opportunity to claim the benefit of any income tax deduction that may be available to it under the circumstances, Optionee shall promptly notify the Company of the dates of acquisition and disposition of such Shares, the number of Shares so disposed of, and the consideration, if any, received for such Shares. In order to comply with all applicable federal and state income tax laws and regulations, the Company may take such action as it deems appropriate to ensure that, if necessary, all applicable federal or state payroll, withholding, income or other taxes are withheld or collected from Optionee.

[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, PhD
Title: President and CEO

____
Optionee

Grant ID XXXXX

ENTEROMEDICS INC.
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”).

2. Duration and Exerciseability. 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 and may be exercised by Optionee as follows:

On or after each of the following dates	Shares as to which the Option is exercisable
XXXXX, XXXX	________
Each subsequent month for 35 months	________
36th subsequent month	________

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; <u>provided</u>, <u>however</u>, 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. 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

EXHIBIT 10.15

ENTEROMEDICS INC.

STOCK RESTRICTION AGREEMENT

This Stock Restriction Agreement (the "Agreement") is dated as of [Date], by and between EnteroMedics Inc., a Delaware corporation (the "Company"), and [Name] (the "Holder").

BACKGROUND

1. The Holder is a founder of the Company, and the Holder's continued participation is considered by the Company to be important for the Company's growth.

2. Effective as of [Date], the Company issued to the Holder and the Holder acquired from the Company [Number] (______) shares of the Company's Common Stock, $.01 par value (the "Shares").

AGREEMENT

In consideration of the mutual covenants and representations herein set forth, the Company and the Holder agree as follows:

1. **Repurchase Option**.

(a) The Shares (the "Repurchase Shares") shall be subject to the right and option of the Company to repurchase such Repurchase Shares (the "Repurchase Option") as set forth in this Section 1. In the event (i) the Holder shall voluntarily terminate Holder's position as a director or executive officer of the Company or otherwise no longer is performing services at the direction of the Company's Board of Directors, the Company's Chief Executive Officer, or their successors and assigns, whether as (y) an employee or director or (z) as an advisor or consultant; provided, that if such services are provided as an advisor or consultant, the Holder has entered into a written consulting agreement with the Company in such form as authorized by the Board of Directors or Chief Executive Officer of the Company, or (ii) if then employed by the Company, the Company shall terminate the Holder's employment for any reason (each a "Termination"), the Repurchase Option shall come into effect.

(b) Following a Termination, the Company shall have the right, as provided in subsection (c) hereof, to purchase from the Holder or his personal representative, as the case may be, the Repurchase Shares at a price of $.01 per share (the "Option Price"); provided, however, that such Repurchase Option shall lapse as to [1/48] of the Repurchase Shares as of the last day of each month following [Date], beginning with [Date]; provided further, that in no event shall any fractional share vest, but instead, all share calculations made for purposes of the vesting provisions set forth in this Section 1(b) shall be rounded up or down to the nearest whole share, and such rounded shares shall vest pursuant to the terms of this Section 1(b). Notwithstanding the foregoing, the

Holder shall have no right, title or beneficial interest in the Repurchase Shares prior to [Date], the date of Holder's acquisition of the Repurchase Shares. Notwithstanding the foregoing, all Repurchase Shares shall automatically vest (and the Repurchase Option shall automatically terminate with respect to all such Repurchase Shares) upon the occurrence of all of the following events: (i) consummation of the merger, consolidation or sale of shares of capital stock or all or substantially all of the assets or of the Company whereby the shareholders of the Company immediately prior to such transaction own less than fifty percent (50%) of the acquiring or surviving company, as the case may be (a "Change in Control") and (ii) the Holder is subject to an Involuntary Termination (as defined below) within twelve (12) months after such a Change in Control. For purposes of this Section 1(b), "Involuntary Termination" shall mean (x) the involuntary discharge of the Holder by the Company for reasons other than for Cause (as defined below) or (y) the voluntary resignation of the Holder following (A) a change in the Holder's position with the Company that materially reduces his or her level of authority or responsibility, (B) a reduction in the Purchaser's base salary by more than ten percent (10%) or (C) receipt of notice that the Holder's principal workplace will be relocated to a location other than the greater Minneapolis-St. Paul metropolitan area.

(c) Within 60 days following a Termination, the Company shall notify the Holder by written notice delivered or mailed as provided in Section 8 hereof, as to whether the Company wishes to purchase the Repurchase Shares pursuant to exercise of the Repurchase Option. If the Company elects to purchase the Repurchase Shares hereunder, it shall set a date for the closing of the transaction at a place and time specified by the Company or, at the Company's option, such closing may be consummated by mail; all required documents shall be delivered in accordance with the provisions of Section 8 hereof. At such closing, the Company (or its assignee) shall tender payment for the Repurchase Shares, and the certificates representing the Repurchase Shares so purchased shall be canceled. The Option Price shall be payable in cash.

(d) Subject to the terms hereof, the Holder shall have all the rights of a shareholder with respect to the Repurchase Shares, including without limitation, the right to vote the Repurchase Shares and to receive any cash dividends declared thereon. If, from time to time during the term of the Repurchase Option, there is (i) any stock dividend, stock split or other change in the Repurchase Shares, or (ii) any merger or sale of all or substantially all of the assets or other acquisition of the Company, any and all new, substituted or additional securities to which the Holder is entitled by reason of the Holder's ownership of the Repurchase Shares shall be deemed Repurchase Shares.

For purposes of this Section 1, "Cause" shall mean the following actions by the Holder: (i) fraud, misrepresentation, theft or embezzlement of Company assets; (ii) material intentional violations of law or Company policies; or (iii) the repeated failure of Holder to perform his duties as an executive officer of the Company as set forth by the Board of Directors; provided, however, that a termination for Cause pursuant to this subsection (iii) shall only be effective upon: (1) the Holder receiving written notice of Holder's failure to perform his duties as an executive officer of the Company; and (2) a determination by the Board of Director's that Holder failed to improve his work performance within thirty (30) days of receiving such notice.

2. **Restriction on Transfer**.

(a) Except for the transfer of Repurchase Shares to the Company as contemplated herein, none of the Repurchase Shares or any beneficial interest therein shall be transferred, encumbered or otherwise disposed of in any way until the termination of the Company's Repurchase Option as set forth in Section 1.

(b) The Holder agrees in connection with the Company's initial public offering of its equity securities pursuant to a registration statement filed under the Act not to sell, make any short sale of, loan, grant any option for the purchase of or otherwise dispose of any equity securities of the Company without the prior written consent of the Company or its underwriters, for such period of time (not to exceed one hundred eighty (180) days) from the effective date of such registration as may be requested by the Company or such underwriters; provided that the officers and directors of the Company who own stock of the Company also agree to such restrictions.

(c) The Company shall not be required (i) to transfer on its books any Repurchase Shares which shall have been sold or transferred in violation of any of the provisions set forth in this Agreement, or (ii) to treat as owner of such Repurchase Shares or to accord the right to vote as such owner or to pay dividends to any transferee to whom such Repurchase Shares shall have been so transferred.

3. **Legends.** All certificates representing any of the Repurchase Shares subject to the provisions of this Agreement shall have endorsed thereon legends substantially in the following term:

(a) "THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS UPON TRANSFER AND RIGHTS OF REPURCHASE AND MAY BE TRANSFERRED ONLY IN ACCORDANCE WITH THE TERMS OF AN AGREEMENT BETWEEN THE COMPANY AND THE REGISTERED HOLDER, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THE COMPANY."

(b) "THE SHARES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933. THEY MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT AS TO THE SHARES UNDER SAID ACT OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED."

(c) Any legend required to be placed thereon by applicable blue sky laws of any state.

4. **<u>Holder's Representations</u>.** In connection with its purchase of the Shares, the Holder hereby represents and warrants to the Company as follows:

(a) **<u>Investment Intent: Capacity to Protect Interests</u>.** The Holder has acquired the Shares solely for his own account for investment and not with a view to or for sale in connection with any distribution of the Shares or any portion thereof and not with any present intention of selling, offering to sell or otherwise disposing of or distributing the Shares or any portion thereof in any transaction other than a transaction exempt from registration under the Act. The Holder also represents that the entire legal and beneficial interest of the Shares has been acquired by, and will be held for, the Holder's account only, and neither in whole or in part for any other person. The Holder as founder of the Company fully understands the Company's plans, operations, and financial condition and has received all information the Holder has deemed appropriate to enable the Holder to evaluate the financial risk inherent in investing in the Shares.

(b) **<u>Residence</u>.** The Holder's principal residence or business office is located at the address indicated beneath the Holder's signature below.

(c) **<u>Economic Risk</u>.** The Holder realizes that the acquisition of the Shares is a highly speculative investment and involves a high degree of risk, and the Holder is able, without impairing his financial condition, to hold the Shares for an indefinite period of time and to suffer a complete loss of the Holder's investment.

(d) **<u>Restricted Securities</u>.** The Holder understands and acknowledges that the sale of the Shares has not been registered under the Act. The Shares must be held indefinitely unless subsequently registered under the Act or an exemption from such registration is available, and the Company is under no obligation to register the Shares.

(e) **<u>Disposition under the Act</u>.** The Holder understands that the Shares are "restricted securities" within the meaning of Rule 144 promulgated under the Act; that the exemption from registration under Rule 144 will not be available in any event for at least one year from the date of acquisition of the Shares, and even then will not be available unless (i) a public trading market then exists for the Common Stock of the Company, (ii) adequate information concerning the Company is then available to the public and (iii) other terms and conditions of Rule 144 are complied with; and that any sale of the Shares may be made only in limited amounts in accordance with such terms and conditions.

(f) **<u>Further Limitations on Disposition</u>.** Without in any way limiting its representations set forth above, the Holder further agrees that the Holder shall in no event make any disposition of all or any portion of the Repurchase Shares unless and until (i) there is then in effect a Registration Statement under the Act covering such proposed disposition and such disposition is made in accordance with said Registration Statement, (ii) the resale provisions of Rule 144(k) are available in the opinion of counsel to the Company or (iii) (A) the Holder shall have notified the Company of the proposed disposition and shall have furnished the Company with a detailed statement of the circumstances surrounding the proposed disposition, (B) the Holder shall have furnished the Company with an opinion of the Holder's counsel to the effect that such disposition will not require registration of such stock under the Act and (C) such opinion of the Holder's counsel shall have been concurred in by counsel for the Company, and the Company shall have advised the Holder of such concurrence.

(g) **Section 83(b) Election.** The Holder understands that Section 83 of the Internal Revenue Code of 1986 (the "Code"), taxes as ordinary income the difference between the amount paid for the Shares and the fair market value of the Shares as of the date any restrictions on the Shares lapse. In this context, "restriction" means the right of the Company to buy back the Repurchase Shares pursuant to the Repurchase Option. In the event the Company has registered under the Exchange Act, "restriction" with respect to officers, directors and 10% shareholders also means the 6-month period during which such officers, directors and 10% shareholders are subject to suit under Section 16(b) of the Exchange Act. The Holder understands that he may elect to be taxed at the time the Repurchase Shares are purchased rather than when and as the Repurchase Option or 6-month 16(b) period expires by filing an election under Section 83(b) of the Code with the Internal Revenue Service within 30 days from the date of purchase and satisfying certain other requirements. The Holder acknowledges and understands that, even if the fair market value of the Repurchase Shares equals the amount paid for the Repurchase Shares, the election must be made to avoid adverse tax consequences in the future. The form for making this election is attached as Exhibit A hereto. The Holder understands that failure to make this filing timely and to file a copy of such election with Holder's federal income tax return for the year of the election and to supply the Company with a copy of the election, will result in the recognition of ordinary income by the Holder as the Repurchase Option lapses, or after the lapse of the 6-month 16(b) period, with the amount of such tax and ordinary income equal to the difference between the Purchase Price and the fair market value of the Repurchase Shares at the time such restrictions lapse.

THE HOLDER ACKNOWLEDGES THAT IT IS THE HOLDER'S SOLE RESPONSIBILITY AND NOT THE COMPANY'S TO TIMELY FILE THE ELECTION UNDER SECTION 83(b), EVEN IF THE HOLDER REQUESTS THE COMPANY OR ITS REPRESENTATIVES TO MAKE THIS FILING ON THE HOLDER'S BEHALF.

(h) **Valuation of Shares.** The Holder understands that the Shares have been valued by the Board of Directors for the purpose of this sale, and that the Company believes this valuation represents a fair attempt at reaching an accurate appraisal of their worth. The Holder understands, however, that the Company can give no assurance that the price is in fact the fair market value of the Shares and that it is possible that the Internal Revenue Service would successfully assert that the value of the Shares on the date of purchase is substantially greater than so determined. If the Internal Revenue Service were to succeed in a determination that the Shares had a value on the date of sale greater than the Purchase Price, the additional value would constitute ordinary income as of the date of its receipt. The additional taxes (and interest) due would be payable by the Holder, and there is no provision for the Company to reimburse him for that tax liability. The Holder assumes all responsibility for such potential tax liability.

5. **Governing Law**.

This agreement shall be governed by the laws of the State of Minnesota.

6. **Attorneys' Fees**.

The prevailing party in any legal action, including an arbitration proceeding, arising out of this agreement shall be entitled, in addition to any other rights and remedies such party may have, to reimbursement for its expenses, including costs and reasonable attorneys' fees.

7. **Additional Actions**.

The parties will execute such further instruments and take such further action as may reasonably be necessary to carry out the intent of this agreement.

8. **Notices**.

Any notices required or permitted hereunder shall be given in writing and shall be deemed effectively given upon personal delivery or upon deposit in the United States Post Office, by regular or certified mail with postage and fees prepaid, addressed, if to Holder, at his address shown on the Company's records and, if to the Company, at the address of its principal corporate offices (attention: President) or at such other address as such party may designate by ten days' advance written notice to the other party.

9. **Adjustment for Stock Split**.

All references to the number of Repurchase Shares and the Purchase Price of the Repurchase Shares in this Agreement shall be appropriately adjusted to reflect any stock split, stock dividend or other change in the number or type of shares of stock (or other securities or other property) which may be made by the Company with respect to the Repurchase Shares after the date of this Agreement.

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

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

HOLDER	**ENTEROMEDICS INC.**
______________________________	By: ______________________________
Signature	Its: ______________________________
Name: ______________________________	
Address: ______________________________	
SS #: ______________________________	

Signature Page to Stock Restriction Agreement

**STATEMENT OF ELECTION UNDER
SECTION 83(b) OF THE INTERNAL REVENUE CODE**

1. Name, address and social security number of taxpayer:

   Social Security Number:

2. Description of property:

   __________ shares of Common Stock, $.01 par value, of EnteroMedics Inc. (the "Company"), a Delaware corporation.

3. Date or dates property was transferred and taxable year in which election is made:

4. Nature of the restrictions to which the property is subject:

5. Fair market value at time of transfer:

6. Amount paid:

7. A copy of this Statement has been furnished to the Company for which taxpayer has performed services as an independent contractor or an employee, as the case may be.

FILE: One copy of this Statement immediately with the Service Center where the taxpayer's federal income tax return is filed (but in no event more than 30 days following purchase of the stock), one copy immediately with the Company and a third copy by attachment to taxpayer's federal income tax return for the year.

SIGNED: ____
[Name]

ENTEROMEDICS INC.

CODE OF BUSINESS CONDUCT AND ETHICS FOR DIRECTORS, OFFICERS AND EMPLOYEES

Introduction

This Code of Business Conduct and Ethics (the "Code") covers a wide range of business practices and procedures for EnteroMedics Inc. ("EnteroMedics," "we," "us," or "our"). This Code does not cover every issue that may arise, but it sets out basic principles to guide all of our employees, officers and directors.

All of our employees, officers and directors are expected to read and become familiar with the ethical standards described in this Code, must conduct themselves accordingly and seek to avoid even the appearance of improper behavior.

The Code also should be provided to and followed by our agents and representatives, including consultants.

Our Board of Directors is responsible for setting the standards of business conduct contained in this Code and updating these standards as it deems appropriate to reflect changes in the legal and regulatory framework that applies to our business, the business practices within our industry, and the prevailing ethical standards of the communities in which we operate. While our Chief Financial Officer (or other officer designated from time to time by the Board of Directors) will oversee the procedures designed to implement this Code to ensure that they are operating effectively, it is the individual responsibility of each of our directors, officers and employees to comply with this Code.

If a law conflicts with a policy in this Code, you must comply with the law; however, if a local custom or policy conflicts with this Code, you must comply with the Code. Questions should be referred to the employee's supervisor or to our Chief Financial Officer.

Those individuals who violate the standards in this Code, or who make false attestations as to their compliance with this Code, will be subject to appropriate disciplinary action, which may include demotion or termination of employment. If you are in a situation that you believe may violate or lead to a violation of this Code, follow the guidelines described in Sections 14 and 15 of this Code.

1. Compliance with Laws, Rules and Regulations

Obeying the law, both in letter and in spirit, is the foundation on which our ethical standards are built. All employees, officers and directors must respect and obey the laws of the cities, states and countries in which we operate. Although not all employees, officers and directors are expected to know the details of these laws, it is important to know enough to determine when to seek advice from supervisors, managers or other appropriate personnel.

2. Conflicts of Interest

Conflicts of interest are prohibited as a matter of EnteroMedics policy, except under guidelines approved by our Board of Directors. A “conflict of interest” exists when a person’s private interests interfere in any way with the interests of EnteroMedics. A conflict situation can arise when an employee, officer or director takes actions or has interests that may make it difficult to perform his or her work for EnteroMedics objectively and effectively.

Conflicts of interest may also arise when an employee, officer or director, or members of his or her family, receives improper personal benefits as a result of his or her position within EnteroMedics. Loans to, or guarantees of obligations of, employees and/or their family members may create conflicts of interest and are expressly prohibited, with the exception of pre-approved loans from EnteroMedics to employees for moving and relocation, or except as otherwise expressly approved, in writing, by the appropriate officers and/or directors of EnteroMedics in accordance with our written policies.

The best policy is to avoid any direct or indirect business connection with our customers, suppliers or competitors, except on behalf of EnteroMedics. In particular, without the specific permission of our Chief Financial Officer, no director, officer or employee shall

- be a consultant to, or a director, officer or employee of, or otherwise operate or have a significant financial interest in an outside business that markets products or services in competition with our current or potential products and services or supplies or purchase products or services to or from us.
- seek or accept any personal loan or services from any entity with which we do business, except from financial institutions or service providers offering similar loans or services to third parties under similar terms in the ordinary course of their respective businesses; or
- be a consultant to, or a director, officer or employee of, or otherwise operate an outside business if the demands of the outside business would interfere with the director’s, officer’s or employee’s responsibilities to us (if in doubt, consult your supervisor or our Chief Financial Officer).

Directors and employees must notify and inform our Chief Financial Officer prior to accepting an appointment to the board of directors or the advisory board of any public or privately held company. The disclosure requirements and other possible conflict of interest issues involved will be analyzed and discussed at the time of any such notification.

Conflicts of interest may not always be clear-cut, so if an employee has a question, he or she should consult with his or her supervisor or our Chief Financial Officer. Any employee, officer or director who becomes aware of an actual or apparent conflict or potential conflict should bring it to the attention of a supervisor, manager or other appropriate personnel or consult the procedures described in Section 15 of this Code.

3. Insider Trading

Employees, officers and directors who have access to confidential information about EnteroMedics, its business relationships and operations are not permitted to use or share that information for stock trading purposes or for any other purpose except the conduct of our business. All non-public information about EnteroMedics, its business relationships and operations should be considered confidential information. To use non-public information for personal financial benefit or to "tip" others who might make an investment decision on the basis of this information is not only unethical but also illegal. In order to assist us in our efforts to ensure compliance with laws against insider trading, we have adopted a specific policy governing employee's trading in securities of EnteroMedics. This policy will be made available to every employee. If you have any questions, please consult our Chief Financial Officer.

4. Corporate Opportunities

Our employees, officers and directors are prohibited from personally taking advantage of opportunities that are discovered through the use of corporate property, information or position without the consent of our Board of Directors. No employee or director may use corporate property, information, or position for improper personal gain, and no employee may compete with EnteroMedics directly or indirectly. Employees, officers and directors owe a duty to EnteroMedics to advance its legitimate interests when the opportunity to do so arises.

5. Competition and Fair Dealing

We seek to outperform our competition fairly and honestly. We seek competitive advantages through superior performance, never through unethical or illegal business practices. Stealing proprietary information, possessing trade secret information that was obtained without the owner's consent, or inducing such disclosures by past or present employees of other companies is prohibited. Each of our employees should endeavor to respect the rights of and deal fairly with our customers, suppliers, competitors and employees. None of our employees should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other intentional unfair-dealing practice.

To build and maintain our valuable reputation, compliance with our quality processes and safety requirements is essential. In the context of ethics, quality requires that our products and services be designed and manufactured to meet our obligations to customers. All inspection and testing documents must be handled in accordance with all applicable regulations.

The purpose of business entertainment and gifts in a commercial setting is to create goodwill and sound working relationships, not to gain unfair advantage with customers. No gift or entertainment should ever be offered, given, provided or accepted by any of our employees, directors, agents, or family members thereof, unless it: (1) is not a cash gift; (2) is consistent with customary business practices; (3) cannot be construed as a bribe or payoff, and (4) does not violate any laws or regulations. Business gifts given or received should be of nominal value. Employees should discuss with their supervisors or our Chief Financial Officer any gifts or proposed gifts that they are not certain are appropriate.

6. Discrimination and Harassment

The diversity of our employees, officers and directors is a tremendous asset and resource. We are firmly committed to providing equal opportunity in all aspects of employment and will not tolerate any illegal discrimination or harassment of any kind. Examples include derogatory comments based on racial or ethnic characteristics, sexual preference, religious beliefs, and unwelcome sexual advances.

7. Health and Safety

We strive to provide each of our employees with a safe and healthy work environment and to conduct our activities in full compliance with all applicable environmental laws. Each of our employees has responsibility for maintaining a safe and healthy workplace for all employees by following safety and health rules and practices and reporting accidents, injuries and unsafe equipment, practices or conditions.

Violence and threatening behavior are not permitted. Employees should report to work in condition to perform their duties, free from the influence of illegal drugs or alcohol. The use of illegal drugs in the workplace will not be tolerated.

8. Record-Keeping

We require honest and accurate recording and reporting of information in order to make responsible business decisions. For example, only the true and actual number of hours worked should be reported.

Many employees regularly use business expense accounts, which must be documented and recorded accurately. If you are not sure whether a certain expense is legitimate, ask your supervisor or our Chief Financial Officer. All of our books, records, accounts and financial statements must be maintained in reasonable detail, must appropriately reflect EnteroMedics' transactions and must conform both to applicable legal requirements and to our system of internal controls. Unrecorded or "off the books" funds, assets or obligations are prohibited and should not be maintained.

Business records and communications often become public, and we should avoid exaggeration, derogatory remarks, guesswork, or inappropriate characterizations of people and companies that can be misunderstood. This policy applies equally to e-mail, internal memos, and formal reports. Records should always be retained or destroyed according to our record retention policies. In accordance with those policies, in the event of litigation or governmental investigation please consult our Chief Financial Officer.

9. Confidentiality

Employees, officers and directors must not disclose confidential information entrusted to them by us or our customers, except when disclosure is authorized by our legal counsel, or as may otherwise be required by applicable laws or regulations. Confidential information includes all non-public information that might be of use to competitors, or harmful to us or our customers, if disclosed. Confidential information also includes information that suppliers and customers have entrusted to us.

Maintaining confidentially includes ensuring that access to work areas and computers is properly controlled, and refraining from discussions of sensitive matters in public places, such as elevators, hallways, restaurants, restrooms, etc. Not disclosing confidential information means not communicating the information by any means including, without limitation, orally, in writing, or electronically (e.g., in person or via telephone, mail, fax, email, Internet "chat rooms," posting to community bulletin boards, or otherwise). In addition to the foregoing, you are also prohibited from using any proprietary or confidential information for any unauthorized purpose, including for your own personal gain. The obligation to preserve confidential information continues even after employment or directorship terminates.

10. Protection and Proper Use of EnteroMedics Assets

All employees, officers and directors should endeavor to protect our assets and ensure their efficient use. Theft, carelessness, and waste have a direct impact on our profitability. Any suspected incident of fraud or theft should be immediately reported for investigation. EnteroMedics equipment should not be used for non-company business, though incidental personal use may be permitted.

The obligation of our employees, officers and directors to protect our assets includes our proprietary information. Proprietary information includes intellectual property such as trade secrets, patents, trademarks and copyrights, as well as business, marketing and service plans, engineering and manufacturing ideas, designs, databases, records, salary information and any unpublished financial data and reports. Unauthorized use or distribution of this information would violate EnteroMedics policy, and it also could be illegal and result in civil or criminal penalties.

11. Payments to Government Personnel

The U.S. Foreign Corrupt Practices Act (“FCPA”) prohibits giving anything of value, directly or indirectly, to officials of foreign governments or foreign political candidates in order to obtain or retain business. Making illegal payments to government officials of any country is strictly prohibited. In addition, the U.S. government has a number of laws and regulations regarding business gratuities that may be accepted by U.S. government personnel. The promise, offer or delivery to an official or employee of the U.S. government of a gift, favor or other gratuity in violation of these rules would not only violate EnteroMedics policy but could also be a criminal offense. State and local governments, as well as foreign governments, may have similar rules. Questions and/or requests for interpretations should be reviewed and all actions pre-approved by our legal counsel responsible for FCPA compliance.

12. Anti-Boycott Laws

U.S. law prohibits U.S. persons from taking actions or entering into agreements that have the effect of furthering any unsanctioned boycott of a country that is friendly to the United States. This prohibition applies to persons located in the United States (including individuals and companies), U.S. citizens and permanent residents anywhere in the world, and most activities of U.S. subsidiaries abroad. In general, these laws prohibit the following actions (and agreements to take such actions) that could further any boycott not approved by the United States: (1) refusing to do business with other persons or companies (because of their nationality, for example); (2) discriminating in employment practices; (3) furnishing information on the race, religion, gender, or national origin of any U.S. person; (4) furnishing information about any person’s affiliations or business relationships with a boycotted country or with any person believed to be blacklisted by a boycotting country; or (5) utilizing letters of credit that contain prohibited boycott provisions.

We are required to report any request to take action, or any attempt to reach agreement on such action, that would violate these prohibitions. Each employee should understand the policies of their business unit that are designed to ensure compliance with these laws. All employees should also be alert to the fact that boycott-related requests can be subtle and indirect. Questions and/or requests for interpretations should be reviewed and all actions pre-approved by our legal counsel responsible for anti-boycott compliance.

13. U.S. Embargoes and Sanctions

We comply fully with U.S. economic sanctions and embargoes restricting U.S. persons, corporations and, in some cases, foreign subsidiaries, from doing business with certain countries, groups and individuals, including organizations associated with terrorist activity and narcotics trafficking. Economic sanctions may prohibit doing business of any kind with targeted governments and organizations, as well as individuals and entities that act on their behalf. U.S. economic sanctions also may restrict investments in certain targeted countries, as well as trading in goods, technology, and services with a targeted country. U.S. persons may not approve or facilitate transactions by a third party that the U.S. person could not do directly. Questions and/or requests for interpretations should be reviewed and all actions pre-approved by our legal counsel responsible for compliance with U.S. economic sanctions.

14. Reporting Fraud or any other Illegal or Unethical Behavior

All employees are responsible for reporting fraud, falsification of records or reports, misappropriation of funds or other assets of EnteroMedics and other irregularities. Managers should become familiar with the types of irregularities that might occur in their area of responsibility and must establish standards and procedures designed to prevent and detect irregularities. Fraud applies to any irregularity or suspected irregularity related to our business and involving employees, vendors, or persons that provide service or materials.

Employees, officers and directors are encouraged to talk to supervisors, managers or other appropriate personnel about observed fraudulent, illegal or unethical behavior and, when in doubt, about the best course of action in a particular situation. If you suspect fraud, do not discuss the matter with any of the individuals involved and do not attempt to investigate or determine facts on your own. To report fraudulent, illegal or unethical behavior, or if you have a question regarding the appropriate course of action, follow the guidelines described in Section 15 of this Code. It is our policy not to allow retaliation for reports of misconduct by others made in good faith by employees. Employees are expected to cooperate in internal investigations of misconduct. Our Chief Financial Officer will investigate any reported violations and will oversee an appropriate response, including corrective action and preventative measures.

Employees must read our Employee Complaint Procedures for Accounting and Auditing Matters below, which describes our procedures for the receipt, retention, and treatment of complaints that we receive regarding accounting, internal accounting controls, or auditing matters. Any employee may submit a good faith concern regarding questionable accounting or auditing matters without fear of dismissal or retaliation of any kind.

15. Compliance Procedures

We must all work to ensure prompt and consistent action against violations of this Code. However, in some situations it is difficult to know if a violation has occurred. Since we cannot anticipate every situation that will arise, it is important that we have a way to approach a new question or problem. All employees should keep the following steps keep in mind when evaluating a possible violation of the Code:

- Make sure you have all the facts. In order to reach the right solutions, we must be as fully informed as possible.
- Ask yourself: What specifically am I being asked to do? Does it seem unethical or improper? This question will enable you to focus on the specific situation you are faced with, and the alternatives you may have. Use your judgment and common sense; if something seems unethical or improper, it probably is.
- Clarify your responsibility and role. In most situations, there is shared responsibility. Are your colleagues informed? If so, it may help to get others involved and discuss the problem.
- Discuss the problem with your supervisor. This recommendation is basic guidance for all situations. In many cases, your supervisor will be more knowledgeable about the question, and will appreciate being brought into the decision-making process. Remember that it is your supervisor's responsibility to help solve problems.
- Seek help from EnteroMedics resources. In the rare case where it may not be appropriate to discuss an issue with your supervisor, or in situations where you do not feel comfortable approaching your supervisor with your question, please discuss the issue with our Chief Financial Officer.

You may report the ethical violations in confidence and without fear of retaliation. If your situation requires that your identity be kept secret, we will take steps to ensure your anonymity will be protected. We do not permit retaliation of any kind against employees for good faith reports of ethical violations.

16. Code of Ethics for Senior Financial Officers

Our Chief Executive Officer and Chief Financial Officer and the other senior financial officers performing similar functions who have been identified by our Chief Executive Officer (collectively, the "Senior Financial Officers") are responsible for full, fair, accurate, timely and understandable disclosure in the periodic reports that we are required to file with the Securities and Exchange Commission (“SEC”). In addition to being bound by all other provisions of our Code of Business Conduct and Ethics, our Chief Executive Officer and all Senior Financial Officers are subject to the following specific provisions:

- Each Senior Financial Officer shall act with honesty and integrity in the performance of his or her duties at EnteroMedics, shall comply with laws, rules and regulations of federal, state and local governments and other private and public regulatory agencies that affect the conduct of our business and our financial reporting.
- Each Senior Financial Officer is prohibited from directly or indirectly taking any action to interfere with, fraudulently influence, coerce, manipulate or mislead our independent public auditors in the course of any audit of our financial statements or accounting books and records.
- Each Senior Financial Officer shall promptly bring to the attention of the internal management disclosure team any material information of which he or she may become aware that could affect the disclosures made by us in our public filings or otherwise assist management in fulfilling its responsibilities.
- Each Senior Financial Officer shall promptly bring to the attention of our internal management disclosure team and the Audit Committee of our Board of Directors any information he or she may have concerning (a) significant deficiencies in the design or operation of internal controls which could adversely affect our ability to record, process, summarize and report financial data, or (b) any fraud, whether or not material, that involves management or other employees who have a significant role in our financial reporting, disclosures or internal controls.
- Each Senior Financial Officer shall promptly bring to the attention of the Audit Committee of our Board of Directors any information he or she may have concerning any violation of this Code by any employee who has a significant role in our financial reporting, disclosures or internal controls.
- Each Senior Financial Officer shall promptly bring to the attention of our Chief Financial Officer and the Audit Committee of our Board of Directors any information he or she may have concerning evidence of a material violation of the securities or other laws, rules or regulations that apply to us and the operation of our business, by us or any of our agents, or of violation of this Code or of these additional procedures.

- Each Senior Financial Officer shall promptly bring to the attention of our Chief Financial Officer and the Audit Committee of our Board of Directors, any material transaction or relationship that arises and of which he or she becomes aware that reasonably could be expected to give rise to an actual or apparent conflict of interest.

Our Board of Directors shall determine, or designate appropriate persons to determine, appropriate actions to be taken in the event of violations of this Code by our Senior Financial Officers. Such actions shall be reasonably designed to deter wrongdoing and to promote accountability for adherence to this Code, and may include written notices to the individual involved that our Board has determined that there has been a violation, censure by our Board, demotion or re-assignment of the individual involved, suspension with or without pay or benefits and termination of the individual's employment.

17. Employee Complaint Procedures for Accounting and Auditing Matters

Any of our employees may submit a good faith complaint regarding accounting or auditing matters to our management without fear of dismissal or retaliation of any kind. We are committed to achieving compliance with all applicable securities laws and regulations, accounting standards, accounting controls and audit practices. The Audit Committee of our Board of Directors will oversee treatment of employee concerns in this area.

In order to facilitate the reporting of employee complaints, the Audit Committee of our Board of Directors has established the following procedures for (1) the receipt, retention and treatment of complaints regarding accounting, internal accounting controls, or auditing matters, and (2) the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters (collectively, "Accounting Matters").

Receipt of Employee Complaints

- Employees with concerns regarding Accounting Matters may report their concerns to our Chief Financial Officer.
- Employees may forward complaints on a confidential or anonymous basis to the Chairman of our Audit Committee of our Board of Directors via e-mail at the following address: auditchair@enteromedics.com

Scope of Matters Covered by these Procedures

These procedures relate to employee complaints relating to any Accounting Matters, including, without limitation, the following:

- fraud or deliberate error in the preparation, evaluation, review or audit of any of our financial statements;
- fraud or deliberate error in the recording and maintaining of any of our financial records;
- deficiencies in or noncompliance with the our internal accounting controls;
- misrepresentation or false statement to or by a senior officer or accountant with respect to a matter contained in our financial records, financial statements or audit reports; or
- deviation from full and fair reporting of our financial condition.

Treatment of Complaints

- Upon receipt of a complaint, our Chief Financial Officer or the Chairman of our Audit Committee, as appropriate, will (1) determine whether the complaint actually pertains to Accounting Matters, and (2) when possible, acknowledge receipt of the complaint to the sender.
- Complaints relating to Accounting Matters will be reviewed under Audit Committee direction and oversight by our Chief Financial Officer or another senior officer designated by our Audit Committee (or such other persons as our Audit Committee determines to be appropriate). Confidentiality will be maintained to the fullest extent possible, consistent with the need to conduct an adequate review.
- Prompt and appropriate corrective action will be taken when and as warranted in the judgment of our Audit Committee.
- We will not discharge, demote, suspend, threaten, harass or in any manner discriminate against any employee in the terms and conditions of his or her employment based upon any lawful actions of such employee with respect to good faith reporting of complaints regarding Accounting Matters or otherwise as specified in Section 806 of the Sarbanes-Oxley Act of 2002.

Reporting and Retention of Complaints and Investigations.

Our Chief Financial Officer will maintain a log of all complaints, tracking their receipt, investigation and resolution and shall prepare a periodic summary report thereof for our Audit Committee. Copies of complaints and such log will be maintained as directed by our Audit Committee.

18. Waivers of the Code

Every effort will be made to resolve potential conflicts of interest or potential violations of this Code when these situations are disclosed promptly to management and the parties involved have acted in good faith. In the unlikely event potential conflicts of this Code cannot be resolved, waivers will only be given for matters where it is absolutely appropriate under the circumstances and granting of such a waiver will not present a material financial or reputational risk to EnteroMedics. Any waiver for executive officers and directors must be approved, in advance, by our full Board of Directors and will be promptly disclosed to our stockholders, along with the reasons for the waiver, as required by applicable law or stock exchange regulation.

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the use in this Registration Statement on Form S-1 of our report dated May 21, 2007 (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the January 1, 2006 adoption of the provisions of Statement of Financial Accounting Standards No. 123R, “Share-Based Payment”) relating to the consolidated financial statements of EnteroMedics Inc. and subsidiary appearing in the Prospectus, which is part of this Registration Statement.

We also consent to the reference to us under the headings “Selected Financial Data” and “Experts” in such Prospectus.

/s/ DELOITTE & TOUCHE LLP

Minneapolis, MN
May 24, 2007

EXHIBIT 24.1

POWER OF ATTORNEY

We, the undersigned directors of EnteroMedics Inc. (the "Company"), hereby severally constitute and appoint Mark B. Knudson, Ph.D. as our true and lawful attorney, having full power to sign for us and in our names in the capacities indicated below the Registration Statement on Form S-1 filed herewith, and any and all pre-effective and post-effective amendments to said registration statement, and any registration statement filed pursuant to Rule 462(b) under the Securities Act of 1933, as amended, in connection with the registration under the Securities Act of 1933, as amended, of equity securities of the Company, and to file or cause to be filed the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, and hereby ratifying and confirming all that said attorney shall do or cause to be done by virtue of this Power of Attorney.

IN WITNESS WHEREOF, this Power of Attorney has been signed on the 25th day of May, 2007, by the following persons:

Signature
/s/ Luke Evnin, Ph.D. Luke Evnin, Ph.D.
/s/ Catherine Friedman Catherine Friedman
/s/ Carl Goldfischer, M.D. Carl Goldfischer, M.D.
/s/ Bobby I. Griffin Bobby I. Griffin
/s/ Donald C. Harrison, M.D. Donald C. Harrison, M.D.
/s/ Paul H. Klingenstein Paul H. Klingenstein
/s/ Ellen Koskinas Ellen Koskinas
/s/ Nicholas L. Teti, Jr. Nicholas L. Teti, Jr.

[Dorsey & Whitney LLP Letterhead]

TED HOLLIFIELD
(650) 843-2719
FAX (650) 857-1288
hollifield.ted@dorsey.com

May 25, 2007

Securities and Exchange Commission
100 F. Street, N.E., Room 1580
Washington D.C. 20549

Re: EnteroMedics Inc./Registration Statement on Form S-1

Ladies and Gentlemen:

On behalf of EnteroMedics Inc. (the "Company"), we transmit herewith for filing under the Securities Act of 1933, as amended, a Registration Statement on Form S-1, including exhibits (the "Registration Statement"), relating to an offering of common stock by the Company for aggregate proceeds of up to $86,250,000.

The filing has been effected via EDGAR under the Company's CIK No. 1371217. The registration filing fee in the amount of $2,648 has been transmitted to the Securities and Exchange Commission's account at Mellon Bank.

If any questions should arise in connection with this submission, please call me at (650) 843-2719 or Kenneth L. Cutler at (612) 340-2740. You can also fax me at (650) 843-1288 or Kenneth L. Cutler at (612) 340-2868.

Very truly yours,

/s/ Ted Hollifield

Enclosures

cc: Kenneth L. Cutler