Table of Contents

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q

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

**For the quarterly period ended March 31, 2017**

**Commission file number: 1-33818**

# ENTEROMEDICS INC.

**(Exact name of registrant as specified in its charter)**

| **Delaware** | **48-1293684** |
|---|---|
| **(State or other jurisdiction of incorporation)** | **(IRS Employer Identification No.)** |

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ☐ | Accelerated Filer | ☐ |
| Non-accelerated filer | ☐ (Do not check if a smaller reporting entity) | Smaller Reporting Company | ☒ |
| Emerging Growth Company | ☐ | | |

If an emerging growth company, indicate by check mark whether the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of the Exchange Act. ☐

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

As of April 28, 2017, 6,906,878 shares of the registrant's Common Stock were outstanding.

**INDEX**

**PART I – FINANCIAL INFORMATION**



**PART II – OTHER INFORMATION**



**Registered Trademarks and Trademark Applications:** In the United States we have registered trademarks for vBLOC®, ENTEROMEDICS® and MAESTRO®, each registered with the United States Patent and Trademark Office, and trademark applications for vBLOC POWER TO CHOOSE and VBLOC POWER TO CHOOSE AND DESIGN. In addition, some or all of the marks vBLOC, ENTEROMEDICS, MAESTRO, MAESTRO SYSTEM ORCHESTRATING OBESITY SOLUTIONS, vBLOC POWER TO CHOOSE and vBLOC POWER TO CHOOSE AND DESIGN are the subject of either a trademark registration or application for registration in Australia, Brazil, China, the European Community, India, Kuwait, Mexico, Saudi Arabia, Switzerland and the United Arab Emirates. This Quarterly Report on Form 10-Q contains other trade names and trademarks and service marks of EnteroMedics and of other companies.

## PART I – FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**ENTEROMEDICS INC.**
**Condensed Consolidated Balance Sheets**
**(Unaudited)**

| | March 31, 2017 | December 31, 2016 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 18,681,046 | $ 3,310,787 |
| Accounts receivable (net of allowance for bad debts of $20,000 at March 31, 2017 and December 31, 2016) | 68,153 | 143,692 |
| Inventory | 1,702,928 | 1,789,578 |
| Prepaid expenses and other current assets | 401,757 | 476,624 |
| Total current assets | 20,853,884 | 5,720,681 |
| Property and equipment, net | 171,598 | 200,720 |
| Other assets | 684,343 | 1,119,405 |
| Total assets | $ 21,709,825 | $ 7,040,806 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 533,597 | $ 1,311,706 |
| Accrued expenses | 3,183,909 | 2,751,415 |
| Total current liabilities | 3,717,506 | 4,063,121 |
| Common stock warrant liability | 46,737 | 39,119 |
| Total liabilities | 3,764,243 | 4,102,240 |
| Commitments and contingencies (Note 5) | | |
| Stockholders' equity: | | |
| Preferred stock, $0.01 par value; 5,000,000 shares authorized and zero shares outstanding at March 31, 2017 and December 31, 2016; 12,531 and zero shares issued at March 31, 2017 and December 31, 2016, respectively | — | — |
| Common stock, $0.01 par value; 300,000,000 shares authorized; 6,906,878 and 2,736,621 shares issued and outstanding at March 31, 2017 and December 31, 2016, respectively | 69,069 | 27,366 |
| Additional paid-in capital | 326,184,707 | 303,852,582 |
| Accumulated deficit | (308,308,194) | (300,941,382) |
| Total stockholders' equity | 17,945,582 | 2,938,566 |
| Total liabilities and stockholders' equity | $ 21,709,825 | $ 7,040,806 |

See accompanying notes to condensed consolidated financial statements.

**ENTEROMEDICS INC.**
**Condensed Consolidated Statements of Operations**
**(Unaudited)**

| | Three Months Ended March 31, | |
|---|---|---|
| | 2017 | 2016 |
| Sales | $ 40,040 | $ 72,000 |
| Cost of goods sold | 29,523 | 40,135 |
| Gross profit | 10,517 | 31,865 |
| Operating expenses: | | |
| Selling, general and administrative | 5,928,986 | 6,141,177 |
| Research and development | 1,124,413 | 1,432,381 |
| Total operating expenses | 7,053,399 | 7,573,558 |
| Operating loss | (7,042,882) | (7,541,693) |
| Other income (expense): | | |
| Interest income | 100 | 1,691 |
| Interest expense | — | (1,149,294) |
| Change in value of warrant liability | (323,130) | 1,779,414 |
| Change in value of convertible notes payable | — | (499,568) |
| Other, net | (900) | 688 |
| Net loss | $ (7,366,812) | $ (7,408,762) |
| Net loss per share—basic and diluted | $ (1.27) | $ (66.14) |
| Shares used to compute basic and diluted net loss per share | 5,788,282 | 112,014 |

See accompanying notes to condensed consolidated financial statements.

**ENTEROMEDICS INC.**
**Condensed Consolidated Statements of Cash Flows**
**(Unaudited)**

| | Three Months Ended March 31, | |
|---|---|---|
| | 2017 | 2016 |
| **Cash flows from operating activities:** | | |
| Net loss | $ (7,366,812) | $ (7,408,762) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 29,122 | 39,393 |
| Stock-based compensation | 2,246,400 | 1,092,488 |
| Amortization of commitment fees, debt issuance costs and original issue discount | — | 815,421 |
| Change in value of convertible notes payable | — | 499,568 |
| Change in value of warrant liability | 323,130 | (1,779,414) |
| Change in operating assets and liabilities: | | |
| Accounts receivable | 75,539 | 2,928 |
| Inventory | 86,650 | (181,882) |
| Prepaid expenses and other current assets | 74,867 | (42,036) |
| Other assets | 435,063 | (87,520) |
| Accounts payable | (778,109) | 89,397 |
| Accrued expenses | 432,492 | (112,135) |
| Accrued interest payable | — | 174,148 |
| Net cash used in operating activities | (4,441,658) | (6,898,406) |
| **Cash flows from investing activities:** | | |
| Purchases of property and equipment | — | (11,544) |
| Net cash used in investing activities | — | (11,544) |
| **Cash flows from financing activities:** | | |
| Proceeds from warrants exercised | 3,318,013 | — |
| Proceeds from sale of common stock and warrants for purchase of common stock | 6,468,148 | — |
| Proceeds from sale of convertible preferred stock | 12,531,000 | — |
| Common stock financing costs | (2,505,244) | (14,000) |
| Proceeds from convertible notes payable | — | 11,000,000 |
| Repayments on convertible notes payable | — | (404,762) |
| Debt issuance costs | — | (445,003) |
| Net cash provided by financing activities | 19,811,917 | 10,136,235 |
| Net increase in cash and cash equivalents | 15,370,259 | 3,226,285 |
| **Cash and cash equivalents:** | | |
| Beginning of period | 3,310,787 | 7,927,240 |
| End of period | $ 18,681,046 | $ 11,153,525 |
| **Supplemental disclosure:** | | |
| Cash paid for interest | $ — | $ 163,152 |
| **Noncash investing and financing activities:** | | |
| Conversion of convertible preferred shares to common stock | $ 12,531,000 | $ — |
| Conversion of convertible notes and interest payable | $ — | $ 1,397,538 |

See accompanying notes to condensed consolidated financial statements.

**EnteroMedics Inc.**
**Notes to Condensed Consolidated Financial Statements**
**(Unaudited)**

## (1) Summary of Significant Accounting Policies

### *Description of Business*

EnteroMedics Inc. (the Company) develops and sells implantable systems to treat obesity, metabolic diseases and other gastrointestinal disorders. The Company was incorporated in the state of Minnesota on December 19, 2002 and was reincorporated in Delaware on July 22, 2004. The Company is headquartered in St. Paul, Minnesota. In January 2006, the Company established EnteroMedics Europe Sárl, a wholly-owned subsidiary located in Switzerland.

The Company's board of directors and stockholders approved a 1-for-70 reverse split (the Reverse Stock Split) of the Company's outstanding common stock that became effective after trading on December 27, 2016. The Reverse Stock Split did not change the par value of the Company's stock or the number of preferred shares authorized by the Company's Fifth Amended and Restated Certificate of Incorporation. An amendment to the Certificate of Incorporation was also approved in connection with the Reverse Stock Split to increase the number of shares of the Company's common stock authorized for issuance to 300 million shares, effective immediately after the Reverse Stock Split.. All share and per share amounts have been retroactively adjusted to reflect the Reverse Stock Split for all periods presented.

### *Risks and Uncertainties*

The Company is focused on the design and development of medical devices that use neuroblocking technology to treat obesity, metabolic diseases and other gastrointestinal disorders and currently has approvals to commercially launch the vBloc Neuromodulation System (vBloc System) in the United States, the European Economic Area and other countries that recognize the European CE Mark. The Company 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 in 2015 commenced commercial operations in the United States.

The Company's products require approval from the U.S. Food and Drug Administration (FDA) or corresponding foreign regulatory agencies prior to commercial sales. The Company received FDA approval on January 14, 2015 for vBloc Therapy, delivered via the vBloc System, and has begun a controlled commercial launch at select surgical centers in the United States. The vBloc System has also received CE Mark and was previously listed on the Australian Register of Therapeutic Goods (ARTG).

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.

The Company's activities are subject to significant risks and uncertainties, including the ability 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 further reduce its cost structure until financing is obtained and/or 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.

### *Basis of Presentation*

The Company has prepared the accompanying condensed 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.

The accompanying condensed consolidated financial statements and notes thereto are unaudited. In the opinion of the Company's management, these statements include all adjustments, which are of a normal recurring nature, necessary to present a fair presentation. Interim results are not necessarily indicative of results for a full year. The condensed

consolidated balance sheet as of December 31, 2016 was derived from audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The information included in this Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

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

***Fair Value of Financial Instruments***

Carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable and accrued liabilities approximate fair value due to their short maturities. The Company's common stock warrants are required to be reported at fair value and the Company has elected to report its senior amortizing convertible notes at fair value. The fair values of common stock warrants and investments in debt and equity securities, if any, are disclosed in Note 3. The fair values of senior amortizing convertible notes (the Notes) outstanding, if any, are valued using a Binomial Lattice model.

***Common Stock Warrant Liability***

Common stock warrants that were issued in connection with the July 8, 2015 public offering (the Series A Warrants) and the common stock warrants issued in connection with the November 9, 2015, January 11, 2016 and May 2, 2016 7% senior amortizing convertible notes (the Note Warrants) are classified as a liability in the condensed consolidated balance sheets, as the common stock warrants issued provide for certain anti-dilution protections in the event shares of common stock or securities convertible into shares of common stock are issued below the then-existing exercise price. The fair value of these common stock warrants is re-measured at each financial reporting period and immediately before exercise, with any changes in fair value being recognized as a component of other income (expense) in the condensed consolidated statements of operations.

***Cash and Cash Equivalents***

The Company considers highly liquid investments generally 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 certificates of deposit. The Company deposits its cash and cash equivalents in high-quality credit institutions.

***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. The Company also considers certain investments with maturities greater than one year but which are also held for liquidity purposes and are available for sale as short-term investments.

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 in the condensed 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.

***Inventory***

The Company accounts for inventory at the lower of cost or market and records any long-term inventory as other assets in the condensed consolidated balance sheets.

***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 five to seven years for furniture and equipment and three to five years for computer hardware and software. 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 or amortization are removed from the condensed consolidated balance sheets and the resulting gain or loss is reflected in the condensed consolidated statements of operations. Repairs and maintenance are expensed as incurred.

***Impairment of Long-Lived Assets***

The Company evaluates its long-lived assets for 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. The Company's policy is to classify interest and penalties related to income taxes as income tax expense in the condensed consolidated statements of operations.

***Medical Device Excise Tax***

On January 14, 2015, the Company received FDA approval for vBloc Therapy, delivered via the vBloc System, and starting in the second quarter of 2015 revenues were generated from sales in the United States. As a result, the Company is now required to pay a quarterly Medical Device Tax which is a part of the Affordable Care Act, which imposes a 2.3% excise tax on the sale of certain medical devices by device manufactures, producers or importers. The excise tax was effective on sales of devices made after December 31, 2012. The Company records the Medical Device Tax as an operating expense in the condensed consolidated statements of operations. A moratorium was placed on the Medical Device Tax for 2016 and 2017.

***Comprehensive Loss***

Comprehensive loss is defined as the change in equity of a company during a period from transactions and other events and circumstances excluding transactions resulting from investment owners and distributions to owners. There was no difference from reported net loss for the three months ended March 31, 2017 and 2016.

***Revenue Recognition***

Revenue is recognized when persuasive evidence of an arrangement exists, title or risk of loss has passed, the selling price is fixed or determinable and collection is reasonably assured. Products are sold through direct sales or medical device distributors and revenue is recognized upon sale to a bariatric center of excellence or a medical device distributor when no right of return or price protection exists. Terms of sales to international distributors are generally EXW, reflecting that goods are shipped “ex works,” in which risk of loss is assumed by the distributor at the shipping point. A provision for returns is recorded only if product sales provide for a right of return. No provision for returns was recorded for the three months ended March 31, 2017 and 2016, as the product sales recorded did not provide for rights of return.

***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 trial expenses, including supplies, devices, explants and revisions, quality assurance, regulatory expenses, payroll and other personnel expenses, materials 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.

***Stock-Based Compensation***

The fair value method is applied to all share-based payment awards issued to employees and where appropriate, nonemployees, unless another source of literature applies. All option grants are expensed on a straight-line basis over the vesting period.

***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. Diluted net loss per share is based on the weighted-average common shares outstanding during the period plus dilutive potential common shares calculated using the treasury stock method. Such potentially dilutive shares are excluded when the effect would be to reduce a net loss per share. The Company’s potential dilutive shares, which include outstanding common stock options 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.

The following table sets forth the computation of basic and diluted net loss per share for the three and nine months ended March 31, 2017 and 2016:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2017 | 2016 |
| Numerator: | | |
| Net loss | $ (7,366,812) | $ (7,408,762) |
| Denominator for basic and diluted net loss per share: | | |
| Weighted-average common shares outstanding | 5,788,282 | 112,014 |
| Net loss per share—basic and diluted | $ (1.27) | $ (66.14) |

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:

| | March 31, | |
|---|---|---|
| | 2017 | 2016 |
| Stock options outstanding | 1,132,394 | 27,912 |
| Warrants to purchase common stock | 3,040,751 | 63,955 |

***Recently Issued or Adopted Accounting Standards***

In May 2014, FASB issued Revenue from Contracts with Customers, Topic 606 (Accounting Standards Update No. 2014-09 (ASU 2014-09)), which provides a framework for the recognition of revenue, with the objective that recognized revenues properly reflect amounts an entity is entitled to receive in exchange for goods and services. This guidance will be effective for interim and annual reporting periods beginning after December 15, 2017. The Company does not believe that the adoption of the new standard will have a material effect on its previously reported revenue in that the accounting related to its current revenue-based business practices will not change under the new standard, though incremental disclosures required by the new standard may be significant.

In March 2016, FASB issued Improvements to Employee Share-Based Payment Accounting, (Accounting Standards Update No. 2016-09 (ASU 2016-09)), which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, the estimation of forfeitures, shares withheld for taxes and classification of shares withheld for taxes on the statement of cash flows. As part of the adoption of this guidance the Company has elected to account for forfeitures of share-based awards as they occur. The Company prospectively adopted ASU 2016-09 as required on January 1, 2017 and the adoption did not have a material effect on its consolidated financial statements.

There have been no other significant changes in recent accounting pronouncements during the three months ended March 31, 2017 as compared to the recent accounting pronouncements described in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

**(2) Liquidity and Management's Plans**

The accompanying condensed consolidated financial statements have been prepared assuming the Company will continue as a going concern. The Company currently is not generating revenue from operations that is significant relative to its level of operating expenses, and does not anticipate generating significant revenue from operations or otherwise in the short-term. The Company has financed its operations to date principally through the sale of equity securities, debt financing and interest earned on investments. The Company's history of operating losses, limited cash resources and lack of certainty regarding obtaining significant third-party reimbursement for the vBloc System or timing thereof, raise substantial doubt about our ability to continue as a going concern absent a strengthening of our cash position.

On January 23, 2017, the Company closed an underwritten public offering consisting of units of common stock, convertible preferred stock and warrants to purchase common stock. Gross proceeds of the offering were $19.0 million, prior to deducting underwriting discounts and commissions and offering expenses of $2.5 million. During the three months ended March 31, 2017, common stock warrants for 592,256 shares of common stock were exercised by warrant holders with proceeds to the Company of $3.3 million. As of March 31, 2017, the Company had $18.7 million of cash and cash equivalents to fund its operations into early 2018.

The Company's anticipated operations include plans to expand the controlled commercial launch of vBloc Therapy, delivered via the vBloc System. The Company believes that it has the flexibility to manage the growth of its expenditures and operations depending on the amount of available cash flows, which could include reducing expenditures for marketing, clinical and product development activities. However, the Company will ultimately need to achieve sufficient revenues from product sales and/or obtain additional debt or equity financing to support its operations.

Management is currently pursuing various funding options, including seeking additional equity financing as well as a strategic merger or other transaction to obtain additional funding or expand its product line during 2017 to continue the development of, and to successfully commercialize, the vBloc System. While there can be no assurance that the Company will be successful in its efforts, the Company has a long history of raising equity financing to fund its development activities. Should the Company be unable to obtain adequate financing or generate sufficient revenue in the future, the Company's business, result of operations, liquidity and financial condition would be materially and negatively affected, and the Company would be unable to continue as a going concern. Additionally, there can be no assurance that, assuming the Company is able to strengthen its cash position, it will achieve sufficient revenue or profitable operations to continue as a going concern.

**(3) Fair Value Measurements**

Fair value of financial assets and liabilities is defined as the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy has been established that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

- Level 1—Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

- Level 2—Quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active or model-derived valuations for which all significant inputs are observable, either directly or indirectly.

- Level 3—Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

The Company's assets that are measured at fair value on a recurring basis are classified within Level 1 or Level 2 of the fair value hierarchy. The Company does not hold any assets that are measured at fair value using Level 3 inputs. The types of instruments the Company invests in that are valued based on quoted market prices in active markets may include U.S. treasury securities and money market funds. Such instruments are classified by the company within Level 1 of the fair value hierarchy. U.S. treasuries are valued using unadjusted quoted prices for identical assets in active markets that the Company can access.

The types of instruments the Company invests in that are valued based on quoted prices in less active markets, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include the Company's U.S. agency securities, commercial paper, U.S. corporate bonds and municipal obligations. Such instruments are classified by the Company within Level 2 of the fair value hierarchy. The Company values these types of assets using consensus pricing or a weighted average price, which is based on multiple pricing sources received from a variety of industry standard data providers (e.g. Bloomberg), security master files from large financial institutions, and other third-party sources. The multiple prices obtained are then used as inputs into a distribution-curve-based algorithm to determine the daily market price.

The Company did not hold any short-term investments classified as available for sale or held to maturity as of March 31, 2017 and December 31, 2016.

The fair value of the Company's common stock warrant liability is calculated using a Black-Scholes valuation model and is classified as Level 2 in the fair value hierarchy. The fair values are presented below along with the valuation assumptions:

| | Series A Warrants | | November 2015 Note Warrants | |
|---|---|---|---|---|
| | March 31, 2017 | December 31, 2016 | March 31, 2017 | December 31, 2016 |
| Risk-free interest rates | 1.27 % | 1.20 % | 1.50 % | 1.47 % |
| Expected life | 21 months | 24 months | 43 months | 46 months |
| Expected dividends | — % | — % | — % | — % |
| Expected volatility | 181.45 % | 122.03 % | 136.37 % | 102.29 % |
| Fair value | $ 20,626 | $ 36,000 | $ 2,303 | $ 449 |

| | January 2016 Note Warrants | | May 2016 Note Warrants | |
|---|---|---|---|---|
| | March 31, 2017 | December 31, 2016 | March 31, 2017 | December 31, 2016 |
| Risk-free interest rates | 1.93 % | 1.93 % | 1.93 % | 1.93 % |
| Expected life | 45 months | 48 months | 49 months | 52 months |
| Expected dividends | — % | — % | — % | — % |
| Expected volatility | 133.88 % | 108.57 % | 130.39 % | 106.37 % |
| Fair value | $ 15,163 | $ 1,633 | $ 8,645 | $ 1,037 |

The following table summarizes fair value measurements of the Series A Warrants and Note Warrants by level at December 31, 2016 and March 31, 2017:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Common stock warrants at December 31, 2016 | $ — | $ 39,119 | $ — | $ 39,119 |
| Common stock warrants at March 31, 2017 | $ — | $ 46,737 | $ — | $ 46,737 |

During the three months ended March 31, 2016, the Company had amounts outstanding from 7% senior amortizing convertible notes (the Notes) related to Note issuances on November 9, 2015 (the First Closing) and January 11, 2016 (the Second Closing), when the Company issued Notes with principal amounts of $1.5 million and $11.0 million, respectively. As of December 31, 2015 and March 31, 2016, the fair value of the outstanding Notes from the First Closing was determined to be $1.3 million and $1.2 million, respectively. The fair value of the Notes issued with the Second Closing was determined to be $9.9 million on the January 11, 2016 issue date and $9.5 million on March 31, 2016. The fair values were calculated using a Binomial Lattice model and the following assumptions:

| | November 2015 Notes | | January 2016 Notes | |
|---|---|---|---|---|
| | March 31, 2016 | December 31, 2015 | March 31, 2016 | January 11, 2016 |
| Risk-free interest rates | 0.68 % | 1.11 % | 0.68 % | 1.01 % |
| Expected life | 1.61 years | 1.86 years | 1.61 years | 1.83 years |
| Expected dividends | — % | — % | — % | — % |
| Expected volatility | 65.0 % | 57.5 % | 65.0 % | 60.0 % |
| Fair value per share of common stock | $ 0.01 | $ 0.03 | 0.01 | $ 0.02 |

**(4) Inventory**

From the Company's inception, inventory related purchases had been used for research and development related activities and had accordingly been expensed as incurred. In December 2011, the Company began receiving ARTG listings for components of the VBloc Rechargeable System from the Australian Therapeutic Goods Administration, with the final components being listed on the ARTG in January 2012. As a result, the Company determined certain assets were recoverable as inventory beginning in December 2011. The Company accounts for inventory at the lower of cost or market and records any long-term inventory as other assets in the condensed consolidated balance sheets. There was $667,000 and $676,000 of long-term inventory, primarily consisting of raw materials, as March 31, 2017 and December 31, 2016, respectively.

Current inventory consists of the following as of:

| | March 31, 2017 | December 31, 2016 |
|---|---|---|
| Raw materials | $ 283,281 | $ 335,606 |
| Work-in-process | 1,403,761 | 1,437,957 |
| Finished goods | 15,886 | 16,015 |
| Inventory | $ 1,702,928 | $ 1,789,578 |

**(5) Commitments and Contingencies**

***Operating Lease***

The Company rents its office, warehouse and laboratory facilities under an operating lease, which was originally set to expire on September 30, 2015. On August 25, 2015, the Company entered into an amendment extending the term of the operating lease for three years until September 30, 2018, with monthly base rent ranging from $18,925 to $20,345. Total rent expense recognized for each of the three month periods ended March 31, 2017 and 2016 was $58,905 and $67,718. At March 31, 2017, future minimum payments under the lease are as follows:

| Year ending December 31, | |
|---|---|
| Remaining nine months of 2017 | $ 178,844 |
| 2018 | 183,103 |
| | $ 361,947 |

***Clinical Trials***

The Company is evaluating the vBloc System in human clinical trials, including the EMPOWER trial and ReCharge trial. Both of these clinical trials require patients to be followed out to 60 months. The Company is required to pay for patient follow up visits only to the extent they occur. In the event a patient does not attend a follow up visit, the Company has no financial obligation. The Company is also required to pay for explants or revisions, including potential conversions of ReCharge control devices to active devices, should a patient request or be required to have one during the course of the clinical trials. The Company has no financial obligation unless an explant, revision or conversion is requested or required. Clinical trial costs are expensed as incurred.

***Product Liability Claims***

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. The Company is not currently a party to any product liability litigation and is not aware of any pending or threatened product liability litigation that could have a material adverse effect on the Company's business, operating results or financial condition.

***Litigation***

On February 28, 2017, the Company received a class action and derivative complaint filed on February 24, 2017 in U. S. District Court for the District of Delaware by Vinh Du, one of the Company's shareholders. The complaint names as defendants EnteroMedics, the board of directors and four members of our senior management, namely, Scott Youngstrom, Nick Ansari, Peter DeLange and Paul Hickey, and contains a purported class action claim for breach of fiduciary duty against the board of directors and derivative claims for breach of fiduciary duty against the board of directors and unjust enrichment against our senior management. The allegations in the complaint relate to the increase in the number of shares authorized for grant under our Second Amended and Restated 2003 Stock Incentive Plan (the "Plan"), which was approved by our shareholders at the Special Meeting of Shareholders held on December 12, 2016 (the "Special Meeting"), and to our subsequent grant of stock options on February 8, 2017, to the Company's Directors and senior management to purchase an aggregate of 1,093,450 shares of our common stock (the "Option Grants"). In the complaint, the plaintiff contends that (i) the number of shares authorized for grant under the Plan, as adjusted by the board of directors after the Special Meeting for the subsequent recapitalization of the Company, resulted from an alleged breach of fiduciary duties by the board of directors, and (ii) our senior management was allegedly unjustly enriched by the subsequent Option Grants. The plaintiff seeks relief in the form of an order rescinding the Plan as approved by the shareholders at the Special Meeting, an order cancelling the Option Grants, and an award to plaintiff for his costs, including fees and disbursements of attorneys, experts and accountants. On April 17, 2017, we filed a motion to dismiss the complaint based on the plaintiff's failure to satisfy Delaware's demand requirement for a derivative action and failure to state a valid claim. The defendant has until June 15, 2017 to file its response to the motion to dismiss. We believe the allegations in the complaint are without merit, and intend to defend the action vigorously.

Except as disclosed in the foregoing paragraph, the Company is not currently a party to any litigation and the Company is not aware of any pending or threatened litigation against it that could have a material adverse effect on the Company's business, operating results or financial condition. The medical device industry in which the Company operates 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, the Company may be involved in various legal proceedings from time to time.

**(6) Senior Amortizing Convertible Notes**

On November 9, 2015, January 11, 2016 and May 2, 2016 the Company issued 7% senior amortizing convertible notes (the Notes) with principal amounts of $1.5 million, $11.0 million and $6.25 million. Note Warrants were also issued in connection with each of the three Notes. As of December 31, 2016 the Notes were fully amortized, primarily through non-cash conversions of the Notes into shares of common stock. For the three months ended March 31, 2016, the condensed consolidated statement of operations includes interest expense related to the Notes. See further details regarding the Notes and Note Warrants in footnote 8 to the Company's Consolidated Financial Statements contained in our Annual Report on Form 10-K for the Year Ended December 31, 2016.

**(7) Stock-based Compensation**

The fair value method of accounting for share-based payments is applied to all share-based payment awards issued to employees and where appropriate, nonemployees, unless another source of literature applies.

Based on the application of these standards, stock-based compensation expense for stock-based awards under the Company's Amended and Restated 2003 Stock Incentive Plan (the Plan) and inducement grants for the three months ended March 31, 2017 and 2016, including $142,000 and $3,000 for nonemployees, respectively, was allocated to operating expenses follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2017 | 2016 |
| Selling, general and administrative | $ 2,217,200 | $ 839,777 |
| Research and development | 29,200 | 252,711 |
| Total | $ 2,246,400 | $ 1,092,488 |

As of March 31, 2017 there was approximately $6.4 million of total unrecognized compensation costs, net of estimated forfeitures, related to employee unvested stock option awards, which are expected to be recognized over a weighted-average period of 2.8 years.

The estimated grant-date fair values of the stock options were calculated using the Black-Scholes valuation model, based on the following assumptions for the three and nine months ended March 31, 2017 and 2016:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2017 | 2016 |
| Risk-free interest rates | 1.92%–2.39% | 1.16%–1.64% |
| Expected life | 6.00 years | 5.00 years–6.25 years |
| Expected dividends | 0% | 0% |
| Expected volatility | 114.38%–131.24% | 88.43%–92.24% |

Option activity under the Plan for the three months ended March 31, 2017 was as follows:

| | | Outstanding Options | |
|---|---|---|---|
| | Shares Available For Grant | Number of Shares [1] | Weighted-Average Exercise Price [1] |
| **Balance, December 31, 2016** | 2,988,243 | 19,840 | $ 770.35 |
| Shares reserved | — | — | — |
| Options granted | (1,113,450) | 1,113,450 | 7.12 |
| Options exercised | — | — | — |
| Options cancelled | 896 | (896) | 65.14 |
| **Balance, March 31, 2017** | 1,875,689 | 1,132,394 | $ 20.34 |

(1) Outstanding option amounts as of December 31, 2016 and March 31, 2017 include both 2003 Plan options as well as inducement options granted in November 2015 and January 2016 to executive officers in conjunction with their recruitment.

**(8) Stock Sales**

On January 23, 2017, the Company closed an underwritten public offering consisting of units of common stock, convertible preferred stock and warrants to purchase common stock. Gross proceeds of the offering were $19.0 million, prior to deducting underwriting discounts and commissions and offering expenses of $2.5 million.

The offering was comprised of Class A Units, priced at a public offering price of $5.31 per unit, with each unit consisting of one share of common stock and one five-year warrant (each, a "2017 Warrant") to purchase one share of common stock with an exercise price of $5.84 per share, and Class B Units, priced at a public offering price of $1,000 per unit, with each unit comprised of one share of Series A Preferred Stock (the Preferred Stock), which was convertible into 188 shares of common stock, and 2017 Warrants to purchase 188 shares of common stock. The conversion price of the Preferred Stock issued in the transaction as well as the exercise price of the 2017 Warrants are fixed priced and do not contain any variable pricing features nor any price based anti-dilutive features apart from customary adjustments for splits and reverse splits of common stock and both have been recorded within Shareholders' Equity in the condensed consolidated balance sheet. The Preferred Stock included a beneficial ownership limitation of 4.99%, but had no dividend preference (except to extent dividends are also paid on the common stock), liquidation preference or other preferences over common stock. The securities comprising the units were immediately separable were issued separately.

A total of 1,218,107 shares of common stock, 12,531 shares of Preferred Stock convertible into 2,359,894 shares of common stock, and 2017 Warrants to purchase 3,577,994 shares of common stock were issued in the offering including the underwriters' exercise of their over-allotment option to purchase 466,695 shares of common stock and 2017 Warrants to purchase an additional 466,695 shares of common stock.

On January 23 and January 24, 2017 all shares of Preferred Stock issued in conjunction with the offering were converted by their holders into 2,359,894 shares of common stock.

**(9) Warrants**

During the three months ended March 31, 2017, common stock warrants for 592,256 shares of common stock were exercised by warrant holders with proceeds to the Company of $3.3 million.

Stock warrant activity for the three months ended March 31, 2017 is as follows:

| | Common Shares | Weighted Average Exercise Price |
|---|---|---|
| **Balance, December 31, 2016** | 55,049 | $ 238.90 |
| Granted (1) | 3,577,994 | 5.84 |
| Exercised | (592,256) | 5.60 |
| Cancelled | (36) | 238.90 |
| **Balance, March 31, 2017** | 3,040,751 | $ 8.00 |

(1) See Note 8 regarding the issuance of 2017 Warrants

**(10) Subsequent Events**

On April 26, 2017, the Company entered into a Clinical Trial Agreement (the “Agreement”) with Southern California Permanente Medical Group (“Southern”) with an effective date of June 1, 2017. Under the Agreement, the Company is sponsoring an investigator-initiated study with Southern California Permanente Medical Group, a division of Kaiser Permanente, to study vBloc therapy as a treatment for Type 2 diabetic patients with obesity over a three-year period. As sponsor of the study, the Company is obligated to pay Southern approximately $3.4 million over three years to fund the study. Either party may terminate the Agreement at any time upon 30 days’ notice.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q.*

*Except for the historical information contained herein, the matters discussed in this "Management's Discussion and Analysis of Financial Condition and Results of Operations," are forward-looking statements that involve risks and uncertainties. In some cases, these statements may be identified by terminology such as "may," "will," "should," "expects," "could," "intends," "might," "plans," "anticipates," "believes," "estimates," "predicts," "potential," or "continue," or the negative of such terms and other comparable terminology. These statements involve known and unknown risks and uncertainties that may cause our results, level of activity, performance or achievements to be materially different from those expressed or implied by the forward-looking statements. Factors that may cause or contribute to such differences include, among others, those discussed in Part I, Item 1A, "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2016. Except as may be required by law, we undertake no obligation to update any forward-looking statement to reflect events after the date of this report.*

**Overview**

We are a medical device company with approvals to commercially launch our product, the vBloc Neuromodulation System (vBloc System), in the United States, the European Economic Area and other countries that recognize the European CE Mark. We are focused on the design and development of devices that use neuroblocking technology to treat obesity, metabolic diseases 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 only recently received U.S. Food and Drug Administration (FDA) approval to sell our product in the United States. In addition, we have regulatory approval to sell our product in the European Economic Area and other countries that recognize the European CE Mark and currently do not have any other source of revenue. We were incorporated in Minnesota on December 19, 2002 and later reincorporated in Delaware on July 22, 2004. We have devoted substantially all of our resources to the development and commercialization of the vBloc System, which was formerly known as the Maestro Rechargeable System.

The vBloc System uses vBloc Therapy to limit the expansion of the stomach, help control hunger sensations between meals, reduce the frequency and intensity of stomach contractions and produce a feeling of early and prolonged fullness. We believe the vBloc System offers obese patients a minimally-invasive treatment that can result in significant, durable and sustained weight loss. We believe that our vBloc System allows bariatric surgeons to offer a new option to obese patients who are concerned about the risks and complications associated with currently available anatomy-altering, restrictive or malabsorptive surgical procedures.

We received FDA approval on January 14, 2015 for vBloc Therapy, delivered via the vBloc System, for the treatment of adult patients with obesity who have a Body Mass Index (BMI) of at least 40 to 45 kg/m2, or a BMI of at least 35 to 39.9 kg/m2 with a related health condition such as high blood pressure or high cholesterol levels, and who have tried to lose weight in a supervised weight management program and failed within the past five years. In 2015 we began a controlled commercial launch at select surgical centers in the United States and had our first commercial sales. During 2015, we initiated a controlled expansion of our commercial operations and started the process of building a sales force. In January 2016, we hired new executives to oversee this expansion. Our direct sales force is supported by field clinical engineers who provide training, technical and other support services to our customers. Throughout 2016, our sales force called directly on key opinion leaders and bariatric surgeons at commercially-driven surgical centers that met our certification criteria. Additionally, in 2016, through a distribution agreement with Academy Medical, LLC, U.S. Department of Veterans Affairs (VA) medical facilities now offer the vBloc System as a treatment option to veterans using their veteran healthcare benefits. We plan to build on these efforts in 2017 with self-pay and veteran patient focused direct-to-patient marketing, key opinion leader and center specific partnering, and a multi-faceted reimbursement strategy.

To date, we have relied on, and anticipate that we will continue to rely on, third-party manufacturers and suppliers for the production of the vBloc System.

In 2016, we continued our commercialization efforts in the United States, deriving revenues from our primary business activity. We expect to incur significant sales and marketing expenses prior to recording sufficient revenue to offset these expenses. We expect our selling, general and administrative expenses to increase as we continue to add the infrastructure necessary to support our commercial sales, operate as a public company and develop our intellectual property portfolio. During the first quarter of 2017, we began to pursue additional commercial data of vBloc Therapy from our customers and their patients as well as from research institutions in order to enhance our case with third-party payers that the vBloc System can have a clinically meaningful level of effectiveness in reducing the incidence of diabetes and other co-morbidities in certain patients. One aspect of this strategy is providing vBloc System devices to customers at significant discounts to normal pricing or a limited number of promotional units to customers at no charge. For these reasons, we expect to continue to incur operating losses for the next several years. We have financed our operations to date principally through the sale of equity securities, debt financing and interest earned on investments.

**Financial Overview**

***Revenue***

We received FDA approval on January 14, 2015 for vBloc Therapy, delivered via the vBloc System, and began a controlled commercial launch at select surgical centers in the United States. We had our first commercial sales within the United States in 2015 and we recognized $292,000 in revenue. During the year ended December 31, 2016, recognized 787,000 in revenue. We have not generated revenue from commercial sales outside of the United States since 2012.

Any revenue from initial sales of a new product in the United States or internationally is difficult to predict and in any event will only modestly reduce our continued losses resulting from our research and development and other activities.

***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 professional services and consulting fees, costs associated with attending medical conferences, other professional fees for legal services, 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 and travel expenses. Also included are the cost of promotional units periodically provided to select customers at no charge in order to introduce them to our product and to enhance our ability to collect commercial data of vBloc Therapy.

***Research and Development Expenses***

Our research and development expenses primarily consist of engineering, product development, quality assurance and clinical and regulatory expenses, incurred in the development of our vBloc Rechargeable System. Research and development expenses also include employee compensation, including stock-based compensation, consulting services, outside services, materials, clinical trial expenses, including supplies, devices, explants and revisions, depreciation and travel. We expense research and development costs as they are incurred.

**Results of Operations**

***Comparison of the Three Months Ended March 31, 2017 and 2016***

*Sales*. Sales were $40,000 for the three months ended March 31, 2017 compared with $72,000 for the first quarter of 2016. Unit sales for both the first quarter of 2017 and the first quarter of 2016 were six units. The reduction in sales revenue was primarily due to two factors: (a) reduced pricing offered customers in connection with our efforts to initially place vBloc systems and, subsequently, gather commercial data of vBloc Therapy and (b) marketing program cost savings measures undertaken during the 2016 fourth quarter which resulted in the Company beginning 2017 with limited sales momentum.

*Cost of Goods Sold*. Cost of goods sold were $30,000 for the three months ended March 31, 2017, compared to $40,000 cost of goods sold for the three months ended March 31, 2016. The expense decrease was driven primarily by the product mix of units sold over the prior year period. The Company’s gross margin percentage declined to 26.3% for

the three months ended March 31, 2017 from 44.3% in the prior year period due primarily to discounting and downward pressure on pricing.

*Selling , General and Administrative Expenses*. Selling, general and administrative expenses were $5.9 million for the three months ended March 31, 2017, compared to $6.1 million for the three months ended March 31, 2016. The decrease of $212,000, or 3.5%, from the prior year period was primarily due to declines of $635,000, $150,000, and $48,000 of professional services expenses, travel expenses, and facilities expenses, respectively, partially offset by an increase of $531,000 of payroll-related expenses. The payroll-related expense increase includes an increase of $1.2 million of non-cash stock compensation expense for employees, partially offset by a decline in other compensation expenses of $711,000. Other compensation expenses declined as the result of fewer employees on the Company's payroll during first quarter of 2017 than the comparable period of 2016 and from a 20% reduction in base salaries imposed on all employees during January of 2017.

*Research and Development Expenses*. Research and development expenses declined to $1.1 million for the three months ended March 31, 2017 from $1.4 million for the three months ended March 31, 2016. The decrease of $308,000, or 21.5%, was primarily due to decreases of $353,000 and $69,000 in payroll-related expenses, and professional services expenses, respectively, partially offset by increases of $94,000 in supply expenses. The decrease in payroll-related expenses includes a $224,000 reduction in non-cash stock compensation expense and as well as reductions of other compensation expense resulting from fewer employees on the Company's payroll during first quarter of 2017 than the comparable period of 2016 and from a 20% reduction in base salaries imposed on all employees during January of 2017. The overall decrease in expense levels are the result of the Company's continued shift away from a research and development focus toward commercialization following FDA approval on January 14, 2015.

*Interest Expense*. Interest expense was zero for the three months ended March 31, 2017, compared to $1.1 million for the three months ended March 31, 2016. Interest expense for the first quarter of 2016 included interest related to the then outstanding 7% senior amortizing convertible notes (the Notes) with original principal amounts of $1.5 million and $11.0 million, respectively, and issuance dates of November 9, 2015 and January 11, 2016, respectively. As of December 31, 2016 the Notes were fully amortized.

*Change in Value of Convertible Notes Payable*. Since the convertible notes were fully amortized as of December 31, 2016, there was no valuation change to be recognized in the condensed consolidated statements of operations for the three months ended March 31, 2017. For the three months ended March 31, 2016 the value of the liability increased $500,000 based on the then outstanding Notes' fair market value calculated using a Binomial Lattice model.

*Change in Value of Warrant Liability*. The value of the common stock warrant liability for our Series A and Notes Warrants increased $323,000 during the three months ended March 31, 2017, primarily the result of marking to market Series A and Note Warrants for 40,858 common shares as of the date of their exercise. The value of the common stock warrant liability for our Series A and Notes Warrants decreased $1.8 million during the three months ended March 31, 2016. The fair market value of the warrant liability is calculated using the Black-Scholes valuation model, and is primarily driven by the reduction in the Company's stock price from $0.03 at December 31, 2015 to $0.01 at March 31, 2016.

**Liquidity and Capital Resources**

As of March 31, 2017, we had $18.7 million in cash bank deposits. While we had no short-term money market funds or other investments at March 31, 2017, we periodically invest in short-term money market funds that are not considered to be bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Company or other government agency. These money market funds seek to preserve the value of the investment at $1.00 per share; however, it is possible to lose money investing in these funds. Periodically, we invest cash in excess of immediate requirements in accordance with our investment policy, primarily with a view to liquidity and capital preservation. At times, such deposits may be in excess of insured limits. We have not experienced any losses on our deposits of cash and cash equivalents.

We have financed our operations to date principally through the sale of equity securities, debt financing and interest earned on investments. On January 23, 2017, we received $19.0 million in gross proceeds, prior to deducting offering expenses of $2.5 million, at the closing of an underwritten public offering of units in order to fund our future

operations (see Note 8, “Stock Sales” to the condensed consolidated financial statements included with this Form 10-Q for the Quarter Ended March 31, 2017). In addition during the three months ended March 31, 2017, the Company collected proceeds of $3.3 million from the exercise of common stock warrants for 592,256 shares of common stock.

Our anticipated operations include plans to continue the controlled commercial launch of vBloc Therapy, delivered via the vBloc System, which was approved by the FDA on January 14, 2015. We believe that we have the flexibility to manage the growth of our expenditures and operations. In order to accelerate the execution of our business plans we intend to raise additional funds.

Management is currently pursuing various funding options, including seeking additional equity financing as well as a strategic merger or other transactions to obtain additional funding or expand its product line during 2017 to continue the development of, and to successfully commercialize, the vBloc System. While there can be no assurance that the Company will be successful in its efforts, the Company has a long history of raising equity financing to fund its development activities. Should the Company be unable to obtain adequate financing or generate sufficient revenue in the future, the Company’s business, result of operations, liquidity and financial condition would be materially and negatively affected, and the Company would be unable to continue as a going concern. Additionally, there can be no assurance that, assuming the Company is able to strengthen its cash position, it will achieve sufficient revenue or profitable operations to continue as a going concern.

***Senior Amortizing Convertible Notes***

On November 9, 2015, January 11, 2016 and May 2, 2016 the Company issued 7% senior amortizing convertible notes (the Notes) with principal amounts of $1.5 million, $11.0 million and $6.25 million. Note Warrants were also issued in connection with each of the three Notes. As of December 31, 2016 the Notes were fully amortized, primarily through non-cash conversions of the Notes into shares of common stock. For the three months ended March 31, 2016, the condensed consolidated statement of operations includes interest expense related to the Notes. See further details regarding the Notes and Note Warrants in footnote 8 to the Company’s consolidated financial statements contained in our Annual Report on Form 10-K for the Year Ended December 31, 2016, which are incorporated herein by reference.

***Net Cash Used in Operating Activities***

Net cash used in operating activities was $4.4 million and $6.9 million for the three months ended March 31, 2017 and 2016, respectively. The decrease of $2.5 million was primarily due to reductions in operating expenses during the first quarter of 2017 versus the first quarter of 2016. Net cash used in operating activities primarily reflects the net loss for those periods, less noncash expenses for stock-based compensation, depreciation and amortization, change in value of convertible notes payable, change in value of warrant liability, and partially offset by changes in operating assets and liabilities.

***Net Cash Used in Investing Activities***

Net cash used in investing activities was zero and $12,000 for the three months ended March 31, 2017 and 2016, respectively. Net cash used in investing activities for the period is attributable to the purchase of property and equipment.

***Net Cash Provided by Financing Activities***

Net cash provided by financing activities was $19.8 million and $10.1 million for the three months ended March 31, 2017 and 2016, respectively. Net cash provided by financing activities for the three months ended March 31, 2017 was due to $19.0 million in gross proceeds from the issuance equity securities on January 23, 2017 along with $3.3 million in proceeds from the exercise of common stock warrants. Partially offsetting these amounts were $2.5 million of expenses related to the equity offering. For the three months ended March 31, 2017, cash provided by financing activities consisted of $11.0 million from the issuance of Notes on January 11, 2016, partially offset by $405,000 of cash payments on the notes and $459,000 in debt issuance and common stock financing costs.

***Operating Capital and Capital Expenditure Requirements***

We received FDA approval on January 14, 2015 for vBloc Therapy, delivered via the vBloc System, and began a controlled commercial launch at select bariatric centers of excellence in the United States. We had our first commercial sales within the United States in 2015 and for the years ended December 31, 2015 and 2016, we recognized $292,000 and $787,000 in revenue, respectively. For the three months ended March 31, 2017, we recognized $40,000 in revenue. We anticipate that we will continue to incur net losses for the next several years as we develop our products, commercialize our vBloc System, develop the corporate infrastructure required to sell our products, operate as a publicly-traded company and pursue additional applications for our technology platform.

We have financed our operations to date principally through the sale of equity securities, debt financing and interest earned on investments. As of December 31, 2016, we had $3.3 million of cash and cash equivalents. On January 23, 2017, we received $19.0 million in gross proceeds, prior to deducting offering expenses of $2.5 million, at the closing of an underwritten public offering of units consisting of common stock, convertible preferred stock and common stock warrants in order to fund our operations. Additionally, during the three months ended March 31, 2017, common stock warrants for 592,256 shares of common stock were exercised by warrant holders with proceeds to the Company of $3.3 million (see also Notes 8 and 9 to the condensed consolidated financial statements included with this Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2017).

Our anticipated operations include plans that consider the controlled commercial launch of vBloc Therapy, delivered via the vBloc System. We believe that we have the flexibility to manage the growth of our expenditures and operations depending on the amount of our cash flows. However, we will ultimately need to achieve sufficient revenues from product sales and/or obtain additional debt or equity financing in order to support our operations.

Management is currently pursuing various funding options, including seeking additional equity financing as well as a strategic, merger or other transactions to obtain additional funding or expand its product line during 2017 to continue the development of, and to successfully commercialize, the vBloc System. While there can be no assurance that the Company will be successful in its efforts, the Company has a long history of raising equity financing to fund its development activities. Should the Company be unable to obtain adequate financing or generate sufficient revenue in the future, the Company's business, result of operations, liquidity and financial condition would be materially and negatively affected, and the Company would be unable to continue as a going concern. Additionally, there can be no assurance that, assuming the Company is able to strengthen its cash position, it will achieve sufficient revenue or profitable operations to continue as a going concern.

Obtaining funds through the warrant holders' exercise of outstanding common stock warrants or 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. The sale of additional equity may require us to obtain approval from our stockholders to increase the number of shares of common stock we have authorized under our certificate of incorporation. 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. In addition, if we raise additional funds through collaboration, licensing or other similar arrangements, it may be necessary to relinquish valuable rights to products or proprietary technologies, or grant licenses on terms that are not favorable.

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 Part I, Item 1A, *Risk Factors*, of our Annual Report on Form 10-K. 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 vBloc 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 cost and timing of establishing sales, marketing and distribution capabilities;
- the cost of establishing clinical and commercial supplies of our vBloc System and any products that we may develop;
- the rate of market acceptance of our vBloc 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 vBloc System or our future products;
- the scope, rate of progress, results and cost of our clinical trials and other research and development activities;
- the cost and timing of obtaining any further required regulatory approvals; and
- the extent to which we invest in products and technologies, although we currently have no commitments or agreements relating to any of these types of transactions.

**Critical Accounting Policies and Estimates**

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States. In doing so, we have to make estimates and assumptions that affect our reported amounts of assets, liabilities and expenses, as well as related disclosure of contingent assets and liabilities. In many cases, we could reasonably have used different accounting policies and estimates. In some cases, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ materially from our estimates. To the extent that there are material differences between these estimates and actual results, our financial condition or results of operations will be affected. We base our estimates on past experiences and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis.

During the three months ended March 31, 2017, there were no material changes to our significant accounting policies which are fully described in Note 2 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2016.

**Off-Balance Sheet Arrangements**

As of March 31, 2017, we did not have any off-balance sheet arrangements.

**Recent Accounting Pronouncements**

In May 2014, FASB issued Revenue from Contracts with Customers, Topic 606 (Accounting Standards Update No. 2014-09 (ASU 2014-09)), which provides a framework for the recognition of revenue, with the objective that recognized revenues properly reflect amounts an entity is entitled to receive in exchange for goods and services. This

guidance will be effective for interim and annual reporting periods beginning after December 15, 2017. The Company does not believe that the adoption of the new standard will have a material effect on its previously reported revenue in that the accounting related to its current revenue-based business practices will not change under the new standard, though incremental disclosures required by the new standard may be significant.

In March 2016, FASB issued Improvements to Employee Share-Based Payment Accounting, (Accounting Standards Update No. 2016-09 (ASU 2016-09)), which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, the estimation of forfeitures, shares withheld for taxes and classification of shares withheld for taxes on the statement of cash flows. As part of the adoption of this guidance the Company has elected to account for forfeitures of share-based awards as they occur. The Company prospectively adopted ASU 2016-09 as required on January 1, 2017 and the adoption did not have a material effect on its consolidated financial statements.

There have been no other significant changes in recent accounting pronouncements during the three months ended March 31, 2017 as compared to the recent accounting pronouncements described in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk is confined to our cash and cash equivalents. As of March 31, 2017, we had $18.7 million in cash and cash equivalents. 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 may maintain a portfolio of cash equivalents and investments in a variety of securities of high credit quality. The securities in our investment portfolio, if any, 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 cash equivalents, we do not believe that an increase in market rates would have any material negative impact on the value of our investment portfolio. We have no investments denominated in foreign currencies and therefore our investments are not subject to foreign currency exchange risk.

## ITEM 4. CONTROLS AND PROCEDURES

### *Evaluation of Disclosure Controls and Procedures*

Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), defines the term "disclosure controls and procedures" as those controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on their evaluation as of March 31, 2017, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

### *Changes in Internal Control Over Financial Reporting*

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended March 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

On February 28, 2017, the Company received a class action and derivative complaint filed on February 24, 2017 in U. S. District Court for the District of Delaware by Vinh Du, one of the Company's shareholders. The complaint names as defendants EnteroMedics, the board of directors and four members of our senior management, namely, Scott Youngstrom, Nick Ansari, Peter DeLange and Paul Hickey, and contains a purported class action claim for breach of fiduciary duty against the board of directors and derivative claims for breach of fiduciary duty against the board of directors and unjust enrichment against our senior management. The allegations in the complaint relate to the increase in the number of shares authorized for grant under our Second Amended and Restated 2003 Stock Incentive Plan (the "Plan"), which was approved by our shareholders at the Special Meeting of Shareholders held on December 12, 2016 (the "Special Meeting"), and to our subsequent grant of stock options on February 8, 2017, to the Company's Directors and senior management to purchase an aggregate of 1,093,450 shares of our common stock (the "Option Grants"). In the complaint, the plaintiff contends that (i) the number of shares authorized for grant under the Plan, as adjusted by the board of directors after the Special Meeting for the subsequent recapitalization of the Company, resulted from an alleged breach of fiduciary duties by the board of directors, and (ii) our senior management was allegedly unjustly enriched by the subsequent Option Grants. The plaintiff seeks relief in the form of an order rescinding the Plan as approved by the shareholders at the Special Meeting, an order cancelling the Option Grants, and an award to plaintiff for his costs, including fees and disbursements of attorneys, experts and accountants. On April 17, 2017, we filed a motion to dismiss the complaint based on the plaintiff's failure to satisfy Delaware's demand requirement for a derivative action and failure to state a valid claim. The defendant has until June 15, 2017 to file its response to the motion to dismiss. We believe the allegations in the complaint are without merit, and intend to defend the action vigorously.

Except as disclosed in the foregoing paragraph, the Company is not currently a party to any litigation and the Company is not aware of any pending or threatened litigation against it that could have a material adverse effect on the Company's business, operating results or financial condition. The medical device industry in which the Company operates 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, the Company may be involved in various legal proceedings from time to time.

### ITEM 1A. RISK FACTORS

Except for the addition of the risk factor shown below, there have been no material changes during the three months ended March 31, 2017 to the risk factors set forth in Part I, Item 1A, *Risk Factors*, of our Annual Report on Form 10-K for the year ended December 31, 2016.

***If we are unsuccessful in our pursuit of various funding options, we will be unable to continue as a going concern.***

Management is currently pursuing various funding options, including seeking additional equity financing as well as a strategic merger or other transactions to obtain additional funding or expand its product line to continue the development of, and to successfully commercialize, the vBloc System. There can be no assurance that the Company will be successful in its efforts. Should the Company be unable to obtain adequate financing or generate sufficient revenue in the future, the Company's business, result of operations, liquidity and financial condition would be materially and adversely harmed, and the Company would be unable to continue as a going concern. Additionally, there can be no assurance that, assuming the Company is able to strengthen its cash position, it will achieve sufficient revenue or profitable operations to continue as a going concern.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

***Unregistered Sales of Equity Securities***

None.

***Uses of Proceeds from Sale of Registered Securities***

None.

***Purchases of Equity Securities***

None.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS

The list of exhibits on the accompanying Exhibit Index are filed or incorporated by reference (as stated therein) as part of this Quarterly Report on Form 10-Q.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**ENTEROMEDICS INC.**

BY: /S/ DAN W. GLADNEY
**Dan W. Gladney**
**President and Chief Executive Officer**
**(Principal Executive Officer)**

BY: /s/ Scott P. Youngstrom
**Scott P. Youngstrom**
**Chief Financial**
**Officer and Chief Compliance Officer**
**(Principal Financial and Accounting Officer)**

Dated: May 15, 2017

EXHIBIT INDEX

| Exhibit Number | Description of Document |
|---|---|
| 10.1 | Clinical Trial Agreement by and between EnteroMedics Inc. and Southern California Permanente Medical Group effective as of June 1, 2017. |
| 31.1* | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2* | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101* | Financial statements from the Quarterly Report on Form 10-Q of the Company for the quarter ended March 31, 2017, formatted in Extensible Business Reporting Language: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Comprehensive Loss, (iv) the Condensed Consolidated Statements of Cash flows and (v) the Notes to Condensed Consolidated Financial Statements. |

* Filed herewith.

**Exhibit 10.1**

# CLINICAL TRIAL AGREEMENT

This Clinical Trial Agreement ("Agreement"), effective this 1st day of June 2017 ("Effective Date"), is made by and between Southern California Permanente Medical Group, with its offices at 100 South Los Robles, 2nd Floor, Pasadena, California 91101 (hereinafter "Institution"), and Enteromedics, Inc., with its offices at 2800 Patton Road, St. Paul, MN 55113 (hereinafter "Sponsor"), to have the Institution conduct a clinical trial (the "Study") at several sites.

Investigators. Anny H. Xiang, PhD, will serve as the principal investigator, and (hereinafter, collectively "Investigator"). Dr. Xiang, as the principal investigator shall work with Institution to ensure that she and the co-investigators comply with the obligations and terms of this Agreement as specified for the Investigator hereunder.

## 1. STUDY CONDUCT

1.1 Study Product. Sponsor agrees to provide vBloc Maestro® Rechargeable System (the "Study Product") in amounts necessary to conduct the Study. Sponsor will provide the Study Product free of charge to the Institution. Institution and Investigator agree that the Study Product will be used solely for purposes of performing the Protocol under this Agreement. At the completion of the Study, Institution shall return any remaining Study Product to Sponsor, unless otherwise instructed by Sponsor.

1.2 Protocol. The Protocol which was developed by the Institution includes the details of the Study known as "Kaiser Permanente So CA Partnership Study Design Outline for vBloc Therapy with the Maestro Rechargeable System," (the "Protocol"), which is incorporated along with any Protocol Amendments by reference as part of this Agreement.

1.3 Compliance with Laws; IRB Approval; HIPAA. Institution and Investigator agree to comply with this Agreement, the Protocol, requirements of the IRB in connection with the Study, and all applicable federal, state and local laws and regulations, including but not limited to the privacy regulations issued pursuant to the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"), 45 C.F.R. Parts 160 & 164. Institution and Investigator agree that it will appropriately safeguard protected health information ("PHI"). As used in this Agreement, PHI shall have the meaning of that term as defined in the HIPAA privacy regulations. The Investigator and Institution shall handle all Study data, including medical records of Study participants, in accordance with HIPAA requirements and all other applicable laws. The Investigator and Institution shall obtain from each Study participant a valid authorization that complies with HIPAA before the Investigator or Institution provide any Study data to Sponsor.

Sponsor also shall comply with this Agreement and all applicable laws and regulations. Sponsor shall comply with the regulations of HIPAA, governing the privacy and security of health information. To the extent required by applicable law, Sponsor will also require all personnel and any other third parties involved in the conduct of the Study to comply with applicable law. Sponsor shall treat all information regarding diagnosis, history or treatment that allows unique identification of an individual's PHI, as confidential information.

## 2. PROTOCOL

2.1 Protocol Submission to IRB. Institution and Investigator will submit the Protocol for approval to the Institutional Review Board ("IRB"). Protocol will become final upon approval by the designated IRB. Investigator will ensure that the IRB will be responsible for the continuing review and approval of the Study.

2.2 IRB Required Documents. Institution and Investigator will submit to the IRB, any documents required by the IRB in connection with the Study, including Informed Consent and HIPAA Authorizations. These documents will become final upon approval, if applicable, by the IRB. Institution and Investigator will use the current IRB approved version of the Informed Consent to obtain consent from each Study participant.

2.3 Changes to Protocol. Institution and Investigator will submit to the IRB, any proposed amendment to, or deviation from, the Protocol, or such other documents as required by the IRB in connection with the Study. Prior to implementation of any amended Protocol, Institution and Investigator will submit such amendments to the IRB and obtain prior written approval, or a determination that written approval is not required.

2.4 Data Safety Monitoring Board. Sponsor understands that the Data Safety Monitoring is a requirement of this study and the Data Safety Monitoring Board (DSMB) services provided by Sponsor must meet the requirements of the FDA policy (reference: https://www.fda.gov/OHRMS/DOCKETS/98fr/01d-0489-gdl0003.pdf). DSMB Members will not be Staff of the Sponsor or Institution. Additionally, Sponsor will allow Institution's Principal Investigator to review and approve DSMB Committee Members prior to their appointment to the Committee."

## 3. COMPENSATION

3.1 Compensation. In consideration of the work to be performed under this Agreement, Sponsor will provide payments to Institution in accordance with the budget, which is attached hereto as Exhibit A. Institution represents that the budget is based on fair market value of the work and services to be provided for Institutions of similar size and scope. Payment as set forth in this Section and Exhibit A constitutes full payment for the Study, and other than applicable Study participant injuries under Section 5.2, Sponsor shall have no other payment obligations either under this Agreement or in connection with the Study.

3.2 Schedule of Payments. All payments due hereunder shall be paid by Sponsor within forty-five (45) days from its receipt of an invoice for such payment from Institution. Invoices must be provided to Sponsor no more than six (6) months after the date of Study completion or termination. Final payment will be made after Sponsor receives any remaining Study Product.

3.3 Disclosure. Institution and Investigator understand and agree that, pursuant to local, state, and federal laws, Sponsor may have a legal obligation to disclose the financial relationship between Sponsor and the Investigator and Institution, including any compensation under this Agreement, and does not object to any such disclosure required by law.

Institution acknowledges that pursuant to the federal Physician Payments Sunshine Act (Section 6002 of the 2010 Patient Protection and Affordable Care Act) and certain State laws, Sponsor may be obligated to report all payments made to Institution in performance of this Agreement to Government agencies for further public disclosure. For clarity and avoidance of doubt, and consistent with the invoicing and payment provisions of this Agreement, Institution and Sponsor agree that Southern California Permanente Medical Group is the Institution contracting entity and recipient of all payments to be made by Sponsor under this Agreement. Sponsor will report such payments accordingly. Institution and Sponsor will cooperate to resolve any apparent errors or discrepancies discovered in publicly reported information about payments made in performance of this Agreement and obtain or make corrections in such information.

In the event that Sponsor requires Investigator or Institution personnel to attend meetings for the Study, Sponsor will arrange and pay for the expenses directly for travel, accommodation, and meals in connection with such attendance. Such covered expenses may be publicly reportable. No compensation will be paid in connection with attending the investigator meeting. Sponsor shall provide Institution documentation verifying the amount of anything of value provided to Investigator and Institution personnel including all travel accommodations and meals. Institution shall reimburse Investigator and Institution personnel for incidental expenses authorized by Sponsor and shall invoice and be reimbursed by Sponsor for those expenses.

## 4. INVESTIGATOR AND INSTITUTION REPRESENTATIONS

4.1 Investigator. Investigator is a Partner of Institution and will be responsible for performing the Study and supervising any individual performing portions of the Study. Investigator represents and certifies that he/she will conduct the Study in compliance with the Protocol, any other documents required by the IRB in connection with the Study, and all terms and conditions of this Agreement. Investigator or assigned qualified designee will: (a) maintain patient records and source documentation for each Study participant and monitor the Study for compliance to good clinical practices; and (b) assist Sponsor in clarification of clinical results and resolve and account for any data discrepancies, Study participant missed visits, and Protocol discrepancies.

4.2 Unavailability of Investigator. Investigator is essential to the Study. If Investigator becomes unable to complete the Study, Institution will consult with and obtain written approval from Sponsor prior to appointing a new Investigator. Sponsor reserves the right to terminate this Agreement if Institution and Sponsor cannot agree upon an acceptable substitute within sixty (60) days.

4.3 Independent Contractors. In undertaking to perform this Study for Sponsor, it is understood and agreed that Investigator and Institution are doing so as independent contractors and not as an employee, partner or joint venture of Sponsor.

4.4 Event of Debarment or Disqualification. If, during the term of this Agreement, Institution or Investigator or any employee or agent performing services for the Study (i) becomes debarred, suspended, excluded, or otherwise sanctioned, or (ii) receives notice of an action or threat of an action with respect to any such debarment, suspension, exclusion, or sanction, Institution and Investigator each agrees to immediately notify Sponsor. Institution and Investigator also each agrees that if it/he/she becomes debarred, suspended, excluded, or

otherwise sanctioned, Institution and Investigator will immediately notify Sponsor and cease all activities relating to this Agreement, to the extent medically permissible and otherwise possible.

4.5 Restrictions on Charging. Neither Institution nor Investigator will charge any participant in the Study or third party payer for the Study Product, or procedures associated with administering the Study Product, or any other research services covered by the budget as specified in Exhibit A.

4.6 Assignment and Subcontracting Restrictions. Institution and Investigator may not assign their rights, delegate their obligations, or otherwise transfer or subcontract under this Agreement without the prior written consent of Sponsor, which consent will not be unreasonably withheld.

4.7 Permitted Sites at Institution. Sponsor acknowledges and agrees that the Study will be conducted at the following sites within the Institution:

a. Kaiser Permanente
South Bay Medical Center
25825 S. Vermont Avenue, Lot 33
Floor PVKW 3rd
Harbor City, CA 90710

## 5. PARTICIPANTS

5.1 Clinical Study Participants. Institution and Investigator will include only participants in the Study who upon entrance into the Study meet all of the inclusion criteria and none of the exclusion criteria set forth in the Protocol, have executed a written informed consent form, and have executed a HIPAA Authorization.

5.2 Participant Injuries. Sponsor shall reimburse the Institution for the cost of reasonable and necessary medical care, including hospitalization, incurred by a Study participant in treating an injury that directly results from the use of the Study Product performed in accordance with the Protocol, provided such costs are in no way attributable to the Study participant not following instructions. In no case will Sponsor reimburse the Institution or any other party for (i) the treatment of medical complications that are a part of the natural course of the primary disease or for any medical treatment for injuries that are unrelated to the use of the Study Product, (ii) other injury-or illness-related costs (such as lost wages), or (iii) medical expenses that are incurred as a result of a material violation of the Protocol. It is understood and acknowledged that Sponsor’s obligations under this provision are primary to the obligations of Medicare or any other government provider. Sponsor will not reimburse for any reasonable and necessary medical expenses incurred by Study participants to the extent caused by the Institution’s or its personnel’s negligent acts or omissions or violations of this Agreement, intentional wrongdoing or failure to follow the Protocol or applicable law.

## 6. CONFIDENTIALITY

6.1 Sponsor Confidential Information. Institution and Investigator each agree to maintain in confidence and not disclose to any third party, or use for its benefit or the benefit of any third party, without the prior written consent of Sponsor any confidential or proprietary information, including the Study Product ("Sponsor Confidential Information").

6.2 Institution Confidential Information. Sponsor, including its representatives or employees, shall not release, disclose or use Institution's confidential information other than in connection with the Study unless required by law or regulation. "Institution Confidential Information" means the Protocol, all participant medical records and other data originating at Institution (including but not limited to any PHI) from which Study data is collected or generated ("Source Documents"), including without limitation of the foregoing any such information obtained by inspection or copying in connection with an audit or examination under this Agreement or any Study Addendum; any confidential or proprietary information (including all tangible and intangible embodiments thereof) concerning any Institution's business practices (e.g., health care delivery practices, utilization data, membership or other health plan information).

Institution's electronic medical record system known as KP HealthConnect™ contains confidential and proprietary information of Institution and its software licensors. Accordingly, in the event Sponsor comes into contact with KP HealthConnect™, Sponsor agrees to treat the design, functionality, features and information available in KP HealthConnect as Institution's Confidential Information, which Sponsor will hold in confidence and will not use or disclose for any purpose other than performance of the Study.

6.3 Use of Confidential Information. Each Party agrees to use the Confidential Information of the other Party only for fulfilling their respective obligations under this Agreement. If requested, the Party receiving the Confidential Information ("Receiving Party") will return such Confidential Information of the Party disclosing the Confidential Information ("Disclosing Party") at the end of the Study, other than items required to be retained under Regulations.

6.4 Exceptions. The obligations of non-disclosure and non-use do not apply when:

1. The information is in the public domain or becomes publicly available through no fault of Receiving Party or any employee, agent or representative of Receiving Party;

2. Receiving Party knows the information before receipt from the Disclosing Party, as evidenced by written records maintained by Receiving Party prior to the disclosure of the information;

3. The information is lawfully received from a third party that has a right to make such disclosure, who did not obtain such information in violation of Disclosing Party's or its affiliates' rights or under obligation of confidentiality to Disclosing Party and/or its affiliates;

4. Applicable law, rule, regulation or order requires disclosure of Confidential Information. If such disclosure is required, Receiving Party will notify Disclosing Party immediately, will give Disclosing Party time and opportunity to file appropriate

motions to protect the confidentiality of such information, and, at Disclosing Party's request will reasonably cooperate in any Disclosing Party's efforts to obtain a protective order, confidential treatment or an exemption or limitation with respect to such required disclosure; or

5. Disclosing Party grants written permission for disclosure.

## 7. INTELLECTUAL PROPERTY

7.1 Rights to Study Data. All clinical data, including case report forms and other relevant information generated during the Study, will be promptly and fully disclosed to Sponsor and may be used by Sponsor for any purpose(s) stated in the informed consent form or otherwise in compliance with applicable law. All data generated during this Study (including without limitation all case report forms, safety information and other data reports) is and will be jointly owned by Institution and Sponsor. The Institution and the Investigator hereby assign to Sponsor any rights, title or interest they may have therein. "Original Source Documents" defined as individual patient records, investigators' research and clinical records, hospital records, clinical and patient charts, laboratory notes, pharmacy dispensing records, recorded data from automated instruments, microfiches, photographic negatives, microfilm or magnetic media, X-rays and other diagnostic images, and other records generated and maintained by the pharmacy, laboratories and medico-technical departments of the Institution and any other information that the Institution maintains for regulatory, research and patient care purposes will remain the property of the Institution. The Institution will be free to use the results of the Study for its own teaching, research, educational, clinical and publication purposes, subject to Section 8 (Publication) and Section 6 (Confidentiality) of this Agreement. The Institution understands and agrees that (i) it will have no ownership, license or access rights in or to Sponsor's regulatory filings based upon the inclusion of research results therein and (ii) they will not acquire any interest whatsoever in the Study Product as a result of performing the Study contemplated by this Agreement. This Section is subject to all applicable law, including any privacy legislation applicable to the performance of the Study by the Institution and the Institution personnel, and will survive the expiration and termination of this Agreement.

7.2 Biological Samples**.** Institution owns biological samples and grants Sponsor access to use biological samples for purposes of the Study and in accordance with the Study subjects' Informed Consent Forms, HIPAA Authorizations, and Applicable Law. Upon completion or termination of the Study, or sooner at the request of Sponsor, all biological samples shall remain with Institution.

7.3 Existing Inventions. It is recognized and understood that certain existing inventions and technologies are the separate property of Sponsor or Institution and are not affected by this Agreement, and neither Party shall have any claims to or rights in such separate inventions and technologies.

7.3 Sponsor's Rights. Any concepts, know-how, ideas, innovations, inventions, discoveries, data, designs, technology and improvements, whether or not protectable under patent, copyright, trade secrecy or similar laws (collectively, "Intellectual Property"), and conceived of and/or

reduced to practice by Investigator or any Institution personnel whether alone or jointly with others, including but not limited to Sponsor's personnel, during the course of the Study or otherwise as a result of the services performed under this Agreement which constitutes a new use, modification, enhancement or improvement to the Study Product, shall be owned solely by Sponsor. The Intellectual Property described in the preceding sentence is defined herein collectively as "Sponsor's Rights." The Institution hereby assigns, and shall ensure that the Investigator and the other Institution personnel will assign, to Sponsor the entire right, title and interest they may have in and to any and all Sponsor's Rights and they will execute and deliver all agreements or instruments deemed reasonably necessary to effectuate any assignment of right at the expense of Sponsor.

7.4 Joint Rights. Other than Sponsor's Rights, Intellectual Property jointly conceived or developed by the Institution or other Institution personnel and Sponsor shall be owned jointly by the Institution and Sponsor ("Joint Rights"). The parties hereto shall not license or otherwise transfer any rights in or to any Joint Rights until the parties have entered into a joint cooperation agreement regarding licensing and patenting; provided, however,

Sponsor shall have the right to exploit the Joint Rights in any way, including but not limited to commercial sales or licensing to third parties, and shall not be required to provide an accounting or remit any revenues therefrom to the Institution.

Sponsor shall have the first option to negotiate an exclusive, worldwide, royalty-bearing license for the Institution's interest in and to the Joint Rights or purchase such Joint Rights. Sponsor may exercise its option with regard to any Joint Rights at any time during the period of one hundred eighty (180) days after disclosure of such Joint Rights by providing the Institution with written notice of its desire to exercise its option. The aforesaid disclosure shall specify the terms upon which Sponsor may acquire such exclusive license. The Institution shall provide Sponsor with the information Sponsor reasonably requests to determine whether to exercise its option. If Sponsor does not exercise its option during the 180-day period, the Institution may license such Joint Rights to third parties, provided, however, that the Institution may not, for a period of one (1) year, license such Joint Rights to third parties on terms more favorable than those offered to the Sponsor.

Upon Sponsor's exercise of its option with regard to any Joint Rights, the Institution and Sponsor will negotiate in good faith in an attempt to reach a license or sale agreement satisfactory to both parties; provided however, that the negotiation period shall not exceed twelve (12) months. If both parties participate in good faith and in a timely manner in the negotiations but cannot reach an agreement, then upon the expiration of the twelve-month negotiation period the Institution shall have no further obligation to Sponsor under this Agreement with regard to the Institution's interests under the Joint Rights; provided, however, Sponsor shall continue have the right to exploit the Joint Rights in any way.

7.5 Institution's Rights. Other than Sponsor's Rights and Joint Rights, any Intellectual Property that is conceived and/or reduced to practice solely by Institution employees or agents during the performance of services pursuant to this Agreement shall be owned by the Institution (collectively, "Institution's Rights").

7.6 Treatment. The Institution shall promptly disclose in writing to Sponsor all Intellectual Property conceived of and/or reduced to practice by the Investigator or any other Institution personnel as a result of performing services under this Agreement.

7.7 Use of Name/Logo. Except as required by law or regulation, no party to this Agreement will use the name or logo of any other party or of any employee, agent or representative of any other party in connection with any product, service, promotion, news release, report, or other publication, oral or written without the prior written approval of the party or individual whose name or logo is to be used.

## 8. PUBLICATION

8.1 Right to Publish. The Institution and Sponsor will each have a right to publish, present or use any final results arising out of the performance of the Study (individually, a "Publication") for their publication objectives. With respect to Institution and Investigator Publication, such Publication shall occur only after completion of the Study, shall contain only final research data and analysis, and shall be subject to the regulations and the provisions of this Agreement relating to confidentiality and non-disclosure. At least thirty (30) days prior to submission for publication, presentation or use, Institution or Investigator will submit to Sponsor for review any proposed oral or written Publication.

If Sponsor believes that any Publication contains confidential or proprietary information belonging to Sponsor, Sponsor will notify the Institution or Investigator, which will remove all references to such confidential or proprietary information prior to publication, presentation or use. Any comments regarding the deletion of materials shall not be editorial in nature or content, but shall constitute comments pertaining to matters that Sponsor considers confidential or proprietary in nature. Upon Sponsor's notice to Institution or Investigator that Sponsor reasonably believes that one or more patent applications should be filed, which relate to inventions owned by Sponsor according to Section 7, prior to any Publication, such Publication will be delayed until such patent application(s) have been filed, provided that Investigator, Institution and Sponsor will cooperate in expeditiously filing any such patent application(s), and provided further that any such delay of a Publication will not exceed forty-five (45) days from the date of such notice to Institution or Investigator.

The foregoing notwithstanding, Sponsor will not make any public presentation of Study Data or reports provided to Sponsor by Institution or Investigator until the earlier of (i) such data or reports have been publicly disclosed; (ii) twenty four (24) months following completion or earlier termination of the Study; or (iii) Institution's prior written consent, which shall not be unreasonably delayed or withheld. For the avoidance of doubt, Sponsor may use non-public Study Data or reports at any time for regulatory or risk management evaluation purposes. At least thirty (30) days prior to submission for publication, presentation or use, Sponsor will submit to Institution for review any proposed oral or written Publication; provided that such information has not previously been publicly disclosed by Institution.

## 9. TERM AND TERMINATION

9.1 Term. The terms of this Agreement will commence on the Effective Date and will continue in force until the Study has been completed or this Agreement has been terminated, whichever occurs sooner.

9.2 Termination. This Agreement may be terminated in accordance with the following provisions: (i) Either party may terminate this Agreement if the other party materially breaches any of its obligations or provisions of this Agreement, provided, however, that the breaching party shall be given not less than thirty (30) days' prior written notice of such material breach and the opportunity to cure the breach during such period; (ii) Institution may terminate this Agreement immediately for safety reasons relating to the use of the Study Product; and (iii) Institution and/or Sponsor may terminate this Agreement for any reason upon thirty (30) days' prior written notice to the other party.

9.3 Effect of Receipt of Termination. Upon receipt of notice of termination, Institution shall immediately stop entering new Study participants into the Study and, to the extent medically permissible, cease use of the Study Product and conducting procedures on participants already entered into the Study. Institution and Investigator shall immediately deliver to Sponsor all unused Study Product, if any, unless otherwise instructed by Sponsor. In the event of termination, Institution and Investigator will provide notice of such termination to the IRB. Upon termination, Sponsor's sole obligation shall be to pay Institution a pro-rated amount for actual work performed and non-cancellable obligations incurred by Institution within forty (45) days of receipt of termination notice.

## 10. INDEMNIFICATION

10.1 Sponsor Indemnity. Except as set forth below, Sponsor agrees to defend, indemnify and hold harmless Investigator and Institution, its trustees, officers, affiliates, agents and employees (collectively, the "Institutional Indemnitees") from any and all liabilities, claims, actions, suits, or proceedings from third-parties (collectively "Claims"), for any injury arising out of Sponsor's performance of the activities under this Agreement to the extent caused by the use of the Study Product in accordance with the Protocol. Indemnification shall not extend, however, to that portion of any Claims resulting from Institutional Indemnitees (a) negligence or malfeasance (b) failure of Institution to comply with the terms of this Agreement, and/or any written instructions provided by Sponsor regarding the contents of this Agreement. Notwithstanding the foregoing, Sponsor shall not settle, or admit liability with respect to, any such Claims, which would result in liability to Institution without prior written consent of Institution.

10.2 Institution Indemnity. Institution agrees to defend, indemnify, and hold harmless Sponsor, its agents and employees (collectively, the "Sponsor Indemnitees") from any and all liabilities, claims, actions, suits, or proceedings (collectively "Claims"), resulting from the negligent or intentional misconduct of Investigator and Institution, and their agents or employees arising out of the performance of the activities under this Agreement. Indemnification shall not extend, however, to that portion of any Claims resulting from Sponsor Indemnitees (a) negligence or malfeasance (b) failure of Sponsor to comply with the terms of this Agreement, and/or any written instructions provided by Institution regarding the contents of this Agreement.

Notwithstanding the foregoing, Institution shall not settle, or admit liability with respect to, any such Claims, which would result in liability to Sponsor without prior written consent of Sponsor.

## 11. INSURANCE

11.1 Insurance. Institution represents that it is self-insured. Institution will at Sponsor's request provide a certificate of self-insurance coverage to Sponsor to evidence dedicated financial capacity to cover losses in amounts specified in the certificate.

## 12. RECORDS

12.1 Records. Institution and Investigator will maintain adequate records and documents pertaining to the conduct of the Study, including, but not limited to, Study participant identifications, clinical observations, informed consents, HIPAA authorizations, laboratory tests and other records required by the regulations to be maintained, and will maintain those records during the Study and as long as required by applicable law.

12.2 Case Report Forms. The Investigator will complete any forms or reports requested by Sponsor and/or described in the Protocol and will do so in an accurate, complete and timely manner, in accordance with applicable law and as permitted under the consent forms. If a referring physician is following the Study participant, the Investigator will coordinate data collection with the referring physician. All case report forms will be completed by the Investigator and submitted to Sponsor at Study completion or termination, whichever is earlier.

12.3 Reports. The Investigator will provide in a timely manner annual and final reports to Sponsor, as described in the Protocol.

12.4 Access. Institution shall allow Sponsor's authorized representatives to visit Institution's facilities where the Study is conducted at reasonable times and with reasonable advance notice to observe and verify Institution's compliance with this Agreement and to review the work being performed for the Study, to inspect the facilities which are being utilized in the Study, including having access to all relevant records, including the Study Data, as needed. Institution will provide Sponsor's Representatives the necessary access to the Institution's electronic medical record system and other Study Data only if Sponsor's Representatives provide the required information and complete the necessary training.

## 13. REVIEW RIGHTS

13.1 Audit and Review Rights. Institution will review and audit records for data quality purposes. Except for the rights granted in Section 12, Sponsor or its authorized representatives shall not have the right to review, audit or monitor site records.

## 14. NOTICES

14.1 Notices. Notices under this Agreement will be given by personal delivery, first class mail, recognized overnight courier service or by FAX to the person designated below:

If to Sponsor:

Enteromedics, Inc.
2800 Patton Road
St. Paul, MN 55113

If to Institution:

Southern California Permanente Medical Group
100 South Los Robles, 2nd Floor
Pasadena, California 91101
Attn: **********, Manager, Sponsored Projects Administration

Payment remit to:
Kaiser Foundation Hospitals Inc
P. O. Box ******
Los Angeles, CA 90074-1134

Overnight Mail:
Bank of America Lockbox Services
Kaiser Foundation Hospitals Inc
Lockbox ******
2706 Media Center Drive
Los Angeles, CA 90065-1733
Phone: 888-715-1000 X 38233

If to Investigator:
Anny H. Xiang, PhD
Director, Biostatistics Research
Southern California Permanente Medical Group
Department of Research & Evaluation
100 S Los Robles, 5th Floor, Pasadena, CA 91101

## 15. GENERAL TERMS

15.1 Non-Referral/Anti-Corruption Language. The parties agree that it is not their intent under this Agreement to induce or encourage the unlawful referral of Study participants or business between the parties, and there shall not be any requirement under this Agreement that either party, its employees or affiliates, including its medical staff, engage in any unlawful referral of subjects to, or order or purchase products or services from, the other party. Each party shall require that their employees, who are involved in the conduct of the Study, will not offer, pay, request or accept any bribe, inducement, kickback or facilitation payment, and shall not make or cause another to make any offer or payment to any individual or entity for the purpose of influencing a decision for the benefit of the other party.

15.2 Entire Agreement. This Agreement sets forth the entire Agreement and understanding between the parties hereto as to the subject matter hereof and has priority over all documents, verbal consents or understandings made between Sponsor, Institution and Investigator with respect to the subject matter hereto. None of the terms of this Agreement may be amended or modified except in writing and signed by the parties hereto.

15.3 Amendment or Modification. Any amendment to or modification of this Agreement must be in writing and signed by authorized representatives of each party.

15.4 Severability. The invalidity or unenforceability of any provision of this Agreement will in no way affect the validity or enforceability of any other provision of this Agreement.

15.5 Governing Law. This Agreement, and all disputes and claims arising under this Agreement, will be interpreted and governed by the laws of the State of California, without regard to conflicts of laws principles.

15.6 Event of Inconsistency Between This Agreement and Protocol. In the event of inconsistency between this Agreement and the Protocol, this Agreement shall govern and control as to any legal issue, and the Protocol shall govern and control as to any issue regarding treatment of Study participants.

15.7 Construction. The headings of this Agreement are for convenience and ease of reference only and do not define, describe, extend or limit the scope or intent of this Agreement of the scope or intent of any provision contained in the Agreement.

15.8 Counterparts. This Agreement may be executed in two or more counterpart copies, each of which shall be deemed an original and all of which, taken together, shall be deemed to constitute one and the same instrument.

15.9 Force Majeure. No party will be liable or deemed to be in default for any delay or failure in performance under this Agreement or other interruption of service resulting directly or indirectly from Acts of God, civil or military authority, acts of public enemy, war, accident, fire, explosion, earthquake, flood, failure of transportation, strike, or other work interruption by a party's employees or any similar or dissimilar cause beyond the reasonable control of the party.

IN WITNESS THEREOF, the parties caused this Agreement to be executed by their duly authorized representatives:

Sponsor: By: /s/ Dan W. Gladney Date: 4/21/2017

Name: Dan Gladney

Title: Chief Executive Officer, Enteromedics, Inc.

Institution: By: /s/ Marilyn Owsley Date: 4/26/2017

Name: Marilyn Owsley

Title: Chief Financial Officer, SCPMG

Although not a party to this Agreement, the **Principal Investigator's** signature below indicates that she understands the terms of this Agreement and her obligations hereunder

Investigator: By: /s/ Anny H. Xiang Date: 4/24/2017

Name: Anny H. Xiang, PhD

Title: Principal Investigator

**EXHIBIT A**



| | | | |
|---|---|---|---|
| Southern California Permanente Medical Group | | | |
| PI Dr. Anny Xiang and Co-I's Drs. Robert Zane and Edward Mun | | | |
| vBloc - Enteromedics | | | |
| | | | |
| | **Year 1** | **Year 2** | **Year 3** |
| | | | |
| Labor | 495,501 | 536,348 | 544,399 |
| | | | |
| Consultant | 30,852 | 31,778 | 32,731 |
| Supplies | 38,474 | 40,148 | 10,888 |
| Local Travel | 9,255 | 9,533 | 0 |
| Travel Scientific Meetings | 6,450 | 9,125 | 9,399 |
| Labs & Spec Storage | 65,927 | 76,247 | 0 |
| Implant | 229,564 | 236,451 | 0 |
| Translation | 3,750 | 625 | 0 |
| Weight Loss Program | 20,278 | 20,886 | |
| Stipends | 16,875 | 16,875 | |
| | | | |
| Total Direct Cost | 916,926 | 978,015 | 597,417 |
| IDC | 320,924 | 342,305 | 209,096 |
| | | | |
| Total Cost | 1,237,850 | 1,320,320 | 806,512 |
| | | | |
| | | | |
| Total Project | | | 3,364,683 |
| | | | |
| | | | |
| **Budget Labor** | | | |
| PI - Anny Xiang PhD - 20% all three years | | | |
| CO-I (Dr. Robert Zane - Bariatric Surgeon) - 5% all three years | | | |
| CO-I (Dr. Edward Mun - Bariatric Surgeon) - 5% all three years | | | |
| Physician Assistant - 10% FTE all three years | | | |
| Programmer/Analyst - years 1 and 2 25% and year 3 40% | | | |
| RA IV - 100% all three years | | | |
| RN - 22% all three years | | | |
| Project Manager - 10% all three years | | | |
| Regulatory Specialist - Year 1 - 12% FTE, Year 2 - 27% FTE and Year 3 - 2% FTE | | | |
| | | | |
| USC Consultant | | | |
| Supplies - include a mailing and postage | | | |
| Travel for 2 persons to Scientific Meetings and the first DSMB Committee Meeting | | | |
| Local Mileage - RA to travel to South Bay | | | |
| Labs and Specimen storage | | | |
| Implant - no device costs included | | | |
| Translation of documents into Spanish | | | |
| Weight Loss Program | | | |
| Stipends | | | |

# Milestone Payments

| | | |
|---|---|---|
| **Year 1** | $148,051 | Quarterly or 4 payments |
| | $21,522 | *per patient @ 30 patients |
| Total budget year 1 $592,202 in fixed payments and $645,648 in per patient costs | | |
| **Year 2** | $168,669 | Quarterly or 4 payments |
| | $21,522 | *per patient @ 30 patients |
| Total budget year 2 $674,675 in fixed payments and $645,648 in per patient costs | | |
| **Year 3** | $201,628 | Quarterly or 4 payments |
| Total budget in year 3 $806,512 in fixed payments | | |
| *In years 1 and 2, the enrollment goal is 60 patients and we reserve the right to re-evaluate per patient costs based on study progression. | | |

**Lockbox payment info**
**Post Office Remittance Address:**
**Kaiser Foundation Hospitals Inc**
P. O. Box ******
Los Angeles, CA 90074-1134

**Overnight Mail:**
Bank of America Lockbox Services
**Kaiser Foundation Hospitals Inc**
Lockbox ******
2706 Media Center Drive
Los Angeles, CA 90065-1733
Phone: 888-715-1000 X 38233

**SCPMG Finance Contact**
**********, Director of Research Finance & Sponsored Projects
100 S. Los Robles, 2nd floor
Pasadena, CA 91101
Phone: **********
email: **********

**Exhibit 31.1**

**CERTIFICATION**

I, Dan W. Gladney, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of EnteroMedics Inc.;

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

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

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

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

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

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

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

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

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

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

/S/ DAN W. GLADNEY
**Dan W. Gladney**
**President and Chief Executive Officer**

Date: May 15, 2017

**Exhibit 31.2**

**CERTIFICATION**

I, Scott P. Youngstrom certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of EnteroMedics Inc.;

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

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

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

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

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

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

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

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

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

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

/s/ Scott P. Youngstrom
**Scott P. Youngstrom**
**Chief Financial Officer**
**and Chief Compliance Officer**

Date: May 15, 2017

**Exhibit 32.1**

**CERTIFICATION**

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Dan W. Gladney, in his capacity as Chief Executive Officer of EnteroMedics Inc., hereby certifies that, to the best of his knowledge:

1. 1.The Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2017 to which this Certification is attached as Exhibit 32.1 (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and

2. 2.The information contained in the Report fairly presents, in all material respects, the financial condition and the results of operations of EnteroMedics Inc. as of, and for, the periods covered by the Report.

By: /S/ DAN W. GLADNEY
**Dan W. Gladney**
**President and Chief Executive Officer**

Date: May 15, 2017

**Exhibit 32.2**

**CERTIFICATION**

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Scott P. Youngstrom, in his capacity as Chief Financial Officer of EnteroMedics Inc., hereby certifies that, to the best of his knowledge:

1. 1.The Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2017 to which this Certification is attached as Exhibit 32.2 (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and

2. 2.The information contained in the Report fairly presents, in all material respects, the financial condition and the results of operations of EnteroMedics Inc. as of, and for, the periods covered by the Report.

By: /s/ Scott P. Youngstrom
**Scott P. Youngstrom**
**Chief Financial Officer**
**and Chief Compliance Officer**

Date: May 15, 2017