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To: Private Equity Fund Clients

From: Fund Services Group

Date: December 17, 2006

Re: **ERISA Rules Applicable to Venture Capital Funds**

Many venture capital and other private equity funds accept capital commitments from pension and retirement plans regulated under the Employee Retirement Income Security Act of 1974 ("ERISA"). This memorandum briefly describes the key ERISA requirements that must be satisfied when a venture capital fund ("Fund") accepts such commitments.[1]

This memorandum has been updated to reflect changes to the Significant Participation Test (defined below) arising under the Pension Protection Act of 2006 (the "2006 Act").

Background: The Plan Asset Regulation

The "Plan Asset Regulation" was issued under ERISA by the Department of Labor (the "DOL") in 1986. It defines the circumstances under which a Fund manager (a "General Partner") can be deemed a fiduciary with respect to ERISA plans that invest in the Fund. For this purpose, the term "ERISA plan" includes pension, profit sharing, stock bonus, and employee stock ownership plans as well as cash or deferred arrangements (section 401(k) plans), the plans of self-employed individuals (Keogh plans), and individual retirement accounts (IRAs).

In general, an ERISA plan is administered by one or more "named fiduciaries." A named fiduciary may be the sponsoring employer or a third party who specializes in providing such services. Even if not "named," however, a person can be deemed to serve as an ERISA plan fiduciary if that person: (x) acts as a trustee or investment manager with respect to a plan's assets; (y) otherwise exercises discretion or control with respect to such assets; or (z) renders investment advice regarding such assets for a fee.

ERISA plan fiduciaries are required to act in accordance with the highest standards of care and loyalty, and may not engage in self-dealing or certain prohibited transactions with regard to the assets of a plan.

If a General Partner were an ERISA plan fiduciary, it would become subject to ERISA's standards of care and loyalty, which likely would be materially higher than the standards arising under the Fund's limited partnership (or LLC) agreement. Moreover, the General Partner's "carried interest" in the Fund may violate ERISA's self-dealing or prohibited transaction rules, with the result that the General Partner may be required to: (x) rebate all or a portion of its carried interest profits to the Fund's ERISA plan investors; and (y) pay substantial excise taxes.

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[1] While this memorandum is focused upon issues specific to venture capital funds, the analysis set forth herein also applies to many other types of private equity funds, including many types of buyout funds and funds-of-funds.

Typically, a General Partner that is not a named fiduciary will be considered an ERISA plan fiduciary only if the Fund is deemed to hold ERISA plan assets. In general, a venture capital fund will ***not*** be deemed to hold ERISA plan assets so long as either:

1. Participation in the Fund by "Benefit Plan Investors" is not significant (the "Significant Participation Test"); or

2. The Fund qualifies as a venture capital operating company ("VCOC").[2]

Significant Participation Test

Typically, participation in a Fund by Benefit Plan Investors will not be deemed "significant" if less than 25 percent of the Fund's total capital (disregarding any capital provided by the General Partner and certain related parties) is provided by such investors.[3]

Prior to the 2006 Act, the definition of "Benefit Plan Investors" was very broad. It included retirement funds of any kind, even retirement funds (such as state retirement systems and foreign pension plans) that are not regulated under ERISA.

Under the 2006 Act, the definition of Benefit Plan Investors generally was narrowed to include only: (i) employee benefit plans actually regulated under ERISA; (ii) plans subject to Section 4975 of the Internal Revenue Code (e.g., a tax-exempt, domestic, employee stock bonus, pension or profit-sharing plan, or a qualified annuity plan, individual retirement account, individual retirement annuity, Archer medical savings account, health savings account, or education savings account); and (iii) any entity whose underlying assets include ERISA plan assets by reason of a plan's investment in such entity.

As used in this memorandum, the Significant Participation Test is deemed satisfied if participation by Benefit Plan Investors is ***not*** significant.

The Significant Participation Test must be applied immediately after each acquisition of an interest in the Fund. For this purpose, the DOL interprets the term "acquisition" to include: (x) any direct acquisition via

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[2] Different rules apply to Funds that issue publicly traded securities or are registered as investment companies under the Investment Company Act of 1940. Those rules are not discussed in this memorandum.

[3] In some cases, an equityholder of the General Partner (e.g., an individual venture capitalist) will also invest in the Fund directly or through an affiliated entity. For purposes of the Significant Participation Test, such investment will be disregarded if the equityholder has "the power to exercise a controlling influence over the management or policies" of the General Partner.

Technically, the Significant Participation Test must be applied separately for each "class" of interests issued by the Fund and is based upon the "value" of interests held by Benefit Plan Investors vs. non-Benefit Plan Investors in each class (rather than upon their respective capital commitments). Thus, care must be taken in granting special rights or privileges to a subset of the Fund's investors (e.g., in the Fund's limited partnership or LLC agreement, or by means of a side letter). Such rights or privileges could be deemed to create a separate class of interests in respect of which the Significant Participation Test is not satisfied. Moreover, even if investors are in the same "class," the "value" of their interests might not be directly proportional to their capital commitments. For example, if a non-Benefit Plan Investor breached its obligations under the Fund's limited partnership or LLC agreement, it might thereby become subject to penalties that reduce the value of its interest and increase the relative value of interests held by Benefit Plan Investors.

the original issuance of a Fund interest, a secondary market transfer, or any similar transaction; and (y) any indirect acquisition via the redemption or reduction of another investor's interest. Thus, for example, a Fund that initially satisfies the Significant Participation Test may subsequently fail the Test if a non-Benefit Plan Investor defaults on its capital commitment or withdraws from the Fund, and thereby indirectly increases the percentage of total Fund capital provided by Benefit Plan Investors.

Because a Fund can fail the Significant Participation Test as a result of circumstances outside the Fund's control, ***it often will be advisable for a Fund to qualify as a VCOC even if the Fund generally expects to satisfy the Significant Participation Test.*** In fact, many sophisticated ERISA plans will not invest in a Fund unless the Fund agrees to qualify as a VCOC.

When applying the Significant Participation Test, special care must be taken in determining the status of "funds-of-funds" and similar vehicles that raise capital for the purpose of investing in Funds. In general, a fund-of-funds will not be deemed an ERISA plan, even if it accepts investments from ERISA plans, unless it is deemed to hold ERISA plan assets under the rules described in this memorandum. Similarly, a fund-of-funds will not be deemed a Benefit Plan Investor, even if it accepts investments from Benefit Plan Investors, unless it is deemed to hold Benefit Plan Investor plan assets under such rules. Thus, for example, a fund-of-funds that itself satisfies the Significant Participation Test or qualifies as a VCOC would not be deemed either an ERISA plan or a Benefit Plan Investor when it invests in a Fund.

Prior to the 2006 Act, it was clear that, if a fund-of-funds were deemed a Benefit Plan Investor, the entire amount of its investment in a Fund must be treated as having been made by a Benefit Plan Investor for purposes of the Significant Participation Test. It appears that the 2006 Act was intended to change this rule so that a fund-of-funds which is deemed a Benefit Plan Investor must be treated as such only with respect to that percentage of its investment that consists of ERISA plan assets on a "look-through" basis. The text of the 2006 Act is somewhat ambiguous on this point so it is hoped that interpretive guidance will be forthcoming.[4]

Venture Capital Operating Company

In general, a Fund will be a VCOC if at least 50 percent of its "Portfolio Investments" are "Venture Capital Investments" in "Operating Companies" with regard to which the Fund is entitled to exercise "Management Rights" (together, the "50 Percent Test").

A Fund that has not yet made any Portfolio Investments has not satisfied the 50 Percent Test and is not yet a VCOC.

A Portfolio Investment is any investment held for long-term income or gain. It does not include short-term investments of idle cash pending long-term commitment or distribution ("Short-Term Investments"). The Plan Asset Regulation does not provide detailed rules for distinguishing Portfolio Investments from Short-Term Investments, but it appears that the primary distinction is between an asset held for ready liquidity and an asset held for investment return. Thus, it appears that investments should be considered Short-Term Investments if they are held for the purpose of funding near-term: (x) payment of

[4] For example, assume that: (i) fund-of-funds "A" invests $10 million in Fund "B"; (ii) 30 percent of A's capital has been invested in A by Benefit Plan Investors; and (iii) A is not a VCOC. Under the pre-2006 Act Significant Participation Test, B must treat 100 percent of A's $10 million investment as having been made by a Benefit Plan Investor, even though only 30 percent of such investment actually originated with Benefit Plan Investors on a "look-through" basis. Under the 2006 Act, it appears that only 30 percent of A's investment would be treated as having been made by a Benefit Plan Investor.

operating or similar expenses; (y) distributions to the General Partner or Fund investors; or (z) purchases of Portfolio Investments. A Fund seeking to make a Short-Term Investment should avoid investment vehicles (such as corporate stock) that frequently are associated with long-term investment intent and should instead focus on vehicles (such as commercial paper, money market accounts and bank accounts) that more frequently are associated with short-term investment intent. Bridge loans, because they typically are expected to be converted into stock, generally should be considered Portfolio Investments. Without regard to the type of investment vehicle used, it may be difficult to demonstrate that an investment held for a substantial period of time (e.g., a year or more) is a Short-Term Investment.

An Operating Company is an entity that is primarily engaged in the production or sale of a product or service other than the investment of capital. Most portfolio companies of venture capital funds are Operating Companies.[5] However, the DOL has informally suggested that companies in their formative stage may not be "primarily engaged" in the production or sale of a product or service. For example, a company may not be an Operating Company if it consists of nothing more than a few scientists and an idea. Although this informal view of the DOL may not be well founded, it would be prudent to seek a more developed company for a Fund's first Portfolio Investment and at other times when satisfaction of the 50 Percent Test may be a close call.

A Venture Capital Investment is an investment by a venture capital fund in an Operating Company with respect to which the Fund has obtained Management Rights (see below). The definition of Operating Company includes a holding company as well as that company's majority-owned subsidiaries. Thus, a Fund is not required to invest directly in an operating subsidiary, but may instead invest in a holding company parent. However, Management Rights in respect of the operating subsidiary must be held ***directly*** by the Fund. Management Rights, if any, in the holding company are immaterial for this purpose.[6]

An Operating Company investment will be a Venture Capital Investment if Management Rights are obtained at the time the investment is made. It also appears that an Operating Company investment can become a Venture Capital Investment if Management Rights are obtained on a subsequent date. However, obtaining Management Rights in this manner generally should not be deemed to have retroactive effect. In other words, an Operating Company investment generally should not be treated as a Venture Capital Investment for any period prior to the date on which Management Rights were actually obtained.[7]

In applying the 50 Percent Test, only Portfolio Investments are counted and such investments are valued at cost. There is no clear guidance on the meaning of "cost" in this context, but it appears appropriate to include only the purchase price of such investments, plus direct acquisition fees or expenses (e.g., brokerage fees).

To qualify as a VCOC, a venture capital fund must initially satisfy the 50 Percent Test on the date it makes its first Portfolio Investment (the "Initial Valuation Date"). A Fund that fails to do so generally

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[5] A venture capital fund, even if it qualifies as a VCOC, is not an Operating Company.

[6] If a Fund is structured as a "tiered" entity, with a subsidiary that is a "drop-down" small business investment company, management rights generally should run directly to both the parent fund and its subsidiary.

[7] Many people assume that only an equity investment can qualify as a Venture Capital Investment. However, the Plan Asset Regulation explicitly contemplates that a Venture Capital Investment can be a debt investment, so long as Management Rights are obtained. Thus, a Fund that specializes in making venture debt or similar investments can be a VCOC.

cannot subsequently obtain VCOC status. It does not matter whether the Fund includes any Benefit Plan Investors as of such date, whether the investment is made using borrowed capital, or whether the investment is made using capital provided solely by non-Benefit Plan Investors. Accordingly, if there is any possibility that a Fund may ultimately need to qualify as a VCOC, it should take steps to ensure qualification beginning with its very first Portfolio Investment.[8]

After the Initial Valuation Date, a Fund must satisfy the 50 Percent Test on at least one day during each "Annual Valuation Period." The Annual Valuation Period is a 90-day period during each year, selected by the Fund in the first instance but generally not thereafter alterable, which must initially commence no later than the first anniversary of the Initial Valuation Date.[9] A Fund should pick a period which is convenient given its normal accounting and record-keeping procedures. Many Funds select an Annual Valuation Period that coincides with the first or last 90-day period of each fiscal year. While no filing with the DOL is required, it is important to have written documentation to demonstrate compliance. Reporting on these matters in the Fund's periodic financial statements can be an easy way to generate suitable documentation.

For purposes of the 50 Percent Test, "Derivative Investments" generally are counted as if they were Venture Capital Investments. Derivative Investments include: (x) a Venture Capital Investment with respect to which Management Rights have terminated in connection with an initial public offering by the issuer; and (y) an investment acquired by a Fund in exchange for a pre-existing Venture Capital Investment pursuant to a public offering by, or a merger or reorganization of, the issuer. A Derivative Investment will cease to be treated as a Venture Capital Investment upon the later of: (x) ten years after the underlying Venture Capital Investment was originally acquired by the Fund; or (y) 30 months after the date on which the underlying Venture Capital Investment became a Derivative Investment.

During a "Distribution Period," a Fund will continue to qualify as a VCOC without regard to the 50 Percent Test. A Distribution Period begins with an election that can be made any time after the Fund has distributed to investors the proceeds of at least 50 percent of the maximum amount (based on cost) of its Portfolio Investments outstanding at any time prior to such election.[10] For this purpose, the in-kind distribution of an investment security is treated as a distribution of "proceeds" from such investment.[11]

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[8] Under limited circumstances, it may be possible to obtain VCOC status by restructuring a Fund that failed to satisfy the 50 Percent Test. For a discussion of the restructuring technique, see our presentation titled "Qualifying as a VCOC After a Fund's Initial Investment: Preliminary Report on an Evolving Technique."

[9] For example, assume that the Initial Valuation Date of Fund X was August 15, 2001. Fund X would then be entitled to select the starting date for its first Annual Valuation Period, but must select a starting date that is prior to August 16, 2002. If Fund X selected January 1, 2002 as the start of its first Annual Valuation Period, the Fund would start a new Annual Valuation Period on January 1st of each subsequent year.

Once selected, a Fund's Annual Valuation Period can be changed only for "good cause" that is unrelated to the Fund's efforts to qualify as a VCOC.

[10] For example, assume that Fund X made 10 Portfolio Investments during its term. Each investment had a cost of $100, but the first investment was sold for cash before the last investment was made. Thus, the maximum amount of Fund X's outstanding Portfolio Investments at any time was $900. Six of the investments declined in value to $10 each, while four appreciated in value to $500 each. Fund X then sells the six "loss" investments for a total of $60, which it distributes to its investors. Because those investments had an aggregate cost of $600, Fund X satisfies the requirement and may elect to begin a Distribution Period. If, instead of selling the "loss" investments, Fund X had sold one of the "gain" investments and distributed $500 to its investors, it would have distributed proceeds from investments with a cost of only $100 and, therefore, would not be entitled to start a Distribution Period.

A Distribution Period ends ten years after it begins, or earlier if the Fund makes a Portfolio Investment in a new portfolio company. For this purpose, a "new portfolio company" is any issuer in respect of which the Fund has not held a Venture Capital Investment at all times since the start of the Distribution Period.

Following the end of a Distribution Period, a Fund can no longer qualify as a VCOC (even if it otherwise satisfies the 50 Percent Test) and no new Distribution Period can begin. Thus, great care should be taken in determining when, or whether, to make a Distribution Period election.

Management Rights

Management rights are direct contractual rights between a Fund and an Operating Company which entitle the Fund to "substantially participate in, or substantially influence the conduct of" the management of the Operating Company.

The preamble to the Plan Asset Regulation indicates that the right to designate a representative of the Fund on an Operating Company's board of directors is indicative of Management Rights. Beyond that, formal guidance is scant. Some industry participants have suggested that service by an individual partner or member of the General Partner on an Operating Company's board of directors, by itself, constitutes Management Rights with respect to the Operating Company. However, it would not be prudent to rely upon such service in the absence of a direct contractual right held by the Fund to place and maintain a representative on the board. It is rare to see such direct contractual rights with regard to a board seat. More commonly, the right to elect one or more directors is given to a class of securities, and not to a particular holder of such securities.

Thus, even if a Fund representative sits on the Operating Company's board, we recommend that the Fund also obtain direct contractual rights which, apart from any board seat, constitute Management Rights. A model agreement, common to the transactions in which our clients engage, is attached to this memorandum as Exhibit A.[12] The model agreement is designed to grant a "bundle" of rights which together constitute Management Rights. The most important right in the model agreement is the right to consult with company management, because Management Rights are rights to "substantially participate in" or "influence" the management of the company. However, because a mere consultation right may not, by itself, constitute Management Rights in any particular situation, it would be dangerous to eliminate any provision of the model agreement without consulting your Fund Services Group attorney.

The Plan Asset Regulation does not clearly indicate whether distributions to the General Partner may be treated as distributions to an "investor." However, it appears that distributions to the General Partner *should* be so treated, at least in those cases where the General Partner previously made one or more actual capital contributions to the Fund.

[11] As with the selection of an Annual Valuation Period, no DOL filing is required in connection with an election to begin a Distribution Period. Nevertheless, it is important to have written documentation (such as a note in the Fund's periodic financial statements) which confirms that the election has been made.

[12] The model agreement also includes language intended to facilitate compliance with California's Finance Lenders Law and regulation of investment advisers. For additional information, please see our memorandum titled "California Finance Lenders Law Amendment Creates Safe Harbor for Venture Capital Bridge Loans," and our presentation titled "California Regulation of Investment Advisers: Recent Changes Affecting Venture Capital Firms." Both are available at http://www.wsgr.com/FSG/gen_mat/.

It is not necessary to enter into a separate Management Rights agreement. Management Rights may be written into a stock purchase agreement, investors' rights agreement, voting agreement, or side letter.[13]

To maintain VCOC status, a Fund must exercise its Management Rights annually, in a material way, with respect to at least one Venture Capital Investment. Such exercise must be in the normal course of the Fund's business and the Fund must devote substantial resources thereto. The first annual period for this requirement is deemed to begin on the Initial Valuation Date and end on the last day of the first Annual Valuation Period. Subsequent annual periods begin on the last day of each Annual Valuation Period.[14] While a Fund is not required to document its exercise of Management Rights in any particular manner, it would be prudent to maintain books and records which provide evidence of the Fund's activities in this regard.

Even though a Fund may qualify as a VCOC by obtaining Management Rights with respect to only 50 percent of its Portfolio Investments, ***it is prudent to seek Management Rights whenever possible***. Sales or distributions of Venture Capital Investments, or the termination of Management Rights, could cause the relative percentage of the Fund's portfolio consisting of non-Venture Capital Investments to increase, resulting in possible failure to satisfy the 50 Percent Test.[15]

Capital Commitments vs. Capital Contributions

In general, merely accepting a capital commitment from an ERISA plan will not cause a Fund to hold ERISA plan assets. It is receipt of an actual capital contribution which triggers a requirement that the Fund either satisfy the Significant Participation Test or qualify as a VCOC. Thus, if a Fund would fail the Significant Participation Test, it must not accept capital contributions from ERISA plans prior to qualifying as a VCOC. It is permissible for a Fund to receive such capital contributions on the same day as the Fund's initial Portfolio Investment,[16] even if the investment technically closes later in the day than the receipt of such contributions. However, if capital contributions are received on the day that the initial Portfolio Investment is scheduled to close, and the closing does not occur, such capital contributions must be returned to the ERISA plan investors on the same day. To minimize potential administrative complexity in such situations, it may be helpful to close an initial Portfolio Investment using capital contributed by non-ERISA plan investors or borrowed from a third party.[17] Alternatively, initial capital contributions from ERISA plan investors may be held by a qualified third-party escrow agent, who can transfer capital to the Fund simultaneously with the closing of the initial Portfolio Investment. In our experience, however, such escrow arrangements often are costly and administratively burdensome.

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[13] Particular care is required if a Fund invests as part of a syndicate. The Fund must have its own direct contractual Management Rights for the investment to qualify as a Venture Capital Investment. Joint, or jointly exercised, contractual rights for the benefit of multiple investors typically will not qualify as Management Rights.

[14] For example, if the Initial Valuation Date of Fund X was August 15, 2001 and the Fund selected January 1, 2002 as the start of its first Annual Valuation Period, the Fund must exercise its Management Rights with respect to at least one Operating Company during the period starting August 15, 2001 and ending on March 31, 2002. Thereafter, the Fund must similarly exercise its Management Rights with respect to annual periods commencing on March 31st of each year.

[15] As described above, a Fund that fails to satisfy the 50 Percent Test for such reasons may nevertheless continue to qualify as a VCOC during a Distribution Period, but it often will be imprudent to assume that this protection will be available.

[16] Assuming, of course, that such investment enables the Fund to qualify as a VCOC.

[17] For a discussion of "unrelated business taxable income" issues associated with such borrowing, see our memorandum to clients titled "Borrowing to Bridge Capital Calls."

Affiliated Funds

Many Funds operate as part of a family of entities that co-invest in portfolio companies. For example, a single Fund family may include one Fund for "accredited investors," another Fund for "qualified purchasers," and yet another Fund for non-U.S. investors. It may also include a special purpose Fund that invests only in certain categories of portfolio companies (e.g., companies within a specific geographical region or technology space). In general, affiliated entities should not be integrated (i.e., treated as a single Fund) for purposes of the Significant Participation Test or VCOC qualification. Thus, a Fund that seeks to satisfy the Significant Participation Test generally should not take into account investments in an affiliated Fund made by non-Benefit Plan Investors. Similarly, a Fund that seeks to qualify as a VCOC should directly obtain its own Management Rights and should not rely upon Management Rights obtained by an affiliated Fund.

The model management rights agreement in Exhibit A directly grants Management Rights to a main fund and all of its affiliated funds, so that only one agreement is needed for an entire affiliated Fund family.

Opinions and Certifications

As a condition to investing in a venture capital fund, many sophisticated ERISA plan investors require an opinion of counsel regarding the Fund's qualification as a VCOC. In order to render such an opinion, we must carefully review the key documents associated with the initial Portfolio Investment and be sufficiently familiar with the issuer to conclude that it is an Operating Company. As noted above, it may not be possible to reach this conclusion with regard to an issuer that is at an extremely early stage of development.

Some ERISA plan investors also require annual certification of VCOC status. A sample form of such certification is attached hereto as Exhibit B.

Ensuring Compliance

As described above, the ERISA rules applicable to venture capital funds are complex and can require changes in a Fund's behavior or portfolio at any time. Accordingly, we recommend that the General Partner establish detailed procedures to monitor and maintain compliance throughout the Fund's term.

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This memorandum is intended only as a general discussion of the information presented and should not be regarded as legal advice. For more information, please contact your Fund Services Group attorney.

EXHIBIT A

MANAGEMENT RIGHTS AGREEMENT

This MANAGEMENT RIGHTS AGREEMENT (this "Agreement") is entered into as of _____ by and between Sample Portfolio Company, Inc., a Delaware corporation (the "Company"), and Sample Venture Capital Fund I, L.P., a Delaware limited partnership (the "Fund") (together, the "Parties").

RECITALS

WHEREAS, the Fund is seeking to satisfy certain requirements to qualify, or to maintain its qualification, as a "venture capital operating company" within the meaning of Department of Labor Regulation Section 2510.3-101(d) (the "Regulation"); and

WHEREAS, the Regulation generally requires that a venture capital operating company have direct contractual rights to substantially participate in, or substantially influence the conduct of, the management of its portfolio companies; and

WHEREAS, the Fund additionally is seeking to establish, or to maintain, such rights for purposes of Section 22062 of the California Financial Code and Rule 260.204.9 of the California Code of Regulations (the "California Rules"); and

WHEREAS, in order to induce the Fund to invest in the Company, the Company has agreed to provide such rights to the Fund.

NOW, THEREFORE, the Parties, intending to be legally bound, hereby agree as follows.

1. ***Grant of Management Rights.*** From and after the Fund's purchase of [_____shares of Series A Preferred Stock] of the Company (the "Securities"), the Fund shall have the following contractual management rights. Such rights shall be in addition to, and nothing in this Agreement shall be deemed to limit, any other rights that the Fund may hold as a holder of the Securities or otherwise.

(a) The Fund shall be entitled to consult with and advise management of the Company on significant business issues, including without limitation management's proposed quarterly and annual operating plans. Upon request by the Fund, management of the Company shall meet with authorized representatives of the Fund, at a mutually agreeable time and place, within thirty days after the end of each calendar quarter for such consultation and advice and to review progress in achieving such plans.

(b) The Fund shall be entitled to examine the books and records of the Company, inspect its facilities, and receive other information at reasonable times and intervals concerning the general status of the Company's financial condition and operations.

(c) For any period during which an authorized representative of the Fund is not a member of the Company's Board of Directors, the Company shall invite the Fund's authorized representative to attend all meetings of the Board and in connection therewith shall provide to such representative copies of all notices, minutes, consents, and other materials that it provides to its directors. Such representative may participate in discussions of matters brought before the Board, but shall in all other respects be a nonvoting observer.

2. ***Limitation on Management Rights.*** The Company shall not be required under this Agreement to provide access to attorney/client privileged communications or other information of an extremely sensitive nature the disclosure of which to the Fund would be materially detrimental to the Company. The Company acknowledges and agrees that the preceding sentence is not intended to prevent the Fund from obtaining information necessary for the Fund to substantially participate in, or substantially influence the conduct of, management of the Company within the meaning of the Regulation or the California Rules.

3. ***Termination of Management Rights.*** The management rights granted in paragraph 1, above, shall terminate upon the earlier of: (i) consummation of a sale of the Company's securities pursuant to a registration statement filed by the Company under the Securities Act of 1933 in connection with a firm commitment underwritten offering of the Company's securities to the general public; (ii) any transaction (including, without limitation, a merger, acquisition or reorganization of the Company) pursuant to which the Fund exchanges 100 percent of the Securities for cash and/or securities that are, have become, or will within 12 months become freely tradable on a United States domestic, national securities exchange; (iii) distribution by the Fund to its constituent partners of 100 percent of the Securities; or (iv) any other transaction pursuant to which the Fund disposes of 100 percent of the Securities exclusively for cash and/or other consideration that does not include debt or equity securities or instruments.

4. ***Confidentiality.*** Except as otherwise required by applicable law, the Fund and any authorized representative acting on behalf of the Fund pursuant to this Agreement shall maintain the confidentiality of all proprietary Company information acquired pursuant to this Agreement and shall not disclose or use such information other than for a Company purpose or with the Company's consent.

5. ***Restructuring.*** Subject to paragraph 3, above, if the Company engages in a restructuring or similar transaction, any resulting entity or entities shall be subject to this Agreement in the same manner as the Company.

6. ***Affiliated Funds.*** The Parties acknowledge that one or more investment vehicles that control, are controlled by, or are under common control with the Fund, or that otherwise operate under the "Sample Venture Capital" name (each, an "Affiliated Fund") may currently or subsequently co-invest with the Fund. Solely with respect to those Affiliated Funds that hold debt or equity securities or instruments issued by the Company, each Affiliated Fund shall (automatically and without the need for further action) independently be entitled to all of the rights granted in this Agreement in the same manner as if such Affiliated Fund and the Company had directly entered into an agreement identical to this Agreement. The Affiliated Funds are intended third party beneficiaries of this paragraph 6.

7. ***Counterparts.*** This Agreement may be executed in any number of counterparts and, when so executed, all of such counterparts shall constitute a single instrument binding upon all Parties notwithstanding the fact that all Parties are not signatory to the original or to the same counterpart.

[Remainder of this page intentionally left blank; signature page follows.]

IN WITNESS WHEREOF the Parties have executed this Management Rights Agreement as of the date first above written.

SAMPLE PORTFOLIO COMPANY, INC.,
a Delaware corporation

By:

_____

Name:
Title:

SAMPLE VENTURE CAPITAL FUND I, L.P.,
a Delaware limited partnership

By: Sample General Partner I, L.L.C.,
a Delaware limited liability company
Title: General Partner

By:

_____

Name:
Title:

EXHIBIT B

CERTIFICATION OF VCOC STATUS

This CERTIFICATION OF VCOC STATUS (this "Certification") is delivered by Sample General Partner I, L.L.C., a Delaware limited liability company (the "General Partner"), in respect of Sample Venture Capital Fund I, L.P., a Delaware limited partnership (the "Partnership").

As used herein, the terms Annual Valuation Period, Initial Valuation Date, Management Rights, Operating Company, Venture Capital Investment, and Venture Capital Operating Company have the meanings set forth in Department of Labor Regulation Section 2510.3-101.

On behalf of the Partnership, the General Partner hereby certifies that, as of [insert the last day of the applicable Annual Valuation Period] (the "Effective Date"):

1. The Partnership's Annual Valuation Period is the 90-day period ending on [insert day and month] of each year.

2. During the [for the first year: "period beginning on the Initial Valuation Date and ending on the last day of the first Annual Valuation Period" -- for subsequent years: "12-month period ending on the Effective Date"], the Partnership devoted substantial resources to the active exercise of its Management Rights with respect to at least one Operating Company in which it holds a long-term investment as follows:

[Insert here a brief description of the Partnership's exercise of Management Rights with respect to a specific portfolio company. The description should demonstrate that the exercise was material and performed in the ordinary course of the Partnership's business, and that it involved the use of substantial Partnership resources.]

3. On at least one date during the Annual Valuation Period ending on the Effective Date, at least 50 percent of the Partnership's assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, consisted of Venture Capital Investments.

4. For the period commencing with the Partnership's Initial Valuation Date and ending with the Effective Date, the Partnership qualified as a Venture Capital Operating Company.

IN WITNESS WHEREOF, the General Partner has executed this Certification of VCOC Status as of the Effective Date.

SAMPLE GENERAL PARTNER I, L.L.C.,
a Delaware limited liability company

By:

_____

Name:
Title: