

Watershed Asset Management, L.L.C.

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Watershed Asset Management, L.L.C. (“Watershed”) has been a registered investment adviser with the United States Securities and Exchange Commission since 2006. Watershed’s status as a registered investment adviser does not imply a certain level of skill or training.

This brochure provides information about the qualifications and business practices of Watershed. If you have any questions about the contents of this brochure, please contact us at (415) 391-8900 or investorrelations@wcap.com. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Additional information about Watershed is also available on the SEC’s website at www.adviserinfo.sec.gov.

Item 2

Material Changes

None.

Item 3

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Item 4

Advisory Business

Watershed is a credit-focused, value-oriented asset management firm that seeks to create long-term value and superior risk-adjusted returns for its investors. Since its inception in July 2002, the firm has invested opportunistically in a variety of asset classes, including bank debt, high yield bonds, convertible bonds, credit default swaps, distressed and special situation investments, securitized assets, preferred stock, trade claims, and event and value equities.

Watershed is operated by an experienced team of investment, trading, accounting, legal and administrative professionals led by Meridee A. Moore. Ms. Moore is the Founder, Senior Managing Member and Chief Investment Officer of Watershed. Ms. Moore and Managing Member, Munir Alam, are the principal owners of Watershed. Ms. Moore oversees Watershed's investment activities with Mr. Alam.

Watershed currently offers investment advisory services only to a limited number of private fund clients (the "Funds"). Watershed has investment discretion with respect to each of the Funds, subject to each Fund's investment objectives and restrictions, and is responsible for the investment management of the Funds, including the making of investment decisions and the placing of all orders for the purchase and sale of portfolio investments.

Watershed manages client accounts according to agreed upon investment mandates. From time to time, Watershed may also provide additional investment advisory services with respect to either its core investment mandate or a more narrow investment mandate to additional private fund and/or managed account clients. Watershed may also agree in certain circumstances to invest pursuant to specific instructions from a client.

As of December 31, 2011, Watershed had \$1,468,244,863 in regulatory assets under management, all managed on a discretionary basis. Watershed does not manage any client assets on a non-discretionary basis.

Item 5

Fees and Compensation

Management Fees and Incentive Compensation

Watershed's fee schedule is omitted because this brochure is only being delivered to qualified purchasers as defined in the Investment Company Act of 1940.

Watershed receives compensation from its Fund clients based on a percentage of assets under management (management fees) and performance-based allocations (incentive compensation) calculated according to an agreed upon standard fee schedule. Performance fees are subject to a high watermark should loss years occur. Depending on the arrangement with the Fund client, Watershed either deducts fees from client assets or bills the client or Fund investors, as applicable, for the fees incurred. Management fees are generally billed or deducted quarterly and incentive compensation is generally billed or deducted annually. Management fees must be paid in advance and are not refundable. With respect to any separately managed account, fee arrangements will be negotiated prior to the engagement of Watershed as an investment adviser.

Clients should refer to the offering documentation for the pertinent Fund, which contains a more complete description of such Fund's management fee and incentive compensation arrangements. Clients should also refer to the disclosure below under Item 6 pertaining to the payment of performance-based fees and the conflicts of interest such fees raise.

Other Fees and Expenses Borne by Clients

In addition to management fees and incentive compensation, Watershed's Fund clients are responsible for paying the offering and organizational expenses, including external legal and accounting expenses, incurred in connection with the offering of interests in the Funds. Watershed bears the cost of all personnel, general research (except to the extent provided through "soft dollars"), office space, office equipment, supplies and other necessary operating, administrative and clerical services to the Funds, and all of its own operating expenses. All other expenses are borne by the Funds, including, without limitation, legal, accounting, auditing, administrator and other professional expenses, insurance, transaction-related research expenses, custodian fees, taxes on securities transactions, interest on borrowed moneys, brokerage fees and commissions and any other similar fees, clearing expenses, due diligence expenses related to actual or potential investments (whether or not consummated), litigation expenses and extraordinary expenses. Clients will incur brokerage and other transaction costs in addition to many or all of those other expenses discussed above. *Clients are encouraged to read and review carefully the disclosure under Item 12 "Brokerage Practices" set forth below.*

Item 6

Performance-Based Fees and Side-By-Side Management

As discussed above under Item 5, Watershed accepts performance-based incentive compensation from its clients. Such fees are based on a share of the capital appreciation of the client's assets.

Conflicts of Interest Presented by Performance-Based Fees

Any incentive compensation will be charged in accordance with Section 205 of the Investment Advisers Act of 1940 (the "Advisers Act") and Rule 205-3 thereunder. The fact that Watershed's compensation is based in part on the performance of its clients' portfolios may create an incentive for Watershed to cause its clients to make investments that are more speculative than would be the case in the absence of performance-based compensation. Watershed's employees and affiliates' significant investments in the Funds mitigates this risk by aligning the interests of the Funds and Watershed.

From time to time, Watershed may manage client portfolios that are charged different levels of performance fees. In such situations, Watershed may have an incentive to allocate its time and most profitable positions to the clients that currently bear the greatest performance-based incentive compensation. To resolve this potential conflict of interest, Watershed has adopted trade aggregation and allocation procedures pursuant to which it allocates trades among its clients on a fair and equitable basis over time.

Item 7

Types of Clients

As noted above, Watershed principally acts as an advisor to the Funds, although from time to time, Watershed may also provide investment advisory services to a select group of managed account clients and/or additional investment funds. Should any such new accounts be established, Watershed will endeavor to reduce any conflicts among new and existing clients through pre-established allocation procedures. Clients must satisfy certain criteria indicative of sophistication and capability to understand and participate in the types of investments Watershed makes.

Item 8

Methods of Analysis, Investment Strategies and Risk of Loss

Methods of Analysis and Investment Strategy

Watershed seeks to earn attractive, risk-adjusted absolute returns over time by investing in value-oriented and event driven debt and equity securities with a focus on current income. Although Watershed seeks to achieve capital appreciation, capital preservation is a priority.

Through fundamental research and analysis, Watershed seeks to capitalize on the inefficiencies inherent in industries, companies and other assets affected by change. Many of Watershed's investments are expected to be in companies that are undergoing changes such as a crisis of confidence, a business misstep, a major litigation, legislative or regulatory change, a cyclical business trough, a corporate reorganization, recapitalization, bankruptcy, restructuring or liquidation. In addition, Watershed may take advantage of major market dislocations caused by market collapses, leverage unwinds or other forced selling.

Once an inefficiency is uncovered, Watershed analyzes the drivers of cash flows using a "bottom up" fundamental value approach. Watershed rigorously researches business, legal, and credit issues in order to determine the intrinsic value of the enterprise. Once enterprise value is assessed, Watershed determines security selection by analyzing priority of claims, legal risk and potential downside. Finally, Watershed identifies securities which can be purchased at a price Watershed believes represents a discount to intrinsic value, and identifies catalysts which can unlock that value.

While Watershed's investment strategy is long biased, it may also sell securities short, either directly or through derivatives, for hedging and outright investing purposes. Watershed seeks to employ portfolio and position risk management through position level research, portfolio mix (asset allocation), various portfolio limitations, specific risk hedges and market hedges, and holding more or less cash.

Types of Investments

Watershed's Funds may invest in a variety of foreign and domestic debt securities, convertible debt, preferred and common equity, in each case on a long or short basis, credit default swaps, liquidations, mortgage-backed securities, municipal bonds, equipment trust certificates, trade claims, structured products, and other securities and interests that meet Watershed's valuation and risk management objectives.

Risk Factors

The following is a summary of some of the material risks associated with Watershed's clients' investments. This summary does not attempt to describe all of the

risks associated with Watershed's strategies, and clients should refer to the confidential private placement memorandum for the pertinent Fund, which contains a more complete description of the risks associated with an investment in such Fund.

Watershed may not be able to identify and exploit investment opportunities and its judgments may prove incorrect, which may cause clients to incur losses.

The success of Watershed's investment activities depends on Watershed's ability to identify and exploit investment opportunities, which involves a high degree of difficulty and uncertainty. There can be no assurance that Watershed's perception of an inefficiency or mispricing, its business analysis, or its prediction of the timing of expected events will prove correct. If Watershed's judgments with respect to these factors should prove incorrect, clients may not achieve their investment objectives and may incur losses.

Watershed's due diligence may be based on limited and/or unreliable inputs.

When conducting due diligence and research, Watershed is often required to evaluate complex business, financial, tax, accounting and legal issues. Outside advisers may be involved in the due diligence process depending on the type of investment, and advice provided by such advisers may be unreliable or may contain questionable judgments or errors. Information provided by companies, governmental agencies, rating agencies or third party research providers may also be unreliable or limited in scope. Due diligence and research conducted may therefore not reveal all of the relevant facts and information that may be necessary to properly evaluate an investment opportunity. In the worst case scenario, information may be manipulated or fraudulent. Because Watershed may not have the ability to independently verify such information, clients could incur losses as a result of Watershed's reliance on such information.

Investment concentration and correlation of risks may increase the likelihood of losses.

Watershed does not have fixed guidelines for diversification, although it seeks to follow general policies regarding maximum portfolio positions. Concentration of investments may increase losses suffered by clients. Even if Watershed is successful in diversifying a client's portfolio, risks associated with different assets or markets may be correlated in unexpected ways that may adversely affect a client's portfolio.

The market value of Watershed's investments may decline in response to changes in interest rates.

Watershed generally invests a significant amount of its assets under management in fixed income securities. Such securities include both fixed and floating rate instruments. While Watershed's investment strategy is not predicated on interest rate movements, holding fixed rate fixed income securities may expose Watershed's clients to risk of loss in a rising interest rate environment. The magnitude of such losses will generally be greater for securities with longer maturities. While Watershed will attempt

to anticipate these changes and/or hedge appropriately to avoid materially adverse effects of such changes on its investments, there can be no assurance that Watershed will be successful in these endeavours or that its clients will avoid losses due to changes or anticipated changes in interest rates.

Watershed invests in bank loans, which presents unique risks of loss.

Watershed may invest a significant amount of its assets under management in bank loans. Risks associated with investing in these obligations include, among others, the following: (i) certain loans and related guarantees may be unsecured or there may be inadequate or invalid perfection of a loan's security interest; (ii) loans may be invalidated or compromised as fraudulent conveyances or preferences under relevant creditors' rights laws; (iii) bank loans may have only a limited trading market; (iv) Watershed may elect not to receive material, non-public bank level information in order to retain flexibility to invest in public securities of the issuer, which may place Watershed's clients at an information disadvantage relative to other lenders; (v) Watershed may elect to receive material, non-public bank level information, which will limit Watershed's ability under applicable securities laws to trade in other securities of the issuer; (vi) lenders may be subject to lender liability claims by the issuer of the loan and to potential environmental liabilities that may arise with respect to collateral securing the loan obligations and the liens related thereto; (vii) holding loans via participation subjects lenders to the credit risk of the participating institution in addition to the credit risk of the borrower and may also limit the lender's ability to enforce its rights; and (viii) loans settle on a delayed basis, which subjects the purchaser and seller of loans to increased counterparty risk. While Watershed attempts to employ due diligence and operational controls to limit these risks, there can be no assurance that such efforts will be effective or that clients will avoid losses arising from such risks.

Watershed invests in high yield and lower or non-rated debt and preferred securities, which presents unique risks of loss.

Watershed's investments include "high yield" bonds, convertible and preferred securities that are rated in the lower rating categories by the various rating agencies and securities and interests that are not rated at all. The markets for such securities may be more volatile, less liquid and less active than for higher-rated securities, which can adversely affect the prices at which these securities can be sold and may even make it impractical or impossible to sell such securities at times of extreme market dislocation. Moreover, during an economic downturn or a sustained period of rising interest rates, issuers of lower or non-rated debt and preferred securities may be more likely to experience financial stress, especially if such issuers are highly leveraged. The risk of loss due to default by the issuer is significantly greater for the holders of such securities because such securities may be unsecured and may be subordinated to obligations owed to other creditors of the issuer of such securities.

Watershed invests in structured finance securities, which presents unique risks of loss.

The Fund may invest in structured finance securities, generally in the form of trust certificates or similar securities of a type considered to be repackaged securities. The Fund's structured finance investments may include residential mortgage-backed securities, commercial mortgage-backed securities, asset-backed securities, and collateralized debt obligations.

Investing in structured finance securities may entail a variety of unique risks, including prepayment risks, credit risk, liquidity risk, market risk, structural risk, legal risk and interest rate risk. In addition, the performance of a structured finance security will be affected by a variety of factors, including the level and timing of payments and recoveries on, and the characteristics of, the underlying collateral, the remoteness of those assets from the originator or transferor and the adequacy of, and the ability to realize upon, any related collateral. The risk that the performance of the Fund could be adversely affected by losses on the structured finance securities may be increased to the extent the portfolio of the structured finance securities is concentrated in any one issuer, industry, region or country.

Watershed invests in distressed and bankrupt companies, which exposes clients to a high risk of loss and unusual expense.

Investing in distressed and bankrupt companies involves substantial risks not normally associated with investments in healthier companies, including adverse business, financial or economic conditions that can lead to defaulted payments and insolvency proceedings. Such investments may require substantial workout negotiations that may entail, among other things, a substantial reduction in the interest rate, a substantial write down of the principal of the loan and/or the deferral of payments. Clients may also be forced to incur additional expenses to the extent they are required to seek recovery upon default or participate in the restructuring of such obligations. Troubled company investments also may be adversely affected by laws relating to, among other things, fraudulent conveyances, voidable preferences, lender liability and the bankruptcy court's discretionary power to classify, disallow, subordinate or disenfranchise particular claims. To the extent that any payments are voided, such payments may be recaptured from Watershed's clients. Moreover, there may be little or no market for securities of troubled companies, and any markets therein may show high volatility.

Watershed may invest in illiquid securities and instruments, which exposes clients to increased costs of ownership and potentially over or understated valuation.

Watershed may purchase securities for clients notwithstanding the fact that price quotations may be difficult to obtain or that the disposition of such assets may be restricted by contract or securities laws. Watershed's ability to sell such securities or instruments may be adversely affected by limited trading volume, lack of a market maker or legal restrictions. The sale of such securities may also require more time and greater transaction costs than the sale of more liquid securities. As a result, during periods of market illiquidity, the value of such investments may be difficult to determine and subject

to wide fluctuation. Moreover, for certain clients, Watershed may invest in special situation, or “side pocket”, investments. Because such securities and instruments may not be readily marketable or saleable, once owned, they may have to be held by clients for an indefinite period of time.

Watershed invests in derivative instruments for hedging and direct investment purposes, which exposes its clients to unique risks not found when investing in cash instruments.

Watershed trades in both exchange traded and over the counter derivatives, including put and call options, forward contracts and swaps (including, among others, interest rate, currency and credit default swaps). Watershed’s clients may be exposed to the following unique risks, among others, due to Watershed’s use of derivative instruments:

- when used for hedging purposes, an imperfect or variable degree of correlation between price movements of the derivative instrument and the underlying investment sought to be hedged may prevent Watershed from achieving its intended hedging effect or expose clients to the risk of loss;
- many swaps are complex and often valued based on quotations given by the Fund’s swap counterparty, who has adverse interests to the Fund with respect to the value of the swap. In certain cases, the Fund’s swap counterparty may be the only source of value quotations for a swap, while in other cases, multiple quotes may be available. There are also different methodologies that may be used to determine the value of a credit default swap and credit default swap spreads may be wide.
- there has been substantial regulatory reform passed that will require significant changes in the over the counter derivatives market, which reform has the potential for making trading in such instruments more or less economic for Watershed and its clients.

Several of Watershed’s investment strategies expose its clients to counterparty credit risks.

Watershed’s investments include purchases, sales, financing arrangements, bank debt (acquired on participation and by assignment), and derivative instruments that are not traded on an exchange but are instead traded between counterparties based on contractual relationships. This exposes clients to the risk that a counterparty will not perform or settle a transaction in accordance with its terms and conditions because of a credit or liquidity problem with the counterparty or due to a dispute over terms of the contract. Although Watershed attempts to diversify and monitor credit risk and execute, clear and settle transactions through entities Watershed believes to be sound, there can be no assurance that a failure by any such entity will not lead to losses for clients.

Watershed employs short selling on behalf of its clients, which involves unique risks of loss.

Watershed's investment program includes short selling both for hedging and outright investment purposes. An uncovered equity short sale may be subject to theoretically unlimited risk of loss because there may be no limit on how much the price of a security may appreciate before the position is closed out. In addition, the supply of securities that can be borrowed fluctuates from time to time. Although Watershed believes that its prime broker has excellent stock and bond loan capabilities, clients may be subject to losses if the lender of a security demands return of the borrowed security and an alternative source cannot be found. The rules affecting short selling are constantly evolving. It is impossible to predict what, if any, changes to the rules affecting short sales may occur in the future, but any new regulation could have a materially adverse impact on the ability of Watershed to achieve its investment objectives for its clients.

Watershed may employ leverage, which exposes clients to increased risk of loss.

Although it has historically rarely if ever been used and Watershed's strategy is not predicated on its use, Watershed is permitted to employ leverage on behalf of clients. Leverage, or borrowings, may exaggerate the effect on net asset value of any increase or decrease in the market value of a client's portfolio. While gains made with borrowed funds generally would cause the value of a client's account to increase more significantly than without the use of borrowed funds, if the value of securities purchased with borrowed funds declines, or does not appreciate sufficiently to cover the costs of borrowing, the value of the client's account will decrease more significantly than without the use of borrowed funds.

Watershed invests in non-U.S. securities and other investments on behalf of clients, which poses additional risks not typically associated with U.S.-based investments.

Although Watershed intends to invest primarily in developed international markets, all non-U.S. based investments involve certain risks and uncertainties not typically associated with U.S.-based investments. Such considerations include, among other things, exchange control regulations, non-U.S. taxes and difficulty in enforcing contractual obligations. In addition, non-U.S. investments may carry higher risks than similar investments in the U.S. capital markets, including, among other things, less liquidity, greater price volatility, higher transaction costs, less government supervision, less available information and less uniform accounting and auditing standards than are typical in the United States. Due to the foregoing, and other risks and complications, the costs associated with investments in foreign markets' securities generally are higher than for securities of issuers based in the United States.

Although Watershed expects most of its investments to be U.S. dollar-denominated, client assets that are denominated in a non-U.S. currency are subject to the risk that the value of a particular currency will change in relation to one or more other currencies. Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in relative values of similar assets in

different currencies, long-term opportunities for investment and capital appreciation and political developments. Watershed intends, but is under no obligation, to employ hedging techniques to minimize these risks, and there can be no assurance that such strategies will be available or effective.

Watershed may become involved in litigation in connection with carrying out its investment strategy.

As a result of Watershed's investment strategies, it is possible that clients may become involved in litigation. Litigation entails expense and the possibility of counterclaims against clients and ultimately judgments may be rendered against clients for which Watershed does not carry insurance.

Investment Related Conflicts of Interest

Watershed and its related persons will at times have conflicts of interest with respect to, among and/or between, as the case may be, the Funds, its other clients (if any) and each of their respective investments. Generally, Watershed and its related persons resolve or manage these conflicts of interest in accordance with the proper exercise of their fiduciary duties without input from disinterested third parties. Some of the expected conflicts of interest and Watershed's policies and procedures for resolving or mitigating such conflicts of interest are set forth below.

While Watershed generally purchases securities and other instruments for investment purposes and not for the purpose of influencing or controlling management of the issuer, Watershed may seek to influence or control management of the companies and/or securities in which it invests through discussing issues informally with management, serving as part of a creditor's committee established in connection with an investee company's reorganization process or liquidation, joining the board of directors of an investee company or other methods. Watershed will do so if it believes that the potential increase in the value of its investment will outweigh the risks and opportunity costs associated with the active role taken. In the event that Watershed or a related person (i) obtains material non-public information in such capacity with respect to any such company or security or (ii) is subject to trading restrictions pursuant to the internal policies of Watershed, Watershed may be prohibited from trading in the securities or instruments with respect to which such material non-public information relates, which prohibition may have an adverse effect on clients of Watershed. Watershed weighs the costs and benefits of any such active involvements and attempts to limit such engagements for the Funds to mitigate these adverse effects.

Watershed and its officers, employees and affiliates may on occasion receive or be offered board of directors' fees, backstop, arrangement and/or financing fees and other similar investment-related fees, options or other benefits from a company in which one or more of its clients invest. To resolve such potential conflicts, Watershed and its officers, employees and affiliates structure such investments so that the management fee charged to its clients is reduced or so that its clients otherwise are reimbursed by their share of any such fees, options or other benefits directly received by Watershed or any of its

officers, employees or affiliates. In the event that an investment cannot be structured in such a manner, Watershed will waive such consideration altogether.

From time to time, Watershed advisory personnel may serve as directors or on creditors' committees or similar bodies with respect to issuers of securities purchased or sold on behalf of its clients. A member of any creditors' committee, board of directors or similar body may owe certain obligations generally to all parties similarly situated that the committee, board or body represents. If Watershed or an affiliate concludes that its obligations owed to the other parties as a committee, board or body member conflict with its duties owed to the Funds or Watershed's other clients, it will resolve such conflicts in accordance with the good faith exercise of its fiduciary duties.

Watershed's clients may on occasion participate in discrete investment opportunities through vehicles with independent managers of the particular investment opportunity if Watershed determines that doing so is the best way to access or manage such opportunity. Clients may incur various costs relating to such ventures, including on occasion performance-based or fixed asset-based fees or allocations payable to the managers promoting or managing such ventures. Such fees and allocations will not generally be applied to reduce Watershed's management fees or incentive compensation.

Certain investments (including the Funds' Special Situation Investments and certain bank debt and securities positions for which there is not an active market and for which broker quotes may be scarce or unreliable) are difficult to value and such valuations may be volatile. It is not unusual for broker-dealers to provide "bid" and "ask" quotes on a preliminary or "soft" basis. Such quotations may not reflect prices at which such broker-dealer would be willing to effect actual transactions or may be valid only for a smaller block of securities. Determining fair value under such circumstances can be difficult and Watershed may have a conflict of interest in making such determinations. In order to resolve such conflicts, Watershed has implemented controls and procedures with respect to determining the valuation of its clients' assets, including, but not limited to designating a third party administrator for the Funds, conducting valuation committee meetings overseen by Watershed's Chief Financial Officer and conducting annual independent audits of the Funds' portfolios.

Under certain limited circumstances, Watershed may determine that it is in the best interests of the Funds to effect trades of securities or instruments between or among the Funds. This may occur, for example, to accommodate the varying liquidity needs of the Funds while minimizing execution and other transaction costs and limiting market impact. In such cases, one Fund may purchase securities or other instruments held by another Fund and, in certain circumstances, each may have conflicting price, performance, liquidity, timing and other objectives. Watershed and their related persons will not receive any brokerage or transaction fee related to these transactions. Moreover, to the extent that these transactions may be viewed as principal transactions due to the ownership interest in the Funds by Watershed, its related persons and personnel, Watershed will also comply with the requirements of Section 206(3) of the Advisers Act, including that Watershed will notify the respective Funds in writing of the transaction and obtain the consent of the respective Funds. When effecting principal or cross

transactions between or among the Funds, Watershed will have potentially conflicting interests and duties, performance objectives, ownership interests and compensation arrangements with respect to each participating Fund. To address these conflicts, Watershed's legal and compliance department would implement procedures to be followed by Watershed's traders and investment professionals in carrying out such potential cross and/or principal transactions.

Watershed's investment strategies involve a high degree of risk and are suitable only for sophisticated investors. No assurance can be given that Watershed will achieve its investment objectives or that clients will avoid losses.

Item 9

Disciplinary Information

Not applicable.

Item 10

Other Financial Industry Activities and Affiliations

Watershed has an on-going relationship with Farallon Capital Management, L.L.C. and its affiliates (collectively, “FCM”). Watershed’s Senior Managing Member is a former Managing Member of FCM and continues to have personal investments in certain of the funds managed by FCM. Watershed and FCM, however, are not related persons and each entity is managed and operated independently of the other. FCM and its affiliates have no ownership or other economic interest in Watershed.

Watershed has established certain funds (the “Parallel Funds”) for the sole purpose of managing assets of funds advised by FCM which previously invested directly in Watershed’s flagship funds. The Parallel Funds generally invest on a parallel basis with Watershed’s other Fund clients.

Certain Funds managed by Watershed own the majority of the equity interests in Leader Ventures, LLC (“Leader”) and its clients. Leader is a private investment advisory firm providing debt and equity financing to a diversified portfolio of early and late stage private companies. The Funds currently have the right to elect a majority of the members of Leader’s board of directors.

Item 11

Code of Ethics, Participation or Interest in Client Transactions and Personal Trading

Code of Ethics

Watershed has adopted a Code of Ethics (the “Code”), which governs, among other things, the personal securities transactions of Watershed’s employees and others. The general principles of the Code provide that every employee who engages in personal transactions must: (i) consider the interests of Watershed’s clients before requesting permission, and place the clients’ interests first, particularly in the case of any security that might provide a suitable and beneficial opportunity for any client; (ii) not use his or her position with Watershed to influence a broker, dealer or underwriter to effect a personal transaction for the benefit of the employee; and (iii) conduct all personal transactions in accordance with the provisions of the Code and in avoidance of any actual or potential conflicts of interest or abuse of fiduciary responsibilities. In furtherance of the objectives of the Code, the Code permits personal securities transactions (as defined in the Code) by Watershed’s employees only with the prior written authorization of designated officers of Watershed (subject to certain exceptions for transactions deemed by Watershed to present a low potential for impropriety or the appearance of impropriety, including without limitation, transactions in certain broad based ETFs, currencies and government issued or guaranteed securities, purchases pursuant to the exercise of rights issued pro rata to all holders of a class of securities, transactions that occur by operation of law or over which the Watershed employee otherwise lacks discretion and purchases pursuant to an automatic dividend reinvestment plan). The Code also places restrictions on the receipt and provision of gifts and entertainment by Watershed personnel, limits the ability of Watershed personnel to serve on various boards of directors or otherwise pursue outside business opportunities and places restrictions on the making of certain political contributions by Watershed personnel and members of their family/household. *Investors in the Funds and other clients may request a copy of the Code by contacting Watershed.*

Participation or Interest in Client Transactions

Watershed and its related persons may on limited occasions, purchase or sell on behalf of a client a security or other investment in which a Managing Member or employee of Watershed has an interest. Such securities may be purchased at or about the same time that Watershed buys or sells the same securities for its clients. If not effectively monitored and managed, this practice could disadvantage client trading. In order to reduce, monitor and resolve the conflicts of interest arising from this practice, Watershed permits only very limited personal account trading, which personal account trading must be carried out in accordance with the policies described above under the heading *Code of Ethics*.

Although Watershed and its personnel maintain significant investments in Watershed's Fund clients, Watershed and its personnel may have a conflict in that they may have different levels of investments in the various Funds and they may not have investments in the Parallel Funds and/or other clients. In addition, Watershed may face a conflict of interest due to the differing compensation arrangements it has with its various clients. As a result, Watershed may face conflicts in allocating its time, services and investments among its clients. Watershed will allocate investments among its clients in a manner that it considers fair and reasonable in accordance with its allocation policies and procedures discussed in greater detail under the heading *Trade Aggregation and Allocation* in Item 12.

Item 12

Brokerage Practices

Selection of Broker-Dealers and Best Execution

In selecting an appropriate broker or dealer to effect a trade on behalf of one or more of Watershed's clients, Watershed seeks to obtain best execution, meaning generally that Watershed seeks to execute securities transactions so that the total costs or proceeds in each transaction are the most favorable under the circumstances. Consistent with its duty of best execution, Watershed may consider not only quantitative factors such as prices, commissions and other expenses paid in connection with transactions, but also a broad range of qualitative factors such as:

- the quality of execution, including the broker or dealer's history of accurate and timely execution, clearance and error/dispute resolution;
- the overall reputation, experience, financial strength, stability and ongoing reliability of the broker or dealer;
- the quality of the broker or dealer's relationship with Watershed, including the responsiveness, attention and consistency of trading personnel with whom transactions are conducted, the nature and quality of the investment ideas presented by the broker or dealer's personnel and the allocation of limited investment opportunities to Watershed;
- the broker or dealer's trading and block positioning capabilities;
- the broker or dealer's trading expertise, including the willingness and ability to execute difficult transactions while minimizing total trading costs without adverse impact to the market and Watershed's clients' positions;
- the broker or dealer's willingness and ability to commit capital;
- the broker or dealer's expertise regarding the nature of the security and market making position relative to other brokers or dealers and its ability to provide market intelligence regarding trading activity;
- the ability, when possible, to maintain Watershed's anonymity when executing a trade;
- the broker or dealer's infrastructure in areas such as order entry, clearing, settlement and custody;
- the broker or dealer's ability to provide quality research and access to company management and industry specialists;

- whether the broker or dealer is the agent for the credit facility (in the case of bank debt trades);
- whether the broker or dealer is buying for its own account;
- the belief that Watershed has been treated fairly and honestly in prior trades; and
- the availability of the broker or dealer to stand ready to execute possibly difficult transactions in the future.

Watershed has adopted a policy relating to the selection of brokers and dealers to execute transactions in securities.

Accordingly, in consideration of the foregoing factors, the commission rates (or dealer mark-ups and mark-downs arising in connection with certain principal transactions) charged to Watershed's clients by brokers with valuable qualitative characteristics or who provide valuable research and/or services may be higher than those charged by other brokers who may not have such characteristics, or who may not offer such research or services.

Research and Other Soft Dollar Benefits

The use of commission or "soft dollars" to pay for research or brokerage services by Watershed falls within the safe harbor for soft dollars created by Section 28(e) of the Securities Exchange Act of 1934 and in a manner consistent with prevailing SEC guidance. The Section 28(e) safe harbor allows Watershed to pay more than the lowest available commissions provided that it determines that the commissions paid are reasonable in relation to the value of the brokerage and research services provided by such brokers and/or dealers. This type of arrangement is known as "paying-up". Such arrangements can be formal or informal. An informal arrangement may arise for example when trades are effected through a broker in return for an investment idea, access to an analyst or for proprietary research. Watershed generally permits informal soft dollar arrangements provided that they occur in the normal course of business and are consistent with Watershed's best execution obligations. A formal soft dollar arrangement often involves the receipt of a third party product or service, as well as specified commission target and/or written agreements. None of Watershed's soft dollar arrangements involve specified commission targets.

Within the last fiscal year, Watershed employed both formal and informal soft dollar arrangements and received research and brokerage services in exchange. Research services provided by brokers or dealers included among other topics, information on the economy, foreign markets, industries, groups of securities, individual companies, new issues of debt and equity, accounting and tax law interpretations, political, legal and regulatory developments affecting portfolio securities, market movements and credit analysis. Such research services were received primarily in the form of written reports, telephone contacts, conferences and personal or telephonic meetings with security

analysts, consultants and company management. Such research services were also provided in the form of access to various computer-generated data, computer software and meetings arranged with corporate and industry spokespersons, economists, academicians and government representatives. In some cases, research services were generated by third parties but were provided to Watershed by or through brokers or dealers.

Brokerage firms will not charge Watershed a separate fee for research or other services. However, while the continued provision of such services to Watershed is not conditioned on Watershed directing any particular level of transactions to these brokerage firms, such services are provided without separate charge in consideration of Watershed's periodic use of such brokerage firms to execute transactions for its clients. Watershed has a conflict of interest in using brokers that offer research or services as it might otherwise have to purchase such research or services with its own money. Similarly, Watershed faces a conflict of interest in that it may have an incentive to select or recommend a broker-dealer based on its interest in receiving research, products or services, rather than on clients' interests in receiving most favorable execution. Watershed will manage such conflicts in accordance with the good faith exercise of its fiduciary duties, including its duty to obtain best execution.

In order to select the broker-dealers with whom Watershed trades on its clients' behalf and to whom Watershed directs client transactions in return for the soft dollar benefits described above, Watershed reviews and monitors trading activity for client accounts and solicits feedback and input from its trading and analytical personnel regarding the quality and quantity of research and brokerage services provided by such broker-dealers. Such input and feedback is used by Watershed to evaluate the quality of the research services Watershed receives from the broker-dealers with whom it does business and to determine whether the commissions paid are reasonable in relation to the value of the brokerage and research products and services received. Where a product or service obtained with commission dollars provides both research and non-research assistance to Watershed, Watershed makes a reasonable allocation of the cost which may be paid for with commission dollars. In making good faith allocations of costs between research and non-research assistance, a conflict of interest may exist by reason of Watershed's allocation of the costs of such benefits and services as between Watershed on one hand and its clients on the other hand. As noted above, Watershed does not use soft dollars for items not falling within the safe harbor (e.g., computer facilities used for accounting for the Funds). Finally, consistent with Section 28(e), research products or services obtained with "soft dollars" generated by one or more of Watershed's clients may be used by Watershed to service one or more of Watershed's other clients. While Watershed believes that these products or services provide useful resources to Watershed in its management of client accounts, and therefore are generally of benefit to all clients, in any particular case, a client may not directly or indirectly benefit from the products or services provided. Watershed does not seek to allocate soft dollar benefits to client accounts proportionately to the soft dollar credits the accounts generate.

Brokerage for Client Referrals

Subject to the considerations described above under the heading “*Brokerage Practices—Selection of Broker-Dealers and Best Execution*”, the selection of a broker (including a prime broker) to execute transactions, provide financing and securities on loan, hold cash and short balances and provide other brokerage services may be influenced by, among other things, the provision by the broker of capital introduction and operations related consulting services. From time to time, in the last fiscal year, Watershed received such services from a limited number of broker-dealers, including Goldman Sachs, Watershed’s prime broker. None of Watershed, the Funds nor Watershed’s other clients separately compensate these broker-dealers for any of these services. Watershed may face a conflict of interest in its selection of a broker based on its interest in receiving the provision of such capital introduction and consulting services, rather than on its clients’ interests in receiving lowest cost/highest quality execution and other brokerage (including prime brokerage) services. In connection with the provision of capital introduction services by such broker-dealers, Watershed conducts its own due diligence regarding the suitability of an investment in a Fund for any potential investor.

Directed Brokerage

Not applicable.

Trade Aggregation and Allocation

Watershed typically will aggregate purchase or sale orders, as applicable, on behalf of clients and allocate the securities or other investments purchased or sold on an average price basis among the participating clients when it believes that the aggregated transaction will allow it to negotiate more favorable commission rates or otherwise reduce transaction costs. When allocating aggregated orders, Watershed endeavors to (i) not unfairly favor any of its clients over time and (ii) recognize and minimize conflicts of interest among clients and between clients and Watershed. Since Watershed’s various clients have somewhat differing limitations and investment guidelines and restrictions, Watershed’s allocation objective is to allocate trades in the best interests of its clients as a whole over time taking into account, when appropriate, tax, leverage, special situation (or “side pocket”) availability, investment limitations, guidelines and restrictions, available capital and relative account market values, diversification and concentration considerations, any other anticipated investment opportunities, transaction size and the amount of potential follow-on investing that may be deemed appropriate, target position sizes and other relevant factors particular to each client (collectively, “Transaction Considerations”).

Before a decision has been made to purchase or sell a specific investment for any Watershed client(s), the various Transaction Considerations of such clients are considered to determine whether and to what extent a transaction is appropriate for each client. Due to these various Transaction Considerations, the investment returns of clients with similar investment strategies may differ.

When participation in the purchase of a specific investment is appropriate for multiple clients, Watershed generally allocates the investment to the participating clients *pro rata* in accordance with the then applicable formula set by Watershed. The applicable allocation formula will be fixed from time to time based on either the relative market values of the various clients (which may be adjusted to take account of variations in available cash balances (including future projected variations arising from capital commitments to and withdrawals or redemptions from client accounts) and appropriate available borrowing levels) and/or the relative amounts of capital available in a client account or in a client account for a particular strategy (which are computed taking into account daily cash balances, the amount of available borrowings then deemed to be appropriate by Watershed, and capital commitments to and withdrawals or redemptions from client accounts). From time to time it may be necessary for Watershed in the good faith exercise of its fiduciary duties to vary the purchase allocations among its clients from the foregoing standard allocation procedures. Purchase allocations may be varied for a number of reasons, including if the investment is a special situation or “side pocket” investment (as described below), if the investment is being allocated as a hedge and otherwise in connection with the good faith portfolio management activities of Watershed.

In the case of any new client, in addition to the Transaction Considerations and other factors described above, as applicable, Watershed also may consider the amount of available capital for such client during its initial investment (or “ramp-up”) period.

When existing positions are being reduced or sold, sales are generally allocated to the extent practicable among Watershed’s clients *pro rata* according to existing inventory. Sale allocations may be varied from time to time from the standard allocation methodology for a number of reasons, including the liquidity of one or more clients due to capital contributions, redemptions and projected investments that are pending and in connection with the good faith portfolio management activities of Watershed.

Certain illiquid investments that lack a readily assessable market value, known as special situation or “side pocket” investments, are allocated among participating clients taking into account additional factors such as whether such investment is a follow-on investment, the net asset values of the then side pocket eligible investors’ assets and the individual client’s caps on the amount of such illiquid investments.

As suggested above, Watershed’s clients may have conflicting investment, tax, regulatory and other interests with respect to their investments. This may result in Watershed taking actions with respect to one or more of its clients which may differ from the timing or the nature of an action taken with respect to other Watershed clients, and as a result, the investment returns of clients with similar investments and/or investment mandates may differ. This may also result in Watershed acquiring securities or other financial instruments of an issuer for one client which are senior or junior to securities or financial instruments of the same issuer that are held by, or acquired for, another client

(e.g., one client may acquire senior debt and equity while another client may acquire only equity, or one or more clients may provide debtor in possession financing to a company that also benefits the investments in that company held by other clients that do not participate in the debtor in possession financing). This may also result in one or more clients participating in the refinancing of securities also held by clients that due to tax, regulatory or other investment related restrictions are not able to participate in such refinancing transactions, but that may nonetheless benefit indirectly from such refinancing transactions. The conflicting interests of individual clients may also relate to, or arise from the structuring or the acquisition of investments and the timing of disposition of investments. As a consequence, conflicts of interest may arise in connection with the decisions made by Watershed and its related persons that may be more beneficial for one or more clients than for other clients. Watershed recognizes that conflicts may arise under such circumstances and attempts to minimize their occurrence. In cases where conflicts do arise, Watershed will endeavour to manage the clients by considering the best interests of the clients as a whole.

The Funds may, from time to time, invest in initial public offerings of equity securities or “new issues.” The Funds, in compliance with The Financial Industry Regulatory Authority (“FINRA”) regulations, will allocate profit and loss from “new issues” only to investors that may participate in such allocations.

Trade and Other Errors

Watershed may on occasion experience trade, administration, operations and other human errors when conducting investment and administration activities on behalf of its clients. Such errors, which may result in losses or gains, can result from a variety of situations, including, for example, when the wrong security is purchased or sold, the correct security is purchased or sold but for the wrong account or the wrong quantity is purchased or sold (e.g., 1,000 shares instead of 10,000 shares are traded). Watershed will endeavor to detect trade errors prior to settlement and correct and/or mitigate them in an expeditious manner. To the extent an error is caused by a counterparty, such as a broker or dealer, Watershed will strive to recover any losses associated with such error from the counterparty. To the extent an administration or operational error arises in connection with the administration of a client’s account, Watershed will endeavor to correct the error through review and reconciliation procedures and correct and/or mitigate the error in an expeditious manner. Pursuant to the various exculpation and indemnification provisions described in the Funds’ governing documents, Watershed and its affiliates and personnel are generally not liable to the Funds for any act or omission, absent bad faith, willful misconduct or gross negligence, and the Funds are generally required to indemnify such persons against any losses they may incur by reason of any act or omission related to the Funds, absent bad faith, willful misconduct or gross negligence. Given the large volume of transactions executed by Watershed on behalf of its clients, investors should assume that trading, administration, operations and similar human errors will occur and that the Funds will be responsible for any resulting losses, even if such losses result from the negligence (but not gross negligence) of Watershed’s personnel. Watershed has implemented policies and procedures for dealing with errors. The decision by Watershed

to reimburse its clients in any given instance(s) for losses incurred as a result of errors should not be construed as creating any obligation on the part of Watershed to reimburse its client(s) for losses arising from errors in the future. *None of the foregoing disclosure or provisions in the Funds or other client's governing documents constitutes a waiver by a client of any rights such client has under Federal securities laws (which under certain circumstances, impose liabilities even on persons who act in good faith).*

Item 13

Review of Accounts

Account Reviews

Watershed generates daily profit and loss reports for every position held by a Fund client. Watershed's Senior Managing Member, Traders and Chief Financial Officer review the daily profit and loss reports every trading day. Watershed's Senior Managing Member, Managing Member and Head Trader regularly review each client's portfolio and every significant position held by such clients. Such reviews also generally involve performing regular stress tests under various assumptions for corporate spreads, short and long term interest rates and equity market moves to consider potential downside scenarios and portfolio correlations. A review of a client's account may also be undertaken following a significant event or market move or in connection with other special circumstances. Based on such reviews, decisions to change positions or portfolio allocations are made by Watershed's Senior Managing Member either alone or in consultation with relevant investment professionals and Traders. A review of a client account may also be conducted by the Chief Compliance Officer with a view toward monitoring for best execution, compliance with investment guidelines and/or restrictions, equitable allocations, trade errors or other unusual activity.

To the extent that Watershed advises other types of clients, it engages in similar reviews of such client's accounts, which reviews may vary from the reviews undertaken for the Funds based on the frequency of trading, the liquidity of the positions and other factors unique to the investment mandates of such accounts.

Client/Investor Reports

Watershed sends the investors in its Fund clients the following regular written reports through its password protected investor website:

- (i) the audited annual financial statements of the applicable Fund within 120 days of the applicable Fund's fiscal year end;
- (ii) a quarterly letter generally within 45 days after the close of each three month quarterly period during the fiscal year; and
- (iii) monthly Fund level exposure reports, preliminary return information and final investor account summaries.

Watershed also currently holds semi-annual conference calls for all current Fund investors. Watershed may agree, in its discretion, to provide certain additional or more frequent information to one or more investors in its Funds. To the extent that Watershed

advises other types of clients, it will provide such clients with such reports as may be agreed between Watershed and such clients from time to time.

Item 14

Client Referrals and Other Compensation

Watershed may from time to time utilize the services of third-parties for investor or client referrals. To the extent Watershed uses such third parties, Watershed will compensate them for their services. Any such arrangements will be consistent with the requirements of Rule 206(4)-3 under the Advisers Act, to the extent applicable and/or state rules requiring registration of investment adviser representatives.

Item 15

Custody

Goldman Sachs (which has its principal offices at One New York Plaza, New York, New York), Watershed's prime broker, acts as principal qualified custodian for regulatory purposes for each of the Funds' publicly traded securities and other financial instruments, other than bank debt, trade claims, other private investments and certain cash equivalent securities. The Northern Trust Company (which has its principal offices at 50 South La Salle Street, Chicago, Illinois) and First Republic Bank (with offices at 101 Pine Street, San Francisco, California) also act as custodians for certain of the Funds' securities and instruments. Watershed's third party administrator, SEI Global Services, Inc., also maintains bank accounts for the Funds at JPMorgan Chase (with offices at 1 Chase Manhattan Plaza, New York, NY 10005) for the purposes of processing subscriptions and redemptions. Notwithstanding the foregoing, Watershed is deemed to have custody of the assets contained in the Funds' portfolios, since Watershed or an affiliate serves as general partner of each of the Funds. Fund investors do not receive account statements from the custodian; rather, the Funds are subject to an annual audit in accordance with U.S. generally accepted accounting principles and the audited financial statements are distributed to each Fund investor.

Item 16

Investment Discretion

Watershed accepts discretionary authority to manage securities accounts on behalf of clients, subject to the guidelines, limitations and restrictions set forth in the client's operative documents and Watershed's own internal policies and procedures. Watershed may also agree in certain circumstances to invest pursuant to specific instructions from a client. Customary limitations on Watershed's authority generally pertain to tax, leverage, investment concentration and other similar considerations. Prior to accepting discretionary authority to invest on behalf of a client, Watershed and the client execute formal investment management agreements.

Item 17

Voting Client Securities

Proxy Voting

Watershed has authority to vote securities held by its Fund clients. Investors in Watershed's Funds are not solicited, and thus may not direct Watershed as to how to vote in any particular situation. Rule 206(4)-6 of the Advisers Act requires registered investment advisers that exercise voting authority over client securities to implement proxy voting policies. In accordance with this rule, Watershed has adopted policies intended to ensure that it votes proxies in the best interests of its clients and that address how Watershed resolves any conflict of interest that may arise when voting proxies. Watershed's general policy when voting on proxy proposals, amendments, consents or resolutions (collectively, "proxies") relating to investments made by its clients is to vote in a manner that seeks to maximize the long term economic interests of the clients. Consideration will be given to both the short and long term implications of the proposal to be voted on when considering the optimal vote. *Clients may obtain a complete copy of Watershed's proxy voting policies and procedures, as well as a record of how Watershed voted client proxies by contacting Watershed.*

Class Action Law Suits

From time to time, Watershed may receive notices regarding class action lawsuits involving securities that are or were held by its clients. As a matter of policy, Watershed refrains from serving as the lead plaintiff in class action matters and may also refrain from submitting proofs of claim where Watershed believes that the recovery amounts are likely to be negligible. However, in other cases, Watershed may participate in class action law suits. In the event that any client does participate and recover damages as a plaintiff in a class action or other law suit, such recoveries will be credited to such clients and its then current investors.

Item 18

Financial Information

Not applicable.