
EDGAR Submission Header Summary

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Documents

8-K	catasys_8k-111511.htm Form 8-K
EX-4.1	ex4-1.htm Exhibit 4.1
EX-4.2	ex4-2.htm Exhibit 4.2
EX-4.3	ex4-3.htm Exhibit 4.3
EX-4.4	ex4-4.htm Exhibit 4.4
EX-10.1	ex10-1.htm Exhibit 10.1

Module and Segment References

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

FORM 8-K

CURRENT REPORT

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

Date of Report (Date of earliest event reported): **November 15, 2011**

Catasys, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation)

001-31932
(Commission File Number)

88-0464853
(IRS Employer
Identification No.)

11150 Santa Monica Boulevard, Suite 1500
Los Angeles, California
(Address of principal executive offices)

90025
(Zip Code)

Registrant's telephone number, including area code **(310) 444-4300**

(Former name or former address, if changed since last report.)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instructions A.2. below):

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
 - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
 - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
 - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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Item 1.01. Entry into a Material Definitive Agreement.

On November 15, 2011, Catasys, Inc. (the “Company”) issued Second Amended and Restated Secured Convertible Promissory Notes (the “Second Amended and Restated Notes”) to Socius Capital Group, LLC (“Socius”), an affiliate of Terren S. Peizer, Chairman and Chief Executive Officer of the Company, and David E. Smith (collectively, the Parties), to increase the outstanding principal amounts under the Amended and Restated Socius Note (as defined below) by \$160,000 and under the Amended and Restated Smith Note by \$100,000 (as defined below) in exchange for loans in such increased amounts from the Parties. The Company had previously issued Amended and Restated Secured Convertible Promissory Notes dated November 2, 2011 to Socius (the “Amended and Restated Socius Note”) and Smith (the “Amended and Restated Smith Note”) in the principal amounts of \$810,000 and \$780,000, respectively, as previously disclosed in the Company’s Current Report on Form 8-K filed with the Securities and Exchange Commission on November 8, 2011. In connection with the Second Amended and Restated Notes additional warrants were issued to the Parties to purchase an additional 615,385 and 384,615 shares of the Company’s common stock, par value \$0.0001 per share (the “Common Stock”), at an exercise price of \$0.32 per share (the “Amended and Restated Warrants”), respectively. The exercise price of and number of shares of Common Stock underlying the Warrants are subject to adjustment for financings and share issuances below the initial exercise price.

The Second Amended and Restated Notes mature on January 5, 2012 and bear interest at an annual rate of 12% payable in cash at maturity, prepayment or conversion. The Second Amended and Restated Notes and any accrued interest are convertible at the holder’s option into common stock or the next financing the Company enters into in an amount of at least \$2,000,000 (a “Qualified Financing”). The conversion price for the Second Amended and Restated Notes is equal to the lower of (i) \$0.26 per share of Common Stock, and (ii) the lowest price per share of Common Stock into which any security is convertible in any Qualified Financing.

Effective November 15, 2011, the Company entered into a Second Amendment to Consent Agreement (the “Second Consent Amendment”) with the Parties to amend the Consent Agreement dated October 5, 2011 as amended by that Amendment dated November 2, 2011 (the “Consent Agreement”), to adjust Socius’s and Mr. Smith’s respective sharing percentages in recoveries against collateral securing the Second Amended and Restated Notes in order to reflect the increased principal amounts thereunder.

The foregoing descriptions of the Second Consent Amendment, the Second Amended and Restated Notes, and the Second Amended and Restated Warrants do not purport to be complete and are qualified in their entirety by the documents, which are attached as Exhibits 10.1, 4.1, 4.2, and 4.3, respectively, to this Current Report on Form 8-K and incorporated herein by reference.

Item 2.01 Completion of Acquisition or Disposition of Assets.

On November 15, 2011, the Company issued Second Amended and Restated Notes secured by all of the Company’s assets as described in Item 1.01 of this Current Report on Form 8-K.

Item 2.03 Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant.

On November 15, 2011, the Company incurred a direct obligation to repay \$970,000 and \$880,000 as described in Item 1.01 of this Current Report on Form 8-K.

Item 3.02 Unregistered Sales of Equity Securities.

On November 15, 2011, the Company issued the Second Amended and Restated Notes and the Second Amended and Restated Warrants as described in Item 1.01 of this Current Report on Form 8-K. The issuance was exempt from registration pursuant to the exemption afforded by Rule 506 of Regulation D promulgated under the Securities Act of 1933, as amended.

Item 9.01 Financial Statements and Exhibits

(d) Exhibits.

<u>No.</u>	<u>Description</u>
4.1	Second Amended and Restated Secured Convertible Promissory Note by and between Catasys, Inc. and Socius Capital Group, LLC, dated November 15, 2011.
4.2	Second Amended and Restated Secured Convertible Promissory Note by and between Catasys, Inc. and David E. Smith, dated November 15, 2011.
4.3	Second Amended and Restated Warrant by and between Catasys, Inc. and Socius Capital Group, LLC, dated November 15, 2011.
4.4	Second Amended and Restated Warrant by and between Catasys, Inc. and David E. Smith, dated November 15, 2011
10.1	Second Amendment to Consent Agreement, dated November 15, 2011.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

CATASYS, INC.

Date: November 16, 2011

By: /s/ SUSAN E. ETZEL

Susan E. Etzel

Chief Financial Officer

THIS NOTE AND THE SECURITIES ISSUABLE UPON CONVERSION OF THIS NOTE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR QUALIFIED UNDER ANY STATE SECURITIES LAW, AND MAY NOT BE OFFERED FOR SALE OR SOLD UNLESS A REGISTRATION STATEMENT UNDER THE SECURITIES ACT AND APPLICABLE STATE SECURITIES LAWS SHALL BE EFFECTIVE WITH RESPECT THERETO OR AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT AND/OR QUALIFICATION UNDER APPLICABLE STATE SECURITIES LAWS IS AVAILABLE IN CONNECTION WITH SUCH OFFER OR SALE. THIS NOTE DOES NOT REQUIRE PHYSICAL SURRENDER HEREOF IN ORDER TO EFFECT A PARTIAL PAYMENT, REDEMPTION OR CONVERSION HEREOF. ACCORDINGLY, THE OUTSTANDING PRINCIPAL AMOUNT OF THIS NOTE MAY BE LESS THAN THE PRINCIPAL AMOUNT SHOWN BELOW.

CATASYS, INC.

SECOND AMENDED AND RESTATED SECURED CONVERTIBLE PROMISSORY NOTE

Original Issue Date: August 17, 2011

\$970,000.00

First Amendment and Restatement Date: November 2, 2011

Second Amendment and Restatement Date: November 15, 2011

FOR VALUE RECEIVED, CATASYS, INC., a Delaware corporation (the "*Company*"), hereby promises to pay to the order of **SOCIUS CAPITAL GROUP, LLC, a Delaware limited liability company**, or its successors or assigns (the "*Holder*") the sum of Nine Hundred and Seventy Thousand Dollars (\$970,000.00) in same day funds on or before 90 calendar days from the Issue Date (the "*Maturity Date*"), unless this Secured Convertible Promissory Note (this "*Note*") is earlier converted pursuant to Section 3 hereof. This Note amends, restates and replaces that certain secured convertible promissory note, originally issued as of August 17, 2011, in the original principal amount of \$650,000.00, and that amended and restated secured convertible promissory note, issued as of November 2, 2011, in the principal amount of \$810,000.00.

The following terms shall apply to this Note:

1. **DEFINITIONS.**

"*Applicable Interest Rate*" means an annual rate equal to twelve percent (12%) prior to any Event of Default, and twenty-four percent (24%) after the occurrence of any Event of Default, computed on the basis of a 365-day year and calculated using the actual number of days elapsed since the Issue Date or the date on which Interest was most recently paid.

"*Business Day*" means any day other than a Saturday, a Sunday or a day on which the New York Stock Exchange is closed or on which banks are authorized by law to close in New York, New York.

“**Common Stock**” means the common stock of the Company, \$0.0001 par value per share, and any securities into which such common stock may hereafter be reclassified.

“**Conversion Date**” means the date of closing of the Qualified Financing pursuant to which the Company has received at least \$2,000,000.00.

“**Highest Lawful Rate**” means the maximum non-usurious rate of interest, as in effect from time to time, which may be charged, contracted for, reserved, received or collected by the Holder in connection with this Note under applicable law.

“**Issue Date**” means the date first written above.

“**Maturity Date**” has the meaning set forth in the preamble of this Note.

“**Principal Market**” means the principal securities exchange or market on which the Common Stock is listed or traded.

“**Qualified Financing**” means the first round of equity financing (which shall include any convertible debt, convertible preferred stock or other equity-linked derivative security financing) in a single or series of related transactions, which raises gross proceeds to the Company of at least Two Million Dollars (\$2,000,000) in the aggregate.

“**Qualified Financing Securities**” means the Company’s securities issued and sold at the Qualified Financing.

“**Trading Day**” means a Business Day on which shares of Common Stock are purchased and sold on the Principal Market.

All definitions contained in this Note are equally applicable to the singular and plural forms of the terms defined. The words “hereof,” “herein” and “hereunder” and words of similar import referring to this Note refer to this Note as a whole and not to any particular provision of this Note. Any capitalized term used but not defined herein has the meaning specified in the Securities Purchase Agreement.

2. **INTEREST.**

(a) **Interest Rate.** This Note shall bear interest on the unpaid principal amount hereof (“**Interest**”) at a rate per annum equal to the Applicable Interest Rate.

(b) **Interest Payments.** The Company shall pay accrued and unpaid Interest (unless this Note is converted pursuant to the terms hereof) (i) on the Maturity Date and (ii) on any date on which the entire principal amount of this Note is paid in full (whether through conversion or otherwise). The Company shall pay Interest in cash by wire transfer of immediately available funds.

3. **CONVERSION.**

(a) **Conversion upon Qualified Financing.** Upon a Qualified Financing that occurs prior to the Maturity Date, Holder may, at its sole option, by written notice convert all or any part of the entire unpaid principal amount of this Note, together with any Interest accrued but unpaid thereon, into Qualified Financing Securities (a “**Financing Conversion**”). Upon a Conversion, the Holder shall be entitled to receive, and shall be issued, the same type and number of Qualified Financing Securities (the “**Financing Conversion Securities**”) as such Holder would have received had such Holder invested any such amount in such Qualified Financing. The issuance of the Conversion Securities upon a Conversion shall be upon the same terms and subject to the same conditions as are applicable to the Qualified Financing Securities issued in the Qualified Financing.

(b) Conversion into Common Stock. The Holder may, at its sole option, by written notice convert all or any part of the entire unpaid principal amount of this Note, together with any Interest accrued but unpaid thereon, into shares of Common Stock (a “**Common Conversion**”). (Either of a Financing Conversion and Common Conversion are referred to herein as a “**Conversion**.”) Upon a Common Conversion, the Holder shall be entitled to receive, and shall be issued, the number of shares of Common Stock (the “**Common Conversion Securities**”) equal to the amount converted multiplied by a price per share equal to the lower of (i) \$0.26 per share of Common Stock and (ii) the lowest price per share of Common Stock into which any security is convertible in any Qualified Financing (either of the Financing Conversion Securities and Common Conversion Securities are referred to herein as “**Conversion Securities**”).

(c) Conversion Mechanics. The Holder shall not be required to physically surrender this Note to the Company in order to effect any Conversion. Upon a Conversion, the Holder shall be deemed to be the holder of record of the Conversion Securities upon the Conversion Date. As soon as practicable after the Conversion Date, the Company shall, at its expense, issue and deliver to Holder (i) one or more certificates (bearing such legends as are required by applicable state and federal securities laws in the opinion of counsel to the Company) for the applicable Conversion Securities, registered in the name of Holder, free of any and all liens, encumbrances or other impediments to clear title and (ii) if applicable, and if requested by the Holder, cash in the aggregate amount of any accrued, unpaid and unconverted Interest. No fractional Conversion Securities shall be issued upon conversion of this Note, and any fractional Conversion Securities to which the Holder would otherwise be entitled shall be rounded up to the nearest whole Conversion Security and issued to the Holder along with the other Conversion Securities. Upon the Conversion or payment, as applicable, of all amounts due Holder in accordance with this terms of this Note, this Note shall be cancelled and no further amounts shall be due hereunder. Any full or partial payment or Conversion by Holder shall have no impact on the Warrant issued pursuant to the Securities Purchase Agreement concurrently herewith.

4. EVENTS OF DEFAULT. Upon the occurrence of any of the following events (each, an “**Event of Default**”):

(a) the Company or any of its subsidiaries shall (i) apply for or consent to the appointment of a receiver, trustee or liquidator of itself or of its property, (ii) be unable, or admit in writing its inability, to pay its debts as they mature, (iii) make a general assignment for the benefit of creditors, (iv) be adjudicated a bankrupt or insolvent, (v) file a voluntary petition in bankruptcy, or a petition or answer seeking reorganization or an arrangement with creditors to take advantage of any insolvency law, or an answer admitting the material allegations of a bankruptcy, reorganization or insolvency petition filed against it, (vi) take corporate action for the purpose of effecting any of the foregoing, or (vii) have an order for relief entered against it in any proceeding under the United States Bankruptcy Code;

(b) an order, judgment or decree shall be entered, without the application, approval or consent of the Company or any of its subsidiaries, by any court of competent jurisdiction, approving a petition seeking reorganization of the Company or any of its subsidiaries, or appointing a receiver, trustee or liquidator of the Company or any of its subsidiaries, or of all or a substantial part of its assets, and such order, judgment or decree shall not be dismissed within thirty (30) consecutive days thereof;

(c) the Company or any of its subsidiaries shall fail to pay as and when due any principal or Interest hereunder;

(d) the Company breaches any condition or obligation under this Note, the Transaction Documents, or any other material agreement to which Company is a party, and such breach continues uncured for thirty (30) days after receipt of notice thereof; or

(e) the Company or any of its subsidiaries shall cease, substantially curtail, or substantially reduce its business operations;

then, and in every such event and at any time thereafter, the Holder, at its election, and without presentment, demand, notice of any kind, all of which are expressly waived by the Company, may (i) declare the entire outstanding balance of principal and Interest thereon immediately due and payable, together with all costs of collection, including attorneys' fees, and (ii) whether or not the actions referred to in (i) above have been taken, exercise any or all of the Holder's other rights and remedies available to the Holder under applicable law.

5. **HOLDER COSTS.** The Company agrees to promptly pay, on demand, all of the losses, costs, and expenses (including, without limitation, attorneys' fees and disbursements) which the Holder incurs in connection with enforcement of this Note, or the protection or preservation of the Holder's rights under this Note, whether by judicial proceeding or otherwise. Such costs and expenses include, without limitation, those incurred in connection with any workout or refinancing, or any bankruptcy, insolvency, liquidation or similar proceedings.

6. **PREPAYMENT.** This Note may be prepaid by the Company at any time prior to issuance of a notice of conversion by Holder.

7. **COMPANY WAIVERS.** The Company hereby waives diligence, demand, presentment, protest or notice of any kind. The Company agrees to make all payments under this Note without setoff or deduction and regardless of any counterclaim or defense.

8. **SECURITY.**

(a) **Security Interest.** As security for the due and prompt payment and performance of all payment obligations under this Note and any modifications, replacements and extensions hereof (collectively, "Secured Obligations"), the Company hereby pledges and grants a first priority security interest to the Holder on a pari passu basis with the holder of the Secured Convertible Promissory Note, dated October 5, 2011, in favor of David E. Smith, as amended and restated from time to time, in all assets of the Company, whether now owned or hereafter acquired, including without limitation all intellectual property, as more fully set forth on Schedule 1 hereto (collectively, the "*Collateral*").

(b) Financing Statement; Further Assurances. The Company agrees, concurrently with executing this Note, that the Holder may file a UCC-1 financing statement relating to the Collateral in favor of the Holder, and any similar financing statements in any jurisdiction in which the Holder reasonably determines such filing to be necessary. The Company further agrees that at any time and from time to time the Company shall promptly execute and deliver all further instruments and documents that the Holder may request in order to perfect and protect the security interest granted hereby, or to enable the Holder to exercise and enforce its rights and remedies with respect to any Collateral following an Event of Default.

(c) Default. Following an Event of Default, the Company shall deliver the Collateral, including original certificates or other instruments representing any Collateral, to the Holder to hold as secured party, and Company shall, if requested by the Holder, execute a securities account control agreement. In addition, the Holder shall have all rights of a secured party under the Uniform Commercial Code, including without limitation the right to foreclose on all or any of the Collateral, in any order.

(d) Powers of the Holder. The Company hereby appoints the Holder as Company's true and lawful attorney-in-fact to perform any and all of the following acts, which power is coupled with an interest, is irrevocable until the Secured Obligations are paid and performed in full, and may be exercised from time to time by the Holder in its discretion: To take any action and to execute any instrument which the Holder may deem reasonably necessary or desirable to accomplish the purposes of this Section 8(d) and, more broadly, this Note including, without limitation: (i) during the continuance of any Event of Default hereunder, to receive, endorse and collect all instruments or other forms of payment made payable to the Company representing any dividend, interest payment or other distribution in respect of the Collateral or any part thereof and to give full discharge for the same, when and to the extent permitted by this Note, (ii) to perform or cause the performance of any obligation of the Company hereunder in the Company's name or otherwise, (iii) during the continuance of any Event of Default hereunder, to liquidate any Collateral pledged to the Holder hereunder and to apply proceeds thereof to the payment of the Secured Obligations or to place such proceeds into a cash collateral account or to transfer the Collateral into the name of the Holder, all at the Holder's sole discretion, (iv) to enter into any extension, reorganization or other agreement relating to or affecting the Collateral, and, in connection therewith, to deposit or surrender control of the Collateral, (v) to accept other property in exchange for the Collateral, (vi) to make any compromise or settlement the Holder deems desirable or proper, and (vii) to execute on the Company's behalf and in the Company's name any documents required in order to give the Holder a continuing first lien upon the Collateral or any part thereof.

(e) Full Recourse Note. This is a full recourse Note. Accordingly, notwithstanding that the Company's obligations under this Note are secured by the Collateral, in the event of a material default hereunder, the Holder shall have full recourse to all the other assets of Company. Moreover, the Holder shall not be required to proceed against or exhaust any Collateral, or to pursue any Collateral in any particular order, before the Holder pursues any other remedies against Company or against any of Company's assets.

9. MISCELLANEOUS.

(a) Notices. Any and all notices or other communications or deliveries required or permitted to be provided hereunder shall be in writing and shall be deemed given and effective on the earliest of (i) the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section, or via electronic mail, prior to 6:30 p.m. (New York City time) on a Trading Day and an electronic confirmation of delivery is received by the sender, (ii) the next Trading Day after the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section on a day that is not a Trading Day or later than 6:30 p.m. (New York City time) on any Trading Day, (iii) the Trading Day following the date of mailing, if sent by nationally recognized overnight courier service, or (iv) upon actual receipt by the party to whom such notice is required to be given by personal delivery.

(b) Amendments; Waivers; No Oral Changes. No provision of this Note may be waived or amended except in a written instrument signed by the Company and the Holder. No waiver of any default with respect to any provision, condition or requirement of this Note shall be deemed to be a continuing waiver in the future or a waiver of any subsequent default or a waiver of any other provision, condition or requirement hereof, nor shall any delay or omission of either party to exercise any right hereunder in any manner impair the exercise of any such right. This Note may not be modified, amended, waived, extended, changed, discharged or terminated orally or by any act or failure to act on the part of the Holder or the Company, but only by an agreement in writing signed by both parties.

(c) Lost or Stolen Note. Upon receipt by the Company of evidence of the loss, theft, destruction or mutilation of this Note, and (in the case of loss, theft or destruction) of indemnity or security reasonably satisfactory to the Company, and upon surrender and cancellation of this Note, if mutilated, the Company shall execute and deliver to the Holder a new Note identical in all respects to this Note.

(d) Governing Law. This Note shall be governed by and construed in accordance with the laws of the State of New York applicable to contracts made and to be performed entirely within the State of New York, without giving effect to conflict of law principles thereof.

(e) Headings. The headings in this Note are for purposes of reference only, and shall not limit or otherwise affect the meaning hereof.

(f) Transfer; Successors and Assigns. The terms of this Note shall inure to the benefit of and bind the parties hereto and their successors and assigns. As used herein the term "Company" shall include the undersigned Company and any other person or entity who may subsequently become liable for the payment hereof; provided however, that the Company shall not have the right to assign this Note or its obligations or rights hereunder without the prior written consent of the Holder. The term "Holder" shall include the named Holder as well as any other person or entity to whom this Note or any interest in this Note is conveyed, transferred or assigned. The person signing this Note on behalf of the Company represents and warrants that he or she has full authority to do so and that this Note binds the Company in accordance with its terms, and that there are no other agreements, judgments, or other circumstances which would cause this Note to not be fully binding against the Company. In the event Holder takes any action to enforce any provision of this Note, either through legal proceedings or otherwise, the Company shall reimburse the Holder for attorneys' fees and all other costs and expenses so incurred.

THIS NOTE AND THE SECURITIES ISSUABLE UPON CONVERSION OF THIS NOTE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR QUALIFIED UNDER ANY STATE SECURITIES LAW, AND MAY NOT BE OFFERED FOR SALE OR SOLD UNLESS A REGISTRATION STATEMENT UNDER THE SECURITIES ACT AND APPLICABLE STATE SECURITIES LAWS SHALL BE EFFECTIVE WITH RESPECT THERETO OR AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT AND/OR QUALIFICATION UNDER APPLICABLE STATE SECURITIES LAWS IS AVAILABLE IN CONNECTION WITH SUCH OFFER OR SALE. THIS NOTE DOES NOT REQUIRE PHYSICAL SURRENDER HEREOF IN ORDER TO EFFECT A PARTIAL PAYMENT, REDEMPTION OR CONVERSION HEREOF. ACCORDINGLY, THE OUTSTANDING PRINCIPAL AMOUNT OF THIS NOTE MAY BE LESS THAN THE PRINCIPAL AMOUNT SHOWN BELOW.

CATASYS, INC.

SECOND AMENDED AND RESTATED SECURED CONVERTIBLE PROMISSORY NOTE

Original Issue Date: October 5, 2011

\$880,000.00

First Amendment and Restatement Date: November 2, 2011

Second Amendment and Restatement Date: November 15, 2011

FOR VALUE RECEIVED, CATASYS, INC., a Delaware corporation (the "*Company*"), hereby promises to pay to the order of **David E. Smith**, or his successors or assigns (the "*Holder*") the sum of Eight Hundred and Eighty Thousand Dollars (\$880,000.00) in same day funds on or before 90 calendar days from the Issue Date (the "*Maturity Date*"), unless this Secured Convertible Promissory Note (this "*Note*") is earlier converted pursuant to Section 3 hereof. This Note amends, restates and replaces that certain secured convertible promissory note, originally issued as of October 5, 2011, in the original principal amount of \$680,000.00, and that amended and restated secured convertible promissory note, issued as of November 2, 2011, in the principal amount of \$780,000.00.

The following terms shall apply to this Note:

1. **DEFINITIONS.**

"*Applicable Interest Rate*" means an annual rate equal to twelve percent (12%) prior to any Event of Default, and twenty-four percent (24%) after the occurrence of any Event of Default, computed on the basis of a 365-day year and calculated using the actual number of days elapsed since the Issue Date or the date on which Interest was most recently paid.

"*Business Day*" means any day other than a Saturday, a Sunday or a day on which the New York Stock Exchange is closed or on which banks are authorized by law to close in New York, New York.

"*Common Stock*" means the common stock of the Company, \$0.0001 par value per share, and any securities into which such common stock may hereafter be reclassified.

“**Conversion Date**” means the date of closing of the Qualified Financing pursuant to which the Company has received at least \$2,000,000.00.

“**Highest Lawful Rate**” means the maximum non-usurious rate of interest, as in effect from time to time, which may be charged, contracted for, reserved, received or collected by the Holder in connection with this Note under applicable law.

“**Issue Date**” means the date first written above.

“**Maturity Date**” has the meaning set forth in the preamble of this Note.

“**Principal Market**” means the principal securities exchange or market on which the Common Stock is listed or traded.

“**Qualified Financing**” means the first round of equity financing (which shall include any convertible debt, convertible preferred stock or other equity-linked derivative security financing) in a single or series of related transactions, which raises gross proceeds to the Company of at least Two Million Dollars (\$2,000,000) in the aggregate.

“**Qualified Financing Securities**” means the Company’s securities issued and sold at the Qualified Financing.

“**Trading Day**” means a Business Day on which shares of Common Stock are purchased and sold on the Principal Market.

All definitions contained in this Note are equally applicable to the singular and plural forms of the terms defined. The words “hereof,” “herein” and “hereunder” and words of similar import referring to this Note refer to this Note as a whole and not to any particular provision of this Note. Any capitalized term used but not defined herein has the meaning specified in the Securities Purchase Agreement.

2. INTEREST.

(a) Interest Rate. This Note shall bear interest on the unpaid principal amount hereof (“**Interest**”) at a rate per annum equal to the Applicable Interest Rate.

(b) Interest Payments. The Company shall pay accrued and unpaid Interest (unless this Note is converted pursuant to the terms hereof) (i) on the Maturity Date and (ii) on any date on which the entire principal amount of this Note is paid in full (whether through conversion or otherwise). The Company shall pay Interest in cash by wire transfer of immediately available funds.

3. CONVERSION.

(a) Conversion upon Qualified Financing. Upon a Qualified Financing that occurs prior to the Maturity Date, Holder may, at its sole option, by written notice convert all or any part of the entire unpaid principal amount of this Note, together with any Interest accrued but unpaid thereon, into Qualified Financing Securities (a “**Financing Conversion**”). Upon a Conversion, the Holder shall be entitled to receive, and shall be issued, the same type and number of Qualified Financing Securities (the “**Financing Conversion Securities**”) as such Holder would have received had such Holder invested any such amount in such Qualified Financing. The issuance of the Conversion Securities upon a Conversion shall be upon the same terms and subject to the same conditions as are applicable to the Qualified Financing Securities issued in the Qualified Financing.

(b) Conversion into Common Stock. The Holder may, at its sole option, by written notice convert all or any part of the entire unpaid principal amount of this Note, together with any Interest accrued but unpaid thereon, into shares of Common Stock (a “**Common Conversion**”). (Either of a Financing Conversion and Common Conversion are referred to herein as a “**Conversion**.”) Upon a Common Conversion, the Holder shall be entitled to receive, and shall be issued, the number of shares of Common Stock (the “**Common Conversion Securities**”) equal to the amount converted multiplied by a price per share equal to the lower of (i) \$0.26 per share of Common Stock and (ii) the lowest price per share of Common Stock into which any security is convertible in any Qualified Financing (either of the Financing Conversion Securities and Common Conversion Securities are referred to herein as “**Conversion Securities**”).

(c) Conversion Mechanics. The Holder shall not be required to physically surrender this Note to the Company in order to effect any Conversion. Upon a Conversion, the Holder shall be deemed to be the holder of record of the Conversion Securities upon the Conversion Date. As soon as practicable after the Conversion Date, the Company shall, at its expense, issue and deliver to Holder (i) one or more certificates (bearing such legends as are required by applicable state and federal securities laws in the opinion of counsel to the Company) for the applicable Conversion Securities, registered in the name of Holder, free of any and all liens, encumbrances or other impediments to clear title and (ii) if applicable, and if requested by the Holder, cash in the aggregate amount of any accrued, unpaid and unconverted Interest. No fractional Conversion Securities shall be issued upon conversion of this Note, and any fractional Conversion Securities to which the Holder would otherwise be entitled shall be rounded up to the nearest whole Conversion Security and issued to the Holder along with the other Conversion Securities. Upon the Conversion or payment, as applicable, of all amounts due Holder in accordance with this terms of this Note, this Note shall be cancelled and no further amounts shall be due hereunder. Any full or partial payment or Conversion by Holder shall have no impact on the Warrant issued pursuant to the Securities Purchase Agreement concurrently herewith.

4. EVENTS OF DEFAULT. Upon the occurrence of any of the following events (each, an “**Event of Default**”):

(a) the Company or any of its subsidiaries shall (i) apply for or consent to the appointment of a receiver, trustee or liquidator of itself or of its property, (ii) be unable, or admit in writing its inability, to pay its debts as they mature, (iii) make a general assignment for the benefit of creditors, (iv) be adjudicated a bankrupt or insolvent, (v) file a voluntary petition in bankruptcy, or a petition or answer seeking reorganization or an arrangement with creditors to take advantage of any insolvency law, or an answer admitting the material allegations of a bankruptcy, reorganization or insolvency petition filed against it, (vi) take corporate action for the purpose of effecting any of the foregoing, or (vii) have an order for relief entered against it in any proceeding under the United States Bankruptcy Code;

(b) an order, judgment or decree shall be entered, without the application, approval or consent of the Company or any of its subsidiaries, by any court of competent jurisdiction, approving a petition seeking reorganization of the Company or any of its subsidiaries, or appointing a receiver, trustee or liquidator of the Company or any of its subsidiaries, or of all or a substantial part of its assets, and such order, judgment or decree shall not be dismissed within thirty (30) consecutive days thereof;

(c) the Company or any of its subsidiaries shall fail to pay as and when due any principal or Interest hereunder;

(d) the Company breaches any condition or obligation under this Note, the Transaction Documents, or any other material agreement to which Company is a party, and such breach continues uncured for thirty (30) days after receipt of notice thereof; or

(e) the Company or any of its subsidiaries shall cease, substantially curtail, or substantially reduce its business operations;

then, and in every such event and at any time thereafter, the Holder, at its election, and without presentment, demand, notice of any kind, all of which are expressly waived by the Company, may (i) declare the entire outstanding balance of principal and Interest thereon immediately due and payable, together with all costs of collection, including attorneys' fees, and (ii) whether or not the actions referred to in (i) above have been taken, exercise any or all of the Holder's other rights and remedies available to the Holder under applicable law.

5. **HOLDER COSTS.** The Company agrees to promptly pay, on demand, all of the losses, costs, and expenses (including, without limitation, attorneys' fees and disbursements) which the Holder incurs in connection with enforcement of this Note, or the protection or preservation of the Holder's rights under this Note, whether by judicial proceeding or otherwise. Such costs and expenses include, without limitation, those incurred in connection with any workout or refinancing, or any bankruptcy, insolvency, liquidation or similar proceedings.

6. **PREPAYMENT.** This Note may be prepaid by the Company at any time prior to issuance of a notice of conversion by Holder.

7. **COMPANY WAIVERS.** The Company hereby waives diligence, demand, presentment, protest or notice of any kind. The Company agrees to make all payments under this Note without setoff or deduction and regardless of any counterclaim or defense.

8. **SECURITY.**

(a) **Security Interest.** As security for the due and prompt payment and performance of all payment obligations under this Note and any modifications, replacements and extensions hereof (collectively, "Secured Obligations"), the Company hereby pledges and grants a first priority security interest to the Holder, on a pari passu basis with the holder of the Secured Convertible Promissory Note, dated August 17, 2011, in favor of Socius Capital Group, LLC, as amended and restated from time to time, in all assets of the Company, whether now owned or hereafter acquired, including without limitation all intellectual property (collectively, the "*Collateral*").

(b) Financing Statement; Further Assurances. The Company agrees, concurrently with executing this Note, that the Holder may file a UCC-1 financing statement relating to the Collateral in favor of the Holder, and any similar financing statements in any jurisdiction in which the Holder reasonably determines such filing to be necessary. The Company further agrees that at any time and from time to time the Company shall promptly execute and deliver all further instruments and documents that the Holder may request in order to perfect and protect the security interest granted hereby, or to enable the Holder to exercise and enforce its rights and remedies with respect to any Collateral following an Event of Default.

(c) Default. Following an Event of Default, the Company shall deliver the Collateral, including original certificates or other instruments representing any Collateral, to the Holder to hold as secured party, and Company shall, if requested by the Holder, execute a securities account control agreement. In addition, the Holder shall have all rights of a secured party under the Uniform Commercial Code, including without limitation the right to foreclose on all or any of the Collateral, in any order.

(d) Powers of the Holder. The Company hereby appoints the Holder as Company's true and lawful attorney-in-fact to perform any and all of the following acts, which power is coupled with an interest, is irrevocable until the Secured Obligations are paid and performed in full, and may be exercised from time to time by the Holder in its discretion: To take any action and to execute any instrument which the Holder may deem reasonably necessary or desirable to accomplish the purposes of this Section 8(d) and, more broadly, this Note including, without limitation: (i) during the continuance of any Event of Default hereunder, to receive, endorse and collect all instruments or other forms of payment made payable to the Company representing any dividend, interest payment or other distribution in respect of the Collateral or any part thereof and to give full discharge for the same, when and to the extent permitted by this Note, (ii) to perform or cause the performance of any obligation of the Company hereunder in the Company's name or otherwise, (iii) during the continuance of any Event of Default hereunder, to liquidate any Collateral pledged to the Holder hereunder and to apply proceeds thereof to the payment of the Secured Obligations or to place such proceeds into a cash collateral account or to transfer the Collateral into the name of the Holder, all at the Holder's sole discretion, (iv) to enter into any extension, reorganization or other agreement relating to or affecting the Collateral, and, in connection therewith, to deposit or surrender control of the Collateral, (v) to accept other property in exchange for the Collateral, (vi) to make any compromise or settlement the Holder deems desirable or proper, and (vii) to execute on the Company's behalf and in the Company's name any documents required in order to give the Holder a continuing first lien upon the Collateral or any part thereof.

(e) Full Recourse Note. This is a full recourse Note. Accordingly, notwithstanding that the Company's obligations under this Note are secured by the Collateral, in the event of a material default hereunder, the Holder shall have full recourse to all the other assets of Company. Moreover, the Holder shall not be required to proceed against or exhaust any Collateral, or to pursue any Collateral in any particular order, before the Holder pursues any other remedies against Company or against any of Company's assets.

9. MISCELLANEOUS.

(a) Notices. Any and all notices or other communications or deliveries required or permitted to be provided hereunder shall be in writing and shall be deemed given and effective on the earliest of (i) the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section, or via electronic mail, prior to 6:30 p.m. (New York City time) on a Trading Day and an electronic confirmation of delivery is received by the sender, (ii) the next Trading Day after the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section on a day that is not a Trading Day or later than 6:30 p.m. (New York City time) on any Trading Day, (iii) the Trading Day following the date of mailing, if sent by nationally recognized overnight courier service, or (iv) upon actual receipt by the party to whom such notice is required to be given by personal delivery.

(b) Amendments; Waivers; No Oral Changes. No provision of this Note may be waived or amended except in a written instrument signed by the Company and the Holder. No waiver of any default with respect to any provision, condition or requirement of this Note shall be deemed to be a continuing waiver in the future or a waiver of any subsequent default or a waiver of any other provision, condition or requirement hereof, nor shall any delay or omission of either party to exercise any right hereunder in any manner impair the exercise of any such right. This Note may not be modified, amended, waived, extended, changed, discharged or terminated orally or by any act or failure to act on the part of the Holder or the Company, but only by an agreement in writing signed by both parties.

(c) Lost or Stolen Note. Upon receipt by the Company of evidence of the loss, theft, destruction or mutilation of this Note, and (in the case of loss, theft or destruction) of indemnity or security reasonably satisfactory to the Company, and upon surrender and cancellation of this Note, if mutilated, the Company shall execute and deliver to the Holder a new Note identical in all respects to this Note.

(d) Governing Law. This Note shall be governed by and construed in accordance with the laws of the State of New York applicable to contracts made and to be performed entirely within the State of New York, without giving effect to conflict of law principles thereof.

(e) Headings. The headings in this Note are for purposes of reference only, and shall not limit or otherwise affect the meaning hereof.

(f) Transfer; Successors and Assigns. The terms of this Note shall inure to the benefit of and bind the parties hereto and their successors and assigns. As used herein the term "Company" shall include the undersigned Company and any other person or entity who may subsequently become liable for the payment hereof; provided however, that the Company shall not have the right to assign this Note or its obligations or rights hereunder without the prior written consent of the Holder. The term "Holder" shall include the named Holder as well as any other person or entity to whom this Note or any interest in this Note is conveyed, transferred or assigned. The person signing this Note on behalf of the Company represents and warrants that he or she has full authority to do so and that this Note binds the Company in accordance with its terms, and that there are no other agreements, judgments, or other circumstances which would cause this Note to not be fully binding against the Company. In the event Holder takes any action to enforce any provision of this Note, either through legal proceedings or otherwise, the Company shall reimburse the Holder for attorneys' fees and all other costs and expenses so incurred.

(g) Usury. Anything herein to the contrary notwithstanding, if during any period for which interest is computed hereunder the amount of interest, together with all fees, charges and other payments which are treated as interest under applicable law, as provided for herein or in any other document executed in connection herewith, would exceed the amount of such interest computed on the basis of the Highest Lawful Rate, the Company shall not be obligated to pay, and the Holder shall not be entitled to charge, collect, receive, reserve or take, interest in excess of the Highest Lawful Rate.

IN WITNESS WHEREOF, the Company has caused this Note to be signed in its name by its duly authorized officer on the date first above written.

CATASYS, INC.

By: /s/ Susan Etzel

Susan Etzel, Chief Financial Officer

NEITHER THIS WARRANT NOR THE SECURITIES ISSUABLE UPON EXERCISE OF THIS WARRANT HAVE BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION OR QUALIFIED UNDER THE LAWS OF ANY STATE IN RELIANCE UPON AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND, ACCORDINGLY, MAY NOT BE OFFERED OR SOLD EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OR PURSUANT TO AN AVAILABLE EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND IN ACCORDANCE WITH APPLICABLE STATE SECURITIES LAWS AS SUPPORTED BY A LEGAL OPINION OF COUNSEL TO THE TRANSFEROR TO SUCH EFFECT, THE SUBSTANCE OF WHICH SHALL BE REASONABLY ACCEPTABLE TO THE COMPANY. THE SECURITIES ISSUABLE UPON EXERCISE OF THIS WARRANT MAY BE PLEDGED IN CONNECTION WITH A BONA FIDE MARGIN ACCOUNT OR OTHER LOAN OR FINANCING ARRANGEMENT SECURED BY SUCH SECURITIES.

CATASYS, INC.

SECOND AMENDED AND RESTATED WARRANT

Warrant No. 081720111

Date of Original Issuance: August 17, 2011

Date of First Amendment and Restatement: November 2, 2011

Date of Second Amendment and Restatement: November 15, 2011

Catasys, Inc., a Delaware corporation (the "Company"), hereby certifies that, for value received, **SOCIUS CAPITAL GROUP, LLC, a Delaware limited liability company**, or its registered assigns (the "Holder"), is entitled to purchase from the Company up to a total of that number of shares of common stock, par value \$0.0001 per share (the "Common Stock"), of the Company (each such share, a "Warrant Share" and all such shares, the "Warrant Shares") as is determined by dividing \$970,000.00 by \$0.26 or, in the event of a Qualified Financing, the price per share of the securities issued in the Qualified Financing (as determined in accordance with Section 9(c)(ii) hereof) multiplied by a factor equal to twice the product of the number of warrants issued in a Qualified Financing divided by the number of shares of Common Stock issued in a Qualified Financing, but in no event shall the factor be less than one (1), at an exercise price equal to \$0.32 per share (as adjusted from time to time as provided in Section 9, the "Exercise Price"), at any time and from time to time from and after the Original Issuance date and through and including the five-year anniversary of such date (the "Expiration Date"), and subject to the following terms and conditions:

1. Definitions. In addition to the terms defined elsewhere in this Warrant, capitalized terms that are not otherwise defined herein shall have the meanings given to such terms in the Securities Purchase Agreement of August 17, 2011 to which the Company and the original Holder are parties (the "Purchase Agreement").

2. Registration of Warrant. The Company shall register this Warrant, upon records to be maintained by the Company for that purpose (the “**Warrant Register**”), in the name of the record Holder hereof from time to time. The Company may deem and treat the registered Holder of this Warrant as the absolute owner hereof for the purpose of any exercise hereof or any distribution to the Holder, and for all other purposes, absent actual notice to the contrary.

3. Registration of Transfers. The Company shall register the transfer of any portion of this Warrant in the Warrant Register, upon surrender of this Warrant, with the Form of Assignment attached hereto duly completed and signed, to the Company at its address specified herein. Upon any such registration or transfer, a new Warrant to purchase Common Stock, in substantially the form of this Warrant (any such new Warrant, a “**New Warrant**”), evidencing the portion of this Warrant so transferred shall be issued to the transferee and a New Warrant evidencing the remaining portion of this Warrant not so transferred, if any, shall be issued to the transferring Holder. The acceptance of the New Warrant by the transferee thereof shall be deemed the acceptance by such transferee of all of the rights and obligations of a holder of a Warrant.

4. Exercise and Duration of Warrants. This Warrant shall be exercisable by the registered Holder at any time and from time to time on or after the date hereof to and including the Expiration Date. At 5:00 p.m., New York City time on the Expiration Date, the fair market value of that portion of this Warrant not exercised prior thereto shall automatically be deemed exercised pursuant to Cashless Exercise.

5. Delivery of Warrant Shares.

(a) To effect exercises hereunder, the Holder shall not be required to physically surrender this Warrant unless the aggregate Warrant Shares represented by this Warrant is being exercised. Upon delivery of the Exercise Notice to the Company at its address for notice set forth herein and upon payment of the Exercise Price multiplied by the number of Warrant Shares that the Holder intends to purchase hereunder, the Company shall promptly issue and deliver to the Holder, a certificate for the Warrant Shares issuable upon such exercise, which, unless otherwise required by the Purchase Agreement or applicable law, shall be free of restrictive legends. A “**Date of Exercise**” means the date on which the Holder shall have delivered to Company: (i) the Exercise Notice, appropriately completed and duly signed and (ii) if such Holder is not utilizing the cashless exercise provisions set forth in this Warrant, payment of the Exercise Price for the number of Warrant Shares so indicated by the Holder to be purchased.

(b) The Company’s obligations to issue and deliver Warrant Shares in accordance with the terms hereof are absolute and unconditional, irrespective of any action or inaction by the Holder to enforce the same. Nothing herein shall limit a Holder’s right to pursue any other remedies available to it hereunder, at law or in equity including, without limitation, a decree of specific performance and/or injunctive relief with respect to the Company’s failure to timely deliver certificates representing shares of Common Stock upon exercise of the Warrant as required pursuant to the terms hereof, and the Company shall pay all of the Holder’s costs, expenses and fees in connection therewith, include attorneys’ fees.

6. Charges, Taxes and Expenses. Issuance and delivery of certificates for shares of Common Stock upon exercise of this Warrant shall be made without charge to the Holder for any issue or transfer tax, withholding tax, transfer agent fee or other incidental tax or expense in respect of the issuance of such certificates, all of which taxes and expenses shall be paid by the Company.

7. Replacement of Warrant. If this Warrant is mutilated, lost, stolen or destroyed, the Company shall issue or cause to be issued in exchange and substitution for and upon cancellation hereof, or in lieu of and substitution for this Warrant, a New Warrant, but only upon receipt of evidence reasonably satisfactory to the Company of such loss, theft or destruction. All costs associated with the issuance of any New Warrant shall be the sole responsibility of the Company. If a New Warrant is requested as a result of a mutilation of this Warrant, then the Holder shall deliver such mutilated Warrant to the Company as a condition precedent to the Company's obligation to issue the New Warrant.

8. Reservation of Warrant Shares. The Company shall comply with the Warrant Share reservation requirements of Section 5.12 of the Purchase Agreement. The Company covenants that all Warrant Shares shall, upon issuance and the payment of the applicable Exercise Price in accordance with the terms hereof, be duly and validly authorized, issued and fully paid and nonassessable.

9. Certain Adjustments. The Exercise Price and number of Warrant Shares issuable upon exercise of this Warrant are subject to adjustment from time to time as set forth in this Section 9.

(a) Stock Dividends and Splits. If the Company, at any time while this Warrant is outstanding, (i) pays a stock dividend on its Common Stock or otherwise makes a distribution on any class of capital stock that is payable in shares of Common Stock, (ii) subdivides outstanding shares of Common Stock into a larger number of shares, or (iii) combines outstanding shares of Common Stock into a smaller number of shares, then in each such case the Exercise Price shall be multiplied by a fraction of which the numerator shall be the number of shares of Common Stock outstanding immediately before such event and of which the denominator shall be the number of shares of Common Stock outstanding immediately after such event. Any adjustment made pursuant to clause (i) of this paragraph shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution, and any adjustment pursuant to clause (ii) or (iii) of this paragraph shall become effective immediately after the effective date of such subdivision or combination. If any event requiring an adjustment under this paragraph occurs during the period that an Exercise Price is calculated hereunder, then the calculation of such Exercise Price shall be adjusted appropriately to reflect such event.

(b) **Fundamental Transactions.** If, at any time while this Warrant is outstanding, (1) the Company effects any merger or consolidation of the Company with or into another Person, (2) the Company effects any sale of all or substantially all of its assets in one or a series of related transactions, or (3) the Company effects any reclassification of the Common Stock or any compulsory share exchange pursuant to which the Common Stock is effectively converted into or exchanged for other securities, cash or property (in any such case, a **“Fundamental Transaction”**), then the Holder shall have the right thereafter to receive, upon exercise of this Warrant, the same amount and kind of securities, cash or property as it would have been entitled to receive upon the occurrence of such Fundamental Transaction if it had been, immediately prior to such Fundamental Transaction, the holder of the number of Warrant Shares then issuable upon exercise in full of this Warrant (the **“Alternate Consideration”**). For purposes of any such exercise, the determination of the Exercise Price shall be appropriately adjusted to apply to such Alternate Consideration based on the amount of Alternate Consideration issuable in respect of one share of Common Stock in such Fundamental Transaction, and the Company shall apportion the Exercise Price among the Alternate Consideration in a reasonable manner reflecting the relative value of any different components of the Alternate Consideration. If holders of Common Stock are given any choice as to the securities, cash or property to be received in a Fundamental Transaction, then the Holder shall be given the same choice as to the Alternate Consideration it receives upon any exercise of this Warrant following such Fundamental Transaction. The terms of any agreement pursuant to which a Fundamental Transaction is effected shall include terms requiring any such successor or surviving entity to comply with the provisions of this paragraph (b) and insuring that the Warrant (or any such replacement security) will be similarly adjusted upon any subsequent transaction analogous to a Fundamental Transaction.

(c) **Certain Diluting Issuances.** (i) If the Company shall, at any time or from time to time, issue or distribute any shares of Common Stock, or be deemed to have issued shares of Common Stock as provided herein, other than Excluded Stock (as defined in Section 9(c)(iv) below) (each such event, including any event described in paragraphs (ii)(C) and (ii)(D) below, being herein called a **“Common Stock Distribution”**), without consideration or for a consideration per share less than the Exercise Price on the date of such Common Stock Distribution or on the first date of the announcement of such Common Stock Distribution, whichever is greater (the **“New Issuance Price”**), then, effective immediately after the open of business on the day following such Common Stock Distribution, the Exercise Price as in effect immediately prior to such Common Stock Distribution shall be reduced to an amount equal to the New Issuance Price.

The provisions of this paragraph (c), including by operation of subsections (C) or (D) of paragraph (ii) below, shall not operate to adjust in any manner the number of shares of Common Stock subject to purchase upon exercise of this Warrant, or to result in an increase in the Exercise Price.

- (ii) For the purposes of any adjustment of the Exercise Price pursuant to paragraph (i) above, the following provisions shall be applicable:
- (A) In the case of the issuance, sale or distribution of Common Stock for cash in a public offering or private placement, the consideration received therefor shall be deemed to be the amount received by the Company therefor before deducting therefrom any discounts, commissions or placement fees payable by the Company to any underwriter or placement agent in connection therewith;

- (B) In the case of the issuance of Common Stock for a consideration in whole or in part other than cash, the consideration other than cash received by the Company shall be deemed to be the fair market value of such consideration, as determined in good faith by the Board of Directors of the Company, irrespective of any accounting treatment;
- (C) In the case of the issuance, sale, distribution or granting (whether directly or by assumption in a merger or otherwise) of any rights to subscribe for or to purchase, or any warrants or options for the purchase of, Common Stock or any stock or securities convertible into or exchangeable for Common Stock (such rights, warrants or options being herein called “**Options**” and such convertible or exchangeable stock or securities being herein called “**Convertible Securities**”), whether or not such Options or the rights to convert or exchange any such Convertible Securities are immediately exercisable, then, for purposes of paragraph (i) above, the aggregate maximum number of shares of Common Stock issuable upon the exercise of such Options or upon conversion or exchange of such Convertible Securities and subsequent conversion or exchange thereof shall be deemed to have been issued as of the date of issuance of such Options, Convertible Securities or rights and thereafter shall be deemed to be outstanding; and the Company shall be deemed to have received as consideration the amount equal to the consideration, if any, received by the Company upon the issuance of such Options, Convertible Securities or rights plus the minimum additional consideration, if any, to be received by the Company upon the conversion or exchange of such Convertible Securities or the exercise of Options or rights (such consideration in each case to be determined in the manner provided in Sections 9(c)(ii)(A) and 9(c)(ii)(B));
- (D) If the purchase price provided for in any Option, the additional consideration, if any, payable upon the conversion or exchange of any Convertible Securities, or the rate at which any Convertible Securities are convertible into or exchangeable for Common Stock shall change at any time (other than under or by reason of provisions designed to protect against, and having the effect of protecting against, dilution upon an event which results in a related adjustment pursuant to this Section 9), then, the Exercise Price then in effect shall forthwith be readjusted (effective only with respect to any exercise of this Warrant after such readjustment) to the Exercise Price which would then be in effect had the adjustment made upon the issue, sale, distribution or grant of such Options or Convertible Securities been made based upon such changed purchase price, additional consideration or conversion rate, as the case may be; provided, however, that such readjustment shall give effect to such change only with respect to such Options and Convertible Securities as then remain outstanding;

- (E) In the case of the issuance, sale, distribution or granting of any Options as part of a unit consisting of Options and Common Stock and/or Convertible Securities, then for purposes of calculating any adjustment pursuant to this Section 9, no value shall be attributed to such Options in allocating the price paid for the unit among the securities comprising such unit; and
- (F) Upon the expiration of any such Options or the termination of any rights, Convertible Securities or exchangeable securities, the applicable Exercise Price shall forthwith be readjusted to such Exercise Price as would have been in effect at the time of such expiration or termination had such Options, rights, Convertible Securities or exchangeable securities, to the extent outstanding immediately prior to such expiration or termination, never been issued.

(iii) For purposes of determining whether any adjustment is required pursuant to this Section 9(c), any security of the Company having rights substantially equivalent to the Common Stock as to dividends or upon liquidation, dissolution or winding up of the Company shall be treated as if such security were Common Stock. No further adjustment of the Exercise Price adjusted upon the issuance of any such options, rights, convertible securities or exchangeable securities shall be made as a result of the actual issuance of Common Stock on the exercise of any such rights or Options or any conversion or exchange of any such securities.

(iv) **“Excluded Stock”** shall mean (A) shares of Common Stock issued (or issuable upon exercise of rights, options or warrants outstanding from time to time) granted or issued to officers, directors or employees of, or consultants to, the Company pursuant to a stock grant, stock option plan, employee stock purchase plan, restricted stock plan or other similar plan or agreement or otherwise, in each case as approved by the Company’s Board of Directors, (B) shares of Common Stock issued (or issuable upon exercise of rights, options or warrants outstanding from time to time) granted or issued to financial institutions, equipment lessors, brokers or similar persons in connection with commercial credit arrangements, equipment financings, commercial property lease transactions or similar transactions, (C) securities issued in connection with a strategic alliance, acquisition or similar transaction, (D) shares of Common Stock issued (or issuable upon exercise of rights, options or warrants outstanding from time to time) for bona fide services, (E) shares issued or issuable as a result of any stock split, combination, dividend, distribution, reclassification, exchange or substitution, (F) shares of Common Stock issuable upon exercise of rights, options, warrants, notes or other rights to acquire securities of the Company outstanding as of the date hereof, and (G) shares of Common Stock issued (or issuable upon exercise of rights, options or warrants outstanding from time to time) related to the transactions contemplated herein or in the Qualified Financing.

(d) Number of Warrant Shares. Simultaneously with any adjustment to the Exercise Price pursuant to paragraph (a) of this Section, the number of Warrant Shares that may be purchased upon exercise of this Warrant shall be increased or decreased proportionately, so that after such adjustment the aggregate Exercise Price payable hereunder for the adjusted number of Warrant Shares shall be the same as the aggregate Exercise Price in effect immediately prior to such adjustment.

(e) Calculations. All calculations under this Section 9 shall be made to the nearest cent or the nearest 1/100th of a share, as applicable. The number of shares of Common Stock outstanding at any given time shall not include shares owned or held by or for the account of the Company, and the disposition of any such shares shall be considered an issue or sale of Common Stock.

(f) Notice of Corporate Events. If the Company (i) declares a dividend or any other distribution of cash, securities or other property in respect of its Common Stock, including without limitation any granting of rights or warrants to subscribe for or purchase any capital stock of the Company or any subsidiary, (ii) authorizes or approves, enters into any agreement contemplating or solicits stockholder approval for any Fundamental Transaction or (iii) authorizes the voluntary dissolution, liquidation or winding up of the affairs of the Company, then the Company shall deliver to the Holder a notice describing the material terms and conditions of such transaction, at least 20 calendar days prior to the applicable record or effective date on which a Person would need to hold Common Stock in order to participate in or vote with respect to such transaction, and the Company will take all steps reasonably necessary in order to insure that the Holder is given the practical opportunity to exercise this Warrant prior to such time so as to participate in or vote with respect to such transaction; provided, however, that the failure to deliver such notice or any defect therein shall not affect the validity of the corporate action required to be described in such notice.

10. Payment of Exercise Price. The Holder may pay the Exercise Price in one of the following manners:

(a) Cash Exercise. The Holder may deliver immediately available funds; or

(b) Cashless Exercise. The Holder may notify the Company in an Exercise Notice of its election to utilize cashless exercise, in which event the Company shall issue to the Holder the number of Warrant Shares determined as follows:

$$X = Y [(A-B)/A]$$

where:

X = the number of Warrant Shares to be issued to the Holder.

Y = the number of Warrant Shares with respect to which this Warrant is being exercised.

A = the average of the closing prices for the five Trading Days immediately prior to (but not including) the Date of Exercise.

B = the Exercise Price.

For purposes of Rule 144 promulgated under the Securities Act, it is intended, understood and acknowledged that the Warrant Shares issued in a cashless exercise transaction shall be deemed to have been acquired by the Holder, and the holding period for the Warrant Shares shall be deemed to have commenced, on the date this Warrant was originally issued, subject to any change of law after the date hereof.

11. No Fractional Shares. No fractional shares of Warrant Shares will be issued in connection with any exercise of this Warrant. In lieu of any fractional shares which would, otherwise be issuable, the Company shall pay cash equal to the product of such fraction multiplied by the closing price of one Warrant Share as reported by the Trading Market on the Date of Exercise.

12. Notices. Any and all notices or other communications or deliveries hereunder (including, without limitation, any Exercise Notice) shall be in writing and shall be deemed given and effective on the earliest of (i) the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section, or via electronic mail, prior to 6:30 p.m. (New York City time) on a Trading Day and an electronic confirmation of delivery is received by the sender, (ii) the next Trading Day after the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section on a day that is not a Trading Day or later than 6:30 p.m. (New York City time) on any Trading Day, (iii) the Trading Day following the date of mailing, if sent by nationally recognized overnight courier service, or (iv) upon actual receipt by the party to whom such notice is required to be given.

13. Warrant Agent. The Company shall serve as warrant agent under this Warrant. Upon 30 days' notice to the Holder, the Company may appoint a new warrant agent. Any corporation into which the Company or any new warrant agent may be merged or any corporation resulting from any consolidation to which the Company or any new warrant agent shall be a party or any corporation to which the Company or any new warrant agent transfers substantially all of its corporate trust or shareholders services business shall be a successor warrant agent under this Warrant without any further act. Any such successor warrant agent shall promptly cause notice of its succession as warrant agent to be mailed (by first class mail, postage prepaid) to the Holder at the Holder's last address as shown on the Warrant Register.

14. Non-Circumvention. The Company hereby covenants and agrees that the Company will not, by amendment of its Certificate of Incorporation, Bylaws or through any reorganization, transfer of assets, consolidation, merger, scheme of arrangement, dissolution, issue or sale of securities, or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms of this Warrant, and will at all times in good faith carry out all the provisions of this Warrant and take all action as may be required to protect the rights of the Holder. Without limiting the generality of the foregoing, the Company (i) shall not increase the par value of any shares of Common Stock receivable upon the exercise of this Warrant above the Exercise Price then in effect, (ii) shall take all such actions as may be necessary or appropriate in order that the Company may validly and legally issue fully paid and nonassessable shares of Common Stock upon the exercise of this Warrant, and (iii) shall, so long as any portion of this Warrant is outstanding, take all action necessary to reserve and keep available out of its authorized and unissued shares of Common Stock, solely for the purpose of effecting the exercise of the Warrant, 110% of the number of shares of Common Stock as shall from time to time be necessary to effect the exercise of the portion of the Warrant then outstanding (without regard to any limitations on exercise).

15. Amendment and Restatement. This Warrant amends, restates and replaces that certain amended and restated warrant, issued as of November 2, 2011, which, in turn, amended, restated and replaced certain warrant, originally issued as of August 17, 2011, in each case in favor of the Holder.

16. Miscellaneous.

(a) This Warrant shall be binding on and inure to the benefit of the parties hereto and their respective successors and assigns. Subject to the preceding sentence, nothing in this Warrant shall be construed to give to any Person other than the Company and the Holder any legal or equitable right, remedy or cause of action under this Warrant. This Warrant may be amended only in writing signed by the Company and the Holder and their successors and assigns.

(b) All questions concerning the construction, validity, enforcement and interpretation of this Warrant shall be governed by and construed and enforced in accordance with the internal laws of the State of New York, without regard to the principles of conflicts of law thereof.

(c) The headings herein are for convenience only, do not constitute a part of this Warrant and shall not be deemed to limit or affect any of the provisions hereof.

(d) In case any one or more of the provisions of this Warrant shall be invalid or unenforceable in any respect, the validity and enforceability of the remaining terms and provisions of this Warrant shall not in any way be affected or impaired thereby and the parties will attempt in good faith to agree upon a valid and enforceable provision which shall be a commercially reasonable substitute therefor, and upon so agreeing, shall incorporate such substitute provision in this Warrant.

IN WITNESS WHEREOF, the Company has caused this Warrant to be duly executed by its authorized officer as of the date first indicated above.

CATASYS, INC.

By: /s/ Susan Etzel

Susan Etzel, Chief Financial Officer

CATASYS, INC.
WARRANT ORIGINALLY ISSUED AUGUST 17, 2011
AND AMENDED AND RESTATED NOVEMBER 2, 2011
AND FURTHER AMENDED AND RESTATED NOVEMBER 15, 2011 WARRANT NO.
081720111
EXERCISE NOTICE

To **Catasys, Inc.**:

The undersigned hereby irrevocably elects to purchase _____ shares of Common Stock pursuant to the attached Warrant.

The Holder intends that payment of the Exercise Price shall be made as:

_____ a Cash Exercise with respect to _____ Warrant Shares; and/or

_____ a Cashless Exercise with respect to _____ Warrant Shares.

If such Holder is not utilizing the Cashless Exercise provisions set forth in the Warrant, the Holder encloses herewith \$_____ in cash, certified or official bank check or checks or other immediately available funds, which sum represents the aggregate Exercise Price (as defined in the Warrant) for such Warrant Shares, together with any applicable taxes payable by the undersigned pursuant to the Warrant.

The undersigned requests that certificates for the shares of Common Stock issuable upon this exercise be issued in the name of

PLEASE INSERT SOCIAL SECURITY OR TAX
IDENTIFICATION NUMBER

(Please print name and address)

Confirmed:

CATASYS, INC.

By: _____

Name: _____

Title: _____

Date: _____

CATASYS, INC.
WARRANT ORIGINALLY ISSUED AUGUST 17, 2011
AND AMENDED AND RESTATED NOVEMBER 2, 2011
AND FURTHER AMENDED AND RESTATED NOVEMBER 15, 2011
WARRANT NO. 081720111

[To be completed and signed only upon transfer of Warrant]

FOR VALUE RECEIVED, the undersigned hereby sells, assigns and transfers unto _____ the right represented by the above-captioned Warrant to purchase _____ shares of Common Stock to which such Warrant relates and appoints _____ attorney to transfer said right on the books of the Company with full power of substitution in the premises.

Dated: _____, _____

(Signature must conform in all respects to name of holder as specified on the face of the Warrant)

Address of Transferee

In the presence of:

NEITHER THIS WARRANT NOR THE SECURITIES ISSUABLE UPON EXERCISE OF THIS WARRANT HAVE BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION OR QUALIFIED UNDER THE LAWS OF ANY STATE IN RELIANCE UPON AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND, ACCORDINGLY, MAY NOT BE OFFERED OR SOLD EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OR PURSUANT TO AN AVAILABLE EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND IN ACCORDANCE WITH APPLICABLE STATE SECURITIES LAWS AS SUPPORTED BY A LEGAL OPINION OF COUNSEL TO THE TRANSFEROR TO SUCH EFFECT, THE SUBSTANCE OF WHICH SHALL BE REASONABLY ACCEPTABLE TO THE COMPANY. THE SECURITIES ISSUABLE UPON EXERCISE OF THIS WARRANT MAY BE PLEDGED IN CONNECTION WITH A BONA FIDE MARGIN ACCOUNT OR OTHER LOAN OR FINANCING ARRANGEMENT SECURED BY SUCH SECURITIES.

CATASYS, INC.

SECOND AMENDED AND RESTATED WARRANT

Warrant No. 100520111

Date of Original Issuance: October 5, 2011

Date of First Amendment and Restatement: November 2, 2011

Date of Second Amendment and Restatement: November 15, 2011

Catasys, Inc., a Delaware corporation (the "Company"), hereby certifies that, for value received, David E. Smith, or his registered assigns (the "Holder"), is entitled to purchase from the Company up to a total of that number of shares of common stock, par value \$0.0001 per share (the "Common Stock"), of the Company (each such share, a "Warrant Share" and all such shares, the "Warrant Shares") as is determined by dividing \$880,000.00 by \$0.26 or, in the event of a Qualified Financing, the price per share of the securities issued in the Qualified Financing (as determined in accordance with Section 9(c)(ii) hereof) multiplied by a factor equal to twice the product of the number of warrants issued in a Qualified Financing divided by the number of shares of Common Stock issued in a Qualified Financing, but in no event shall the factor be less than one (1), at an exercise price equal to \$0.32 per share (as adjusted from time to time as provided in Section 9, the "Exercise Price"), at any time and from time to time from and after the Original Issuance date and through and including the five-year anniversary of such date (the "Expiration Date"), and subject to the following terms and conditions:

1. Definitions. In addition to the terms defined elsewhere in this Warrant, capitalized terms that are not otherwise defined herein shall have the meanings given to such terms in the Securities Purchase Agreement of October 5, 2011 to which the Company and the original Holder are parties (the "Purchase Agreement").

2. Registration of Warrant. The Company shall register this Warrant, upon records to be maintained by the Company for that purpose (the “**Warrant Register**”), in the name of the record Holder hereof from time to time. The Company may deem and treat the registered Holder of this Warrant as the absolute owner hereof for the purpose of any exercise hereof or any distribution to the Holder, and for all other purposes, absent actual notice to the contrary.

3. Registration of Transfers. The Company shall register the transfer of any portion of this Warrant in the Warrant Register, upon surrender of this Warrant, with the Form of Assignment attached hereto duly completed and signed, to the Company at its address specified herein. Upon any such registration or transfer, a new Warrant to purchase Common Stock, in substantially the form of this Warrant (any such new Warrant, a “**New Warrant**”), evidencing the portion of this Warrant so transferred shall be issued to the transferee and a New Warrant evidencing the remaining portion of this Warrant not so transferred, if any, shall be issued to the transferring Holder. The acceptance of the New Warrant by the transferee thereof shall be deemed the acceptance by such transferee of all of the rights and obligations of a holder of a Warrant.

4. Exercise and Duration of Warrants. This Warrant shall be exercisable by the registered Holder at any time and from time to time on or after the date hereof to and including the Expiration Date. At 5:00 p.m., New York City time on the Expiration Date, the fair market value of that portion of this Warrant not exercised prior thereto shall automatically be deemed exercised pursuant to Cashless Exercise.

5. Delivery of Warrant Shares.

(a) To effect exercises hereunder, the Holder shall not be required to physically surrender this Warrant unless the aggregate Warrant Shares represented by this Warrant is being exercised. Upon delivery of the Exercise Notice to the Company at its address for notice set forth herein and upon payment of the Exercise Price multiplied by the number of Warrant Shares that the Holder intends to purchase hereunder, the Company shall promptly issue and deliver to the Holder, a certificate for the Warrant Shares issuable upon such exercise, which, unless otherwise required by the Purchase Agreement or applicable law, shall be free of restrictive legends. A “**Date of Exercise**” means the date on which the Holder shall have delivered to Company: (i) the Exercise Notice, appropriately completed and duly signed and (ii) if such Holder is not utilizing the cashless exercise provisions set forth in this Warrant, payment of the Exercise Price for the number of Warrant Shares so indicated by the Holder to be purchased.

(b) The Company’s obligations to issue and deliver Warrant Shares in accordance with the terms hereof are absolute and unconditional, irrespective of any action or inaction by the Holder to enforce the same. Nothing herein shall limit a Holder’s right to pursue any other remedies available to it hereunder, at law or in equity including, without limitation, a decree of specific performance and/or injunctive relief with respect to the Company’s failure to timely deliver certificates representing shares of Common Stock upon exercise of the Warrant as required pursuant to the terms hereof, and the Company shall pay all of the Holder’s costs, expenses and fees in connection therewith, include attorneys’ fees.

6. Charges, Taxes and Expenses. Issuance and delivery of certificates for shares of Common Stock upon exercise of this Warrant shall be made without charge to the Holder for any issue or transfer tax, withholding tax, transfer agent fee or other incidental tax or expense in respect of the issuance of such certificates, all of which taxes and expenses shall be paid by the Company.

7. Replacement of Warrant. If this Warrant is mutilated, lost, stolen or destroyed, the Company shall issue or cause to be issued in exchange and substitution for and upon cancellation hereof, or in lieu of and substitution for this Warrant, a New Warrant, but only upon receipt of evidence reasonably satisfactory to the Company of such loss, theft or destruction. All costs associated with the issuance of any New Warrant shall be the sole responsibility of the Company. If a New Warrant is requested as a result of a mutilation of this Warrant, then the Holder shall deliver such mutilated Warrant to the Company as a condition precedent to the Company's obligation to issue the New Warrant.

8. Reservation of Warrant Shares. The Company shall comply with the Warrant Share reservation requirements of Section 5.12 of the Purchase Agreement. The Company covenants that all Warrant Shares shall, upon issuance and the payment of the applicable Exercise Price in accordance with the terms hereof, be duly and validly authorized, issued and fully paid and nonassessable.

9. Certain Adjustments. The Exercise Price and number of Warrant Shares issuable upon exercise of this Warrant are subject to adjustment from time to time as set forth in this Section 9.

(a) Stock Dividends and Splits. If the Company, at any time while this Warrant is outstanding, (i) pays a stock dividend on its Common Stock or otherwise makes a distribution on any class of capital stock that is payable in shares of Common Stock, (ii) subdivides outstanding shares of Common Stock into a larger number of shares, or (iii) combines outstanding shares of Common Stock into a smaller number of shares, then in each such case the Exercise Price shall be multiplied by a fraction of which the numerator shall be the number of shares of Common Stock outstanding immediately before such event and of which the denominator shall be the number of shares of Common Stock outstanding immediately after such event. Any adjustment made pursuant to clause (i) of this paragraph shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution, and any adjustment pursuant to clause (ii) or (iii) of this paragraph shall become effective immediately after the effective date of such subdivision or combination. If any event requiring an adjustment under this paragraph occurs during the period that an Exercise Price is calculated hereunder, then the calculation of such Exercise Price shall be adjusted appropriately to reflect such event.

(b) **Fundamental Transactions.** If, at any time while this Warrant is outstanding, (1) the Company effects any merger or consolidation of the Company with or into another Person, (2) the Company effects any sale of all or substantially all of its assets in one or a series of related transactions, or (3) the Company effects any reclassification of the Common Stock or any compulsory share exchange pursuant to which the Common Stock is effectively converted into or exchanged for other securities, cash or property (in any such case, a **“Fundamental Transaction”**), then the Holder shall have the right thereafter to receive, upon exercise of this Warrant, the same amount and kind of securities, cash or property as it would have been entitled to receive upon the occurrence of such Fundamental Transaction if it had been, immediately prior to such Fundamental Transaction, the holder of the number of Warrant Shares then issuable upon exercise in full of this Warrant (the **“Alternate Consideration”**). For purposes of any such exercise, the determination of the Exercise Price shall be appropriately adjusted to apply to such Alternate Consideration based on the amount of Alternate Consideration issuable in respect of one share of Common Stock in such Fundamental Transaction, and the Company shall apportion the Exercise Price among the Alternate Consideration in a reasonable manner reflecting the relative value of any different components of the Alternate Consideration. If holders of Common Stock are given any choice as to the securities, cash or property to be received in a Fundamental Transaction, then the Holder shall be given the same choice as to the Alternate Consideration it receives upon any exercise of this Warrant following such Fundamental Transaction. The terms of any agreement pursuant to which a Fundamental Transaction is effected shall include terms requiring any such successor or surviving entity to comply with the provisions of this paragraph (b) and insuring that the Warrant (or any such replacement security) will be similarly adjusted upon any subsequent transaction analogous to a Fundamental Transaction.

(c) **Certain Diluting Issuances.** (i) If the Company shall, at any time or from time to time, issue or distribute any shares of Common Stock, or be deemed to have issued shares of Common Stock as provided herein, other than Excluded Stock (as defined in Section 9(c)(iv) below) (each such event, including any event described in paragraphs (ii)(C) and (ii)(D) below, being herein called a **“Common Stock Distribution”**), without consideration or for a consideration per share less than the Exercise Price on the date of such Common Stock Distribution or on the first date of the announcement of such Common Stock Distribution, whichever is greater (the **“New Issuance Price”**), then, effective immediately after the open of business on the day following such Common Stock Distribution, the Exercise Price as in effect immediately prior to such Common Stock Distribution shall be reduced to an amount equal to the New Issuance Price.

The provisions of this paragraph (c), including by operation of subsections (C) or (D) of paragraph (ii) below, shall not operate to adjust in any manner the number of shares of Common Stock subject to purchase upon exercise of this Warrant, or to result in an increase in the Exercise Price.

- (ii) For the purposes of any adjustment of the Exercise Price pursuant to paragraph (i) above, the following provisions shall be applicable:
- (A) In the case of the issuance, sale or distribution of Common Stock for cash in a public offering or private placement, the consideration received therefor shall be deemed to be the amount received by the Company therefor before deducting therefrom any discounts, commissions or placement fees payable by the Company to any underwriter or placement agent in connection therewith;

- (B) In the case of the issuance of Common Stock for a consideration in whole or in part other than cash, the consideration other than cash received by the Company shall be deemed to be the fair market value of such consideration, as determined in good faith by the Board of Directors of the Company, irrespective of any accounting treatment;
- (C) In the case of the issuance, sale, distribution or granting (whether directly or by assumption in a merger or otherwise) of any rights to subscribe for or to purchase, or any warrants or options for the purchase of, Common Stock or any stock or securities convertible into or exchangeable for Common Stock (such rights, warrants or options being herein called “Options” and such convertible or exchangeable stock or securities being herein called “Convertible Securities”), whether or not such Options or the rights to convert or exchange any such Convertible Securities are immediately exercisable, then, for purposes of paragraph (i) above, the aggregate maximum number of shares of Common Stock issuable upon the exercise of such Options or upon conversion or exchange of such Convertible Securities and subsequent conversion or exchange thereof shall be deemed to have been issued as of the date of issuance of such Options, Convertible Securities or rights and thereafter shall be deemed to be outstanding; and the Company shall be deemed to have received as consideration the amount equal to the consideration, if any, received by the Company upon the issuance of such Options, Convertible Securities or rights plus the minimum additional consideration, if any, to be received by the Company upon the conversion or exchange of such Convertible Securities or the exercise of Options or rights (such consideration in each case to be determined in the manner provided in Sections 9(c)(ii)(A) and 9(c)(ii)(B));
- (D) If the purchase price provided for in any Option, the additional consideration, if any, payable upon the conversion or exchange of any Convertible Securities, or the rate at which any Convertible Securities are convertible into or exchangeable for Common Stock shall change at any time (other than under or by reason of provisions designed to protect against, and having the effect of protecting against, dilution upon an event which results in a related adjustment pursuant to this Section 9), then, the Exercise Price then in effect shall forthwith be readjusted (effective only with respect to any exercise of this Warrant after such readjustment) to the Exercise Price which would then be in effect had the adjustment made upon the issue, sale, distribution or grant of such Options or Convertible Securities been made based upon such changed purchase price, additional consideration or conversion rate, as the case may be; provided, however, that such readjustment shall give effect to such change only with respect to such Options and Convertible Securities as then remain outstanding;

- (E) In the case of the issuance, sale, distribution or granting of any Options as part of a unit consisting of Options and Common Stock and/or Convertible Securities, then for purposes of calculating any adjustment pursuant to this Section 9, no value shall be attributed to such Options in allocating the price paid for the unit among the securities comprising such unit; and
- (F) Upon the expiration of any such Options or the termination of any rights, Convertible Securities or exchangeable securities, the applicable Exercise Price shall forthwith be readjusted to such Exercise Price as would have been in effect at the time of such expiration or termination had such Options, rights, Convertible Securities or exchangeable securities, to the extent outstanding immediately prior to such expiration or termination, never been issued.

(iii) For purposes of determining whether any adjustment is required pursuant to this Section 9(c), any security of the Company having rights substantially equivalent to the Common Stock as to dividends or upon liquidation, dissolution or winding up of the Company shall be treated as if such security were Common Stock. No further adjustment of the Exercise Price adjusted upon the issuance of any such options, rights, convertible securities or exchangeable securities shall be made as a result of the actual issuance of Common Stock on the exercise of any such rights or Options or any conversion or exchange of any such securities.

(iv) **“Excluded Stock”** shall mean (A) shares of Common Stock issued (or issuable upon exercise of rights, options or warrants outstanding from time to time) granted or issued to officers, directors or employees of, or consultants to, the Company pursuant to a stock grant, stock option plan, employee stock purchase plan, restricted stock plan or other similar plan or agreement or otherwise, in each case as approved by the Company’s Board of Directors, (B) shares of Common Stock issued (or issuable upon exercise of rights, options or warrants outstanding from time to time) granted or issued to financial institutions, equipment lessors, brokers or similar persons in connection with commercial credit arrangements, equipment financings, commercial property lease transactions or similar transactions, (C) securities issued in connection with a strategic alliance, acquisition or similar transaction, (D) shares of Common Stock issued (or issuable upon exercise of rights, options or warrants outstanding from time to time) for bona fide services, (E) shares issued or issuable as a result of any stock split, combination, dividend, distribution, reclassification, exchange or substitution, (F) shares of Common Stock issuable upon exercise of rights, options, warrants, notes or other rights to acquire securities of the Company outstanding as of the date hereof, and (G) shares of Common Stock issued (or issuable upon exercise of rights, options or warrants outstanding from time to time) related to the transactions contemplated herein or in the Qualified Financing.

(d) Number of Warrant Shares. Simultaneously with any adjustment to the Exercise Price pursuant to paragraph (a) of this Section, the number of Warrant Shares that may be purchased upon exercise of this Warrant shall be increased or decreased proportionately, so that after such adjustment the aggregate Exercise Price payable hereunder for the adjusted number of Warrant Shares shall be the same as the aggregate Exercise Price in effect immediately prior to such adjustment.

(e) Calculations. All calculations under this Section 9 shall be made to the nearest cent or the nearest 1/100th of a share, as applicable. The number of shares of Common Stock outstanding at any given time shall not include shares owned or held by or for the account of the Company, and the disposition of any such shares shall be considered an issue or sale of Common Stock.

(f) Notice of Corporate Events. If the Company (i) declares a dividend or any other distribution of cash, securities or other property in respect of its Common Stock, including without limitation any granting of rights or warrants to subscribe for or purchase any capital stock of the Company or any subsidiary, (ii) authorizes or approves, enters into any agreement contemplating or solicits stockholder approval for any Fundamental Transaction or (iii) authorizes the voluntary dissolution, liquidation or winding up of the affairs of the Company, then the Company shall deliver to the Holder a notice describing the material terms and conditions of such transaction, at least 20 calendar days prior to the applicable record or effective date on which a Person would need to hold Common Stock in order to participate in or vote with respect to such transaction, and the Company will take all steps reasonably necessary in order to insure that the Holder is given the practical opportunity to exercise this Warrant prior to such time so as to participate in or vote with respect to such transaction; provided, however, that the failure to deliver such notice or any defect therein shall not affect the validity of the corporate action required to be described in such notice.

10. Payment of Exercise Price. The Holder may pay the Exercise Price in one of the following manners:

(a) Cash Exercise. The Holder may deliver immediately available funds; or

(b) Cashless Exercise. The Holder may notify the Company in an Exercise Notice of its election to utilize cashless exercise, in which event the Company shall issue to the Holder the number of Warrant Shares determined as follows:

$$X = Y [(A-B)/A]$$

where:

X = the number of Warrant Shares to be issued to the Holder.

Y = the number of Warrant Shares with respect to which this Warrant is being exercised.

A = the average of the closing prices for the five Trading Days immediately prior to (but not including) the Date of Exercise.

B = the Exercise Price.

For purposes of Rule 144 promulgated under the Securities Act, it is intended, understood and acknowledged that the Warrant Shares issued in a cashless exercise transaction shall be deemed to have been acquired by the Holder, and the holding period for the Warrant Shares shall be deemed to have commenced, on the date this Warrant was originally issued, subject to any change of law after the date hereof.

11. No Fractional Shares. No fractional shares of Warrant Shares will be issued in connection with any exercise of this Warrant. In lieu of any fractional shares which would, otherwise be issuable, the Company shall pay cash equal to the product of such fraction multiplied by the closing price of one Warrant Share as reported by the Trading Market on the Date of Exercise.

12. Notices. Any and all notices or other communications or deliveries hereunder (including, without limitation, any Exercise Notice) shall be in writing and shall be deemed given and effective on the earliest of (i) the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section, or via electronic mail, prior to 6:30 p.m. (New York City time) on a Trading Day and an electronic confirmation of delivery is received by the sender, (ii) the next Trading Day after the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number specified in this Section on a day that is not a Trading Day or later than 6:30 p.m. (New York City time) on any Trading Day, (iii) the Trading Day following the date of mailing, if sent by nationally recognized overnight courier service, or (iv) upon actual receipt by the party to whom such notice is required to be given.

13. Warrant Agent. The Company shall serve as warrant agent under this Warrant. Upon 30 days' notice to the Holder, the Company may appoint a new warrant agent. Any corporation into which the Company or any new warrant agent may be merged or any corporation resulting from any consolidation to which the Company or any new warrant agent shall be a party or any corporation to which the Company or any new warrant agent transfers substantially all of its corporate trust or shareholders services business shall be a successor warrant agent under this Warrant without any further act. Any such successor warrant agent shall promptly cause notice of its succession as warrant agent to be mailed (by first class mail, postage prepaid) to the Holder at the Holder's last address as shown on the Warrant Register.

14. Non-Circumvention. The Company hereby covenants and agrees that the Company will not, by amendment of its Certificate of Incorporation, Bylaws or through any reorganization, transfer of assets, consolidation, merger, scheme of arrangement, dissolution, issue or sale of securities, or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms of this Warrant, and will at all times in good faith carry out all the provisions of this Warrant and take all action as may be required to protect the rights of the Holder. Without limiting the generality of the foregoing, the Company (i) shall not increase the par value of any shares of Common Stock receivable upon the exercise of this Warrant above the Exercise Price then in effect, (ii) shall take all such actions as may be necessary or appropriate in order that the Company may validly and legally issue fully paid and nonassessable shares of Common Stock upon the exercise of this Warrant, and (iii) shall, so long as any portion of this Warrant is outstanding, take all action necessary to reserve and keep available out of its authorized and unissued shares of Common Stock, solely for the purpose of effecting the exercise of the Warrant, 110% of the number of shares of Common Stock as shall from time to time be necessary to effect the exercise of the portion of the Warrant then outstanding (without regard to any limitations on exercise).

15. Amendment and Restatement. This Warrant amends, restates and replaces that certain amended and restated warrant, issued as of November 2, 2011, which, in turn, amended, restated and replaced that certain warrant, originally issued as of October 5, 2011, in each case in favor of the Holder.

16. Miscellaneous.

(a) This Warrant shall be binding on and inure to the benefit of the parties hereto and their respective successors and assigns. Subject to the preceding sentence, nothing in this Warrant shall be construed to give to any Person other than the Company and the Holder any legal or equitable right, remedy or cause of action under this Warrant. This Warrant may be amended only in writing signed by the Company and the Holder and their successors and assigns.

(b) All questions concerning the construction, validity, enforcement and interpretation of this Warrant shall be governed by and construed and enforced in accordance with the internal laws of the State of New York, without regard to the principles of conflicts of law thereof.

(c) The headings herein are for convenience only, do not constitute a part of this Warrant and shall not be deemed to limit or affect any of the provisions hereof.

(d) In case any one or more of the provisions of this Warrant shall be invalid or unenforceable in any respect, the validity and enforceability of the remaining terms and provisions of this Warrant shall not in any way be affected or impaired thereby and the parties will attempt in good faith to agree upon a valid and enforceable provision which shall be a commercially reasonable substitute therefor, and upon so agreeing, shall incorporate such substitute provision in this Warrant.

IN WITNESS WHEREOF, the Company has caused this Warrant to be duly executed by its authorized officer as of the date first indicated above.

CATASYS, INC.

By: /s/ Susan Etzel

Susan Etzel, Chief Financial Officer

CATASYS, INC.
WARRANT ORIGINALLY ISSUED OCTOBER 5, 2011
AND AMENDED AND RESTATED NOVEMBER 2, 2011
AND FURTHER AMENDED AND RESTATED NOVEMBER 15, 2011 WARRANT NO.
100520111
EXERCISE NOTICE

To **Catasys, Inc.:**

The undersigned hereby irrevocably elects to purchase _____ shares of Common Stock pursuant to the attached Warrant.

The Holder intends that payment of the Exercise Price shall be made as:

_____ a Cash Exercise with respect to _____ Warrant Shares; and/or

_____ a Cashless Exercise with respect to _____ Warrant Shares.

If such Holder is not utilizing the Cashless Exercise provisions set forth in the Warrant, the Holder encloses herewith \$_____ in cash, certified or official bank check or checks or other immediately available funds, which sum represents the aggregate Exercise Price (as defined in the Warrant) for such Warrant Shares, together with any applicable taxes payable by the undersigned pursuant to the Warrant.

The undersigned requests that certificates for the shares of Common Stock issuable upon this exercise be issued in the name of

PLEASE INSERT SOCIAL SECURITY OR TAX
IDENTIFICATION NUMBER

(Please print name and address)

Confirmed:

CATASYS, INC.

By: _____

Name: _____

Title: _____

Date: _____

CATASYS, INC.
WARRANT ORIGINALLY ISSUED OCTOBER 5, 2011
AND AMENDED AND RESTATED NOVEMBER 2, 2011
AND FURTHER AMENDED AND RESTATED NOVEMBER 15, 2011
WARRANT NO. 100520111

FORM OF ASSIGNMENT

[To be completed and signed only upon transfer of Warrant]

FOR VALUE RECEIVED, the undersigned hereby sells, assigns and transfers unto _____ the right represented by the above-captioned Warrant to purchase _____ shares of Common Stock to which such Warrant relates and appoints _____ attorney to transfer said right on the books of the Company with full power of substitution in the premises.

Dated: _____, _____

(Signature must conform in all respects to name of holder as specified on the face of the Warrant)

Address of Transferee

In the presence of:

CONSENT

This Amendment to the Consent Agreement dated as of October 5, 2011, as amended as of November 2, 2011, (the “**Amendment**”) is dated as of November 15, 2011 (the “**Effective Date**”), among Catasys, Inc., a Delaware corporation (the “**Company**”), Socius Capital Group, LLC, a Delaware limited liability company (the “**Investor**”), and David E. Smith (the “**New Lender**”) (collectively, the “**Parties**”).

WHEREAS, the Parties initially entered into agreements under which the Company issued Secured Convertible Promissory Notes in the amount of \$650,000 dated August 17, 2011 and \$680,000 dated October 5, 2011 (collectively, the “**Original Notes**”);

WHEREAS, the Original Notes were amended and restated into Amended and Restated Secured Convertible Promissory Notes in the amounts of \$810,000 and \$780,000 dated November 2, 2011 (collectively the “**Amended Notes**”);

WHEREAS, the parties are further amending the Amended Notes to increase the amount borrowed;

NOW, THEREFORE, in consideration of the mutual covenants contained in this Agreement, and for other good and valuable consideration the receipt and adequacy of which are hereby acknowledged, the parties hereby agree as follows:

1. Definitions Unless otherwise stated in this Amendment defined terms shall have the meaning set forth in the Consent Agreement dated October 5, 2011 (the “**Consent Agreement**”).

2. Amendment.

a. Section 2(d) of the Consent Agreement is hereby replaced in its entirety by the following:

“It is the intent of the parties hereto that all recoveries with respect to the security interests granted under either Note (including as a result of any foreclosure of any Collateral) be for the ratable benefit (in proportion to the respective original principal amounts under the Notes (i.e., 52.43% to the Investor and 47.57% to the New Lender)) of both the Investor and the New Lender. Each party hereto shall take such actions as may be reasonably requested by any other party hereto (including by transferring any excess recovery to the appropriate other party hereto) to carry out the intent of this Section 2(d).”

b. All other terms of the Consent Agreement remain in full force and effect.

3. Bringdown of Representations and Warranties. The Company hereby represents and warrants to, and as applicable covenants with, the Investor and the New Lender, as of the date hereof, as set forth in Article III and Article V of that certain Securities Purchase Agreement, dated as of October 5, 2011, between the Company and the New Lender, applied mutatis mutandis; provided that, for purposes of the foregoing and for the avoidance of doubt:

- a. references to the term “Transaction Documents” therein shall be deemed to refer to (i) this Amendment, (ii) the Second Amended and Restated Secured Convertible Promissory Note, dated as of the date hereof, by the Company in favor of the Investor (the “**New Peizer Note**”), (iii) the Second Amended and Restated Secured Convertible Promissory Note, dated as of the date hereof, by the Company in favor of the New Lender (the “**New Smith Note**”), (iv) the Second Amended and Restated Warrant, dated as of the date hereof, by the Company in favor of the Investor (the “**New Peizer Warrant**”), and (v) the Second Amended and Restated Warrant, dated as of the date hereof, by the Company in favor of the New Lender (the “**New Smith Warrant**”);
- b. references to the term “Effective Date” therein shall be deemed to refer to the date hereof;
- c. references to the term “Warrant” therein shall be deemed to refer to the New Peizer Warrant and the New Smith Warrant;
- d. references to the term “Securities” therein shall be deemed to refer to (i) the New Peizer Note, (ii) the New Smith Note, (iii) the New Peizer Warrant, (iv) the New Smith Warrant, (v) the securities into which any of the New Peizer Note and the New Smith Note is convertible (and any securities issuable upon the conversion or exercise thereof), and (vi) the shares of common stock of the Company into which the New Peizer Warrant and the New Smith Warrant are exercisable; and
- e. references to the term “Investor” therein shall be deemed to refer to both the Investor and the New Lender.

The Company hereby further represents and warrants that the New Peizer Note and the Smith Note are in the substantially same form in all material respects and the New Peizer Warrant and the Smith Warrant are in the substantially same form in all material respects, in each case, except with respect to the principal amount lent to the Company.

- 4. Bringdown of Representations and Warranties of the Investor. Each of the Investor and the New Lender hereby severally and not jointly represents and warrants (solely with respect to itself or himself and not with respect to the other) to, and as applicable covenants with, the Company, as of the date hereof, as set forth in Article IV of that certain Securities Purchase Agreement, dated as of October 5, 2011, between the Company and the New Lender, applied mutatis mutandis.
 - 5. Amendment. No provision of this Amendment shall be waived, amended or modified except pursuant a written instrument executed by all parties hereto.
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IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed by their respective authorized signatories as of the date first written above.

COMPANY:

CATASYS, INC.

By: /s/ Susan Etzel
Susan Etzel, Chief Financial Officer

INVESTOR:

SOCIUS CAPITAL PARTNERS, LLC

By: /s/ Terren Peizer
Terren Peizer, Managing Director

NEW LENDER:

DAVID E. SMITH

By: /s/ David E. Smith
David E. Smith