ELOYALTY CORP
Form PRES14A
October 04, 2001
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SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities

Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x

Filed by a Party other than the Registrant o

Check the appropriate box:

x Preliminary Proxy Statement
o Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
o Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to Rule 14a-12

eLOYALTY CORPORATION

(Name of Registrant as Specified in Its Charter)

N/A

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.
o Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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150 Field Drive, Suite 250
Lake Forest, Illinois 60045

, 2001

Dear eLoyalty Stockholder:

On behalf of the board of directors and management of eLoyalty Corporation, I cordially invite you to attend a special meeting of eLoyalty s stockholders. The special meeting will be held at 9:00 a.m. Central time on , 2001 at our principal executive offices, 150 Field Drive, Suite 250, Lake Forest, Illinois.

At the special meeting, you will be asked to consider and vote on proposals to approve (1) the issuance and sale of up to $25.0 million of 7% Series B convertible preferred stock in a private placement financing; (2) an increase in the number of authorized shares of our common stock and preferred stock in connection with the private placement and the rights offering described herein; and (3) a one-for-ten reverse split of our common stock and a corresponding reduction in the number of authorized shares of common stock.

The accompanying proxy statement contains information about these proposals, and we urge you to read the entire proxy statement carefully.

OUR BOARD OF DIRECTORS SUPPORTS THESE PROPOSALS AND RECOMMENDS THAT OUR STOCKHOLDERS VOTE TO APPROVE EACH OF THEM.

Your vote is important, regardless of the number of shares you own. Whether or not you plan to attend the special meeting, we encourage you to read the accompanying proxy statement and vote promptly. To ensure that your shares are represented at the meeting, whether or not you plan to attend the meeting in person, we urge you to submit a proxy with your voting instructions by telephone, via the Internet or by signing, dating and mailing your proxy card in accordance with the instructions provided on it.

Sincerely,
[KELLY D. CONWAY SIG]
Kelly D. Conway
President and Chief Executive Officer

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NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

TO BE HELD ON , 2001

NOTICE IS HEREBY GIVEN that a special meeting of stockholders of eLoyalty Corporation, a Delaware corporation, will be held at 9:00 a.m. Central time on , 2001 at our principal executive offices, 150 Field Drive, Suite 250, Lake Forest, Illinois, for the following purposes:

1. To approve the issuance and sale by eLoyalty, pursuant to a private placement, of up to $25.0 million of 7% Series B convertible preferred stock pursuant to a share purchase agreement, dated as of September 24, 2001, with several funds affiliated with Technology Crossover Ventures and several funds affiliated with Sutter Hill Ventures, and the issuance of shares of common stock upon the conversion of the Series B convertible preferred stock;

2. To approve an amendment to eLoyalty s Certificate of Incorporation, as amended, to increase the number of authorized shares of common stock, par value $0.01 per share, from 100,000,000 shares to 500,000,000 shares, and to increase the number of authorized shares of preferred stock, par value $0.01 per share, from 10,000,000 shares to 40,000,000 shares;

3. To approve the amendment of eLoyalty s Certificate of Incorporation, as amended, to effect a one-for-ten stock combination, or reverse stock split, with respect to all of the issued shares of eLoyalty common stock and a corresponding reduction in the number of authorized shares of eLoyalty common stock; and

4. To transact such other business as may properly come before the special meeting or any adjournments or postponements thereof.

We will implement Proposals 1 and 2 only if each of Proposals 1, 2 and 3 are approved by our stockholders and are being implemented. If it is approved, we may implement Proposal 3 even if Proposals 1 and 2 are not approved or implemented for any reason.

These proposals are more fully described in the following pages of the proxy statement.

The record date for the special meeting is the close of business on , 2001. Only stockholders of record as of that time and date will be entitled to notice of, and to vote at, the special meeting. A list of the stockholders entitled to vote at the special meeting will be available for inspection at our offices at 150 Field Drive, Suite 250, Lake Forest, Illinois, during normal business hours for ten days prior to the special meeting.

Your vote is important. Stockholders are urged to submit a proxy with their voting instructions as promptly as possible, whether or not they plan to attend the meeting in person. Record holders of eLoyalty shares as of the record date may submit their proxies with voting instructions by using a toll-free telephone number (within the U.S. or Canada) or the Internet. Instructions for using these convenient services are set forth on the enclosed proxy card. Of course, you also may submit a proxy containing your voting instructions by completing, signing, dating and returning the enclosed proxy card in the enclosed postage-paid reply envelope.

By Order of the Board of Directors,

[TIMOTHY J. CUNNINGHAM SIG]
Timothy J. Cunningham
Corporate Secretary

Lake Forest, Illinois
, 2001

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SUBJECT TO COMPLETION; PRELIMINARY PROXY STATEMENT DATED OCTOBER 4, 2001

eLoyalty Corporation
150 Field Drive, Suite 250
Lake Forest, Illinois 60045

PROXY STATEMENT

FOR
A SPECIAL MEETING OF STOCKHOLDERS

TO BE HELD , 2001

The board of directors of eLoyalty Corporation is soliciting your proxy for use at a special meeting of stockholders of eLoyalty and any postponements or adjournments thereof. These proxy materials are being mailed to eLoyalty stockholders beginning on or about , 2001.

QUESTIONS AND ANSWERS ABOUT VOTING

Who is entitled to vote at the special meeting?

Holders of record of shares of eLoyalty common stock at the close of business on , 2001 may vote at the special meeting. On that date, shares of eLoyalty common stock were issued and outstanding and entitled to be voted at the meeting. Each share entitles the holder to one vote.

How do I vote?

If you were a holder of record of eLoyalty common stock (that is, you held your stock in your own name) at the close of business on , 2001, you may submit a proxy with your voting instructions by any of the following methods.

Through the Internet: Go to the web address, , and follow the instructions on the proxy card.

By Telephone: Call on a touch-tone telephone from anywhere within the United States or Canada and follow the instructions on the proxy card.

By Mail: Complete, sign and mail the proxy card in the enclosed envelope.

If you choose to submit your proxy with voting instructions by telephone or through the Internet, you will be required to provide your assigned control number shown on the enclosed proxy card before your proxy will be accepted. In addition to the instructions that appear on the enclosed proxy card, step-by-step instructions will be provided by recorded telephone message or at the designated Web site on the Internet. Once you have indicated how you want to vote, in accordance with those instructions, you will receive confirmation that your proxy has been successfully submitted by telephone or through the Internet.

If you hold your shares of eLoyalty common stock in street name through a broker, nominee, fiduciary or other custodian, you should check the voting form used by that firm to determine whether you may vote by telephone or through the Internet. If so, use the different toll-free telephone number or Web site address provided on that firm s voting form for its beneficial owners.

How do proxies work?

Giving your proxy means that you authorize the persons named as proxies to vote your shares at the special meeting in the manner you direct. If you sign and return a proxy card without indicating your voting instructions, they will vote your shares (1) FOR the proposal to approve the issuance and sale, pursuant to a private placement, of shares of 7% Series B convertible preferred stock to Technology Crossover Ventures and Sutter Hill Ventures, and the issuance of shares of common stock upon the conversion of the Series B

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convertible preferred stock, (2) FOR the proposal to amend the Certificate of Incorporation to increase the number of authorized shares of common stock from 100,000,000 shares to 500,000,000 shares and authorized shares of preferred stock from 10,000,000 shares to 40,000,000 shares, and (3) FOR the proposal to amend the Certificate of Incorporation to effect a one-for-ten reverse stock split as described herein. In this proxy, we refer to TCV IV, L.P., TCV IV Strategic Partners, L.P., TCV III (GP), TCV III, L.P., TCV III (Q), L.P. and TCV III Strategic Partners, L.P. and other funds affiliated with Technology Crossover Ventures collectively as Technology Crossover Ventures and we refer to Sutter Hill Ventures, Sutter Hill Entrepreneurs Fund (AI), L.P., Sutter Hill Entrepreneurs Fund (QP), L.P. and Sutter Hill Associates,

L.P. and other funds affiliated with Sutter Hill Ventures collectively as Sutter Hill Ventures.

Can I revoke my proxy?

You may revoke your proxy at any time before the voting at the special meeting by any of the following methods:

submitting a new proxy card that is properly signed with a later date;

voting again at a later date by telephone (if you initially voted by telephone) or through the Internet (if you initially voted through the Internet) your most recent voting instructions will be counted and any earlier instructions, using the same procedures, revoked;

sending a properly signed written notice of your revocation to the at ; or

voting in person at the special meeting. Attendance at the special meeting will not itself revoke an earlier submitted proxy.

How can I attend the special meeting?

If you are a registered holder of eLoyalty common stock and you plan to attend the special meeting in person, please retain and bring with you the admission ticket attached to the enclosed proxy card. If you hold your shares in street name (in the name of a broker or other nominee) and you do not receive an admission ticket, please bring proof of your ownership of eLoyalty shares with you to the special meeting. A bank or brokerage account statement showing that you owned eLoyalty common stock on , 2001 would be acceptable for this purpose.

How will votes be counted?

The special meeting will be held if a quorum, consisting of a majority of the outstanding shares entitled to vote, is represented in person or by proxy. Abstentions and broker non-votes will be counted as present and entitled to vote for purposes of determining a quorum. A broker non-vote occurs when a nominee, such as a bank or broker, holding shares for a beneficial owner does not vote on a particular proposal because the nominee does not have discretionary voting power with respect to that item and has not received instructions from the beneficial owner.

The rules of the Nasdaq National Market, on which our stock is traded, require stockholders to approve certain substantial sales of common stock or securities convertible into common stock. For this reason, we are asking you to approve the sale of the Series B convertible preferred stock in the private placement. Delaware law requires stockholder approval for the amendments to our Certificate of Incorporation. The votes required for each of the proposals is as described below.

Approval of Proposal 1 requires the affirmative vote of a majority of the outstanding shares of common stock present in person or represented by proxy at the special meeting and entitled to vote. In addition, because Technology Crossover Ventures and Sutter Hill Ventures are significant stockholders of our company and have representatives who are members of our board of directors, we have determined that we will not proceed with Proposal 1 unless it is also approved by the affirmative vote of a majority of the outstanding shares of common stock present or represented at the special meeting and entitled to vote, excluding any votes cast by Technology Crossover Ventures, Sutter Hill Ventures, Jay C. Hoag, who is a member of our board of

directors and a managing member of the general partner of entities affiliated with Technology Crossover Ventures, Tench Coxe, who is also a member of our board of directors and a managing director of the general partner of Sutter Hill Ventures, and certain of their respective affiliates. Abstentions will be treated as votes against Proposal 1 and broker non-votes will have no effect. Even if it is approved, we will not implement Proposal 1 unless Proposals 2 and 3 are also approved and are being implemented.

The affirmative vote of a majority of the outstanding shares of our common stock entitled to vote at the special meeting is required to approve Proposals 2 and 3. Abstentions and broker non-votes will have the same effect as a vote cast against Proposals 2 and 3. Even if it is approved, we will not implement Proposal 2 unless Proposals 1 and 3 are also approved and are being implemented. We reserve the right to take action on Proposal 3, if it is approved, even if Proposals 1 and 2 are not approved or implemented.

Pursuant to the share purchase agreement we entered into in connection with the private placement, Technology Crossover Ventures and Sutter Hill Ventures have agreed to vote and cause certain of their respective affiliates to vote their shares of eLoyalty common stock (representing approximately % of the common stock entitled to vote at the special meeting) in favor of each of Proposals 1, 2 and 3. As described above, however, we will not count their votes for purposes of determining whether the private placement has been approved by our disinterested stockholders.

How are proxies being solicited and who will pay for the solicitation of proxies?

We have appointed , proxy soliciting firm, to solicit proxies for the special meeting. Initially, will solicit proxies by mail. may also solicit proxies in person, by telephone or over the Internet. We will pay all expenses of solicitation of proxies, which are expected to be approximately $. Our directors, officers and other employees may also solicit proxies by telephone, facsimile, and personal interview without additional compensation.

In addition, arrangements will be made with selected banking institutions, brokerage firms, custodians, trustees, nominees and fiduciaries for forwarding solicitation materials and communicating with the beneficial owners of shares held of record by such persons. We will reimburse these persons for their reasonable expenses incurred in connection with such actions.

Who can help answer my other questions?

If you have more questions about voting or wish to obtain another proxy card, you should contact:

PROPOSAL 1: APPROVAL OF THE PRIVATE PLACEMENT

Introduction

We are asking you to approve the issuance and sale, through a private placement, of up to $25.0 million of 7% Series B convertible preferred stock to Technology Crossover Ventures and Sutter Hill Ventures, as well as the issuance of shares of eLoyalty common stock upon conversion of the Series B convertible preferred stock. We have entered into a share purchase agreement with Technology Crossover Ventures and Sutter Hill Ventures regarding the private placement. Technology Crossover Ventures, which currently owns 7,430,440 shares of our common stock, has agreed to purchase up to $15.0 million of Series B convertible preferred stock and Sutter Hill Ventures, which together with certain related entities currently owns 2,123,004 shares of our common stock, has agreed to purchase up to $10.0 million of Series B convertible preferred stock. The purchase price per share of preferred stock will be the lesser of (i) $0.51, and (ii) 90% of the average of the last sales prices of our common stock over the twenty trading days through and including the fourth trading day prior to the closing, subject to adjustment for the proposed one-for-ten reverse split of our common stock described in Proposal 3. If the reverse split is effected as proposed, the purchase price per share of preferred stock will be the lesser of $5.10 and 90% of the average price of our common stock on a pre-split basis multiplied by ten.

In connection with the private placement, we are conducting a rights offering in which our existing common stockholders are being offered the right to purchase Series B convertible preferred stock at the same

price as the investors in the private placement. The rights will allow our other stockholders to maintain, but not increase, their approximate ownership percentage in eLoyalty immediately prior to the private placement and rights offering, based on the number of shares they held as of October 8, 2001, the record date for the rights offering. The investors in the private placement will not participate in the rights offering. We are not asking our stockholders to vote on the rights offering. However, the closing of the rights offering and the private placement are conditioned on each other and we expect that they would occur simultaneously.

Structure of the Private Placement

The private placement has been structured to comply with restrictions under tax laws that could apply to sales of equity securities by eLoyalty. For our 100% spin-off from Technology Solutions Company (TSC) in February 2000 to remain tax free to TSC, no person or persons may acquire, directly or indirectly, 50% or more of our stock, measured by voting power or value, as part of a plan that includes the spin-off. Under applicable tax laws, there is a rebuttable presumption that any acquisitions of our voting stock within two years before or after the spin-off

are part of such a plan. Although we do not believe that the issuance of the Series B convertible preferred stock in connection with the private placement and the rights offering should be treated as part of such a plan, we have structured the private placement and rights offering in a way that we believe will enable our spin-off to remain tax free to TSC even if the issuances were treated as part of such a plan.

As a result of these tax restrictions, we have structured the private placement so that neither the voting power nor the value of the shares of common stock held by Technology Crossover Ventures and Sutter Hill Ventures and certain related entities, together with the shares of Series B convertible preferred stock purchased by them in the private placement, may exceed 47% of the total voting power or equity value of eLoyalty. As a result, the maximum amount of Series B convertible preferred stock that we can issue in the private placement, without issuing any additional shares in the rights offering, is approximately 22.1 million shares (or 2.2 million shares after giving effect to the reverse split of the common stock and the resulting increase in the purchase price per share of the Series B convertible preferred stock), which would result in a maximum of $11.3 million of proceeds, assuming a purchase price of $0.51 per share. If, however, we issue shares in the rights offering, we will be able to issue additional shares in the private placement because the shares issued in the rights offering would reduce the ownership percentage of the investors in the private placement.

We will not know how many shares of preferred stock will be issued in the private placement or the rights offering until the closing, which we expect will occur on , 2001. We do not expect all of the rights to be exercised. If they were, however, we expect that the maximum number of shares of Series B convertible preferred stock issuable in connection with the private placement and the rights offering would be between approximately 175 million shares, assuming a purchase price of $0.51 per share (or 17.5 million shares at a post-split purchase price of $5.10 per share), and approximately 258 million shares, assuming a purchase price of $0.345 per share or less (or 25.8 million shares at a post-split purchase price of $3.45 or less), and subject to the further assumptions described below. Because we believe it is unlikely that the rights will be fully exercised, we expect to issue fewer shares of preferred stock in the private placement and rights offering than the maximum number possible.

Given the number of shares of preferred stock that may be issued (and the number of shares of common stock that would be issued upon conversion of the preferred stock), we are also seeking approval of Proposal 2 to increase the number of shares of common stock and preferred stock we are authorized to issue. We are also seeking approval of Proposal 3 to effect a reverse split of our common stock to rationalize our resulting equity capital structure. If Proposals 1, 2 and 3 are all approved, we would first implement the increase in our share capital as described in Proposal 2, then implement the reverse stock split as described in Proposal 3. After the reverse split is effected, the closing of the private placement and the rights offering would occur. Because the closing will be after the effective date of the reverse split, the purchase price per share of the Series B convertible preferred stock will be adjusted by multiplying the purchase price by ten, resulting in a corresponding decrease in the number of shares of preferred stock to be issued. Each share of preferred stock will be convertible into one share of post-split common stock beginning six months after the closing of the private placement and the rights offering.

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Under the terms of the share purchase agreement, Technology Crossover Ventures and Sutter Hill Ventures cannot exercise their rights. In addition, rights issued in respect of restricted stock held by our officers and employees that has not vested prior to the closing date cannot be exercised. As a result, the information in this proxy statement related to the amount and percentage of rights exercised is based on the amount and percentage of rights that are eligible to be exercised and excludes rights that cannot be exercised. The information in this proxy statement also assumes that all of the rights that are exercised are exercised in full, which means that the holder elects to subscribe for $1.60 of preferred stock per right. However, stockholders who receive rights will have the option to subscribe for $1.60, $1.00 or $0.50 of preferred stock per right. The number of shares of preferred stock issued in the private placement and the rights offering may be less if rights are exercised for less than the full amount.

In addition, we have assumed for purposes of this proxy statement that the value of our common stock on the closing date will be at least equal to 83.3% of the purchase price of the preferred stock (which would result in a value of the preferred stock for purposes of the tax restrictions described above being no more than 120% of the value of the common stock). If the value of our common stock is less than 83.3% of the purchase price of the preferred stock, the number of shares issued in the private placement and the rights offering may decrease.

We have also assumed for purposes of this proxy statement the issuance of 5,000,000 shares of restricted common stock (500,000 shares after giving effect to the reverse stock split) in connection with an offer we intend to make to our employees to exchange some of their outstanding options for up to 6,500,000 shares of restricted common stock (650,000 shares after giving effect to the reverse stock split). The maximum number of shares of preferred stock that we may issue in the private placement and the rights offering will increase if we issue less than 5,000,000 shares of restricted stock, and will decrease if we issue more than 5,000,000 shares of restricted stock, prior to closing.

Nasdaq Stockholder Approval Requirement

Our common stock is listed on The Nasdaq National Market. The rules governing companies with securities listed on Nasdaq require stockholder approval in connection with a transaction other than a public offering involving the sale or issuance by the issuer of common stock (or securities convertible into or exchangeable for common stock) equal to 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance for less than the greater of book or market value of the stock. This requirement is set forth in Nasdaq Marketplace Rule 4350(i)(1)(D). In addition, stockholder approval is required under Nasdaq Marketplace Rule 4350(i)(1)(B) in connection with the issuance of securities that could result in a change of control of an issuer.

Because the private placement described in this Proposal 1 involves the potential issuance by eLoyalty of securities convertible into shares of common stock that would represent more than 20% of the currently outstanding common stock at below the greater of book or market value of the common stock, and because it could also potentially result in issuances resulting in a change of control for Nasdaq purposes, stockholder approval is required before the investors in the private placement could convert shares of Series B convertible preferred stock into shares of common stock representing 20% or more our outstanding common stock.

Reasons for the Private Placement

The principal reasons for seeking additional financing are to strengthen our balance sheet and to assure our customers and potential customers that we have sufficient financial resources to successfully complete the projects that we are competing for, which are generally complex and relatively long term. We believe that obtaining additional capital is critical to our ability to continue to execute on our business plan during uncertain or difficult economic conditions and to sustain the confidence of our customers, business partners and employees. We also believe that a sale of our securities in the public markets at the current market price of our common stock is not likely to be achievable, given current conditions in the market for public company issuances, particularly for companies in our industry. Further, we believe that a public offering could present the same issues regarding our tax-free spin-off from TSC as are described above with respect to the private

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placement, but afford us less opportunity to address these issues through the transaction structure. The board of directors and management of eLoyalty considered a number of financing alternatives prior to entering into the share purchase agreement for the private placement. We believe that the best option for additional financing is to complete the private placement and the rights offering.

Background to the Private Placement

In June 2001, eLoyalty s management began to explore possible means of obtaining additional financing for its business. During this time period, eLoyalty learned that Technology Crossover Ventures, an existing stockholder who has a representative on eLoyalty s board of directors, might be interested in making an additional equity investment in eLoyalty. In late June 2001, eLoyalty s management continued to explore whether Technology Crossover Ventures or other investors, including other existing stockholders of eLoyalty, would be interested in making a financing proposal to eLoyalty.

On July 3, 2001, a special meeting of the board of directors of eLoyalty was held. At this meeting, the board of directors discussed the desirability of exploring a possible equity financing and discussed the possibility that Technology Crossover Ventures and/ or Sutter Hill Ventures, another existing stockholder of eLoyalty with a representative on the board of directors, would be interested in making an additional investment in eLoyalty. The board of directors of eLoyalty determined that it would be desirable to establish a special committee of the board of directors for the purpose of further exploring the company s financing alternatives. Outside directors John T. Kohler and John R. Purcell expressed a willingness to serve on such a special committee. Accordingly, the board of directors authorized the creation of a special committee of the board of directors consisting of Messrs. Kohler and Purcell and authorized the special committee to evaluate potential financing alternatives and to make a recommendation to the board of directors regarding those alternatives.

On July 5, 2001, the special committee held a meeting at which it determined to retain legal counsel and discussed the retention of a financial advisor. At this meeting, the special committee discussed the company s cash needs with members of management and discussed the means likely to be available to the company to raise the desired financing.

On July 12, 2001, the special committee held a meeting at which it discussed the possibility of seeking financing proposals from existing eLoyalty stockholders, Technology Crossover Ventures and Sutter Hill Ventures. The special committee determined to request that Technology

Crossover Ventures and Sutter Hill Ventures each submit proposals setting forth the terms upon which they would be prepared to make additional equity investments in eLoyalty. The special committee also discussed the status of negotiations regarding the retention of a financial advisor. Following that meeting, a representative of the special committee separately contacted Technology Crossover Ventures and Sutter Hill Ventures to request that each of them submit a proposal to the special committee if either of them were interested in making an additional investment in eLoyalty.

On July 17, 2001, Technology Crossover Ventures submitted a proposal to invest $15 million of its own funds to purchase shares of convertible preferred stock and warrants of eLoyalty in a financing round that would raise a total of $30 million in proceeds.

On July 19, 2001, the special committee held a meeting at which it discussed the financing proposal that had been received from Technology Crossover Ventures. The special committee also discussed the retention of a financial advisor and determined to engage Deutsche Banc Alex. Brown Inc. to act as its financial advisor.

On July 25 and July 26, 2001, the special committee held meetings at which it further discussed the company s financing needs and its strategic financing alternatives, including the Technology Crossover Ventures financing proposal, with Deutsche Banc Alex. Brown and the special committee s legal advisors. At these meetings, Deutsche Banc Alex. Brown reported to the special committee regarding meetings it had with members of eLoyalty s senior management and discussed with the special committee its review of the company s expected cash needs relative to its available cash resources. During this time period, Deutsche Banc Alex. Brown engaged in discussions with Technology Crossover Ventures regarding its proposal and

reported to the special committee regarding those discussions. On July 31, 2001, Technology Crossover Ventures submitted a revised financing proposal in response to the discussions between it and Deutsche Banc Alex. Brown. The July 31 Technology Crossover Ventures proposal called for a series of transactions that would raise between $30 million and $40 million in proceeds to eLoyalty.

On August 1, August 2 and August 6, 2001, the special committee held meetings at which it discussed the revised Technology Crossover Ventures proposal with Deutsche Banc Alex. Brown and the special committee s legal advisors. At these meetings, the special committee continued to discuss the company s cash needs and the possible alternatives that might be available to the company, including the preliminary results of Deutsche Banc Alex. Brown s efforts to contact alternative equity financing sources regarding their possible interest in an investment in the company. During this time period, the special committee also discussed the possible federal income tax implications of any financing transaction in light of eLoyalty s spin-off from Technology Solutions Company in 2000, including the possible limitations this would impose on the ability of the company to effect the transactions contemplated by the Technology Crossover Ventures proposals.

On August 2, 2001, eLoyalty was notified by Nasdaq that it risked being delisted from the Nasdaq National Market if the bid price for its common stock did not exceed $1.00 for at least 10 consecutive days prior to October 31, 2001.

On August 7, 2001, a meeting of the board of directors of eLoyalty was held. At this meeting, the members of the special committee reported to the board of directors on its deliberations and negotiations to date. The board of directors also discussed the merits of a possible reverse stock split and alternatives for establishing appropriate equity-based incentives for the company s employees.

On August 9, 2001, Mr. Purcell resigned as a director of eLoyalty for personal reasons.

On August 13, 2001, a meeting of the board of directors of eLoyalty was held. At this meeting, the board of directors discussed Mr. Purcell s resignation and its implications for the advisability of continuing with the process established with the special committee. After consulting with its legal counsel, the board of directors concluded that a special committee consisting of only one director was unlikely to serve the best interests of the company and its stockholders. The board of directors also concluded that, due to the current composition of the board of directors, a special committee with a sufficient number of directors without any actual or perceived interest in the transactions under consideration might not be feasible. At the request of the board of directors, directors Jay Hoag and Tench Coxe, who are principals in Technology Crossover Ventures and Sutter Hill Ventures, respectively, then recused themselves from the meeting. The board of directors then discussed the advisability of conducting a rights offering which would provide the other stockholders of the company with the opportunity to participate in any investment on terms substantially similar to those offered to Technology Crossover Ventures and Sutter Hill Ventures, as had been under consideration by the special committee. The board of directors also discussed the advisability of requiring that any private placement with Technology Crossover Ventures and Sutter Hill Ventures be approved by a majority of disinterested stockholders present and entitled to vote at a special meeting called

to approve such transaction. After considering all these factors, the board of directors concluded that the company s financing alternatives should be addressed in the future by the board of directors as a whole, subject to recusal of Messrs. Hoag and Coxe as appropriate.

On August 14, 2001, Technology Crossover Ventures submitted a revised financing proposal intended to address the limitations on the amount that it could invest in eLoyalty in light of the restrictions imposed by the federal tax laws related to the 2000 spin-off of eLoyalty. The August 14 proposal called for a $25 million private placement, consisting of $15 million in convertible preferred stock and warrants and $10 million in subordinated notes of eLoyalty, and a simultaneous rights offering of up to $15 million in convertible preferred stock and warrants of eLoyalty to be made available to the stockholders of eLoyalty other than the investors in the private placement. Based on Technology Crossover Ventures understanding that eLoyalty s board of directors would insist on substantive and procedural protections for eLoyalty s disinterested stockholders, this revised proposal contemplated not only a rights offering that would allow disinterested stockholders to make additional investments on similar terms, but also a concession by Technology Crossover Ventures that any

transaction would be conditioned on the prior approval of eLoyalty s stockholders, including a majority of eLoyalty s disinterested stockholders present or represented at the special meeting and entitled to vote.

On August 15, August 17 and August 21, 2001, the board of directors of eLoyalty held meetings at which it discussed the revised Technology Crossover Ventures proposal, the federal tax considerations related to possible financing transactions and the possible timing for such transactions. The board of directors also discussed a possible reverse stock split and alternatives for re-establishing meaningful equity-based incentives for the company s employees. At the request of the board of directors, Messrs. Coxe and Hoag recused themselves from a portion of these meetings to permit the other directors of eLoyalty to discuss these matters without their participation. During the portion of these meetings in which Messrs. Coxe and Hoag were not present, Deutsche Banc Alex. Brown confirmed that its ongoing efforts to attract alternative equity financing sources had yielded no positive results.

On August 30, 2001, Technology Crossover Ventures submitted a further revised financing proposal intended to address continuing concerns about the limitations imposed by the federal tax laws in light of the 2000 spin-off transaction. This proposal called for a $25 million private placement of convertible preferred stock of eLoyalty and a simultaneous rights offering of up to $20 million in convertible preferred stock of eLoyalty to be made available to the stockholders of eLoyalty other than the investors in the private placement.

On August 31, 2001, the board of directors of eLoyalty held a meeting at which it discussed the latest financing proposal from Technology Crossover Ventures and the financial and tax implications of that proposal. At the request of the board of directors, Messrs. Coxe and Hoag recused themselves from a portion of this meeting to permit the other directors of eLoyalty to discuss these matters without their participation.

On September 7, 2001, the board of directors of eLoyalty held a meeting at which the board of directors reviewed the proposed private placement, rights offering and reverse stock split and a proposal to establish appropriate equity-based incentives for the company s employees. After the board of directors discussed its fiduciary duties under applicable law with its legal advisers, representatives of Deutsche Banc Alex. Brown reviewed with the board of directors Deutsche Banc Alex. Brown s overview of the information technology services sector and the company s situation (including, based on information received from the company, its outlook, its foreseeable cash needs and sources of liquidity as compared with other companies, and certain related events, such as the notification the company received from the Nasdaq National Market that the company has failed to maintain Nasdaq s minimum bid price of $1.00 per share). Deutsche Banc Alex. Brown also reviewed with the board of directors the advantages, disadvantages and anticipated feasibility, in light of timing and other considerations, of various financing alternatives and the proposed private placement, rights offering and reverse stock split. Lastly, Deutsche Banc Alex. Brown confirmed that its ongoing efforts to attract alternative equity funding sources had not yielded any positive results. After these discussions, Messrs. Coxe and Hoag recused themselves from the meeting to permit the board of directors to deliberate without their participation.

Discussions and negotiations regarding the terms of the proposed transactions continued throughout early and mid-September. During the course of these negotiations the proposed $20 million limitation on the size of the rights offering was eliminated from the proposal at eLoyalty s request.

On September 17 and September 20, 2001, the board of directors held meetings to review the status of negotiations regarding the terms of the proposed transactions and the status of preparation and negotiation of a definitive private placement agreement and related documents. During this time period, members of our senior management held individual meetings with each of our directors to explain and discuss the terms of the proposed transactions.

On September 24, 2001, the board of directors met to further discuss the matters addressed at the earlier September meetings. At this meeting, Deutsche Banc Alex. Brown representatives reviewed their analyses of the proposed transactions and rendered their written opinion to the board of directors to the effect that, as of that date and based upon and subject to the assumptions made, matters considered and limits of the review undertaken by Deutsche Banc Alex. Brown, the private placement and rights offering were fair, from a

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financial point of view, to eLoyalty s stockholders. Following their deliberations, the board of directors unanimously resolved, with directors Coxe and Hoag abstaining as to the private placement and certain related items, to approve the matters referred to in Proposal Nos. 1, 2 and 3 and to recommend that stockholders of eLoyalty vote to approve those matters. The board of directors also unanimously resolved, with directors Coxe and Hoag abstaining, to authorize the acquisition of additional shares of eLoyalty voting stock by Technology Crossover Ventures and Sutter Hill Ventures for purposes of Section 203 of the Delaware General Corporation Law and to amend eLoyalty s Rights Agreement, dated March 17, 2000 (the Rights Agreement), to permit such acquisition without adverse effect under that agreement.

Opinion of Financial Advisor to the Board of Directors

We engaged Deutsche Banc Alex. Brown to render an opinion as to the fairness to our stockholders, from a financial point of view, of the proposed private placement of Series B convertible preferred stock and offering of rights to purchase Series B convertible preferred stock. At the September 7, 2001 meeting of our board of directors, Deutsche Banc Alex. Brown reviewed analyses related to the proposed transactions. On September 24, 2001, Deutsche Banc Alex. Brown delivered its opinion in writing to our board of directors to the effect that, as of that date and based upon and subject to the assumptions made, matters considered and limits of the review undertaken by Deutsche Banc Alex. Brown, the transactions were fair, from a financial point of view, to our stockholders.

The full text of Deutsche Banc Alex. Brown s written opinion, dated as of September 24, 2001, which sets forth, among other things, the assumptions made, matters considered and limits of the review undertaken by Deutsche Banc Alex. Brown in connection with the opinion, is attached as Appendix A to this proxy statement and is incorporated herein by reference. You are urged to read the Deutsche Banc Alex. Brown opinion in its entirety. The summary of the opinion of Deutsche Banc Alex. Brown set forth in this proxy statement is qualified in its entirety by reference to the full text of the opinion, attached hereto as Appendix A.

Deutsche Banc Alex. Brown s opinion was directed only to our board of directors. The opinion is not a recommendation to our stockholders to approve the transactions or participate in the rights offering and it is limited to the fairness to our stockholders, from a financial point of view, of the transactions. In rendering its opinion, Deutsche Banc Alex. Brown expressed no opinion as to the merits of the underlying decision by us to engage in the transactions or any alternative transaction. The terms of the transactions were determined through arm s-length negotiations between Technology Crossover Ventures and Sutter Hill Ventures and us and were approved by our board of directors (with our two directors who are affiliated with the private placement investors abstaining with respect to the private placement and certain related items). The opinion and presentations of Deutsche Banc Alex. Brown were only one of a number of factors taken into consideration by our board of directors in making its determination to approve the transactions. Deutsche Banc Alex. Brown also did not express any opinion as to the prices at which any class of our stock will trade at any time.

In connection with its role as our financial advisor, and in arriving at its opinion, Deutsche Banc Alex. Brown:

- reviewed certain publicly available financial and other information concerning us and certain internal analyses and other information that we furnished to Deutsche Banc Alex. Brown;
- held discussions with members of our senior management regarding our business and prospects;
- reviewed the reported prices and trading activity for our common stock;
- reviewed the terms of certain comparable private investments in public equity securities and compared the terms of these transactions to the terms of our Series B convertible preferred stock;
- compared our financial and stock market information with similar information for certain other companies whose securities are publicly traded;

made inquiries regarding and discussed the transactions and the terms of the transaction documents with our senior management and our counsel;

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made inquiries of various potential private equity investors regarding their interest in investing in us; and

performed such other studies and analyses and considered such other factors as Deutsche Banc Alex. Brown deemed appropriate.

For purposes of rendering its opinion, Deutsche Banc Alex. Brown assumed that:

the holders of a majority of our common stock present or represented at the special meeting of stockholders described in this proxy statement, other than Technology Crossover Ventures and Sutter Hill Ventures, will approve the transactions;

the rights offering will afford eLoyalty s stockholders the right to purchase sufficient shares of preferred stock so as to maintain each such stockholder s approximate percentage ownership in eLoyalty, with the understanding that Technology Crossover Ventures and Sutter Hill Ventures have agreed not to exercise such rights with respect to any shares of common stock held by them and that the holders of non-vested restricted shares of common stock of eLoyalty will agree not to exercise such rights with respect to such shares;

based entirely on our advice and the advice of our advisors, the transactions as presented to Deutsche Banc Alex. Brown will not adversely affect the tax-free nature of our February 2000 100% tax-free spin off and it is Deutsche Banc Alex. Brown s understanding that the consummation of the transactions is conditioned upon our receipt of an opinion of our counsel to such effect;

all material governmental, regulatory or other consents and approvals necessary to the consummation of the transactions will be obtained without any material adverse impact on us or on the contemplated benefits to us of the transactions;

in all respects material to its analysis, the representations and warranties made by Technology Crossover Ventures, Sutter Hill Ventures and us in the documents executed in connection with the transactions are true and correct and that each of these parties will perform all of the covenants and agreements to be performed by it under such documents;

in all respects material to its analysis, all conditions to the obligation of each of Technology Crossover Ventures, Sutter Hill Ventures and us to consummate the transactions will be satisfied without any waiver of them;

the transactions will be consummated in a manner that complies in all respects with the applicable provisions of the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and all other applicable federal and state statutes, rules and regulations; and

the transaction documents, this proxy statement and the registration statement filed in connection with the rights offering are consistent with eLoyalty s description of these documents to Deutsche Banc Alex. Brown and this proxy statement and such registration statement accurately describe the transactions, the preferred stock, the rights and the transaction documents in all material respects.

In connection with its review, Deutsche Banc Alex. Brown relied on (i) the advice of our counsel as to all legal matters concerning us and (ii) information provided by us and publicly available information as to certain financial matters concerning us. Deutsche Banc Alex. Brown also did not assume responsibility for independent verification of, and did not independently verify, any public or private information furnished to it such as, for example, any financial information, forecasts or projections that it considered in connection with rendering its opinion. Deutsche Banc Alex. Brown assumed and relied upon the accuracy and completeness of such information and did not conduct a physical inspection of any of our properties or assets, nor did Deutsche Banc Alex. Brown prepare or obtain any independent evaluation or appraisal of any of our assets or liabilities. Deutsche Banc Alex. Brown assumed that all financial forecasts and projections made available to it and used in its analyses were reasonably prepared on bases reflecting the best currently available estimates and judgments of our management as to the matters that such financial forecasts and projections covered. In rendering its opinion, Deutsche Banc Alex. Brown expressed no view as to the reasonableness of such forecasts

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and projections or the assumptions on which they were based and considered our management s assessment of our financing requirements, the availability of alternative financing and the potential effects on us and our business of a failure to obtain additional capital in the near term.

Deutsche Banc Alex. Brown s opinion is necessarily based upon economic, market and other conditions as in effect on, and the information made available to it as of, the date of its opinion and events occurring after the date of its opinion could materially affect the assumptions Deutsche Banc Alex. Brown used in preparing its opinion. Deutsche Banc Alex. Brown has assumed no obligation to update, revise or reaffirm its opinion. Deutsche Banc Alex. Brown further assumed that the terms of the transactions were the most beneficial terms from our perspective that under the circumstances could be negotiated among the parties to the transactions and Deutsche Banc Alex. Brown expressed no opinion as to whether any alternative transaction might produce proceeds to us in an amount in excess of that to be received by us in the currently proposed transactions. At our request, Deutsche Banc Alex. Brown did not engage in any discussions with any third parties regarding a merger or any other potential business combination involving eLoyalty.

We paid Deutsche Banc Alex. Brown fees for its services as financial advisor to us in connection with the transactions, including a fee in connection with the delivery of its opinion, and we will pay Deutsche Banc Alex. Brown additional financial advisory fees in the future. Deutsche Banc Alex. Brown is an affiliate of Deutsche Bank AG (together with its affiliates, the DB Group). In the ordinary course of business, members of the DB Group may actively trade in our securities and other instruments and obligations of us for their own accounts and for the accounts of their customers. Accordingly, the DB Group may at any time hold a long or short position in such securities, instruments and obligations. In addition, the DB Group may have investment banking, financial advisory and other relationships with parties other than us pursuant to which the DB Group may acquire information of interest to us and our board of directors. Deutsche Banc Alex. Brown has no obligation to disclose such information to us or our board of directors, nor did it have any obligation to use such information in the preparation of its fairness opinion.

DB Alex. Brown Venture Investors Fund, an affiliate of Deutsche Banc Alex. Brown, is an investor in TCV IV, L.P., which is a holder of a significant number of shares of our common stock and an investor in the private placement. One or more employees of Deutsche Banc Alex. Brown who have provided advisory and investment banking services to us and our board of directors are investors in DB Alex. Brown Venture Investors Fund.

Interests of Certain Persons in the Investment

Mr. Coxe, the chairman of eLoyalty s board of directors, is a managing director of the general partner of the various funds affiliated with Sutter Hill Ventures that have agreed to invest in the private placement. Mr. Hoag, also an eLoyalty director, is a general partner of Technology Crossover Ventures, and one of two managing members of each of the limited liability companies that serves as the general partner to the various funds affiliated with Technology Crossover Ventures that have agreed to invest in the private placement. As disclosed under Security Ownership of Certain Beneficial Owners and Management, as of September 5, 2001, as a result of their respective affiliations with Technology Crossover Ventures and Sutter Hill Ventures, Messrs. Hoag and Coxe may be deemed to beneficially own approximately 14.41% and 4.14%, respectively, of the then-outstanding eLoyalty common stock. In addition, Sutter Hill Ventures L.P. and various Technology Crossover Ventures funds have agreed with eLoyalty and a fund affiliated with Bain Capital to participate in a venture fund, eLoyalty Ventures, L.L.C., to be sponsored by eLoyalty. Pursuant to an operating agreement providing for the formation, management and operation of this fund, each of Sutter Hill Ventures L.P. and such Technology Crossover Ventures funds (considered together) have made a capital commitment of $5.1 million (each representing approximately 17% of the total committed capital) to eLoyalty Ventures. eLoyalty, through a limited liability company in which it and certain of its officers are expected to invest, has made a capital commitment to eLoyalty Ventures of $14.7 million (or approximately 49% of the total committed capital).

In addition, Kelly D. Conway, eLoyalty s President and Chief Executive Officer and a director, holds a limited partnership investment in a fund of Technology Crossover Ventures, TCV IV, L.P., representing a

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total commitment of $1,000,000, of which $477,300 has been funded as of the date of this proxy statement, and a limited partnership investment in Sutter Hill Ventures representing a total commitment of $, of which $ has been funded as of the date of this proxy statement. Michael J. Murray, a director of eLoyalty, holds a limited partnership investment in TCV IV, L.P. representing a total commitment of $3,000,000, of which $1,431,900 has been funded as of the date of this proxy statement. Mr. Coxe holds investments in Page Mill Partners III and Page Mill Partners IV, investors in TCV III, L.P. and TCV IV, L.P., respectively, representing total commitments of $1,000,000 and

$1,900,000, respectively, of which $ and $ has been funded as of the date of this proxy statement.

Required Vote

Approval of the private placement described in this Proposal 1 requires the affirmative vote of a majority of the outstanding shares of common stock present in person or represented by proxy at the special meeting and entitled to vote. In addition, because Technology Crossover Ventures and Sutter Hill Ventures are significant stockholders of our company and have representatives who are members of our board of directors, we have determined that we will not proceed with Proposal 1 unless it is also approved by a majority of the outstanding shares of common stock present or represented at the special meeting and entitled to vote, excluding any votes cast by Technology Crossover Ventures, Sutter Hill Ventures, Messrs. Hoag and Coxe and certain of their respective affiliates. Abstentions will be treated as votes against the proposal and broker non-votes will have no effect. Even if it is approved, we will not implement the private placement unless the increase in our authorized capital stock described in Proposal 2 and the reverse stock split described in Proposal 3 are also approved and are being implemented.

Pursuant to the share purchase agreement, Technology Crossover Ventures and Sutter Hill Ventures have agreed to vote and cause certain of their respective affiliates to vote their shares of eLoyalty common stock (representing approximately % of the common stock entitled to vote at the special meeting) in favor of this proposal. As described above, however, we will not count their votes for purposes of determining whether the private placement has been approved by our disinterested stockholders.

Recommendation of the Board of Directors

The Board of Directors has approved the matters included in Proposal 1 and believes that they are fair to, and in the best interests of, us and our stockholders. The Board recommends that stockholders vote FOR Proposal 1.

Effect of the Proposed Investment by Technology Crossover Ventures and Sutter Hill Ventures

The amount of proceeds we will raise from the private placement and the rights offering depends on the number of and extent to which the rights are exercised. If every stockholder that is eligible to exercise rights exercises their rights in full, the maximum proceeds from the private placement and the rights offering would be approximately $89.1 million. It is unlikely that all eligible stockholders will fully exercise their rights. Assuming the purchase price for the Series B convertible preferred stock is the maximum of $0.51 per share ($5.10 after giving effect to the proposed reverse stock split) as established in the share purchase agreement, total proceeds to eLoyalty from the private placement and rights offering would be (i) $13.0 million and $2.1 million, respectively, assuming 20% of the rights are exercised in full, (ii) $18.9 million and $14.3 million, respectively, assuming 60% of the rights are exercised in full, and (iii) $25.0 million and $64.1 million, respectively, assuming 100% of the rights are exercised in full.

The issuance of the Series B convertible preferred stock in the private placement and the rights offering may result in substantial dilution of your ownership interest in eLoyalty, particularly if you are not eligible to participate (for example, if you did not own our common stock on October 8, 2001, the record date for the rights offering), or you elect not to participate, in the rights offering. It may also result in a substantial decrease in your net book value per share. For example, if a stockholder owns 100,000 shares of common stock before the rights offering (which would be 10,000 shares after giving effect to the reverse stock split), or approximately 0.18% of our common stock, and does not exercise his or her rights while all other rights are

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exercised in full, then his or her percentage ownership in our equity will be reduced to 0.04% upon completion of the transactions. The extent of such dilution will depend upon the price at which the Series B convertible preferred stock is sold and the level of stockholder participation in the rights offering.

The percentage ownership of Technology Crossover Ventures and Sutter Hill Ventures in our company will increase as a result of the private placement, to the extent other stockholders do not exercise their rights. This would give each of them significant influence in determining the outcome of any corporate transaction or other matter submitted to our stockholders for approval, including the election of directors and approval of mergers, consolidations and the sale of all or substantially all of our assets. If Technology Crossover Ventures and Sutter Hill Ventures purchase the maximum number of shares they could purchase without any exercise of rights, the ownership percentage of Technology Crossover Ventures would increase from approximately 13.1% to approximately 26.3%, and the ownership percentage of Sutter Hill Ventures would increase from approximately 3.7% to approximately 13.9%, in each case assuming the issuance, prior to closing, of 5.0 million shares (500,000 shares after giving effect to the reverse stock split) of restricted stock in connection with an offer we intend to make to our officers and

employees to exchange options for restricted stock (the maximum number of restricted shares that may be issued in that offer is 6.5 million, or 650,000 after giving effect to the reverse stock split) as well as the other assumptions described under the caption Structure of the Private Placement above. In connection with the private placement, we have amended our Rights Agreement to allow Technology Crossover Ventures to acquire up to 35% of our outstanding common stock, and Sutter Hill Ventures to acquire up to 20% of our outstanding common stock, without any adverse effects under the Rights Agreement.

Technology Crossover Ventures and Sutter Hill Ventures, as holders of the Series B convertible preferred stock, will have the rights and preferences described in this proxy statement, including the right to vote together with the holders of the common stock on an as-converted basis. In addition, the holders of the Series B convertible preferred stock will have dividend rights that are senior to those of the holders of our common stock. The holders of the Series B convertible preferred stock will also have a claim against our assets senior to the claim of the holders of the common stock in the event of our liquidation or bankruptcy. Initially, the aggregate amount of the senior claims of the holders of the Series B convertible preferred stock will equal the amount invested to purchase the Series B convertible preferred stock and may increase thereafter due to the accumulation of dividends on the Series B convertible preferred stock.

The holders of the Series B convertible preferred stock will also have the right to consent to a number of other significant corporate transactions, including the sale of eLoyalty within six months of the closing of the private placement, the creation of additional classes of preferred stock on parity with or senior to the Series B convertible preferred stock, and amendments to the Certificate of Incorporation that would otherwise adversely effect the rights of holders of Series B convertible preferred stock. Technology Crossover Ventures and Sutter Hill Ventures currently have significant investments in other technology solutions companies. As a result, they may have interests with respect to their investment in us that differ from those of other stockholders.

The ownership by Technology Crossover Ventures and Sutter Hill Ventures and their affiliates of a substantial percentage of our total voting power and the terms of the Series B convertible preferred stock could make it more difficult and expensive for a third party to pursue a change of control of eLoyalty, even if a change of control would generally be beneficial to the interests of our stockholders.

Sales of the securities acquired in connection with the sale of Series B convertible preferred stock in the public market could lower our stock price and impair our ability to raise funds in additional stock offerings. Future sales of a substantial number of shares of our common stock in the public market, or the perception that such sales could occur, could adversely affect the prevailing market price of our common stock and could make it more difficult for us to raise funds through a public offering of our equity securities.

In addition, the private placement may jeopardize our future ability to use certain net operating loss carryforwards. At June 30, 2001, we had incurred significant operating losses in the United States for the year to date. If we were to have a U.S. federal and state net operating loss (NOL) for our taxable year ending December 31, 2001, we would be able to carry that NOL forward to reduce taxable income in future years.

These NOL carryforwards would expire in 2021. Our ability to utilize these NOL carryforwards could become subject to significant limitations under Section 382 of the Internal Revenue Code if we undergo an ownership change. We could undergo an ownership change if, among other things, the stockholders who own or have owned, directly or indirectly, 5% or more of our common stock or are otherwise treated as 5% stockholders under Section 382 and the regulations promulgated thereunder increase their aggregate percentage ownership of our stock by more than 50 percentage points over the lowest percentage of the stock owned by these stockholders at any time during the testing period, which is generally the three-year period preceding the potential ownership change. In the event of an ownership change, Section 382 imposes an annual limitation on the amount of taxable income a corporation may offset with NOL carryforwards. Any unused annual limitation may be carried over to later years until the applicable expiration date for the respective NOL carryforwards.

It is possible that the private placement and the rights offering could trigger an ownership change for purposes of Section 382 of the Internal Revenue Code, which would limit our ability to use any U.S. federal and state NOL carryforwards as described above and could result in a writedown of those assets on our balance sheet and a charge against earnings. Even if the private placement and the rights offering do not trigger an ownership change, they will increase the likelihood that we may undergo an ownership change for purposes of Section 382 in the future.

Even though our spin-off from TSC in February 2000 was structured to be tax-free to TSC, that spin-off could become taxable to TSC, although not to TSC s stockholders, under Section 355(e) of the Internal Revenue Code if one or more persons acquire, directly or indirectly, 50% or more of our stock, measured by voting power or value, as part of a plan that includes the spin-off. For this purpose, any acquisitions of our voting stock within two years before or after the spin-off are presumed to be part of that plan, although this presumption is rebuttable.

We have attempted to structure the private placement and rights offering to avoid the application of Section 355(e), and it is a condition to the closing of each of the private placement and the rights offering that we receive an opinion of counsel that the private placement and rights offering will not cause the distribution of our stock by TSC in February 2000 to be taxable under Section 355(e). However, because (1) Section 355(e) is a relatively new statute that is complex and for which there is little guidance, (2) the analysis and requirements under Section 355(e) are inherently factual in nature, and (3) an opinion of counsel is not binding on the Internal Revenue Service or the courts, there can be no assurance that the IRS will not assert that Section 355(e) should apply to the spin-off as a result of the private placement or rights offering, or that the courts will not uphold such a position if the IRS were to make such an assertion. In addition, the opinion of counsel will rely in part on certain assumptions and representations made by us and by the investors in the private placement as to various matters, some of which are based on our knowledge or the knowledge of the investors rather than on established facts. If an acquisition of our stock were to cause Section 355(e) to apply to our spin-off, we would be required to indemnify TSC under an agreement between us and TSC, and such liability, if it were to arise, would be significant and could exceed the value of all of our assets.

In connection with the sale of Series B convertible preferred stock, we will enter into an investor rights agreement with Technology Crossover Ventures and Sutter Hill Ventures that will obligate us to register the shares of common stock issuable upon conversion of the Series B convertible preferred stock within 180 days after the closing of the private placement. We will also grant Technology Crossover Ventures and Sutter Hill Ventures piggyback registration rights to participate in underwritten offerings of our securities. The exercise of these piggyback registration rights will be subject to notice requirements, timing restrictions and volume limitations which may be imposed by the underwriters of an offering. These registration rights are described in further detail under the heading The Share Purchase Agreement Investor Rights Agreement.

The Share Purchase Agreement

General

On September 24, 2001, we entered into a share purchase agreement with Technology Crossover Ventures and Sutter Hill Ventures pursuant to which Technology Crossover Ventures has agreed to purchase

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up to $15 million, and Sutter Hill Ventures has agreed to purchase up to $10 million, of 7% Series B convertible preferred stock. At closing, we will enter into an amended and restated investor rights agreement that will provide registration rights with respect to the shares of common stock issuable upon conversion of the Series B convertible preferred stock issued in the private placement as well as certain other shares owned by Technology Crossover Ventures. The following discussion of the share purchase agreement and amended and restated investor rights agreement, and the transactions contemplated thereby, provide only a summary. For a more complete understanding of these agreements, we urge you to read our Form 8-K filed with the SEC on September 25, 2001, including the share purchase agreement and form of amended and restated investor rights agreement which are filed as exhibits thereto.

Price

The purchase price per share of preferred stock will be the lesser of (i) $0.51, and (ii) 90% of the average of the last sales prices of our common stock over the twenty trading days through and including the fourth trading day prior to the closing, subject to adjustment for the proposed one-for-ten reverse split of our common stock. If the reverse split is effected as proposed, the purchase price per share of preferred stock will be the lesser of $5.10 and 90% of the average price of our common stock on a pre-split basis multiplied by ten.

Representations, Warranties, Covenants and Agreements

The share purchase agreement contains representations and warranties by us relating to, among other things, our capitalization and due authorization, the issuance and sale of the Series B convertible preferred stock, our SEC filings and our lack of undisclosed liabilities and material adverse changes. The share purchase agreement also contains representations and warranties by the investors relating to, among other things, their status as accredited investors and investment intent.

We and Technology Crossover Ventures and Sutter Hill Ventures have agreed to use our respective reasonable best efforts to satisfy the conditions to closing of the private placement, including obtaining any necessary regulatory approvals. We have also agreed to conduct the

rights offering, hold this special meeting and to not take specified actions with respect to our capital stock, Certificate of Incorporation and by-laws prior to closing. Technology Crossover Ventures and Sutter Hill Investors have agreed to vote their shares of common stock in favor of the proposals described in this proxy statement, not exercise any rights received in the rights offering and not purchase or dispose of shares of our common stock for specified periods.

In connection with the share purchase agreement, we have amended our Rights Agreement to permit Technology Crossover Ventures to acquire up to 35% of our outstanding common stock and to permit Sutter Hill Ventures to acquire up to 20% of our outstanding common stock without adverse effect under the plan.

Conditions to Closing

The closing of the private placement is conditioned on the satisfaction or waiver of various conditions, including the accuracy of the representations and warranties included in the share purchase agreement as of closing, each party s compliance with its covenants and agreements in the share purchase agreement prior to closing, our receipt of a favorable opinion of tax counsel that the private placement and rights offering will not cause our spin-off from TSC to be taxable to TSC, our receipt of an opinion of Deutsche Banc Alex. Brown stating that, as of September 24, 2001 (and based upon and subject to the assumptions made, matters considered and limits of the review undertaken by Deutsche Banc. Alex Brown), the private placement and rights offering were fair, from a financial point of view, to our stockholders (and the lack of any withdrawal or modification of that opinion), approval of the proposals described in this proxy statement by our stockholders, the absence of regulatory constraints and the delivery of customary closing documents. In addition, the obligations of Technology Crossover Ventures and Sutter Hill Ventures to effect the closing are conditioned on our listing the shares of common stock to be issued upon conversion of the Series B convertible preferred stock on Nasdaq and the absence of any material adverse change to our company since the date of the share purchase agreement. Our obligations to effect the closing are also conditioned on a concurrent closing of the rights offering.

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Investor Rights Agreement

In connection with the closing of the private placement, we will enter into an amended and restated investor rights agreement with Technology Crossover Ventures and Sutter Hill Ventures. The agreement will require us to use our reasonable best efforts to have a registration statement on Form S-3 for the shares of common stock issuable upon the conversion of the Series B convertible preferred stock issued in the private placement, plus certain shares of common stock sold to Technology Crossover Ventures in May 2000, declared effective within 180 days after the closing. We will be required to maintain the effectiveness of the registration statement until all of the common stock underlying the Series B convertible preferred stock issued in the private placement can be resold in any and all three month periods under Rule 144 under the Securities Act of 1933, without giving effect to Rule 144(k). We will be entitled to one blackout period not to exceed 90 days in any twelve-month period. Technology Crossover Ventures and Sutter Hill Ventures will also be granted piggyback registration rights to participate in underwritten offerings of our securities, subject to customary limitations.

Fees and Expenses

Whether or not the transactions contemplated in the share purchase agreement are consummated, we will pay the out-of-pocket costs and expenses of Technology Crossover Ventures and Sutter Hill Ventures arising in connection with the share purchase agreement.

Termination

The share purchase agreement may be terminated prior to the closing: (1) with mutual consent of eLoyalty and each of Technology Crossover Ventures and Sutter Hill Ventures; (2) by Technology Crossover Ventures and Sutter Hill Ventures, acting together, or us if the closing under the share purchase agreement is not completed by February 1, 2002 (unless due to a delay or default by the party(ies) seeking to terminate); (3) if specified transactions contemplated by the share purchase agreement, including the rights offering and sale of shares to the investors, is enjoined by a final, unappealable court order; and (4) if our stockholders fail to approve the proposals set forth in this proxy statement.

Use of Proceeds

As described above, the amount of proceeds we will receive from the sale of the Series B convertible preferred stock will depend on the purchase price of the Series B convertible preferred stock and extent to which stockholders exercise their rights to purchase shares of Series B convertible preferred stock pursuant to the rights offering. The total proceeds from the private placement will not exceed an aggregate of $25 million.

We will pay from the net proceeds of the private placement and the rights offering the estimated offering expenses of approximately $2.2 million and $1.0 million, respectively. We will use the net proceeds from the private placement and the rights offering for working capital and general corporate purposes.

Terms of the 7% Series B Convertible Preferred Stock

General

The following summarizes the material terms and provisions of the 7% Series B convertible preferred stock, and is qualified in its entirety by reference to the terms and provisions of our Certificate of Incorporation, as amended by a Certificate of Designation relating to the Series B convertible preferred stock, copies of which have been filed with the SEC and are incorporated by reference in this proxy statement.

When issued, the Series B convertible preferred stock will be validly issued, fully paid and non-assessable. The holders of the Series B convertible preferred stock will have no preemptive rights with respect to any shares of our capital stock or any other securities convertible into or carrying rights or options to purchase any of our capital stock. The Series B convertible preferred stock will not be subject to any obligation on our part to repurchase or retire the Series B convertible preferred stock.

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Rank

The Series B convertible preferred stock will, with respect to dividend rights and rights on liquidation, rank senior to the common stock and to all other equity securities issued by us. For this purpose, the term equity securities does not include debt securities convertible into or exchangeable for equity securities.

Dividends

The holders of record of the Series B convertible preferred stock will be entitled to receive, when, as and if declared by our board of directors, out of funds legally available therefor, cash dividends on each share of Series B convertible preferred stock at an annual rate equal to 7% of the original purchase price per share of Series B convertible preferred stock, payable semi-annually. Additionally, except for dividends payable in common stock, holders of Series B convertible preferred stock shall be entitled to receive dividends paid on the common stock, if any, based on the number of shares of common stock into which such holder s shares of Series B convertible preferred stock would then convert, determined without reference to the limitation on conversion for the first six months after issuance. All dividends will be cumulative. Dividends will cease to accumulate in respect of shares of Series B convertible preferred stock on the date they are converted into shares of common stock.

Rights Upon Liquidation

In the event of any voluntary or involuntary liquidation, dissolution or winding up of the company, the holders of the Series B convertible preferred stock will be entitled to receive out of assets of the company available for distribution to stockholders, before any distribution of assets is made to holders of common stock or any other class of stock ranking junior to the Series B convertible preferred stock upon liquidation, liquidating distributions in the amount per share of Series B convertible preferred stock equal to the original price at which the stock was issued, plus accrued and unpaid dividends. After payment of the full amount of the liquidating distributions to which they are entitled, our remaining assets available for distribution shall be distributed pro rata among the holders of the common stock and Series B convertible preferred stock based on the number of shares of common stock into which the shares of Series B convertible preferred stock would then convert.

Upon a consolidation or merger of eLoyalty with or into any other corporation or other entity or person, or any other corporate reorganization, in which our stockholders immediately prior to such transaction own less than 50% of our voting power immediately after such transaction, or any transaction or series of related transactions to which we are a direct contracting party in which in excess of 50% of our voting power is transferred, or upon a sale of all or substantially all of our assets (each, a Sale Transaction), the holders of the preferred stock will be entitled to the liquidating distribution described in the preceding paragraphs unless the holders of the common stock, assuming conversion of all of the Series B convertible preferred stock into common stock, would receive an amount equal to at least four times the original purchase price of the Series B convertible preferred stock, in which case the holders of the Series B convertible preferred stock will receive the amount that they would be entitled to if they had converted their stock into common stock immediately prior to the transaction.

Conversion

Each share of Series B convertible preferred stock is convertible into one share of our post-reverse stock split common stock, subject to adjustment as described below, at any time on or after six months after the closing of the private placement and the rights offering. In addition, the preferred stock will convert automatically into shares of common stock if at any time beginning six months after the closing the last sale price of our common stock is at least five times the original purchase price per share of the preferred stock for 30 consecutive trading days and, in connection with the shares of preferred stock issued in the private placement, the registration statement we have agreed to file with respect to those shares is effective.

The conversion ratio initially is one share of Series B convertible preferred stock for one share of our post-reverse stock split common stock (see Proposal 3). The conversion ratio will be subject to adjustment if

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certain events occur, including: (1) the payment of dividends (and other distributions) in common stock on the outstanding shares of common stock, or (2) stock splits, combinations, and reclassifications of common stock, unless we take similar actions with respect to the Series B convertible preferred stock. If the company is party to any consolidation or merger in which it is not the surviving entity or transfers all or substantially all of its assets in a transaction that is not deemed to be a liquidation, then each share of Series B convertible preferred stock then outstanding would become convertible only into the kind and amount of securities, cash and other property that is receivable upon the occurrence of such event by a holder of the number of shares of common stock that the shares of Series B convertible preferred stock were convertible into immediately prior to the event, determined without regard to the limitation on conversion during the six months after issuance.

Voting Rights

Holders of the Series B convertible preferred stock will have the right to vote on all matters that the holders of common stock vote on, voting together with the holders of common stock as one class. Each share of Series B convertible preferred stock will be entitled to one vote for each share of common stock in which such share of Series B convertible preferred stock could then be converted, determined without regard to the limitation on conversion during the first six months after issuance.

The affirmative vote of the holders of a majority of the outstanding Series B convertible preferred stock, voting as a separate class, will be required to take any of the following actions:

- the authorization, creation or issuance of any class or series of stock or other securities convertible into or exercisable for equity securities having rights, preferences or privileges that are equal or superior to rights, preferences or privileges of the Series B convertible preferred stock;
- any increase or decrease in the authorized number of shares of Series B convertible preferred stock; or
- any amendment, waiver, alteration or repeal of any provision of our Certificate of Incorporation or our by-laws in a way that adversely affects the rights, preferences or privileges of the Series B convertible preferred stock.

In addition, until six months after the closing of the private placement and the rights offering, the affirmative vote of the holders of at least 85% of the outstanding Series B convertible preferred stock present in person or by proxy and entitled to vote at a meeting held for this purpose shall be required prior to any Sale Transaction.

Restrictions on Transfer

The preferred stock may not be transferred until one year from the date it is initially issued except for transfers: (1) in connection with a Sale Transaction, (2) in connection with a distribution by a partnership or limited liability company to its affiliates or current or former partners or members, or (3) by will or by the laws of intestate succession.

No Maturity Date or Mandatory Redemption

The Series B convertible preferred stock will not mature on a specified date, does not have a stated redemption feature and is not subject to any sinking fund or similar obligation. Holders will have no right to require us to repurchase or redeem any shares of Series B convertible preferred stock except upon a Sale Transaction, in which case the holders of the Series B convertible preferred stock would be entitled to their liquidation preference after the payment of which the preferred stock would be retired.

Absence of Market for Series B Convertible Preferred Stock

There is no established trading market for the Series B convertible preferred stock. We do not currently intend to list the preferred stock on a national securities exchange or qualify the preferred stock for quotation on any automated quotation service such as the Nasdaq National Market.

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PROPOSAL 2: APPROVAL OF AN AMENDMENT TO OUR CERTIFICATE OF INCORPORATION TO INCREASE OUR AUTHORIZED CAPITALIZATION

Introduction

We are asking stockholders to approve an amendment to eLoyalty s Certificate of Incorporation to increase the number of authorized shares of eLoyalty s common stock from 100,000,000 shares to 500,000,000 and to increase the number of authorized shares of eLoyalty s preferred stock from 10,000,000 shares to 40,000,000. Our board of directors has adopted a resolution approving, declaring advisable and recommending to our stockholders for their approval, an amendment to eLoyalty s Certificate of Incorporation to increase the number of authorized shares of eLoyalty common stock and preferred stock.

The form of the Certificate of Amendment to eLoyalty s Certificate of Incorporation to effect an increase in our capitalization is attached as *Appendix B* to this proxy statement. If the required vote is obtained, we will increase the number of authorized shares of eLoyalty s common stock from 100,000,000 shares to 500,000,000 and the number of authorized shares of eLoyalty s preferred stock from 10,000,000 to 40,000,000.

Required Vote

The affirmative vote of a majority of the outstanding shares of our common stock entitled to vote at the special meeting is required to approve this Proposal 2. Abstentions and broker non-votes will have the same effect as a vote cast against this proposal. We will not implement the increase in our authorized capital as described in this Proposal 2 unless the private placement described in Proposal 1 and the reverse stock split described in Proposal 3 are also approved and are being implemented. Under the reverse stock split described in Proposal 3, eLoyalty s Certificate of Incorporation would be further amended to combine our outstanding common stock on a one-for-ten basis and reduce the authorized common stock set forth in *Appendix B* by a factor of ten.

Pursuant to the share purchase agreement, Technology Crossover Ventures and Sutter Hill Ventures have agreed to vote their shares of eLoyalty common stock (representing approximately % of the common stock entitled to vote at the special meeting) in favor of this proposal.

Recommendation of the Board of Directors

The Board of Directors has approved and declared the advisability of the increase in our authorized capitalization included in Proposal 2 and believes that it is fair to, and in the best interests of, us and our stockholders. The Board recommends that stockholders

vote FOR Proposal 2.

Purpose of the Proposed Capitalization Increase

Our Certificate of Incorporation currently authorizes the issuance of 100,000,000 shares of common stock and 10,000,000 shares of preferred stock. On September 24, 2001, in connection with approval of the private placement and rights offering described in Proposal 1, our board of directors adopted resolutions, subject to stockholder approval, proposing an amendment to our Certificate of Incorporation. This amendment provides for an increase in the authorized number of shares of our common stock from 100,000,000 shares to 500,000,000 shares and an increase in the authorized number of shares of our preferred stock from 10,000,000 shares to 40,000,000 shares. If approved by the stockholders, such amendment would become effective upon the filing of a Certificate of Amendment to our Certificate of Incorporation with the Secretary of State of the State of Delaware. Upon the effectiveness of such filing, the Company intends to increase the number of authorized shares of Series A junior participating preferred stock which have been reserved in connection with our Rights Agreement from 1,000,000 to 5,000,000.

We are seeking stockholder approval for this increase in our authorized capital stock so that (i) we have sufficient authorized shares to satisfy our obligations to issue shares of Series B convertible preferred stock pursuant to the private placement and the rights offering and to issue shares of our common stock upon conversion of shares of Series B convertible preferred stock and (ii) after completion of these transactions we

continue to have an adequate amount of authorized and unissued capital stock that we may use to meet our future needs. We may not currently have authorized shares of preferred stock sufficient to meet our obligations under the private placement and the rights offering, depending on the extent to which the rights are exercised. Further, in light of the amount of common stock we currently have outstanding or reserved for issuance in connection with director and employee stock plans, completion of these transactions without any increase in our authorized common stock may leave us with insufficient shares of common stock to issue upon conversion of the Series B convertible preferred stock issued in these transactions and may leave us with no, or virtually no, additional shares of common stock that could be issued in the future.

On September 24, 2001, we entered into the share purchase agreement under which we agreed to issue to Technology Crossover Ventures and Sutter Hill Ventures shares of Series B convertible preferred stock, which initially will be convertible into shares of common stock on a one-for-one basis. Stockholder approval of the increase of our capitalization is a condition to the closing under the share purchase agreement. In connection with the private placement, we are conducting a rights offering entitling holders of our common stock to purchase shares of Series B convertible preferred stock. The actual number of shares of Series B convertible preferred stock, and shares of common stock issuable upon conversion of the Series B convertible preferred stock, necessary to consummate both the private placement and the rights offering depends in part upon the price to be paid for the Series B convertible preferred stock (which may vary depending on the price of our common stock for a specified period prior to closing) and the participation rate in the rights offering. For a more detailed discussion of these transactions, see Proposal 1 above.

In determining the amount of the increase in our authorized preferred stock we are seeking, we analyzed the maximum amount of Series B convertible preferred stock that we expect could be issued in the private placement and rights offering (which will occur after the reverse stock split of the common stock is completed). As described under Proposal 1 above, the amount of preferred stock issuable in connection with these transactions will vary according to the level of participation in the rights offering and the final purchase price for the preferred stock. We believe that the maximum amount of Series B convertible preferred stock issuable in these transactions, based on the assumptions described in Proposal 1, totals approximately 25.8 million shares (after giving effect to the reverse stock split). If the final sale price equals the maximum price as described in Proposal 1, we expect that we could still require about 17.5 million shares of preferred stock in order to complete these transactions (assuming full participation in the rights offering). These amounts are significantly more than the 10.0 million shares we currently have authorized. Accordingly, we are seeking approval of an increase in our authorized preferred stock as described herein.

In determining the amount of the increase in our authorized common stock we are seeking, we analyzed the maximum amount of common stock that we would have outstanding or reserved for issuance upon completion of the private placement and rights offering, but performed this analysis on a pre-reverse stock split basis for ease of comparison to our existing outstanding common stock. We believe, based on the assumptions described in Proposal 1, that the maximum amount of pre-split common stock that would be reserved for conversion of Series B convertible preferred stock after completion of these transactions totals approximately 258 million shares. In addition, we currently have outstanding approximately 51.6 million shares of common stock and an additional 22.8 million shares of common stock reserved for issuance in connection with our director and employee stock plans. This totals approximately 332.4 million shares of pre-split common stock, which is substantially more than the 100 million shares currently authorized. Accordingly, we are seeking approval of an increase in our authorized

common stock to 500 million shares as described herein, provided that upon completion of the reverse stock split both our total outstanding and reserved shares of common stock and our authorized but unissued shares of common stock would be reduced by a factor of ten.

In addition to authorizing shares to satisfy our commitments under the share purchase agreement, our board of directors generally believes it is necessary to increase the number of authorized shares of common stock and preferred stock in order to give us, among other things, the ability to raise and maintain additional capital funds through the sale of stock and preferred stock in other transactions. The ability to raise capital is important for us in order to meet working capital requirements, facilitate growth and to form strategic relationships and alliances.

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Our board of directors also believes that the proposed increase in the number of authorized shares of common stock and preferred stock is desirable to maintain our flexibility in choosing how to pay for acquisitions. We may need to acquire companies in order to expand our ability to provide diverse and innovative solutions to our customers. We may choose to use shares of stock to pay for such possible acquisitions. Nonetheless, we do not presently have any such agreements, understandings or arrangements that will or could result in the issuance of any shares.

In addition, our board of directors believes that the availability of additional shares of common stock and preferred stock will provide us with the flexibility to issue shares for a variety of other purposes that our board may deem advisable without further action by our stockholders, unless required by law, regulation or stock market rules. These purposes could include, among other things, to finance personal property leases, to finance the purchase of property, the use of additional shares for various equity compensation and other employee benefit plans, effecting stock dividends, and other bona fide corporate purposes. Approval of the proposed amendment to our Certificate of Incorporation will give us greater flexibility in pursuing these opportunities and to attract and retain personnel.

We will not effect the increase in our authorized capital described in this proposal unless we are also implementing the sale of the Series B convertible preferred stock contemplated by Proposal 1 and the reverse stock split contemplated by Proposal 3. As described above, the number of shares of Series B convertible preferred stock that will be issued in connection with the private placement and rights offering and, accordingly, the number of shares of common stock that must be reserved for issuance upon conversion of those shares, depends, in part, on the level of participation in the rights offering.

The following table shows, at varying levels of participation in the rights offering, how many shares we will have of (i) authorized common stock, (ii) issued and outstanding common stock, (iii) common stock reserved for issuance upon conversion of the Series B convertible preferred stock and upon exercise of outstanding options to purchase common stock, and (iv) common stock that is authorized, but unissued and unreserved, in each case upon completion of the transactions described in Proposals 1, 2 and 3. The table assumes that the Series B convertible preferred stock will be issued at the maximum price and is based on and reflects the assumptions described under the caption Structure of the Private Placement in Proposal 1. Share numbers are in millions.

Participation in Rights Offering	Common Stock Authorized	Common Stock Outstanding	Common Stock Reserved	Common Stock Available
0%	50.0	5.7	4.0	40.3
20%	50.0	5.7	4.7	39.6
40%	50.0	5.7	6.0	38.3
60%	50.0	5.7	8.3	36.0
80%	50.0	5.7	13.3	31.0
100%	50.0	5.7	19.3	25.0

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The following table shows, at varying levels of participation in the rights offering, how many shares we will have of (i) authorized preferred stock, (ii) preferred stock reserved for issuance as Series A junior participating preferred stock in connection with our Rights Agreement, (iii) issued and outstanding Series B convertible preferred stock, and (iv) preferred stock that is authorized, but unissued and unreserved, in each case upon completion of the transactions described in Proposals 1, 2 and 3. The table assumes that the Series B convertible preferred stock will be issued at its maximum price and is based on and reflects the assumptions described under the caption Structure of the Private Placement in Proposal 1. Share numbers are in millions.

Participation in Rights Offering	Preferred Stock Authorized	Series A Preferred Stock Reserved	Series B Preferred Stock Outstanding	Preferred Stock Available
0%	40.0	5.0	2.2	32.8
20%	40.0	5.0	3.0	32.0
40%	40.0	5.0	4.2	30.8
60%	40.0	5.0	6.5	28.5
80%	40.0	5.0	11.5	23.5
100%	40.0	5.0	17.5	17.5

Material Effects of the Proposed Capitalization Increase

If this proposal is approved and implemented, the board of directors does not intend to seek further stockholder approval prior to the issuance of any additional shares of common stock or preferred stock in future transactions unless required by law, our Certificate of Incorporation, the requirements of The Nasdaq Stock Market or other stock exchange on which our common stock is trading, or unless the board of directors deems it advisable to do so to qualify an employee benefit plan or stock option plan.

Other than the Series B convertible preferred stock to be issued in the private placement and rights offering, we have no current plans to issue the additional preferred stock that would be authorized if this proposal is approved and implemented. The precise terms of this additional preferred stock, if and when we determine to issue it, may be set by our board of directors without further action by our stockholders. The board of directors power with respect to the terms of this preferred stock includes determination of the following: whether dividends will be payable and, if so, the dividend rate; whether the shares will be convertible and, if so, conversion rights and prices; voting rights, if any; redemption rights, if any, and prices; amounts payable on and the preference of the shares in the event of any liquidation or dissolution of the company; and similar matters

The issuance of additional shares of common stock or preferred stock may, depending on the timing and circumstances, dilute earnings per share and book value per share as well as have a dilutive effect on stockholder s equity and voting rights.

The issuance of additional shares, or the perception that additional shares may be issued, may also adversely effect the market price of the common stock. We cannot predict what effect, if any, the proposed increase in authorized common stock will have on the market price of our existing or post-reverse stock split common stock.

The availability for issuance, or the issuance, of additional shares of common stock or preferred stock also could, under certain circumstances, have the effect of rendering more difficult or discouraging any attempt by a third party to obtain control of eLoyalty, making it potentially less likely that our stockholders will obtain a change of control premium sometimes realized in connection with change of control transactions. For example, the issuance of shares of common stock (within the limits imposed by applicable law and the rules of any stock market upon which the common stock may be listed) in a public or private sale, merger or similar transaction would increase the number of our outstanding shares, thereby possibly diluting the interest of a party attempting to obtain control of us and increase the cost of such transaction. The issuance of additional

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shares of common stock could be used to render more difficult a merger or similar transaction even if it appears to be desirable to a majority of our stockholders.

Our board of directors is not proposing the amendment to our Certificate of Incorporation in response to any effort to accumulate our stock or to obtain control of us by means of a merger, tender offer or solicitation in opposition to management. In addition, the proposed amendment to our Certificate of Incorporation is not part of any plan by management to recommend a series of similar amendments to our board of directors and the stockholders. Finally, our board of directors does not currently contemplate recommending the adoption of any other amendments to our Certificate of Incorporation that could be construed to affect the ability of third parties to take over or change control of eLoyalty.

PROPOSAL 3: APPROVAL OF A ONE-FOR-TEN REVERSE STOCK SPLIT

Introduction

We are asking stockholders to approve the amendment of our Certificate of Incorporation to effect a one-for-ten stock combination, or reverse stock split, of our common stock and a corresponding decrease in the number of our authorized shares of common stock.

The board of directors would have the ability to effect the reverse stock split if the private placement described in Proposal 1 and the increase in our authorized capital stock described in Proposal 2 are approved and are being implemented, as well as if the private placement and increase in our authorized capital stock are not approved or implemented. Accordingly, the board of directors has approved two forms of amendment to eLoyalty s Certificate of Incorporation to effect the reverse stock split, one of which would be applicable if the private placement and increase in our authorized capital stock are approved and are being implemented (in which case, immediately prior to the reverse stock split, Proposal 2 will have been effected and will have increased our authorized common stock to 500,000,000 shares) and one of which would be applicable if only the reverse stock split described in this Proposal 3 is being implemented (in which case, immediately prior to the reverse stock split, our authorized common stock would be the same as it is as of the date of this proxy statement, 100,000,000 million shares). Both amendments have the same effect, however, which is to cause a one-for-ten reverse stock split of both our issued and authorized common stock, with no effect on our preferred stock, as described in more detail below. The two forms of the Certificate of Amendment to our Certificate of Incorporation are attached as *Appendix C* to this proxy statement. If one of the forms of Certificate of Amendment is implemented by the board of directors, the other will be abandoned. Our board of directors has adopted a resolution approving, declaring advisable and recommending to our stockholders for their approval these amendments to eLoyalty s Certificate of Incorporation.

In addition, our board of directors has reserved the right to abandon the reverse stock split, without further direction by our stockholders, at any time before it becomes effective. Because the reverse stock split is a condition to the closing of the private placement, if this Proposal 3 is approved we expect to complete the reverse stock split if the private placement is approved and is being implemented. We also expect that, if this Proposal 3 is approved, we would complete the reverse stock split even if the private placement is not approved or implemented, unless in our judgment the market price of our common stock improves sufficiently so that the considerations described herein which make the reverse stock split advisable no longer apply.

Required Vote

The affirmative vote of a majority of the outstanding shares of our common stock entitled to vote at the special meeting is required to approve this Proposal 3. Abstentions and broker non-votes will have the same effect as votes against the proposal. As described above, we have reserved the right not to effect the reverse stock split even if it is approved by our stockholders.

Pursuant to the share purchase agreement, Technology Crossover Ventures and Sutter Hill Ventures have agreed to vote and cause certain of their respective affiliates to vote their shares of our common stock

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(representing approximately of the common stock entitled to vote at the special meeting) in favor of this proposal.

Recommendation of the Board of Directors

The Board of Directors has approved and declared the advisability of the reverse stock split included in Proposal 3 and believes that it is fair to, and in the best interests of, us and our stockholders. The Board recommends that stockholders vote FOR Proposal 3.

Purpose of the Reverse Stock Split

We believe that the board of directors should be granted the authority to implement the reverse stock split for the following reasons:

- if Proposals 1 and 2 are also implemented, to provide for a potential post-transaction capital structure that is more comparable with those of similarly situated companies in our industry and more reasonable in light of our size and market capitalization; and

- regardless of whether Proposals 1 and 2 are implemented, to raise the per share price of our common stock in an effort to continue its listing on the Nasdaq National Market and to enhance the acceptability and marketability of our common stock to the investing public and financial community.

As described in Proposal 1, we have entered into an agreement to sell up to $25.0 million of 7% Series B convertible preferred stock in a private placement and, in connection therewith, we are offering our stockholders rights to purchase 7% Series B convertible preferred stock. Each share of Series B convertible preferred stock will be convertible into our common stock at an initial conversion ratio of one-for-one. If we were to complete these transactions without the reverse stock split, we believe that the maximum amount of common stock we would need to reserve for issuance upon conversion of this preferred stock is about 258.1 million shares, assuming all of the rights are exercised in full and based on the other assumptions described under the caption Structure of the Private Placement in Proposal 1. This is in addition to the approximately 51.6 million shares of common stock we currently have outstanding and the 22.8 million shares of common stock currently reserved for issuance in connection with our director and employee stock plans. This totals approximately 332.5 million shares that could be outstanding, which is substantially more common stock than other similarly situated companies in our industry have outstanding. Further, regardless of the amount of shares we issue in the private placement and rights offering, the reverse stock split would reduce the number of shares of our common stock that could be outstanding upon conversion of the Series B convertible preferred stock and issuance under director and employee stock plans, as well as our authorized and unissued common stock, to amounts that we believe are more reasonable in light of our size and market capitalization. The reverse stock split is a condition to closing of the private placement.

On August 2, 2001, Nasdaq formally notified us of our failure to comply with the Nasdaq Marketplace Rule 4310(c)(4), because our common stock had failed, for more than 30 consecutive days, to maintain the $1.00 minimum bid price. Pursuant to Nasdaq Marketplace Rule 4310(c)(8)(B), Nasdaq gave us 90 calendar days, or until October 31, 2001, to regain compliance with the Rule by having a minimum bid price for our common stock of at least $1.00 for at least ten consecutive trading days (although Nasdaq retained discretion to require a longer period) prior to October 31, 2001. Nasdaq notified us that, if we were unable to demonstrate compliance on or before October 31, 2001, our common stock would be delisted from the Nasdaq National Market.

On September 27, 2001, before the deadline specified in our notification letter, Nasdaq announced a moratorium on the $1.00 minimum bid requirement for continued listing. Nasdaq suspended this requirement until January 2, 2002, including with respect to companies that were under review for bid price deficiencies prior to the suspension, such as eLoyalty. Nasdaq has indicated, however, that during the suspension it will consider whether to recommend further and more permanent action. As of the date of this proxy statement, we are in compliance with the other Nasdaq National Market listing criteria, but the closing bid price of our common stock has been below $1.00 since June 19, 2001. Because we cannot predict what action, if any,

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Nasdaq may take with respect to its minimum bid requirement or our continued listing from and after January 2, 2002, and because of other potentially negative effects that may be associated with a low stock price, we continue to believe that we should be granted the authority to implement the reverse stock split.

If a delisting were to occur, eLoyalty common stock would trade on the OTC Bulletin Board or in the pink sheets maintained by the National Quotation Bureau, Inc. These alternatives are generally considered to be less efficient markets. In addition, if our common stock were to become delisted from trading on the Nasdaq National Market and the trading price were to remain below $5.00 per share, trading in our common stock may also be subject to the requirements of certain rules promulgated under the Securities Exchange Act of 1934, which require additional disclosures by broker-dealers in connection with any trades involving a stock defined as a penny stock (generally, any non-Nasdaq equity security that has a market price of less than $5.00 per share, subject to certain exceptions). The additional burdens imposed upon broker-dealers by these requirements could discourage broker-dealers from facilitating trades in our common stock, which could severely limit the market liquidity of the stock and the ability of investors to trade our common stock.

We also believe that certain securities firms fail to follow and research companies having lower-priced securities. Those firms also may discourage their registered representatives from recommending the purchase of lower-priced securities. In addition, the policies and practices of some brokerages houses tend to discourage individual brokers within those firms from dealing in lower-priced stocks. Some of these policies and practices relate to the payment of brokers commissions and to time-consuming procedures that tend to make the handling of lower-priced stocks economically unattractive to brokers.

Our board also believes that the low per share market price of our common stock impairs its marketability and acceptance to institutional investors and other members of the investing public and creates a negative impression of eLoyalty. Theoretically, the number of shares outstanding should not, by itself, affect the marketability of the shares, the type of investor who would be interesting in acquiring them, or our reputation in the financial community. In practice, however, many investors and market makers consider low-priced stock as unduly speculative in nature and, as a matter of policy, avoid investment and trading in such stocks. These factors may adversely affect not only the pricing of our common stock but also its liquidity and our ability to raise additional capital through the sale of stock.

We believe that the reverse stock split will improve the price level of eLoyalty common stock so that we are able to maintain compliance with the Nasdaq minimum bid requirement (as in effect prior to the recent suspension) and avoid delisting. However, we cannot predict the effect of the reverse stock split upon the market price for eLoyalty common stock, and the history of similar stock split combinations for companies in like circumstances is varied. There can be no assurance that the market price per new share of eLoyalty common stock after the reverse stock split will rise in proportion to the reduction in the number of shares of eLoyalty common stock outstanding. There can be no assurance that, as a result of the reverse stock split, the market price per share of common stock will either exceed or remain in excess of the $1.00 minimum bid price as required by Nasdaq prior to its recent suspension of that requirement, or otherwise meet the requirements of Nasdaq for continued inclusion for trading on the Nasdaq National Market. The market price of eLoyalty common stock is based on our performance and other factors, some of which may be unrelated to the number of shares outstanding.

Material Effects of Proposed Reverse Stock Split

The principal effects of the reverse stock split will be that:

(a) each ten (10) shares of eLoyalty common stock issued immediately prior to the reverse stock split will be reclassified and converted into one (1) share of new eLoyalty common stock, which will continue to have a par value of $0.01 per share;

(b) the number of authorized shares of eLoyalty common stock will be reduced by a factor of ten, to one-tenth of the amount of such authorized common stock immediately prior to the reverse stock split;

(c) if Proposal 2 has been approved and effected, this will mean that the authorized common stock will be reduced from 500,000,000 shares to 50,000,000 shares, and the authorized preferred stock will

remain 40,000,000 shares. If Proposal 2 has not been effected and our board of directors determines to proceed with the reverse stock split, this will mean that the authorized common stock will be reduced from 100,000,000 shares to 10,000,000 shares, and the authorized preferred stock will continue to be 10,000,000 shares. In either event, our authorized Series A junior participating preferred stock, which was designated in connection with our Rights Agreement, will not be reduced as a result of the reverse stock split. If we implement Proposals 1 and 2, we expect to increase the number of authorized Series A junior participating preferred stock from 1,000,000 shares to 5,000,000 shares;

(d) all outstanding warrants, options and other grants entitling the holders to purchase shares of eLoyalty common stock will enable the holders to purchase, upon exercise of their warrants, options or other grants, one-tenth of the number of shares of eLoyalty common stock which these holders would have been able to purchase upon such exercise immediately prior to the reverse stock split, at an exercise price equal to ten times the applicable exercise price before the reverse stock split; and

(e) the number of shares reserved for issuance in our existing plans providing for stock options and other equity-based awards will be reduced to one-tenth of the number of shares reserved under these plans immediately prior to the reverse stock split.

The reverse stock split will affect all of our stockholders uniformly and will not affect any stockholder s percentage ownership interests in us or proportionate voting power, except to the extent that the reverse stock split results in any of our stockholders owning a fractional share. In lieu of issuing fractional shares, we will pay to any stockholder who otherwise would have been entitled to receive a fractional share as a result of the

reverse stock split (after aggregating all shares held by such stockholder) cash at the market price. The market price will be determined by reference to the average closing price of eLoyalty common stock on the Nasdaq National Market for the 20 business days prior to the day on which the amendment effectuating the reverse stock split becomes effective (or, if we are no longer quoted on the Nasdaq National Market, such other process as is determined by our board of directors).

For example, as a result of the reverse stock split, someone holding 509 shares of common stock prior to the reverse stock split would receive 50 shares of common stock and cash in lieu of nine-tenths of a post-split share of common stock.

The reverse stock split will not affect the par value of shares of eLoyalty common stock. As a result, on the effective date of the reverse stock split, the stated capital on our balance sheet attributable to the eLoyalty common stock will be reduced to one-tenth of its present amount, and the additional paid-in capital account shall be credited with the amount by which the stated capital is reduced. The per share net income or loss and per share net book value of eLoyalty common stock will be increased as a result of the reverse stock split, because there will be fewer shares of eLoyalty outstanding.

The eLoyalty common stock issued and outstanding after the reverse stock split will remain fully paid and non-assessable. We will continue to be subject to the periodic reporting requirements of the Securities Exchange Act of 1934.

The reverse stock split will likely reduce the number of round lot stockholders (round lot stockholders are holders of 100 shares or more of the common stock) of our common stock. The Nasdaq National Market Continued Listing Requirements also require that the Company have at least 400 round lot stockholders to maintain its Nasdaq listing. While there can be no assurance, based upon information currently available to the Company from its transfer agent, we do not believe that the implementation of the reverse stock split will result in there being less than 400 round lot holders of the common stock.

We hope that the decrease in the number of shares of common stock outstanding as a consequence of the reverse stock split and the anticipated increase in the price per share will encourage greater interest in the common stock by the financial community and the investing public and possibly promote greater liquidity for our stockholders with respect to those shares presently held by them. However, the possibility exists that liquidity in the market for eLoyalty common stock could be adversely affected by the reduced number of shares that would be outstanding after the reverse stock split. In addition, the reverse stock split will likely increase the number of our stockholders who own odd lots (less than 100 shares). Stockholders who hold odd

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lots typically will experience an increase in the cost of selling their shares, as well as possibly greater difficulty in effecting these sales. Consequently, there can be no assurance that the reverse stock split will achieve the desired results that have been outlined above.

Procedure for Effecting Reverse Stock Split and Exchange of Stock Certificates

If the reverse stock split is approved by our stockholders and implemented, we will file an amendment to our Certificate of Incorporation with the Secretary of State of the State of Delaware. The reverse stock split will become effective at the time specified in the Certificate of Amendment. Beginning at the effective time of the reverse stock split, each certificate representing our common stock that was issued before the reverse stock split will be deemed for all corporate purposes to evidence post-reverse stock split ownership.

As soon as practicable after we file the amendment, eLoyalty stockholders will be notified that the reverse stock split has been effected. Our transfer agent will act as exchange agent for purposes of implementing the exchange of stock certificates. Holders of shares of common stock will be asked to surrender to our transfer agent certificates representing shares of common stock in exchange for certificates representing the reverse-split adjusted shares in accordance with the procedures to be set forth in a letter of transmittal to be sent by the transfer agent. No new certificates will be issued or cash in lieu of a fractional share be paid to a stockholder until the stockholder has surrendered his or her outstanding certificate(s) together with the properly completed and executed letter of transmittal to the transfer agent. Stockholders should not destroy any stock certificate and should not submit any certificates until requested to do so. If your shares of eLoyalty common stock are deposited in book entry, your shares will automatically be converted to reflect the reverse stock split without any action on your part.

No Effect Upon Shares of Preferred Stock

The reverse stock split will have no effect upon the shares of eLoyalty s preferred stock, including the Series B convertible preferred stock issued in the private placement and rights offering (because these shares of Series B convertible preferred stock will be issued on a post-split basis).

Fractional Shares

We will not issue fractional shares in connection with the reverse stock split. Stockholders who otherwise would be entitled to receive a fractional share because they hold an aggregate number of shares of pre-split common stock not evenly divisible by ten, will, upon surrender to the exchange agent of the certificate or certificates representing the pre-split common stock held by them, receive cash in respect of that fractional share at the market price. The market price will be determined by reference to the average closing price of eLoyalty common stock on the Nasdaq National Market for the 20 business days prior to the day before date on which the reverse stock split becomes effective (or, if we are no longer quoted on the Nasdaq National Market, such other process as is determined by our board of directors).

No Dissenters Rights

Under the Delaware General Corporation Law, eLoyalty stockholders are not entitled to dissenters rights with respect to our proposed amendment to our Certificate of Incorporation to effect the reverse stock split and we will not independently provide our stockholders with any such right.

Material U.S. Federal Income Tax Consequences

The following is a discussion of the material U.S. federal income tax consequences that you should consider with respect to the reverse stock split.

General. This discussion is based on the Internal Revenue Code of 1986, as amended (the Code), the Treasury regulations promulgated thereunder, judicial authority, and current administrative rulings and practice, all of which are subject to change on a prospective or retroactive basis. This discussion does not discuss all aspects of U.S. federal income taxation that may be relevant to you, especially if you are subject to special treatment under U.S. federal income tax law. For instance, if you are a bank, a life insurance company,

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a tax-exempt organization or a foreign taxpayer, this discussion may not cover all relevant tax issues as to you. The discussion is only applicable to you if (1) you have held and will hold our common stock as capital assets (generally, property held for investment) within the meaning of Section 1221 of the Code, (2) the reverse stock split is not part of any plan to increase, periodically, your proportionate interest in our assets and earnings, and (3) any cash payment you may receive in lieu of a fractional share represents a mechanical rounding rather than separately bargained for consideration. Further, no foreign, state or local tax consequences are discussed below.

Accordingly, each stockholder should consult his, her or its tax advisor to determine the particular tax consequences to him, her or it of the reverse stock split, including the application and effect of federal, state, local or foreign income tax and other laws.

You will not recognize any gain or loss upon the exchange of shares pursuant to the reverse stock split. Your aggregate tax basis in the shares received in the reverse stock split, including any fractional share interest for which cash is received, will be the same as your aggregate tax basis in the shares surrendered in the reverse stock split. Your holding period for the shares received in the reverse stock split will include the period during which you held the shares surrendered in the reverse stock split.

If you receive cash in lieu of a fractional share interest in the reverse stock split, you will be treated as having received the fractional share interest in the reverse stock split and as having received the cash in redemption of the fractional share interest. The cash payment will be treated as a payment in redemption of the fractional share interest under Section 302 of the Code. In general, you will recognize capital gain or loss on the deemed redemption in an amount equal to the difference between the amount of cash received and your adjusted tax basis allocable to such fractional share. If, however, you are involved in directing corporate affairs, hold more than a minimal interest in us, or own our stock under the constructive ownership rules of Section 318 of the Code, the Internal Revenue Service may take the view that the cash payment should be taxed to you as a dividend.

Information Reporting and Backup Withholding. Under the backup withholding rules of the Code, you may be subject to backup withholding with respect to payments of cash received in lieu of any fractional share unless you (i) are a corporation or come within certain other exempt categories and, when required, demonstrate this fact, or (ii) provide a correct taxpayer identification number and certify under penalties of perjury that the taxpayer identification number is correct and that you are not subject to backup withholding because of a failure to report all dividends and interest income. Any amount withheld under these rules will be credited against your U.S. federal income tax liability. We may require you to establish your exemption from backup withholding or to make arrangements satisfactory to us with respect to the payment of backup withholding.

For payments made before January 1, 2002, backup withholding is imposed at a rate of 30.5%; for payments made in 2002 or 2003, 30%.

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SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

To our knowledge, the following table sets forth information regarding beneficial ownership of outstanding eLoyalty common stock as of September 5, 2001, except as otherwise indicated, by: (1) each person or group that beneficially owns more than 5% of the outstanding shares of common stock; (2) each of the chief executive officer and the company s four most highly compensated executive officers other than the chief executive officer; (3) each of our directors; and (4) all executive officers and directors as a group. The shares shown as beneficially owned by all directors and executive officers as a group include shares beneficially owned by persons who joined eLoyalty or otherwise became executive officers during fiscal 2001 prior to September 5, 2001. Except as otherwise indicated below, each owner has sole voting and investment power with respect to all shares listed as beneficially owned.

Name and Address of Beneficial Owner	Number of Shares of Common Stock Beneficially Owned(l)	Percent of Class(l)
Jay C. Hoag, Richard H. Kimball and various entities associated with Technology Crossover Ventures c/o Technology Crossover Ventures 528 Ramona Street Palo Alto, CA 94301	7,430,440(2)	14.41%
Massachusetts Financial Services Company 500 Boylston Street Boston, MA 02116	5,554,520(3)	10.77%
GeoCapital, LLC 825 Third Avenue New York, NY 10022-7519	3,106,361(4)	6.02%
Kelly D. Conway	1,187,555(l)	2.27%
Tench Coxe	2,135,090(l)(5)	4.14%
John T. Kohler	686,419(l)	1.32%
Michael J. Murray	453,349(l)	*
Timothy J. Cunningham	183,704	*
Craig B. Lashmet	517,733(l)	1.0%

N. Vaughan Thomas	256,125(1)	*
Christopher J. Danson	221,132(l)(6)	*
All directors and executive officers as a group (14 individuals)(1)	13,988,581(l)	25.86%

* Less than 1%

(1) Includes shares of eLoyalty common stock that may be acquired within 60 days after September 5, 2001 through the exercise of stock options outstanding as of such date, as follows: Mr. Conway, 843,638 shares; Mr. Coxe, 15,416 shares; Mr. Kohler, 486,366 shares; Mr. Murray, 163,633 shares; Mr. Lashmet, 359,978 shares; Mr. Thomas, 109,375 shares; Mr. Danson, 104,850 shares (including 2,086 shares that may be acquired by his spouse through the exercise of her employee stock options); and all directors and executive officers as a group, 2,517,138 shares. With respect to each of these individuals and such group, these shares have been deemed to be outstanding in computing the percent of class in the preceding table.

(2) Messrs. Hoag and Kimball are the two managing members of Technology Crossover Management III, L.L.C. (TCM III) and Technology Crossover Management IV, L.L.C. (TCM IV). TCM III is the managing general partner of TCV III (GP) and the sole general partner of TCV III, L.P., TCV III (Q), L.P., and TCV III Strategic Partners, L.P. (the TCV III Funds), and TCM IV is the sole general partner of TCV IV, L.P. and TCV IV Strategic Partners, L.P. (the TCV IV Funds). Each of the TCV III Funds and the TCV IV Funds (collectively, the TCV Funds) hold of record shares of

eLoyalty common stock, and TCM III and TCM IV may be deemed to have sole voting and investment power with respect to the shares of eLoyalty common stock held by the TCV III Funds and the TCV IV Funds, respectively. As a result of their position as the managing members of TCM III and TCM IV, each of Messrs. Hoag and Kimball may be deemed to have sole investment power and shared voting power over all shares of eLoyalty Common Stock held by the TCV Funds. All of the shares of eLoyalty common stock shown in the preceding table as beneficially owned by Messrs. Hoag and Kimball are held of record by the TCV Funds. TCM III and TCM IV and Messrs. Hoag and Kimball disclaim beneficial ownership of such securities, except to the extent of their respective pecuniary interests therein. The number of shares of eLoyalty common stock held of record by each of the TCV Funds as of September 5, 2001 are as follows: TCV III (GP), 13,736 shares; TCV III, L.P., 65,247 shares; TCV III (Q), L.P., 1,734,188 shares; TCV III Strategic Partners, L.P., 78,519 shares; TCV IV, L.P., 5,338,457 shares; and TCV IV Strategic Partners, L.P., 200,293 shares.

(3) This information, which is not within the direct knowledge of the Company, has been derived from a Schedule 13G/ A filed with the Securities and Exchange Commission (SEC) on February 12, 2001 with respect to eLoyalty common stock beneficially owned as of December 31, 2000. Based on the information contained therein, Massachusetts Financial Services Company beneficially owns and has sole investment power with respect to 5,554,520 shares, some of which are also beneficially owned by certain other unnamed entities, and has sole voting power with respect to 4,737,816 shares.

(4) This information, which is not within the direct knowledge of the Company, has been derived from a Schedule 13G filed with the SEC on March 29, 2001 with respect to eLoyalty common stock beneficially owned as of December 31, 2000. Based on the information contained therein, GeoCapital, LLC beneficially owns and has sole investment power and no voting power with respect to 3,106,361 shares of eLoyalty common stock.

(5) Mr. Coxe is one of six Managing Directors of the general partner of each of Sutter Hill Ventures L.P., a California limited partnership, Sutter Hill Entrepreneurs Fund (AI), L.P., and Sutter Hill Entrepreneurs Fund (QP), L.P., which hold of record 2,117,369 shares, 221 shares and 560 shares, respectively, of eLoyalty common stock. In such capacity, Mr. Coxe is deemed to have shared voting and investment power over all shares of eLoyalty common stock held of record by such partnerships. Mr. Coxe disclaims beneficial ownership of such shares except to the extent of his pecuniary interest in such limited partnerships. The number of shares shown in the table also includes 1,524 shares held directly by Mr. Coxe, as to which he has sole voting and investment power.

(6) Includes 4,347 shares of eLoyalty common stock held of record by Mr. Danson s spouse, including 2,086 shares that may be acquired by her within 60 days following September 5, 2001 through the exercise of employee stock options outstanding as of such date. Mr. Danson disclaims beneficial ownership of such shares.

OTHER BUSINESS

The board of directors does not know of any further business to be presented at the special meeting. However, should any other matters requiring a vote of eLoyalty stockholders arise, the persons named as proxies in the enclosed proxy card intend to vote on those matters in accordance with their judgment as to our best interests.

SUBMISSION OF STOCKHOLDER PROPOSALS FOR 2002

Deadline for Inclusion in Proxy Statement

Any stockholder proposal to be considered by eLoyalty for inclusion in the proxy statement and form of proxy for next year s annual meeting of stockholders must be received by the Corporate Secretary of eLoyalty at eLoyalty s principal executive offices, 150 Field Drive, Suite 250, Lake Forest, Illinois 60045, no later than December 11, 2001 and must otherwise satisfy the requirements of applicable SEC rules.

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Other Stockholder Proposals

In accordance with the procedures set forth in eLoyalty s by-laws, only such business shall be conducted at the special meeting as has been brought before the meeting pursuant to this notice. A copy of the by-law provisions governing the matters that may be addressed at a special meeting of stockholders may be obtained by writing to the Corporate Secretary of eLoyalty at the address specified above.

Stockholder proposals that are not intended for inclusion in a proxy statement for an annual meeting, but that stockholders intend to introduce at an annual meeting, as well as proposed stockholder nominations for the election of directors at an annual meeting, must each comply with advance notice procedures set forth in eLoyalty s by-laws in order to be brought properly before that annual meeting of stockholders. In general, written notice of a stockholder proposal or a director nomination for an annual meeting must be delivered to the Corporate Secretary of eLoyalty not less than 75 days nor more than 100 days prior to the anniversary date of the preceding annual meeting of stockholders. With regard to next year s annual meeting of stockholders, the written notice must be received no earlier than January 23, 2002 and no later than February 17, 2002. In addition to timing requirements, the advance notice provisions of the by-laws contain informational content requirements that must also be met. A copy of the by-law provisions governing these timing procedures and content requirements may be obtained by writing to the Corporate Secretary of eLoyalty at the address specified above. If the presiding officer at the annual meeting of stockholders determines that business, or a nomination, was not brought before the meeting in accordance with the by-law provisions, such business will not be transacted or such defective nomination will not be accepted.

ADDITIONAL INFORMATION

We have retained to solicit proxies. The cost of soliciting proxies, which we estimate will be , will be borne by us. In addition to soliciting proxies through the mail, certain employees of eLoyalty may solicit proxies in person, by facsimile or by telephone, without additional compensation. As is customary, we will, upon request, reimburse brokers, banks, custodians and other nominee holders of record for their out-of-pocket expenses of forwarding proxy materials to the beneficial owners of eLoyalty shares.

Your vote is important. Please complete the enclosed proxy card with your voting instructions and mail it in the enclosed postage-paid envelope as soon as possible or, if you wish, submit your proxy with voting instructions by telephone or through the Internet by following the instructions on the proxy card.

WHERE YOU CAN FIND MORE INFORMATION

We are required to file reports and other information with the SEC pursuant to the information requirements of the Securities Exchange Act of 1934.

Our filings with the SEC may be inspected and copied at the public reference facilities maintained by the SEC at Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information relating to the public reference rooms. Copies of our filings may be obtained at the prescribed rates from the Public Reference Section of the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. In addition, the SEC maintains an Internet site *(http://www.sec.gov)* that contains certain reports, proxy statements and other information regarding eLoyalty.

The share purchase agreement, form of amended and restated investor rights agreement and form of certificate of designation for the 7% Series B convertible preferred stock, each of which are discussed in this proxy statement, are filed as exhibits to our Current Report on Form 8-K, filed with the SEC on September 25, 2001. We will provide you with a copy of each of these agreements without charge. You may request copies of these documents by contacting us at: eLoyalty Corporation, 150 Field Drive, Suite 250, Lake Forest, Illinois 60045 or calling us at (847) 582-7000, Attention: Investor Relations. Statements contained in this proxy statement as to the contents of any contract or other document referred to in this proxy statement are not necessarily complete, and in each instance reference is made to the copy of such contract or other document.

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FINANCIAL AND OTHER INFORMATION

The information required by Item 13(a) of Schedule 14A with respect to eLoyalty s consolidated financial statements and management s discussion and analysis of financial condition and results of operations is included as Appendix D and Appendix E to this proxy statement. Representatives of eLoyalty s independent accountants, PricewaterhouseCoopers LLP, are expected to be present at the special meeting and will have the opportunity to make a statement if they desire to do so and are also expected to be available to respond to appropriate questions.

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Appendix A

OPINION OF FINANCIAL ADVISOR TO THE BOARD OF DIRECTORS

Deutsche Banc Alex. Brown Inc.
225 Franklin Street
Boston, MA 02110

September 24, 2001

Board of Directors

eLoyalty Corporation
150 Field Drive, Suite 250
Lake Forest, Illinois 60045

Gentlemen:

Deutsche Banc Alex. Brown Inc. (DBAB) has acted as financial advisor to eLoyalty Corporation (eLoyalty) and DBAB understands (i) that eLoyalty proposes to enter into a transaction evidenced by a Share Purchase Agreement substantially in the form of the draft of such agreement dated September 23, 2001 (the Purchase Agreement), with a group of investors (the Investors) listed on Exhibit A thereto pursuant to which the Investors will purchase shares of eLoyalty s 7% Series B Convertible Preferred Stock (the Preferred Stock), which Preferred Stock will have the rights, preferences, privileges and restrictions set forth in eLoyalty s Certificate of Designation in the form attached as Exhibit B to the Purchase Agreement (the Preferred Stock Offering) and (ii) that eLoyalty proposes to offer rights (the Rights) to each of its stockholders to purchase

shares of Preferred Stock up to an amount that would maintain each such stockholder s approximate percentage ownership of eLoyalty (the Rights Offering and together with the Preferred Stock Offering, the Transactions). DBAB further understands that the Investors will agree not to exercise such rights and the holders of non-vested restricted eLoyalty common stock (the Common Stock) will agree not to exercise such rights with respect to such shares. The terms and conditions of the Transactions are set forth in the Purchase Agreement, the draft of the Amended and Restated Investor Rights Agreement dated September 23, 2001 as proposed to be executed by eLoyalty and the parties listed on Exhibit A thereto (the Investor Rights Agreement), and the draft of eLoyalty s Registration Statement on Form S-3 dated September 22, 2001 as proposed to be filed with the U.S. Securities Exchange Commission (the SEC) on or about the date hereof (the Form S-3). In addition, the terms and conditions of the Transactions will be set forth in a Preliminary Proxy Statement as proposed to be filed by eLoyalty with the SEC as soon as practicable after the date hereof (the Proxy Statement and together with the Purchase Agreement, the Investor Rights Agreement and the Form S-3, the Transaction Documents).

You have requested DBAB s opinion, as investment bankers, as to the fairness of the Transactions, from a financial point of view, to the stockholders of eLoyalty.

In connection with DBAB s role as financial advisor to eLoyalty, and in arriving at its opinion, DBAB has reviewed certain publicly available financial and other information concerning eLoyalty and certain internal analyses and other information furnished to it by eLoyalty. DBAB has also held discussions with members of the senior management of eLoyalty regarding its business and prospects. In addition, DBAB has (i) reviewed the reported prices and trading activity for the Common Stock, (ii) reviewed the terms of certain comparable private investments in public equity securities and compared the terms of these transactions to the terms of the Preferred Stock, (iii) compared certain financial and stock market information for eLoyalty with similar information for certain other companies whose securities are publicly traded, (iv) made inquiries regarding and discussed the Transactions and the terms of the Transaction Documents with eLoyalty s senior management and counsel, (v) made inquiries of various private equity investors regarding their interest in investing in eLoyalty, and (vi) performed such other studies and analyses and considered such other factors as it deemed appropriate.

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DBAB has not assumed responsibility for independent verification of, and has not independently verified, any information, whether publicly available or furnished to it, concerning eLoyalty, including, without limitation, any financial information, forecasts or projections considered in connection with the rendering of its opinion. Accordingly, for purposes of its opinion, DBAB has assumed and relied upon the accuracy and completeness of all such information and DBAB has not conducted a physical inspection of any of the properties or assets, and has not prepared or obtained any independent evaluation or appraisal of any of the assets or liabilities, of eLoyalty. With respect to the financial forecasts and projections made available to DBAB and used in its analyses, DBAB has assumed that they have been reasonably prepared on bases reflecting the best currently available estimates and judgments of the management of eLoyalty as to the matters covered thereby. In rendering its opinion, DBAB expresses no view as to the reasonableness of such forecasts and projections or the assumptions on which they are based. DBAB has considered the assessment of eLoyalty s management as to eLoyalty s financing requirements, the availability of alternative financing and the potential effects on eLoyalty and its business of a failure to obtain additional capital in the near term. DBAB s opinion is necessarily based upon economic, market and other conditions as in effect on, and the information made available to it as of, the date hereof and events occurring after the date hereof could materially affect the assumptions used in preparing this opinion. Further, we have assumed that the terms of the Transactions are the most beneficial terms from eLoyalty s perspective that could under the circumstances be negotiated among the parties to the Transactions and no opinion is expressed whether any alternative transaction might produce proceeds to eLoyalty in an amount in excess of that to be received by eLoyalty in the Transactions. At the request of eLoyalty, DBAB has not engaged in any discussions with any third parties regarding a merger or any other business combination involving eLoyalty.

For purposes of rendering its opinion, DBAB has assumed that, in all respects material to its analysis, the representations and warranties of the parties contained in the Purchase Agreement are true and correct, each party will perform all of the covenants and agreements to be performed by it under the Purchase Agreement and all conditions to the obligations of each party to consummate the Transactions will be satisfied without any waiver thereof. DBAB has assumed that the Transactions will be consummated in a manner that complies in all respects with the applicable provisions of the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and all other applicable federal and state statutes, rules and regulations. DBAB has assumed that all material governmental, regulatory or other approvals and consents required in connection with the consummation of the Transactions will be obtained and that in connection with obtaining any necessary governmental, regulatory or other approvals and consents, or any amendments, modifications or waivers to any agreements, instruments or orders to which eLoyalty is a party or is subject or by which it is bound, no limitations, restrictions or conditions will be imposed or amendments, modifications or waivers made that would have a material adverse effect on eLoyalty or materially reduce the contemplated benefits of the Transactions to eLoyalty.

DBAB has relied on (i) the advice of counsel to eLoyalty as to all legal matters concerning eLoyalty and (ii) the information provided by eLoyalty and publicly available information as to certain financial matters concerning eLoyalty. DBAB has assumed that the holders of a majority of the Common Stock, excluding the Investors, present or represented at the special meeting of stockholders described in the Proxy Statement will approve the Transactions. In addition, DBAB assumed that the Rights Offering will afford eLoyalty s stockholders the right to purchase shares of Preferred Stock up to an amount that would maintain each such stockholder s approximate percentage ownership of eLoyalty; provided that the Investors will agree not to exercise such rights with respect to their shares of Common Stock and the holders of non-vested restricted Common Stock will agree not to exercise such rights with respect to such shares. DBAB has further assumed, based entirely on the advice of eLoyalty and its advisors, that the Transactions as presented to DBAB will not adversely affect the tax-free nature of eLoyalty s February 2000 spin off from Technology Solutions Company and it is DBAB s understanding that the consummation of the Transactions is conditioned upon eLoyalty s receipt of an opinion of eLoyalty s counsel to such effect. Finally, DBAB assumes that the Transaction Documents are, or will be when in final form, consistent in all material respects with eLoyalty s descriptions of such documents to DBAB and that the Proxy Statement and Form S-3, as filed with the SEC, will accurately describe the Transactions, the Preferred Stock, the Rights, the Purchase Agreement and the Investor Rights Agreement in all material respects.

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This opinion is addressed to, and for the use and benefit of, the Board of Directors of eLoyalty and is not a recommendation to the stockholders of eLoyalty to approve the Transactions or participate in the Rights Offering. This opinion is limited to the fairness of the Transactions, from a financial point of view, to the stockholders of eLoyalty and DBAB expresses no opinion as to the merits of the underlying decision by eLoyalty to engage in the Transactions or any alternative transaction. DBAB is not expressing any opinion as to the prices at which any class of eLoyalty s stock will trade at any time.

DBAB has been paid fees for its services as financial advisor to eLoyalty in connection with the Transactions and will be paid additional financial advisory fees in the future, including a fee in connection with the delivery of this opinion. DBAB is an affiliate of Deutsche Bank AG (together with its affiliates, the DB Group). In the ordinary course of business, members of the DB Group may actively trade in the securities and other instruments and obligations of eLoyalty for their own accounts and for the accounts of their customers. Accordingly, the DB Group may at any time hold a long or short position in such securities, instruments and obligations. In addition, the DB Group may have investment banking, financial advisory and other relationships with parties other than eLoyalty pursuant to which the DB Group may acquire information of interest to eLoyalty and the Board of Directors. DBAB has no obligation to disclose such information to eLoyalty or the Board of Directors or to use such information in the preparation of this opinion.

DB Alex. Brown Venture Investors Fund, an affiliate of DBAB, is an investor in TCV IV, L.P., a holder of a significant number of shares of the Common Stock and an Investor in the Preferred Stock Offering. One or more employees of DBAB who provide advisory and investment banking services to eLoyalty and the Board of Directors are investors in DB Alex. Brown Venture Investors Fund.

The opinion may not be used or referred to by eLoyalty, or quoted or disclosed to any person in any manner, without our prior written consent, which consent is hereby given to the inclusion of this opinion in the Proxy Statement.

Based upon and subject to the foregoing, it is DBAB s opinion as investment bankers that the Transactions are fair, from a financial point of view, to the stockholders of eLoyalty.

Very truly yours,

DEUTSCHE BANC ALEX. BROWN INC.

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Appendix B

FORM OF AMENDMENT TO

CERTIFICATE OF INCORPORATION
TO INCREASE AUTHORIZED CAPITALIZATION

Adopted in accordance with the provisions
of Section 242 of the General Corporation
Law of the State of Delaware

The undersigned, being the of eLoyalty Corporation (the Corporation), a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware (the GCL), does hereby certify:

1. That Article IV, paragraph A of the Certificate of Incorporation of the Corporation is hereby amended to read in its entirety as follows:

(A) Authorized Capital Stock. The total number of shares of capital stock which the Corporation shall have authority to issue is 540,000,000, consisting of 500,000,000 shares of common stock, with a par value of $.01 per share (Common Stock), and 40,000,000 shares of preferred stock, with a par value of $.01 per share (Preferred Stock).

2. That the foregoing amendment of the Certificate of Incorporation of the Corporation has been duly adopted in accordance with Section 242 of the GCL.

This Certificate of Amendment, and the amendment effected hereby, shall become effective .

IN WITNESS WHEREOF, the undersigned has caused this Certificate to be signed this th day of , 200 .

eLOYALTY CORPORATION

By:

Name:
Title:

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Appendix C

FORM OF AMENDMENT TO

CERTIFICATE OF INCORPORATION
TO EFFECT REVERSE STOCK SPLIT
(TO BE USED ONLY IF PROPOSALS 1, 2 AND 3 ARE APPROVED
AND ARE BEING IMPLEMENTED)

Adopted in accordance with the provisions
of Section 242 of the General Corporation
Law of the State of Delaware

The undersigned, being the of eLoyalty Corporation (the Corporation), a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware (the GCL), does hereby certify:

1. That Article IV, paragraph (A) of the Certificate of Incorporation of the Corporation, as amended, is hereby amended to read in its entirety as follows:

(A) Authorized Capital Stock. The total number of shares of capital stock which the Corporation shall have authority to issue is 90,000,000, consisting of 50,000,000 shares of common stock, with a par value of $.01 per share (Common Stock), and 40,000,000 shares of preferred stock, with a par value of $.01 per share (Preferred Stock).

2. That Article IV of the Certificate of Incorporation of the Corporation, as amended, is hereby amended to include the following text as paragraph (F) of Article IV:

(F) Upon the Certificate of Amendment to the Certificate of Incorporation of the Corporation which adds this paragraph (F) becoming effective in accordance with the General Corporation Law of the State of Delaware (the Effective Time), each ten (10) shares of common stock, par value $.01 per share, of the Corporation issued immediately prior to the Effective Time (the Old Common Stock) shall be automatically reclassified as and converted into one (1) share of Common Stock (the Reverse Stock Split). Notwithstanding the immediately preceding sentence, no fractional shares of Common Stock shall be issued in connection with the Reverse Stock Split. In lieu thereof, upon surrender after the Effective Time to the Corporation of a certificate formerly representing shares of Old Common Stock, the Corporation shall pay to the holder of the certificate an amount in cash (without interest) equal to the product obtained by multiplying (a) the fraction of a share of Common Stock to which such holder (after taking into account all shares of Old Common Stock held immediately prior to the Effective Time by such holder) would otherwise be entitled to, by (b) the average of the closing sale prices of Old Common Stock (as adjusted to reflect the Reverse Stock Split) for the 20 trading days ending on the date which is the day before the date on which the Effective Time occurs, as officially reported by the Nasdaq National Market. If such price or prices are not available, the fractional shares payment will be based on the average of the last bid and asked prices for the Old Common Stock (as adjusted to reflect the Reverse Stock Split) for such days, in each case as officially reported by the Nasdaq National Market, or other such process as determined by the Board of Directors. The ownership of a fractional interest will not give the holder thereof any voting, dividend, or other rights except to receive payment therefor as described herein. Each stock certificate that, immediately prior to the Effective Time, represented shares of Old Common Stock shall, from and after the Effective Time, automatically and without the necessity of presenting the same for exchange, represent that number of shares of Common Stock into which the shares of Old Common Stock represented by such certificate shall have been reclassified (as well as the right to receive cash in lieu of fractional shares of Common Stock as provided herein), provided, however, that each person of record holding a certificate that represented shares of Old Common Stock shall receive, upon surrender of such certificate to the Corporation, a

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new certificate evidencing and representing the number of shares of Common Stock into which the shares of Old Common Stock represented by such certificate shall have been reclassified pursuant hereto.

3. That the foregoing amendments of the Certificate of Incorporation of the Corporation have been duly adopted in accordance with Section 242 of the GCL.

4. This Certificate of Amendment, and the amendments effected hereby, shall become effective .

IN WITNESS WHEREOF, the undersigned has caused this Certificate to be signed this day of , 200 .

eLOYALTY CORPORATION

By:

Name:

Title:

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FORM OF AMENDMENT TO

CERTIFICATE OF INCORPORATION
TO EFFECT REVERSE STOCK SPLIT

(TO BE USED ONLY IF PROPOSALS 1 AND 2 ARE NOT APPROVED AND IMPLEMENTED, AND IF ONLY PROPOSAL 3 IS IMPLEMENTED)

Adopted in accordance with the provisions
of Section 242 of the General Corporation
Law of the State of Delaware

The undersigned, being the of eLoyalty Corporation (the Corporation), a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware (the GCL), does hereby certify:

1. That Article IV, paragraph (A) of the Certificate of Incorporation of the Corporation, as amended, is hereby amended to read in its entirety as follows:

(A) Authorized Capital Stock. The total number of shares of capital stock which the Corporation shall have authority to issue is 20,000,000, consisting of 10,000,000 shares of common stock, with a par value of $.01 per share (Common Stock), and 10,000,000 shares of preferred stock, with a par value of $.01 per share (Preferred Stock).

2. That Article IV of the Certificate of Incorporation of the Corporation, as amended, is hereby amended to include the following text as paragraph (F) of Article IV:

(F) Upon the Certificate of Amendment to the Certificate of Incorporation of the Corporation which adds this paragraph (F) becoming effective in accordance with the General Corporation Law of the State of Delaware (the Effective Time), each ten (10) shares of common stock, par value $.01 per share, of the Corporation issued immediately prior to the Effective Time (the Old Common Stock) shall be automatically reclassified as and converted into one (1) share of Common Stock (the Reverse Stock Split). Notwithstanding the immediately preceding sentence, no fractional shares of Common Stock shall be issued in connection with the Reverse Stock Split. In lieu thereof, upon surrender after the Effective Time to the Corporation of a certificate formerly representing shares of Old Common Stock, the Corporation shall pay to the holder of the certificate an amount in cash (without interest) equal to the product obtained by multiplying (a) the fraction of a share of Common Stock to which such holder (after taking into account all shares of Old Common Stock held immediately prior to the Effective Time by such holder) would otherwise be entitled to, by (b) the average of the closing sale prices of Old Common Stock (as adjusted to reflect the Reverse Stock Split) for the 20 trading days ending on the date which is the day before the date on which the Effective Time occurs, as officially reported by the Nasdaq National Market. If such price or prices are not available, the fractional shares payment will be based on the average of the last bid and asked prices for the Old Common Stock (as adjusted to reflect the Reverse Stock Split) for such days, in each case as officially reported by the Nasdaq National Market, or other such process as determined by the Board of Directors. The ownership of a fractional interest will not give the holder thereof any voting, dividend, or other rights except to receive payment therefor as described herein. Each stock certificate that, immediately prior to the Effective Time, represented shares of Old Common Stock shall, from and after the Effective Time, automatically and without the necessity of presenting the same for exchange, represent that number of shares of Common Stock into which the shares of Old Common Stock represented by such certificate shall have been reclassified (as well as the right to receive cash in lieu of fractional shares of Common Stock as provided herein), provided, however, that each person of record holding a certificate that represented shares of Old Common Stock shall receive, upon surrender of such certificate to the Corporation, a new certificate evidencing and representing the number of shares of Common Stock into which the shares of Old Common Stock represented by such certificate shall have been reclassified pursuant hereto.

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3. That the foregoing amendments of the Certificate of Incorporation of the Corporation have been duly adopted in accordance with Section 242 of the GCL.

4. This Certificate of Amendment, and the amendments effected hereby, shall become effective .

IN WITNESS WHEREOF, the undersigned has caused this Certificate to be signed this day of , 200 .

eLOYALTY CORPORATION

By:

Name:
Title:

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Appendix D

EXCERPTS FROM ANNUAL REPORT TO STOCKHOLDERS

FOR FISCAL YEAR ENDED DECEMBER 30, 2000

1. Financial Statements and Supplementary Data

RESPONSIBILITY FOR FINANCIAL STATEMENTS

The consolidated financial statements of eLoyalty Corporation have been prepared by eLoyalty in conformity with generally accepted accounting principles. Management is responsible for all information and representations contained in the financial statements and other sections of the Annual Report. In preparing the financial statements, management uses its judgment to make necessary estimates.

Management maintains and relies on a system of internal controls in fulfilling its financial reporting responsibilities. The system is designed to provide reasonable assurance at a reasonable cost that assets are safeguarded and transactions are executed in accordance with management s authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. The internal control systems include written policies and procedures, an organizational structure which provides for division of responsibilities and a development of qualified managers in all areas. In addition, management continually monitors its internal control systems in response to changes in business conditions and operations.

The Audit Committee of the Board of Directors, composed solely of directors who are not officers or employees of eLoyalty Corporation, meets with corporate financial management and the independent accountants to review their activities and to satisfy itself that each is properly discharging its responsibility. The independent accountants have met periodically with the Committee, without the presence of management, to discuss the results of their audit work, the adequacy of internal financial controls and the quality of financial reporting.

/s/ KELLY D. CONWAY	/s/ TIMOTHY J. CUNNINGHAM
Kelly D. Conway President and Chief Executive Officer	Timothy J. Cunningham Senior Vice President, Chief Financial Officer and Corporate Secretary

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of eLoyalty Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows, and of changes in stockholders equity and comprehensive income (loss) present fairly, in all material respects, the financial position of eLoyalty Corporation and subsidiaries (the Company) as of December 30, 2000 and December 31, 1999, and the results of their operations and their cash flows for the years ended December 30, 2000 and December 31, 1999, for the seven month period from June 1, 1998 to December 31, 1998 and for the year ended May 31, 1998, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management; our responsibility is to express an opinion on these financial statements based on

our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PRICEWATERHOUSECOOPERS LLP

PricewaterhouseCoopers LLP
Chicago, Illinois
January 30, 2001

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CONSOLIDATED BALANCE SHEETS
eLoyalty Corporation

Assets (In thousands, except share and per share data)	December 30, 2000	December 31, 1999
Current Assets:		
Cash and cash equivalents	$41,138	$13,462
Marketable securities	9,902	7,175
Receivables, net	75,886	44,056
Deferred income taxes	16,301	9,057
Prepaid expenses	2,935	3,093
Other current assets	7,534	1,072
Total current assets	153,696	77,915
Equipment and leasehold improvements, net	18,784	2,284
Goodwill, net	6,990	12,129
Deferred income taxes	2,664	2,387
Long-term receivables and other	2,484	1,888
Total assets	$184,618	$96,603

Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$6,880	$640
Accrued compensation and related costs	19,964	11,687
Deferred compensation	9,897	7,175
Other current liabilities	7,021	3,486
Total current liabilities	43,762	22,988
Commitments and contingencies		
Stockholders Equity:		
Preferred stock, $.01 par value; 10,000,000 shares authorized; none issued and outstanding		
Common stock, $.01 par value; 100,000,000 shares authorized; 49,925,702 and 41,400,000 shares issued and outstanding, respectively	499	414
Additional paid-in capital	144,860	963
Net advances from Technology Solutions Company		74,048
Retained earnings		2,171
Accumulated other comprehensive loss	(1,970)	(847)
Unearned compensation	(4,704)	(963)
Total stockholders equity	140,856	73,615

Total liabilities and stockholders equity
$184,618 $96,603

The accompanying Notes to Consolidated Financial Statements

are an integral part of this financial information.

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CONSOLIDATED STATEMENTS OF OPERATIONS
eLoyalty Corporation

(In thousands, except per share data)	For the Years Ended December 2000	1999	For the Seven Month Period From June 1 to December 31, 1998	For the Fiscal Year Ended May 31, 1998
Revenues	$211,603	$146,003	$64,415	$84,488
Project personnel costs	104,203	68,483	29,562	39,049
Gross profit	107,400	77,520	34,853	45,439
Other costs and expenses:				
Selling, general and administrative	96,875	58,395	29,132	35,436
Research and development	9,322	5,624	3,089	2,543
Goodwill amortization	4,972	4,996	2,450	3,201

Total other expenses	111,169	69,015	34,671	41,180
Operating (loss) income	(3,769)	8,505	182	4,259
Other income (loss)	2,921	(408)	(327)	(24)
(Loss) income before income taxes	(848)	8,097	(145)	4,235
Income tax (benefit) provision	(424)	4,039	398	2,022
Net (loss) income	$(424)	$4,058	$(543)	$2,213

Basic net (loss) income per common share	$(0.01)	$0.10	$(0.01)	$0.05
Diluted net (loss) income per common share	$(0.01)	$0.09	$(0.01)	$0.05
Shares used to calculate basic net (loss) income per share (in millions)	48.2	41.4	41.4	41.4
Shares used to calculate diluted net (loss) income per share (in millions)	48.2	44.2	41.4	46.8

The accompanying Notes to Consolidated Financial Statements

are an integral part of this financial information.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
eLoyalty Corporation

(In thousands)	For the Years Ended December 2000	1999	For the Seven Month Period From June 1 to December 31, 1998	For the Fiscal Year Ended May 31, 1998
Cash Flows from Operating Activities:				
Net (loss) income	$(424)	$4,058	$(543)	$2,213

Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:				
Depreciation and amortization	7,549	6,355	3,509	3,874
Provisions for doubtful receivables	4,064	2,059	2,652	531
Deferred income taxes	(7,950)	(5,763)	(3,432)	(2,118)
Other		463	412	
Changes in assets and liabilities:				
Receivables	(36,932)	(21,496)	(4,197)	(10,217)
Purchases of trading securities related to deferred compensation program	(2,727)	(2,689)	(830)	(2,096)
Other current assets	(6,407)	(1,038)	278	(1,079)
Accounts payable	6,281	(313)	647	(1,184)
Accrued compensation and related costs	8,565	4,517	776	2,674
Deferred compensation funds from employees	2,722	2,689	830	2,096
Other current liabilities	3,523	653	538	(2,383)
Other long-term assets	(613)	(536)	(11)	(815)
Net cash (used in) provided by operating activities	(22,349)	(11,041)	629	(8,504)
Cash Flows from Investing Activities:				
Capital expenditures	(18,633)	(2,175)	(570)	(1,065)
Investment in unconsolidated investee			(875)	
Acquired businesses			(6,625)	(10,741)

Net cash used in investing activities	(18,633)	(2,175)	(8,070)	(11,806)
Cash Flows from Financing Activities:				
Proceeds from issuance of common stock	34,914			
Proceeds from stock compensation plans	8,552			
Capital contribution from Technology Solutions Company	20,000			
Net advances from Technology Solutions Company	4,802	21,929	7,777	21,608
Net cash provided by financing activities	68,268	21,929	7,777	21,608
Effect of exchange rate changes on cash and cash equivalents	390	338	(651)	(702)
Increase (decrease) in cash and cash equivalents	27,676	9,051	(315)	596

Cash and cash equivalents, beginning of period
13,462 4,411 4,726 4,130

Cash and cash equivalents, end of period
$41,138 $13,462 $4,411 $4,726

The accompanying Notes to Consolidated Financial Statements

are an integral part of this financial information.

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CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS

EQUITY AND COMPREHENSIVE INCOME (LOSS)
eLoyalty Corporation

(In thousands, except share data)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Advances from Technology Solutions Company
Balance, May 31, 1997	-	$ -	$ -	$ 17,420
Net income				2,213
Foreign currency translation				
Comprehensive income				
Net transfers from TSC				21,608

Balance, May 31, 1998					41,241
Net loss					(543)
Foreign currency translation					
Comprehensive loss					
Net transfers from TSC					7,777
Balance, December 31, 1998					48,475
Net income					4,058
Foreign currency translation					
Comprehensive income					
Net transfers from TSC					21,929
Issuance of common stock	41,400,000	414	(414)		
Issuance of compensatory stock options					963

Balance, December 31, 1999			
41,400,000	414	963	74,048