

ELOYALTY CORP
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UNITED STATES
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SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant
Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
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eLoyalty Corporation

(Name of Registrant as Specified In Its Charter)

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150 Field Drive, Suite 250
Lake Forest, Illinois 60045

April 8, 2005

Dear eLoyalty Stockholder:

On behalf of the Board of Directors and management of eLoyalty Corporation, I cordially invite you to attend the 2005 Annual Meeting of eLoyalty's stockholders. The Annual Meeting will be held at 9:00 a.m. Central time on Thursday, May 19, 2005 at the Woodfield Suites, 2000 S. Lakeside Drive, Bannockburn, IL 60015.

At this year's Annual Meeting, the agenda includes the proposed election of the two current Class III Directors whose terms of office expire this year and a proposal to ratify the appointment of our independent auditing firm. Details of the business to be conducted at the Annual Meeting are given in the attached Notice of Annual Meeting and Proxy Statement. At the Annual Meeting, stockholders will have an opportunity to comment and ask appropriate questions.

Whether or not you plan to attend the Annual 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
President and Chief Executive Officer

**eLOYALTY CORPORATION
NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD MAY 19, 2005**

The Annual Meeting of eLoyalty's stockholders will be held at 9:00 a.m. Central time on Thursday, May 19, 2005, at the Woodfield Suites, 2000 S. Lakeside Drive, Bannockburn, IL 60015 for the following purposes:

1. To elect two Class III Directors to serve for an ensuing term of three years;
2. To ratify the appointment of PricewaterhouseCoopers LLP as eLoyalty's independent public accountants for the 2005 fiscal year; and
3. To transact such other business as may properly come before the Annual Meeting or any adjournments or postponements thereof.

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

The record date for the Annual Meeting was the close of business on March 31, 2005. Only stockholders of record as of that time and date will be entitled to notice of, and to vote at, the Annual Meeting. A list of the stockholders entitled to vote at the Annual Meeting will be available for inspection at eLoyalty's offices at 150 Field Drive, Suite 250, Lake Forest, Illinois, during normal business hours for ten days prior to the Annual Meeting.

Your vote is important. Stockholders are urged to submit a proxy with their voting instructions as promptly as possible, whether or not they intend 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,

Robert S. Wert
Corporate Secretary

Lake Forest, Illinois
April 8, 2005

PROXY STATEMENT TABLE OF CONTENTS

	Page
Proxy and Voting Information	1
Proposal 1: Director Election	2
General	2
Board Processes and Committees	4
Compensation of Directors	6
Proposal 2: Ratification of Selection of Independent Public Accountants	7
Report of the Audit Committee	8
Audit Committee Composition and Activities	8
Report	8
Other Business	8
Security Ownership of Certain Beneficial Owners and Management	9
Beneficial Ownership Information	9
Section 16(a) Beneficial Ownership Reporting Compliance	13
Stock Performance Graph	14
Executive Compensation	14
Report of the Compensation Committee	14
Compensation Committee Interlocks and Insider Participation	18
Summary Compensation Table	19
Option Exercises in Fiscal 2004 and Option Values at January 1, 2005	21
Employment Contracts and Employment Termination and Change in Control Arrangements	22
Submission of Stockholder Proposals for 2006	26
Incorporation By Reference	26
Additional Information	26

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

**PROXY STATEMENT
FOR
2005 ANNUAL MEETING OF STOCKHOLDERS
PROXY AND VOTING INFORMATION**

The Board of Directors of eLoyalty Corporation (referred to as eLoyalty, the Company or we in this proxy statement) is soliciting your proxy for use at the 2005 Annual Meeting of Stockholders of eLoyalty and any postponements or adjournments thereof (the Annual Meeting). These proxy materials are first being mailed to eLoyalty stockholders beginning on or about April 8, 2005.

Who May Vote. Holders of record of shares of common stock of eLoyalty, \$0.01 par value per share (Common Stock), and holders of record of shares of the 7% Series B Convertible Preferred Stock of eLoyalty, \$0.01 par value per share (Series B Stock and, together with the Common Stock, eLoyalty Stock), at the close of business on March 31, 2005 (the Record Date) may vote at the Annual Meeting. On that date, 11,535,110 shares of eLoyalty Stock, comprising 7,407,508 shares of Common Stock and 4,127,602 shares of Series B Stock, were issued and outstanding and entitled to be voted at the Annual Meeting. Each share of eLoyalty Stock entitles the holder to one vote.

How to Vote. If you are a holder of record of eLoyalty Stock (that is, you hold your stock in your own name) on the Record Date, you may submit a proxy with your voting instructions by any of the following methods.

Through the Internet: Go to the web address, <http://www.proxyvoting.com/eloy> and follow the instructions on the proxy card.

By Telephone: Call 1-866-540-5760 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 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 and Web site address provided on that firm's voting form for its beneficial owners.

How Proxies Work. Giving your proxy means that you authorize the persons named as proxies to vote your shares at the Annual Meeting in the manner you direct. If you sign and return a proxy card without indicating your voting instructions, they will vote your shares FOR the election of the nominees for director shown under Director Election on the following pages and FOR ratification of the appointment of PricewaterhouseCoopers LLP as our independent public accountants for 2005.

Revocation of Proxies. You may revoke your proxy at any time before the voting at the Annual Meeting by any of the following methods:

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

voting again at a later date by telephone or through the Internet your latest voting instructions will be counted and your earlier instructions, using the same procedures, revoked;

sending a properly signed written notice of your revocation to the Secretary of the Company, at eLoyalty Corporation, 150 Field Drive, Suite 250, Lake Forest, Illinois 60045, Attention: Corporate Secretary; or

voting in person at the Annual Meeting. Attendance at the Annual Meeting will not itself revoke an earlier submitted proxy.

Quorum. In order to conduct the business of the Annual Meeting, we must have a quorum. A quorum requires the presence, in person or by proxy, of a majority of the 11,535,110 shares of eLoyalty Stock outstanding on the Record Date. Proxies that are submitted by brokers as holders of record and that do not indicate a vote for some of the proposals, because the brokers have not received instructions from their customers or other beneficial owners on how to vote on those proposals and do not have discretionary voting authority, are called broker non-votes. We count abstentions, votes withheld with respect to the election of the director nominees and broker non-votes as present at the Annual Meeting for the purpose of determining a quorum.

Required Votes. There are differing voting requirements for the various proposals. The nominees for director will be elected by a plurality of the votes cast at the Annual Meeting. This means that the nominees who receive the greatest number of votes will be elected as directors. Broker non-votes and instructions to withhold authority to vote for a nominee are not counted for this purpose and will not affect the outcome of the election. The Company's organizational documents do not provide for cumulative voting for directors.

The other proposal, to ratify appointment of our independent accountants, requires the approval of a majority of the shares of eLoyalty Stock present in person or represented by proxy at the Annual Meeting and entitled to vote on the proposal. Abstentions from voting on this proposal will have the same effect as votes against it. Broker non-votes are not counted for this purpose and will have no effect on the outcome of the vote.

Attending the Annual Meeting. If you are a registered holder of eLoyalty Stock and you plan to attend the Annual 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 Annual Meeting. A bank or brokerage account statement showing that you owned eLoyalty Common Stock on March 31, 2005 would be acceptable for this purpose.

PROPOSAL 1: DIRECTOR ELECTION

General

The business and affairs of eLoyalty are managed under the direction of its Board of Directors. The Board of Directors has responsibility for establishing broad corporate policies relating to the overall performance of eLoyalty, rather than day-to-day operating details.

The Board of Directors is divided into three classes, each of which is elected for a three-year term. Only one class of directors stands for election at each annual meeting of eLoyalty's stockholders. At this year's Annual Meeting, the Class III Directors stand for election. Two directors, Kelly D. Conway and Michael J. Murray, are in Class III and have been nominated by the independent members of the Board to stand at the Annual Meeting for reelection to a three-year term expiring in 2008. If for any reason either Mr. Conway or Mr. Murray becomes unable or is unwilling to serve at the time of the meeting, the persons named as proxies

in the enclosed proxy card will have discretionary authority to vote for a substitute nominee and would vote for the substitute nominee selected by the independent members of the Board of Directors. It is not anticipated that either Mr. Conway or Mr. Murray will be unavailable for election.

The following sets forth information regarding the nominees for election as directors at this Annual Meeting and each director continuing in office, including his age, present principal occupation, other business experience during at least the last five years, directorships in other publicly held companies and period of service as a director of eLoyalty.

Nominees for Election as Class III Directors at this Annual Meeting (to a three-year term expiring in 2008):

Kelly D. Conway, age 48, is the President and Chief Executive Officer of eLoyalty, a position he has held since its incorporation in May 1999 as a subsidiary of TSC. Mr. Conway joined TSC in November 1993 as Senior Vice President, assumed the position of Executive Vice President in July 1995 and became Group President in October 1998. He has been a director of eLoyalty since May 1999.

Michael J. Murray, age 60, is the retired President of Global Corporate and Investment Banking at Bank of America Corporation, a banking and financial services company. He held such office from 1998 until his retirement in July 2000. From March 1997 until the BankAmerica-NationsBank merger in 1998, Mr. Murray headed BankAmerica Corporation's Global Wholesale Bank and was responsible for its business with large corporate, international and government clients around the world. Mr. Murray was named a BankAmerica Vice Chairman and head of the United States and International Groups in September 1995. He serves as a Director of CNF Corporation and Neoforma Inc., as well as various private companies. Mr. Murray has been a director of eLoyalty since June 1999.

Class I Directors whose Present Terms Continue until 2006:

Tench Coxe, age 47, is a managing director of the general partner of Sutter Hill Ventures, A California Limited Partnership (Sutter Hill), a venture capital company located in Palo Alto, California, and has held that position since 1987. Mr. Coxe is a Director of Copper Mountain Networks, Inc., NVIDIA Corporation and various private companies. He has been a director of eLoyalty and the Chairman of the Board of Directors since February 2000.

John T. Kohler, age 58, is the former President and Chief Executive Officer of Technology Solutions Company (TSC), the business consulting and system integration company which included eLoyalty as a division prior to its spin-off in February 2000. Mr. Kohler held such office from 1995 until his retirement in February 2000. He joined TSC as Senior Vice President in 1992, was promoted to Executive Vice President and named to the Office of the Chairman in 1993 and became President and Chief Operating Officer in 1994. He has been a director of eLoyalty since May 1999.

Class II Directors whose Present Terms Continue until 2007:

Jay C. Hoag, age 46, is a general partner of Technology Crossover Ventures (TCV), a venture capital firm located in Palo Alto, California, and has held that position since 1995. Mr. Hoag is on the Board of Directors of Altiris, Inc., Inphonic, Inc. and Netflix, Inc., as well as various private companies. He has been a director of eLoyalty since February 2000.

John C. Staley, age 63, is the former Managing Partner Lake Michigan Area of Ernst & Young LLP, a global audit and tax firm, a position that he held from 1985 to his retirement in June 2001. Mr. Staley is a Director of Centerpoint Properties Trust and Hospira, Inc., as well as various private companies. Mr. Staley has been a director of eLoyalty since August 2002.

Board Processes and Committees

General

The eLoyalty Board of Directors held seven meetings during the fiscal year ended January 1, 2005. During this period, each of the incumbent Directors attended more than 75% of the aggregate number of meetings of the Board of Directors and of the Board committees on which he served that were held during his period of service. The Company does not have a specific policy regarding Board members' attendance at the annual meetings of stockholders. The 2004 annual meeting was attended by one director, Mr. Conway.

The Board of Directors has determined that five of its six directors—Messrs. Coxe, Hoag, Kohler, Murray and Staley—are independent under the listing standards of The NASDAQ Stock Market.

The Board of Directors has two standing committees to assist it in the discharge of its responsibilities: an Audit Committee and a Compensation Committee. Although the Board of Directors does not have a nominating or similar committee, it has adopted a standing resolution which provides that all nominees for membership on the Board of Directors must be selected, or recommended to the full Board of Directors for selection, by the independent directors.

Audit Committee

The Audit Committee is currently composed of Mr. Kohler, as Chairman, and Messrs. Coxe, Kohler and Murray. The Audit Committee met eight times during fiscal 2004. The Audit Committee is directly responsible for the appointment, compensation, retention and oversight of the Company's public accountants (including resolution of disagreements between management and the public accountants regarding financial reporting), subject to stockholder ratification of the public accountants' appointment at their Annual Meeting, for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company. The Audit Committee approves all audit engagement fees and terms and all non-audit engagements with the public accountants as required by applicable law and the requirements of The NASDAQ Stock Market. In connection with its duties, the Audit Committee regularly meets privately with the Company's independent public accountants. The Audit Committee has adopted a policy for the receipt, retention and treatment of complaints or concerns regarding accounting-related matters. See

Communications with the Board. The Audit Committee operates under a written charter, the current version of which was adopted by the Board of Directors in March 2004 and a copy of which is available on the Company's website at www.loyalty.com. A report of the Audit Committee appears elsewhere in this proxy statement.

The Board of Directors has determined that each member of the Audit Committee meets the enhanced independence requirements applicable to audit committee members under both The NASDAQ Stock Market listing standards and the Sarbanes-Oxley Act of 2002 and the related Securities and Exchange Commission (SEC) rules. Under the SEC rules, a person is not qualified to serve on an audit committee if he or she is an affiliate of the relevant company. The SEC rules create a safe harbor, whereby a person will not be deemed to be an affiliate of a company if he or she does not beneficially own more than 10% of any class of voting equity securities of that company. Mr. Coxe is considered the beneficial owner of 20.2% of eLoyalty's Common Stock and 31.5% of eLoyalty's Series B Stock (representing 15.2% of eLoyalty's voting power, in the aggregate) by virtue of his position as a managing director of the general partner of Sutter Hill. Although Mr. Coxe does not qualify for the safe harbor created by the SEC rules, based on all of the facts and circumstances, the Board of Directors has determined that he is not an affiliate of eLoyalty.

The Board of Directors has determined that each of Messrs. Kohler and Staley qualifies as an audit committee financial expert as that term is defined in the SEC rules adopted pursuant to the Sarbanes-Oxley Act of 2002 and that the remaining members of the Audit Committee meet the financial literacy requirements of The NASDAQ Stock Market.

Compensation Committee

The Compensation Committee, whose current members are Mr. Coxe, as Chairman, Mr. Hoag and Mr. Kohler, met four times during fiscal 2004. The Compensation Committee reviews and acts with respect to

stock incentive and other employee benefit plans, and approves or makes recommendations to the Board of Directors with respect to the salary and annual incentive compensation of, and stock awards for, executive officers of eLoyalty. The Board of Directors has determined that each member of the Compensation Committee is independent for purposes of The NASDAQ Stock Market listing standards. The Compensation Committee does not operate under a written charter. A report of the Compensation Committee appears later in this proxy statement.

Director Nominations

Responsibility. The Board of Directors does not have a nominating or similar committee, although it has adopted a standing resolution which provides that all nominees for membership on the Board of Directors must be selected, or recommended to the full Board of Directors for selection, by the independent directors then in office (the Nominating Directors) in accordance with the rules of The NASDAQ Stock Market. Under this standing resolution, the Nominating Directors are responsible for (1) reviewing and, as applicable, recommending to the full Board of Directors possible candidates for membership on the Board, and assisting in attracting qualified candidates to fill vacant or newly created directorships, (2) reviewing and recommending to the full Board of Directors a management slate of directors to be proposed for election at the annual stockholders meeting and included in the proxy statement for such meeting, as well as reviewing and recommending to the full Board of Directors any directors to fill vacancies that may exist on the Board of Directors, and (3) reviewing the function and composition of the several committees of the Board of Directors and recommending to the full Board of Directors qualified persons for membership on such committees. The affirmative vote of at least a majority of the Nominating Directors is required to approve any action which may or must be taken by the Nominating Directors. The Nominating Directors have the ability to retain, at the Company s expense, special legal, accounting or other consultants or experts they deem necessary in the performance of their duties under the standing resolution. The Board of Directors believes that, in light of the independent directors responsibility for the Company s nominating processes under this resolution, it is unnecessary to have a separate nominating or similar committee of the Board. The Nominating Directors have not held meetings separate from the Board of Directors in their capacities as such. The Board of Director s standing resolution is available on the Company s website at www.loyalty.com.

Stockholder Nominees. The Nominating Directors will consider properly submitted stockholder nominations for candidates for membership on the Board of Directors as described below under Identifying and Evaluating Nominees for Directors. Any stockholder nominations proposed for consideration by the Nominating Directors should include the nominee s name and qualification for Board membership. In addition, they must be submitted within the time frame and to the address specified under Submission of Stockholder Proposals for 2006.

Director Qualifications. In discharging its responsibilities to nominate candidates for election to the Board, the Nominating Directors have not specified any minimum qualifications for serving on the Board. However, the Nominating Directors endeavor to evaluate, propose and approve candidates with business experience and personal skills in technology, finance, marketing, financial reporting and other areas that may be expected to contribute to an effective Board. The Nominating Directors seek to assure that the Board is composed of individuals who have experience relevant to the needs of the Company and who have the highest professional and personal ethics, consistent with the Company s values and standards. Candidates should be committed to enhancing stockholder value and should have sufficient time to carry out their duties and to provide insight and practical wisdom based on experience. Each director must represent the interests of all stockholders.

Identifying and Evaluating Nominees for Directors. The Nominating Directors utilize a variety of methods for identifying and evaluating nominees for director. Candidates may come to the attention of the Nominating Directors through current Board members, professional search firms (for which they may receive a fee), stockholders or other persons. These candidates are evaluated at regular or special meetings of the Board, and may be considered at any point during the year. As described above, the Nominating Directors consider properly submitted stockholder nominations for candidates for the Board. All properly submitted recommendations are aggregated and considered by the Nominating Directors.

Communications with the Board

Anyone who has a concern about eLoyalty's conduct, or about the Company's accounting, internal accounting controls or auditing matters, may communicate that concern directly to the Board of Directors, the non-employee directors or the Audit Committee. All such concerns related to audit or accounting matters will be forwarded to the Audit Committee Chair for his review, as well as to the Company's General Counsel and Chief Financial Officer (unless the report alleges his involvement). After the Audit Committee Chair's initial review and a summary of the matter is prepared, the concern will be forwarded to the remaining Audit Committee members. All other concerns will be forwarded upon receipt to the appropriate directors for their review, as well as to the Company's General Counsel and Chief Financial Officer (unless the report alleges his involvement in the matter).

All reported concerns will be simultaneously reviewed and addressed by the Company's General Counsel or his designee. The status of all outstanding concerns addressed to the Board, the non-employee directors or the Audit Committee will be reported to the Board on a quarterly basis. The Board or any committee may direct special treatment, including the retention of outside advisors or counsel, for any concern addressed to them. The Company's corporate policies prohibit retaliatory action against any employee who raises concerns or questions in good faith about these matters.

Stockholders wishing to communicate with the Board of Directors, the non-employee directors or the Audit Committee may do so by writing to the Company's General Counsel at 150 Field Drive, Suite 250, Lake Forest, Illinois 60045. The General Counsel will forward any communications as directed by the stockholder. The Company maintains a separate, internal system for the receipt of communications from employees.

Compensation of Directors

During eLoyalty's fiscal year ended January 1, 2005, directors who were not employees of eLoyalty or any of its subsidiaries (non-employee directors) each received \$1,500 for their attendance at each meeting of the Board of Directors, \$2,000 per Audit Committee meeting attended and \$500 for each Compensation Committee meeting (each of which was held in tandem with a meeting of the Board of Directors). Had any Compensation Committee meetings been held apart from a Board of Directors meeting, each Compensation Committee member would have received \$1,000 per meeting attended. Mr. Hoag historically has declined to accept any such compensation for his service as a member of the Board of Directors or the committees on which he served. The Company also reimburses directors for their travel-related expenses incurred in attending meetings of the Board of Directors and its committees.

In addition to meeting attendance fees, non-employee directors are eligible to receive automatic grants of stock options under the eLoyalty Corporation 1999 Stock Incentive Plan (the 1999 plan). The 1999 plan provides for each non-employee director to receive: (i) an option to purchase 5,000 shares of eLoyalty Common Stock upon commencement of service as a director (an Initial Grant); and (ii) an option to purchase 1,200 shares of eLoyalty Common Stock on the day following the date of each annual meeting of eLoyalty stockholders during which such service continues (an Annual Grant). Stock options granted to non-employee directors have an exercise price per share equal to the fair market value of a share of eLoyalty Common Stock on the grant date and a maximum term of ten years. Vesting occurs ratably over a period of 48 months from the end of the month following the grant date with respect to each Initial Grant and over a period of 12 months from the end of the month following the grant date with respect to each Annual Grant.

During the last fiscal year, Messrs. Coxe, Murray, Staley and Kohler each received an Annual Grant. Mr. Hoag declined receipt of the Annual Grant that otherwise would have been awarded to him automatically under the 1999 plan.

**PROPOSAL 2: RATIFICATION OF SELECTION OF
INDEPENDENT PUBLIC ACCOUNTANTS**

The Audit Committee has appointed PricewaterhouseCoopers LLP (PwC) as independent public accountants to audit the consolidated financial statements of the Company for the current 2005 fiscal year ending December 31, 2005. PwC served as independent public accountants for the Company during fiscal 2004 and 2003.

A proposal will be presented at the Annual Meeting to ratify the appointment of PwC as eLoyalty s independent public accountants for fiscal 2005. One or more members of the firm are expected to be present at the Annual Meeting and to be available to respond to appropriate questions, and they will have the opportunity to make a statement if they desire to do so. If the Company s stockholders do not ratify this appointment at the Annual Meeting, other independent public accountants will be considered by the Audit Committee.

The Board of Directors recommends a vote FOR ratification of the appointment of the independent public accountants.

Principal Accountant Fees and Services

For fiscal 2004 and 2003, fees for services provided by PwC were as described below. The Audit Committee has concluded that the provision of the services rendered by PwC with respect to the fees described below is compatible with maintaining PwC s independence.

Audit Fees

Total audit fees for fiscal years 2004 and 2003 were \$376,000 and \$418,000, respectively. Of the total audit fees in fiscal 2004 and 2003, \$245,000 and \$240,000, respectively, were for professional services rendered for the audits of the consolidated financial statements of the Company and \$131,000 and \$178,000, respectively, were for statutory audit work for Company affiliates in non-U.S. jurisdictions.

Audit-Related Fees

Audit-related fees for fiscal years 2004 and 2003 of \$35,000 and \$58,000, respectively, were for accounting consultations and Sarbanes Oxley Section 404 advisory services.

Tax Fees

Tax fees for fiscal years 2004 and 2003 of \$599,000 and \$643,000, respectively, were for tax compliance services including the preparation of federal, state, foreign and expatriate tax returns, tax audits and appeals, and other tax advice. In late 2002, the Audit Committee decided to fully outsource the Company s tax compliance services and, after reviewing the terms of alternative proposals, selected PwC to perform this work.

Other Fees

No fees other than those described above were paid to PwC for fiscal year 2004 or 2003.

Pre-Approval Policy

The Audit Committee pre-approves all audit and permissible non-audit services provided to the Company by PwC. Pre-approval is generally provided at a regular meeting of the Audit Committee and covers a several-year period. Any pre-approval is detailed as to the particular service or category of services covered and is generally subject to a specific budget. The independent auditors and management periodically report to the Audit Committee regarding the extent of services provided by PwC in accordance with this pre-approval, and the fees for the services performed to date. The Audit Committee, or its Chairman, may also pre-approve other particular services on a case-by-case basis. All services provided to the Company by PwC during 2003 and 2004 were pre-approved by the Audit Committee in accordance with this policy. Specifically, at various meetings held in 2003 and 2004, the Audit Committee approved PwC s provision of audit services for 2003

and 2004 and approved PwC's provision of foreign statutory audit, expatriate-related, accounting consultation and Sarbanes Oxley Section 404 advisory services for 2003 and 2004 and, at a meeting held in 2002, approved PwC's provision of tax compliance services for 2002 through 2005.

REPORT OF THE AUDIT COMMITTEE

Audit Committee Composition and Activities

The Audit Committee, which comprises four directors, operates under a written Audit Committee Charter.

The composition of the Audit Committee complies with the current listing standards of The NASDAQ Stock Market. The Board of Directors has determined that each member of the Audit Committee meets the enhanced independence requirements applicable to audit committee members under both The NASDAQ Stock Market listing standards and the Sarbanes-Oxley Act of 2002 and related SEC rules. Under the SEC rules, a person is not qualified to serve on an audit committee if he or she is an affiliate of the relevant company. The SEC rules create a safe harbor whereby a person will not be deemed to be an affiliate of a company if he or she does not beneficially own more than 10% of any class of voting equity securities of that company. Mr. Coxe is considered the beneficial owner of 20.2% of eLoyalty's Common Stock and 31.5% of eLoyalty's Series B Stock (representing 15.2% of eLoyalty's voting power, in the aggregate) by virtue of his position as a managing director of the general partner of Sutter Hill. Although Mr. Coxe does not qualify for the safe harbor created by the SEC rules, based on all of the facts and circumstances, the Board of Directors has determined that he is not an affiliate of eLoyalty.

Report

The Audit Committee has furnished the following report:

The Audit Committee has reviewed and discussed with the Company's management and PwC the audited financial statements of the Company contained in the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 2005. The Audit Committee also has discussed with PwC the matters required to be discussed pursuant to SAS No. 61 (*Codification of Statements on Auditing Standards, Communication with Audit Committees*) and SAS No. 90 (*Audit Committee Communications*).

The Audit Committee has received and reviewed the written disclosures and the letter from PwC required by Independence Standards Board Standard No. 1, entitled *Independence Discussions with Audit Committee*, and has discussed with PwC its independence.

Based on the review and discussions referred to above, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 2005 filed with the Securities and Exchange Commission on March 25, 2005.

John T. Kohler, Audit Committee Chair
Tench Coxe, Audit Committee Member
Michael J. Murray, Audit Committee Member
John C. Staley, Audit Committee Member

OTHER BUSINESS

The Board of Directors does not know of any further business to be presented at the Annual 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 the best interests of the Company.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**Beneficial Ownership Information***Common Stock*

To the Company's knowledge, the following table sets forth information regarding beneficial ownership of eLoyalty Common Stock (as beneficial ownership is determined for purposes of Rule 13d-3 under the Securities Exchange Act of 1934) as of March 31, 2005, except as otherwise indicated, by: (i) each person or group that beneficially owns more than 5% of the outstanding shares of eLoyalty Common Stock; (ii) each of the seven executive officers of the Company named in the Summary Compensation Table appearing later in this proxy statement; (iii) each of the directors of the Company; and (iv) all executive officers and directors of the Company as a group. To the Company's knowledge, the table also shows, for such individuals and group, the percentage of the Company's total voting power beneficially owned as of such date (based on the number of shares of Common Stock and Series B Stock, which generally votes with the Common Stock, so owned). The shares shown as beneficially owned by all directors and executive officers as a group do not include the shares shown as beneficially owned by Mr. Cunningham, who left the Company in January 2005, and Ms. Lowe, who left the Company in November 2004 and the information regarding their beneficial ownership is as of the respective dates that each left the Company, after giving effect to the forfeiture of unvested stock options and restricted stock in connection with their respective departures. 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(1)(2)	Percent of Outstanding Common Stock(1)(2)	Percent of Total Voting Power(1)
Jay C. Hoag, Richard H. Kimball and various entities affiliated with Technology Crossover Ventures c/o Technology Crossover Ventures 528 Ramona Street Palo Alto, CA 94301	2,615,843(3)	28.2%	22.7%
Brookside Capital Partners Fund, LP 111 Huntington Avenue Boston, MA 02199	565,472(4)	7.3%	4.9%
S Squared Technology Corp. 515 Madison Avenue New York, New York 10022	666,075(5)	9.0%	5.8%
Kelly D. Conway	466,360	6.3%	4.0%
Tench Coxe	1,763,151(6)	20.2%	15.2%
John T. Kohler	122,005(7)	1.6%	1.0%
Michael J. Murray	99,271	1.3%	*
John C. Staley	30,435	*	*
Karen Bolton	29,511	*	*
Timothy J. Cunningham	62,662	*	*
Christopher J. Danson	105,613(8)	1.4%	*
Jay A. Istvan	128,973(9)	1.7%	1.1%
Diane K. Lowe	19,873	*	*

Name and Address of Beneficial Owner	Number of Shares of Common Stock Beneficially Owned(1)(2)	Percent of Outstanding Common Stock(1)(2)	Percent of Total Voting Power(1)
Steven C. Pollema	153,320	2.1%	1.3%
All directors and executive officers as a group (11 individuals)	5,546,932	51.1%	47.2%

* Less than one percent.

- (1) Includes shares of eLoyalty Common Stock that may be acquired within 60 days after March 31, 2005 through the exercise of stock options outstanding as of such date, as follows: Mr. Conway, 4,692 shares; Mr. Coxe, 32,200 shares; Mr. Kohler, 85,926 shares; Mr. Murray, 47,058 shares; Mr. Staley, 30,435 shares; Ms. Bolton, 2,000 shares; Mr. Danson, 538 shares (including 134 shares that may be acquired by Mr. Danson's spouse); Mr. Pollema, 19,166 shares; and all directors and executive officers as a group, 222,504 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) Includes shares of eLoyalty Common Stock that may be acquired within 60 days after March 31, 2005 through exercise of the conversion feature associated with the shares of eLoyalty Series B Stock held by such person or group, in the amounts reflected for such person or group in the table entitled "Series B Stock" below. With respect to each of these persons and such group, these shares have been deemed to be outstanding in computing the percent of class in the preceding table.
- (3) 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. (TCV III (GP), TCV III, L.P., TCV III (Q), L.P. and TCV III Strategic Partners, L.P., collectively 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") holds 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 numbers of shares of eLoyalty Common Stock held of record by each of the TCV Funds as of March 31, 2005 are as follows: TCV III (GP), 1,372 shares; TCV III, L.P., 6,524 shares; TCV III (Q), L.P., 173,418 shares (6.0% of the Common Stock, after giving effect to the conversion of the Series B Stock held); TCV III Strategic Partners, L.P., 7,851 shares; TCV IV, L.P., 533,845 shares (22.8% of the Common Stock, after giving effect to the conversion of the Series B Stock held); and TCV IV Strategic Partners, L.P., 20,028 shares (1.0% of the Common Stock after giving effect to the conversion of the Series B Stock held). The share amounts in this footnote do not include any shares of Series B Stock, although any Common Stock ownership percentage gives effect to the conversion of any Series B Stock

held.

- (4) This information, which is not within the direct knowledge of the Company, has been derived from a Schedule 13G/A filed with the SEC on February 14, 2005 with respect to eLoyalty Common Stock beneficially owned as of December 31, 2004. Based on the information contained therein, Brookside Capital Partners Fund, LP beneficially owns and has sole voting and investment power with respect to 565,472 shares.
- (5) This information, which is not within the direct knowledge of the Company, has been derived from a Schedule 13G/A filed with the SEC on February 14, 2005 with respect to eLoyalty Common Stock beneficially owned as of December 31, 2004. Based on the information contained therein, S Squared

Technology Corp. beneficially owns and has sole voting and investment power with respect to 666,075 shares.

- (6) Mr. Coxe is a managing director of the general partner of each of Sutter Hill, Sutter Hill Entrepreneurs Fund (AI), L.P., and Sutter Hill Entrepreneurs Fund (QP), L.P., which hold of record 374,102 shares (15.7% of the Common Stock, after giving effect to the conversion of the Series B Stock held), 3,768 shares and 9,555 shares, respectively, of eLoyalty Common Stock. Mr. Coxe is also the managing director of the general partner of Sutter Hill Associates, L.P., which holds of record no shares of Common Stock (but 4.2% of the Common Stock after giving effect to the conversion of the Series B Stock held). 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. Also includes 44,367 shares held in The Coxe Revocable Trust of which Mr. Coxe is a trustee and as to which he has sole voting and investment power. Mr. Coxe disclaims beneficial ownership of such shares held by such limited partnerships and trust except to the extent of his pecuniary interest in such limited partnerships and trust. The share amounts in this footnote do not include any shares of Series B Stock, although the Common Stock ownership percentage gives effect to the conversion of any Series B Stock held.
- (7) Includes 10 shares of eLoyalty Common Stock held of record by Mr. Kohler's spouse. Mr. Kohler disclaims beneficial ownership of such shares.
- (8) Includes 807 shares of eLoyalty Common Stock (including 429 shares that may be acquired upon conversion of Series B Stock) held of record by Mr. Danson's spouse. Mr. Danson disclaims beneficial ownership of such shares.
- (9) Includes 200 shares of eLoyalty Common Stock held of record by a revocable living trust for the benefit of Mr. Istvan's spouse.

Series B Stock

To the Company's knowledge, the following table sets forth information regarding beneficial ownership of eLoyalty Series B Stock (as beneficial ownership is determined for purposes of Rule 13d-3 under the Securities Exchange Act of 1934) as of March 31, 2005, except as otherwise indicated, by: (i) each person or group that beneficially owns more than 5% of the outstanding shares of eLoyalty Series B Stock; (ii) each of the seven executive officers of the Company named in the Summary Compensation Table appearing later in this proxy statement; (iii) each of the directors of the Company; and (iv) all executive officers and directors of the Company as a group. The shares shown as beneficially owned by all directors and executive officers as a group do not include the shares shown as beneficially owned by Mr. Cunningham, who left the Company in January 2005, and Ms. Lowe, who left the Company in November 2004 and the information regarding their beneficial ownership is as of the respective dates that each left the Company. The Series B Stock generally votes with the Common Stock as a single class. See the table under Common Stock, above, for information regarding the aggregate voting power of the Company held by the individuals and groups listed

below. 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 Series B Stock Beneficially Owned	Percent of Outstanding Series B Stock
Jay C. Hoag, Richard H. Kimball and various entities affiliated with Technology Crossover Ventures c/o Technology Crossover Ventures 528 Ramona Street Palo Alto, CA 94301	1,872,805(1)	45.4%
Brookside Capital Partners Fund, LP 111 Huntington Avenue Boston, MA 02199	296,327	7.2%
Tench Coxe and various entities affiliated with Sutter Hill Ventures c/o Sutter Hill Ventures 755 Pagemill Road, Suite A200 Palo Alto, CA 94301	1,299,159(2)	31.5%
Kelly D. Conway	3,862	*
John T. Kohler	16,064(3)	*
Michael J. Murray	23,243	*
John C. Staley	0	*
Karen Bolton	0	*
Timothy J. Cunningham	2,362	*
Christopher J. Danson	2,356(4)	*
Jay A. Istvan	1,515	*
Diane K. Lowe	0	*
Steven C. Pollema	132	*
All directors and executive officers as a group (11 individuals)	3,219,136	78.0%

* Less than one percent.

- (1) Messrs. Hoag and Kimball are the two managing members of TCM III and 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., and TCM IV is the sole general partner of the TCV IV Funds. Each of the TCV Funds holds of record shares of Series B Stock, and TCM III and TCM IV may be deemed to have sole voting and investment power with respect to the shares of Series B 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 Series B Stock held by the TCV Funds. All of the shares of Series B 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 numbers of shares of Series B Stock held of record by each of the TCV Funds as of March 31, 2005 are as follows: TCV III (GP), 2,285 shares; TCV III, L.P., 10,852 shares; TCV III (Q), L.P., 288,422 shares (7.0% of the outstanding Series B Stock); TCV III Strategic Partners, L.P.,

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13,057 shares; TCV IV, L.P., 1,501,673 shares (36.4% of the outstanding Series B Stock); and TCV IV Strategic Partners, L.P., 56,516 shares (1.4% of the outstanding Series B Stock).

- (2) Sutter Hill, Sutter Hill Entrepreneurs Fund (AI), L.P., Sutter Hill Entrepreneurs Fund (QP), L.P., and Sutter Hill Associates, L.P., hold of record 938,952 shares (22.7%), 8,854 shares, 22,418 shares and 322,078 shares (7.8%), respectively, of Series B Stock. Mr. Coxe is a managing director of the general

partner of each of these entities, other than Sutter Hill Associates, L.P., of which he is a general partner. In such capacity, Mr. Coxe is deemed to have shared voting and investment power over all shares of eLoyalty Series B Stock held of record by such partnerships. Also includes 6,857 shares held in The Coxe Revocable Trust of which Mr. Coxe is a trustee and as to which he has sole voting and investment power. Mr. Coxe disclaims beneficial ownership of such shares held by such limited partnerships and trust except to the extent of his pecuniary interest in such limited partnerships and trust.

- (3) Includes 7 shares of Series B Stock held of record by Mr. Kohler's spouse. Mr. Kohler disclaims beneficial ownership of such shares.
- (4) Includes 429 shares of Series B Stock held of record by Mr. Danson's spouse. Mr. Danson disclaims beneficial ownership of such shares.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors and executive officers, as well as any persons who beneficially own more than 10% of eLoyalty Common Stock, to file with the SEC initial reports and reports of changes in beneficial ownership of such stock. Persons subject to Section 16 are required by SEC regulations to furnish the Company with copies of all Section 16(a) reports that they file.

Based on its review of copies of such reports filed through or furnished to the Company and on written representations from certain reporting persons that no other reports were required, the Company believes that, except as described below, all required Section 16(a) reports filed during or for fiscal 2004 with respect to persons who were subject to Section 16(a) reporting obligations during such period were filed on a timely basis.

On January 24, 2005, David L. Anderson, who, as a managing director of the general partner of each of Sutter Hill, Sutter Hill Entrepreneurs Fund (AI), L.P., Sutter Hill Entrepreneurs Fund (QP), L.P., and Sutter Hill Associates, L.P., is deemed to have shared voting and investment power over all shares of eLoyalty Stock held of record by such partnerships, filed an amended initial report of beneficial ownership on Form 3, reflecting 10 shares of eLoyalty Common Stock held by his spouse that