Trading Technologies' patent dispute has brought the issue of protecting intellectual rights to the fore like never before. Paul Cozens looks at the risks behind not taking the right precautions

The patents game: how strong is your hand?

The Trading Technologies (TT) and E-Speed court case is a timely reminder of the importance and potential value (or cost) of patents in the financial sector. The US Court found that E-Speed had infringed TT's patents covering its X Trader order entry platform, and awarded damages of $3.5million. Currently, four other ISVs – GL Trade, Rosenthal Collins Group, CQG and Futurespath – are still in dispute.

TT and E-Speed have obtained millions of dollars in royalties in recent years from patents in relation to electronic trading systems in particular. Both hold granted patents across the globe.

It seems that many of the patent cards in the derivatives area that will dominate the next decade have already been dealt. Those with a poor hand risk losing out: fortunately, there are steps that financial institutions can take firstly to reduce exposure to claims for patent infringement, and secondly to obtain patent protection for their own innovations so as to strengthen market position and generate additional revenues through licensing.

Increase in International Patent Applications

Today's economy is becoming increasingly knowledge-based and intellectual property, particularly in the form of patents, plays a vital role in protecting this knowledge. Companies are realising the importance and economic impact of patenting their innovations. This can be seen for example in the significant rise of International patent filings over the last 15 years (see figure 1 on the next page).

IP in Derivatives

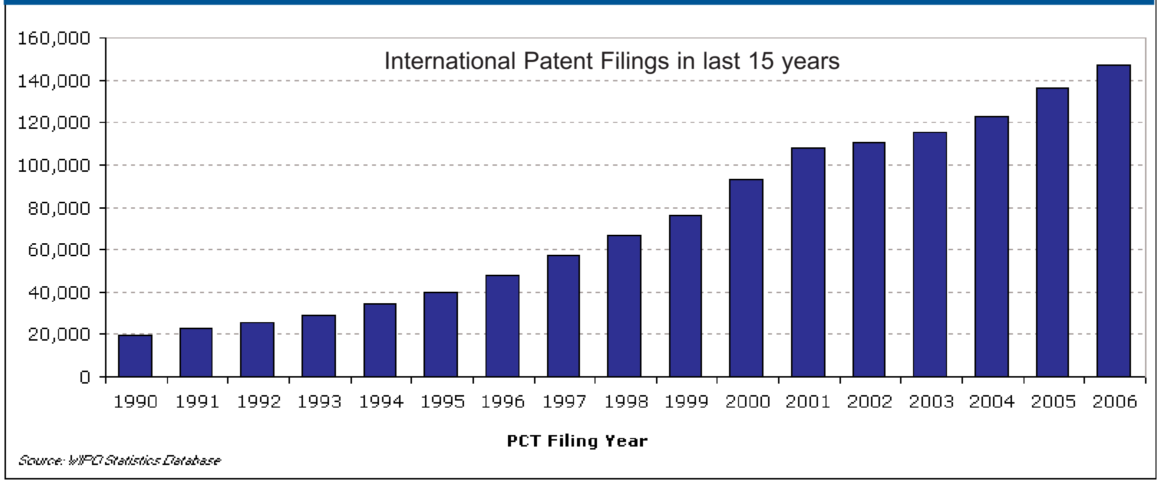
Back in 1998, the State Street Bank decision affirmed that so-called "business method" inventions are patentable in the US, provided the invention produces a "useful, concrete and tangible result". This led to greatly increased numbers of patents being filed in the financial sector.

With electronic trading superseding open outcry in many areas of derivatives trading, patenting the associated technology (e.g. exchange trading systems, algorithmic trading models, and so on) has become de rigeur for a number of ISVs and US investment banks. TT, E-Speed and Goldman Sachs all have significant patent positions, with well over 100 patents and applications apiece.

Trading Technologies v E-Speed

One of the aces in TT's deck is of course the patent rights it asserts covering its X Trader order entry platform. When, back in 2004, TT took out a full page advertisement declaring that it required for its patented technology a 2.5 cents royalty for each applicable future and option transaction, permanently, it was game on.

Figure 1



TT began numerous infringement proceedings. Many were settled out of court and some ended in substantial royalties being paid. E-Speed, with its own rival patented technology, and buoyed by previous success against New York Mercantile Exchange with its Wagner patent, took a more resolute stance. TT consequently sued E-Speed for infringement of two of its US patents relating to its static price ladder.

The first round seemed to go E-Speed's way. In a summary judgment the court interpreted the TT patents more narrowly than TT was urging, with the effect that E-Speed's latest versions of its product did not infringe. However, the case proceeded to full judgment to decide upon validity and further counts of infringement.

In their October 10 2007 decision, the jury's verdict was that the TT patents are valid, and that E-Speed infringed those two patents for a period of six months or so during 2004. The jury awarded TT $3.5 million in damages. Critically, it found that E-Speed had wilfully infringed and consequently, the judge can award up to three times the $3.5 million amount.

So where to next with the litigation? E-Speed has filed a charge of inequitable conduct against TT, alleging it committed fraud or did not disclose required information in the pursuit of the patents. If E-Speed succeeds, the patents may be rendered unenforceable. Whatever that outcome, E-Speed will no doubt appeal the existing finding against it. Equally, it is likely that TT will cross-appeal against the summary judgment of non-infringement.

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TT and E-Speed's battle is set to continue for some time to come, both in the US and elsewhere. TT have *inter alia* a granted European patent, which on paper is broader than the equivalent US patent. However, there are a number of oppositions to the European patent. Whether these will be successful, and what activities might infringe the patent, are issues that will be decided afresh in Europe, with little or no heed being paid by the European courts to the position in the US. Patent law and practice in Europe are quite different to that in the US in a number of key respects.

What's the risk?

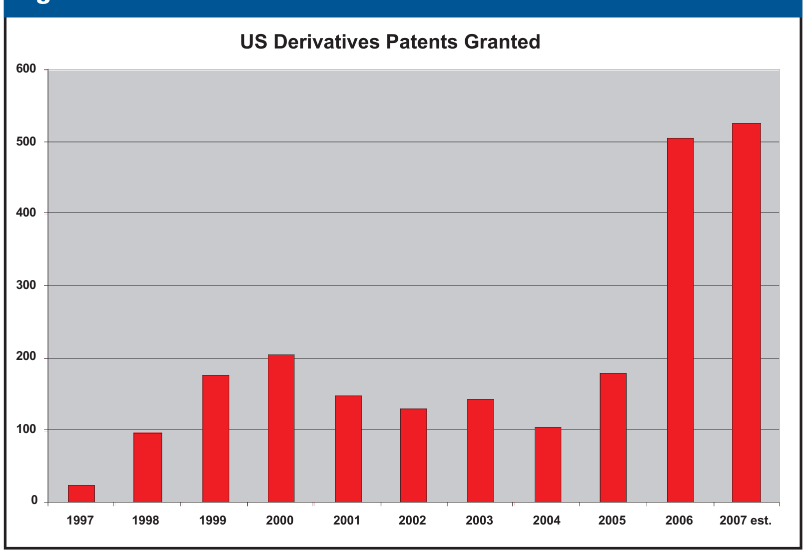
Figure Two shows the increasing number of US patents granted in the derivatives area over the last ten years. Even though the graph rises dramatically from 2005, the way US patents are classified means the estimated numbers still represent a conservatively low estimate of the likely actual numbers.

Investigations suggest a further continued increase in the number of granted patents. This indicates a new era in derivatives in which those players that have protected their innovations appropriately will likely be at a significant advantage.

One way to leverage that advantage is through licensing. E-Speed has reportedly generated licensing revenues in excess of $50 million for its Wagner patent alone.

However, it cannot be assumed that patent holders will necessarily agree to license their patents. With some exceptions, a granted patent

Figure 2



It pays to remember:

- Create internal procedures to help identify and capture new processes and systems which may be capable of patent protection
- Never publicly disclose your invention before filing a patent application
- File as early as possible – remember, if you do not protect your inventions you are effectively donating them to the public when you go to market
- Never assume that an idea is not patentable – this is a question for the experts
- Generally, a separate patent is required for each country where protection is needed (ie patents are territorial)
- Patent rights have a finite term (usually 20 years)
- A patent starts life as a pending application and grants later: it is generally only after grant that a patent can be litigated
- Whatever commercial activity you undertake, you are statistically highly likely to be infringing at least one patent – so take the time to educate yourself as to the risks

affords the patentee an exclusive right. Backed up by the powerful teeth of the Court, a patentee can obtain a final injunction preventing its competitors from using the patented technology.

And a final injunction, obtained at the successful outcome of a trial, is not the patentee's only trump card. In many cases, an interim injunction is available, even before the merits of the matter have been decided, preventing use of the alleged infringing product until the final decision of the court is handed down. Such interim injunctions can in the extreme be awarded within hours of the alleged infringement coming to light. The effect is often sufficient to put alleged infringers out of business.

While some players have dealt themselves a strong hand with their patent protection, many others - notably European companies - have not yet entered the game at all, or have entered with little appetite.

Part of the reason for this seems to be a belief, more common in Europe than in the US, that little or no derivatives technology is patentable. Such a belief is largely unfounded, although it is certainly true that the statutory exclusions from patentability in Europe mean that patent protection needs to be obtained with great care; only a relatively few European Patent Attorneys are geared up to operate in this area.

Another factor seems to be a desire to await the outcome of the TT v E-Speed litigation before embarking on building a patent portfolio. But there is an irony here: whatever the outcome, the litigation has already demonstrated the importance of patents in derivatives, and every day that goes by with their competitors refraining from protecting their technology is another day

"Unless a company has strong intellectual property, it will be unable to compete" – TT, Jan 9 2006

for both TT and E-Speed to achieve further patent dominance.

How can the risk be mitigated?

Schiff Hardin LLP attorney Stacie Hartman (who represented Peregrine Financial Group, a brokerage firm that settled a suit filed by TT similar to that filed against E-Speed) says that the case emphasises the need for futures industry professionals to document and protect their ideas as well as the process of their creation. "Before launching any new product or trading system, consider what patents are already out there, to make sure you're not infringing them. But also consider them offensively – maybe your own work is entitled to protection by patents or other IP."

There are two key (and complementary) ways to mitigate risks:

Assess your competitors' patents

One prevailing view, most notably in Europe, is that it is risky to search for and investigate competitors' patents. The argument runs as follows:-

- A patent search would be expected to find US patents that might be infringed
- If notwithstanding the search results you proceed with an infringing product, you are being "wilful"
- If you are being wilful, you are liable for treble damages in the US

The August 2007 Seagate decision in the US affirms that such an approach is inadvisable. Quite apart from raising the bar for proving wilful infringement, the Court suggested that a competitor launching a product in the US should be expected to have knowledge of the patent risks. Deliberately closing one's eyes to the risks might itself – ironically – be wilful. It would also be short-sighted: given the globalisation of the financial sector a company that finds itself unable to commercialise its technology in the US will be at an increasing disadvantage.

Responsible companies are advised to conduct professional quality patent searches and investigations, with the aim of adopting a properly considered strategy towards third party patents, proportionate to the perceived risks.

Build your own patent position

Even if you do not wish to use patents aggressively they still provide cards to play if you are being pursued for infringement.

A first step might be to have an IP audit carried out by a Patent Attorney, typically covering areas such as:

- Algorithmic trading models
- Electronic trading systems / GUIs
- Front / middle / back office systems
- Business methodology
- Trade marks
- Trade secrets ■