

TRADE TRENDS

Harris Brumfield has been a maverick since arriving in Chicago and quickly becoming one of the largest market makers on the Chicago Board of Trade. He made a remarkable transition from floor to screen, but that may not be as difficult as his current project: making an ISV consistently profitable.

Harris Brumfield makes an offer

BY DANIEL P. COLLINS

Since being awarded two patents for its MD Trader depth of market software in August, Independent Software Vendor (ISV) Trading Technologies (TT) has taken a strategic approach to defending its intellectual property. TT has a patent infringement suit pending against eSpeed and has filed and settled other infringement suits.

TT's CEO Harris Brumfield has developed a strategy to profit from his innovations. Brumfield announced his plan in a big way through an open letter to the futures industry and a full page ad in *The Wall Street Journal* that was published globally. The "manifesto," what the Brumfield proposal is being called, both angered and confounded industry participants.



A successful floor trader, Brumfield not only transferred his successful trading from the floor to the screen but also transformed electronic trading through software innovations he shared with TT before eventually becoming its CEO. Now he is looking to cash in on those innovations. He subsidized TT over the years and most of the \$32 million in losses TT has reported came right out of Brumfield's bank account.

His proposed solution has the industry talking, and despite that many in the industry see his request — that the four major exchanges pay TT 2.5¢ for every contract executed — as bazaar, Brumfield believes the exchanges will eventually accept his solution.

Futures Magazine: The exchanges have been pretty closed mouthed about your 2.5¢ solution. Are you still talking with them?

Harris Brumfield: The responses are all over the place — some negative and some positive. Dialogue continues to be active with multiple exchanges. I have confidence that the exchanges and TT will do business.

FM: So they may not accept your solution in full but some arrangement will be worked out?

HB: Oh I think this is a pretty nice solution. I think this deal will be done.

FM: Implicit in the "manifesto" is a threat that you could sell at any time and the acquirer of TT may be only interested in extracting the most revenue

from TT's intellectual property a la eSpeed and the Wagner patent. Is that a fair interpretation? Is that a real threat to the industry?

HB: We are not making any threats to the industry. We were just stating the fact that it is possible that TT could get acquired and we think that the 2.5¢ deal would be better overall for the industry. We think it is funny that peo-

Trade Trends

ple would criticize us for opening and showing all of our cards. This happens all the time in businesses; we were just a little more open about it. Most companies would keep such plans private. Of course, any company has the right to sell their company at any time.

FM: Your argument for the 2.5¢ solution seems to be that it will save exchanges, futures commission merchants (FCMs) and end-users money in the long run — that once all the lawsuits are settled and agreements are signed, the industry as a whole would spend more than they would by accepting your solution. Even if that were true, aren't these necessary steps?

HB: That's not my main argument. The main argument is that the savings TT brings to the futures industry dwarf a 2.5¢ inclusion. The added value of the TT volume-catalyst effect would further dwarf a 2.5¢ inclusion. I have not focused on the expense of defending the patents. In any event, litigation will not be necessary if the exchanges do the 2.5¢ deal with respect to end users who trade on those exchanges.

FM: Why should an end-user using a competitor's front-end pay TT — the cost inevitably will be passed down — a 2.5¢ tax? If it is because of the patents, doesn't infringement have to be established first?

HB: The 2.5¢ proposal is not a tax. The proposal is a business deal with the exchanges that we think is good for the industry.

Already, the savings that TT brings to the futures industry dwarf a 2.5¢ inclusion, so locking in TT's independent status would seem to be a wise move. Also, part of the deal is a guarantee of two-way level access between TT and the exchange. Another part of this deal will result in TT giving its [intellectual property] — 80 plus patent applications and growing — to users on the participating exchange.

All end-users, regardless of whether they use the particular technology covered by TT's two issued patents, will benefit from this deal because [it] will promote competition and facilitate volume growth at the exchange. So, the proposed deal is something different than just a dispute between TT and a particular end-user over a patent.

However, it is also worth noting that infringement of TT's two issued patents is very widespread and many end users are directly benefiting from the patented technology. It is not uncommon for companies to take patent licenses without going through extensive patent litigation if they believe they are violating the patents. In fact, Goldenberg Hehmeyer and Kingtree have done just that.



FM: Doesn't that have to be tested in court?

HB: The minute you physically get the patent [you hold those rights]. We are going through the court process, but in the meantime damages are accumulating. It is a serious conclusion when they give you a patent, especially the unit we went to. It has an allowance rate of 16% vs. 70% for the patent office in general.

FM: Since settling with Goldenberg Hehmeyer and Kingtree, have you entered into any other licensing deals?

HB: Not yet. We are negotiating some, but those negotiations are confidential.

FM: In your letter to the industry, you said that with eSpeed entering the multi-exchange order entry space, the futures-focused ISV is doomed. Can you explain why?

HB: An exchange has a unique competitive advantage over an ISV. It can use the leverage of any exclusivity it may have with respect to tradeable contracts as a competitive differentiator, and it can subsidize the costs of the software and even offer it for free.

FM: You never directly state the problem that your solution will solve but it is apparent that the problem is that ISVs as a whole are not profitable despite record futures volume. How did the ISV community get itself in this position?

HB: There have been many ISVs all offering very similar products. Much of the software has become a commodity. TT has managed to be successful to date by continually innovating and staying one step ahead of its competitors. But, TT's success has been hampered by the fact that its competitors have been copying its innovations. If ISVs do not innovate and cannot ultimately protect their IP, then it will be difficult for them to stay successful.

TT was steered to its current position in a deliberate manner. I don't think anyone owes us anything. We have a valuable asset. I don't bemoan the exchanges for making a lot of money in the last few years, the FCMs, the banks from making a lot of money, the fact that we're down \$32 million, I could care less about all of that. I am saying today we have a valuable asset, we are very good partners with you, would you like to do a deal with us?

Trade Trends

FM: Despite record growth, the ISVs market model has proven unprofitable. TT is just barely profitable even with 50% market share.

HB: I am not complaining about that. Do I have the right to try and do something about that. Of course I do. If you think a business is valuable, at some point you have to show cash flow that backs up your statement.

FM: You seem to be setting TT up as an industry-wide utility. Doesn't this raise antitrust issues?

HB: No. The patent laws provide us with the right to exclude all participants from using our patented technology. Instead of choosing that route, we have proposed to open it all up to everyone perpetually. This is actually the broadest license that I can imagine for everyone to utilize all of our intellectual property. Anyone can still compete with us, in fact, they can use our own property to compete with us.

I still think an ISV out there is going to need to have intellectual property. You are going to have to innovate and come up with some new stuff, you can't just copy people and expect to make it.

If you go back to the example of eSpeed, [ISVs] have no prayer against that environment; they stand a lot better chance in this environment than under that eSpeed one.

FM: You mentioned an offer for TT to be part of a super exchange. That appears to be a threat, that you are willing to compete directly with the exchanges. Can you name potential partners? You mentioned "joint-venture offers," has this concept gone beyond the theoretical?

HB: You worked hard on that question, [but] I can't comment.

FM: A super exchange at the other end of your software where all contracts could benefit from margin offsets cleared at one clearinghouse would offer

tremendous savings, wouldn't that threaten exchanges?

HB: I don't consider that a threat. I would love if everybody that was going against me to tell me 'hey listen, here are the scenarios, pick.' Do they want us to keep quiet and not say a word to anybody and slowly plan a super exchange and do it. Is it threatening to put out the different possibilities?

FM: What leverage, if any, do you have over the exchanges?

HB: In the current state of things, with TT being independent, TT is good for the exchanges.

FM: In your letter you say that raising the price of the patent protected portion of your software would be the last resort. People expect to pay more for a Cadillac than a Ford and you claim that MD Trader is superior to your competitor's products and your market share supports those claims. Why shouldn't people pay more for a superior product?



HB: We think it would make more sense to align TT's interests with the goal of driving volume. From a business point of view you could do well either way but there is a passion that I have for the industry to maximize the possibilities.

FM: Isn't that the type of thinking that got the ISV industry in the pickle that it is in now, to keep on driving volume without charging more?

HB: The 2.5¢ brings the profitability.

FM: Do you truly expect the exchanges to agree to pay 2.5¢?

HB: Yes.

FM: Short of that are you hoping that the industry works out a more equitable way to compensate ISVs?

HB: I would listen to anything as far as that possibility, but I still have to maximize our assets. But I truly expect the exchanges to do business with us.

FM: You say that you have the best interest of the industry at heart but there is really no one who represents the entire industry. Exchanges, FCMs, IBs, CTAs, ISVs and other service providers all make up the industry. In the end won't they all act in their own interest?

HB: Yes — we think the deal on the table is in their own best interest.

FM: Isn't a market-driven solution the only one possible?

HB: Yes. If you think about it, if an exchange agrees to the 2.5¢ deal, that would be a market-driven solution.

FM: You say in the letter that you could have hoarded your innovations and used them exclusively to trade more profitably. Do you regret handing it over to TT? Do you think the industry as a whole owes you ?

HB: No and No. On a separate note, infringers [as of July 20, 2004] do owe, they have been and continue to free ride on TT's intellectual property.

FM: You do make the point that you could have kept your innovation for your own proprietary trading rather than offering through TT at a price.

HB: I never made any secret that I plan on TT doing very well with this...I do think anytime you can have it both ways, that you can do well and the industry can do well, anybody is going to select that.

FM: Is it possible to act both in the best interest of the industry and TT?

HB: I never said that I was any kind of a saint. All I am doing is trying the best I can. I am not looking for acclimation. There is no doubt that as a CEO I am trying to exercise my capitalistic rights and then all things being equal — like anyone else would — I want to do what is best for the industry.

FM: In the letter you say that you believe that there is no way to equal or better the function that MD Trader performs. Can there really be an end to innovation in this area? Does any true innovator ever believe that he has created the ultimate innovation? Explain what you meant by that.

HB: I don't believe there is an end to innovation in this area. By protecting its IP, TT will actually be promoting innovation in the area. I also think TT's patented technology can be viewed as a building block upon which people could innovate.

FM: Many of our readers are retail traders, what will your proposed solution mean for them?

HB: It is good for them. TT causes competition and overall [the] 2.5¢ inclusion [will be dwarfed by] the savings that we are going to bring to those particular end users. If I were retail I would want the best price possible, I think 2.5¢ in the scheme of their equation versus the competition and eventual savings is a crackerjack deal.

FM: In defending your strategy, many people within the industry have pointed out the inequitable way ISVs are compensated. I understand how you would benefit but I don't understand how other ISVs would benefit. In a sense it would end competition and declare TT the winner. That doesn't appear to help competition or innovation. What am I missing?

HB: I have said forever that if the ISVs do not come up with intellectual property, they do not have a chance. You can't

be in the narrow order entry business and expect to make it without being able to protect your product. If they come up with some good ideas you can have lots of ISVs. If they don't, it doesn't matter what scenario occurs.

FM: All those benefits you talk about [that] the industry has been getting for free, are they going to pay for that retroactively?

HB: That is a great point but you don't get a free lunch forever. Do you think

that the different investors that keep putting the \$1 million to \$2 million into these little public companies [ISVs] do you think they are going to keep falling for that. At some point they are going to quit, especially if eSpeed is coming into this space.

FM: What is your response to those who see this as an attempt at extortion or simply crazy?

HB: First, it is not surprising that some people would react that way ini-



Harris unplugged

While Brumfield says he has acted in his own interests from the start, he continuously reminds us that he took chances many wouldn't have and those risks have had a tremendously beneficial impact on the industry:

"If you have an idea that is mechanical — and obviously TT's ideas are mechanical — they are going to keep them for themselves, they are not going to bring them forward. Before any intellectual property came along, we achieved the 50% market share against all of these competitors.

"I have a fiduciary duty. I have to try and make profit here and do the best we can. It is like any company that has other shareholders, but what I am trying to do with this is have it both ways, come up with what I think is best for the industry [and what is best for TT]. Would I have brought this forward without shares in TT? Would I have brought this forward without the patent office? No.... Everybody says someone is going to pop up and replace [TT]. Was anybody in this position before we came in this position? No. Are we going to — abracadabra — have traders go through this six-year process? Who is going to go take that risk? Do you think the top traders are going to come into a technology company? No, they are going to make money *today*. They are not going to invest like this. They're not going to do it, I don't believe. It is a weird thing that I did it. Again, I am not a saint, and I did it. It's done. Maybe I had some screws loose.

I am very pleased at where we are at this point. How is anybody going to do it when they just saw the path that I [took]? Why in the world would anybody go down that path? Who can get any closer than this? We had to have amazing achievements to get to this point. You are asking for something impossible.... Remember, this is not a demand. If it [bothers] people, just say, "No thank you." You don't even have to say "thank you" to me. Say, "Hell no." If you decide you want to do it, OK, we'll do it."

tially. Many simply do not understand the issues well enough to have an informed opinion. Others are reacting this way initially because what we are proposing is so different than the status quo. Any time you create change, you face that sort of attitude initially. Second, it is baseless to call what we are proposing "extortion." We cannot force the exchanges to do anything. We are just laying out a proposal that we think makes business sense and the exchange can choose to engage on this or not.

FM: The two aspects of your solution people have the greatest problem with is that you would be paid for every contract and you would be paid forever?

HB: On the trader side, we give anybody in the world access to technology that I am pushing for the high end user just like Goldman or the most insane prop shop, no retail shops are going to do that type of style. So [we] are giving a commercial product to the world that, I personally do not think, you would have without TT.

FM: What were you hoping to accomplish with the open letter?

HB: It is education. To try to do something that is so [against] the status quo, it requires much education.

FM: What if Terry Duffy, Charlie Carey, Liffe and Eurex call you up tomorrow and say, "No we are not going to pay you 2.5¢?"

HB: I would say, I love you guys, but I think you are going to change your minds.

FM: Why should they change their minds?

HB: Because we are very good partners with you, and it is in your best interest to keep us independent, for this price.

FM: Why every contract and why forever?

HB: Would you rather me charge [more] in this one area with 70% of the volume, or would you rather me charge 2.5¢ for all? The exchanges will pick the 2.5¢ for everything.

If I can get a minimum of 10¢ on 70% of the volume now, and that is a cut rate deal, I have to try to come up with a number as low as possible and the way you get it low is by coming up with other terms, like every contract, forever.

FM: But don't the patents have to be tested in court before any deal could be made?

HB: We initiated the court process, so we are very confident in that. But if I were the exchanges, I would do the deal. I would want to keep TT independent. I would do it today, I wouldn't wait around. Anything can happen, and if I value a partner like crazy I would try and do a deal with a partner quickly, regardless of court cases. Things can happen in between now

and when a court case is decided, somebody could come up with an offer that I absolutely can't refuse. I wouldn't take that chance.

FM: If I am a retail trader going through a competitor, I will end up paying more even if I am not using TT software. That doesn't seem logical?

HB: If [as we believe] 70% is going through this concept, then obviously that is a big part of the liquidity and tightness of the market in the first place, so as a user of other concepts you are benefiting from TT. From that point of view, if I were anybody in the industry I would want the deal.

FM: You have been a member of the CBOT for a long time so you know exchanges usually don't do anything until they have to, especially in terms of spending money. What would compel them to take your deal.

HB: What if a transaction takes place and then you don't have an opportunity [to make a deal] and a ruling comes down in our favor?

FM: At that point you would have leverage to say I want 2.5¢ now or maybe you would say I want 5¢ now.

HB: Now there we go. Here is your risk, I don't know if it is a risk. In my opinion if a partner is doing a good job for you, you would want to keep him as a partner. They are very interested, I can tell you that. **FM**