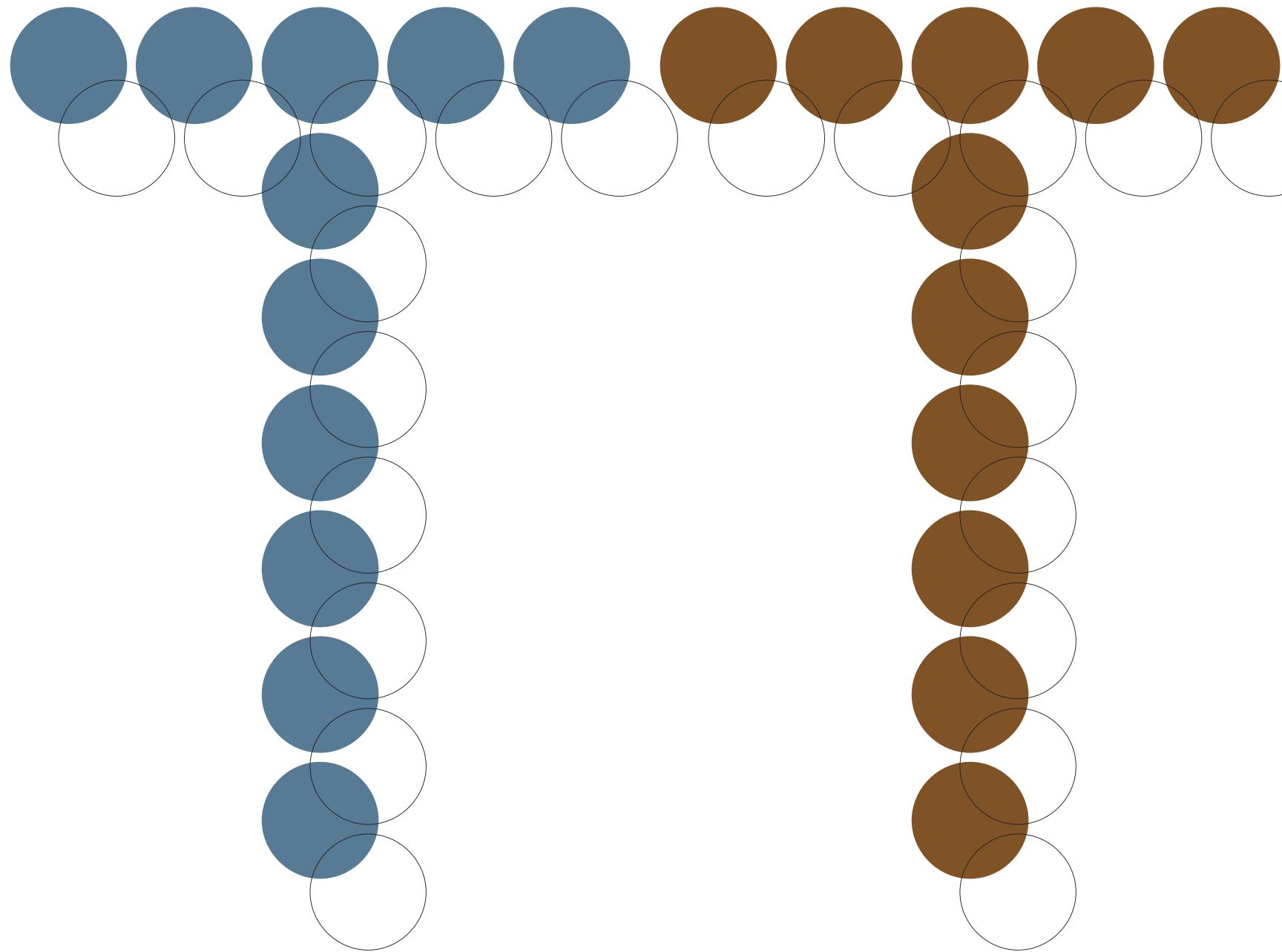


# TRADER MONTHLY



## AGAINST THE WORLD

---

**HARRIS BRUMFIELD** controls a commodities-trading software empire. Now he's laying it all on the line. The stakes? Only the future of electronic trading

BY IMOGEN ROSE-SMITH / ILLUSTRATION BY JOHN EULAND



**AS A PIT TRADER** at the Chicago Board of Trade, Harris Brumfield was known for big bets. He mostly traded 10-year notes, and when he saw an opening, he filled it with size and gusto, quickly amassing a personal account estimated at up to \$250 million.

But even the kind of contracts that yield nine-digit fortunes are dwarfed by the stakes for which Brumfield, the CEO of Chicago-based Trading Technologies, now chooses to play: the entire future of electronic trading, using a software firm into which he has plowed \$40 million as the ante.

“TT is trying to pull off the mother of all deals,” says U.K. screen-based futures trader Martin Duncanson. “A fee for them off every futures contract traded on the planet.”

How did a 40-year-old trader and his midsize software company suddenly find themselves in the middle of the trading world’s biggest battle? Originally launched in Frankfurt in 1994, TT’s technology has been the most important fuel in electronic trading’s rocket-like ascendance. Through TT’s software, all the big futures exchanges — from the Chicago Mercantile Exchange to Euronext.liffe — connect with off-floor, screen-based traders. Of the more than 3 billion contracts electronically traded by the four main futures exchanges last year, half were executed via TT’s software. Many of the rest relied on software similar to TT’s. The firm’s platforms are the arteries that carry the lifeblood animating electronic futures trading.

Such dominance and importance translate into strength, which Brumfield innately knows how to leverage. Last summer, he quietly acquired the necessary ammunition: TT was awarded two software patents it had applied for in 2000. The patents are very specific, referring to the ladder-like grid that displays market depth — bids, offers — along a vertical axis, the graphical heart of the X Trader platform. Numerous trading platforms throughout the industry use a similar design. If you trade electronically, chances are your screen looks like this. In theory, TT could wrestle payment not just for trades made by the screen-based commodities community, but for almost every type of electronically executed trade.

For a few weeks, Brumfield kept a lid on his good fortune and picked his fights. But on August 12, with little warning, he unveiled the patents and simultaneously sued his primary rival, eSpeed, the electronic fixed-income inter-dealer broker spun out of Cantor Fitzgerald. He then sued two big clients — Goldenberg, Hehmeyer and Kingtree Trading — and later added a third, Refco.

But nothing could have prepared the trading community for what came next. Like a general suing for peace on favorable terms after a particularly successful battle, in December Brumfield laid his cards on the table, offering what some would call an alternative, others an ultimatum. In a widely circulated open letter that he followed with a series of full-page ads in the *Financial Times* and the *Wall Street Journal*, Brumfield issued a public deal to the industry. The exchanges could either pay TT 2.5 cents a trade going forward, whether or not it’s executed via his software — compared to the current structure, in which the exchanges generally pay nothing and the traders pay a monthly licensing fee — or the entire industry would risk slaughtering (or at least maiming) the golden goose.

Within days of the letter’s publication, the industry was buzzing. The letter itself was verbose (2,836 words) and highly technical, with an even-tempered, almost plaintive tone. It was a gauntlet thrown: Take the deal and we’ll drop the suits, share the technology and all live

happily ever after. Or else, “if the right offer surfaced, TT would be sold without notice,” presumably to a deep-pocketed company more aggressive about exploiting the patents and less concerned for the futures industry than a trader’s trader such as Harris Brumfield.

“Everyone is waiting to see how this plays out,” says one leading futures-industry executive. “No matter what happens, you have to say one thing — the guy’s got some balls.”

**BY THE TIME** Brumfield’s destiny collided with TT’s in the late 1990s, he had already come a long way. Those who know Brumfield, even those who like him, describe him as a “bully” and “arrogant” but concede he is brilliant, even charming at times with his deep Southern drawl. A true self-made man, he was born to a Mississippi farmer in 1964 and majored in finance at Mississippi State. After graduating in 1986, he dreamed of dealing blackjack in Lake Tahoe but arrived too late for an annual training course. Unemployed and nearly broke, he headed for Chicago, where he crashed on the sofa of a college buddy who was working for the CME. Having caught the trading bug, Brumfield first grabbed a job as a runner in the CBOT’s grain pits, eventually landing in the fabled Treasury pits working with Chuck McElveen (who would later start Kingtree). McElveen staked him; six months later, Brumfield was trading for himself, mostly 10-year notes, establishing himself as one of the best over a decade-long career in the pits.

In 1997, Eurex was looking for some big guns to help capture enough market volume to create liquidity in the electronic markets. The exchange approached Brumfield and suggested he make the transition to screens. He immediately took to the anonymity and

**“What TT is trying to do is pull off THE MOTHER OF ALL DEALS: a fee for them off every futures contract traded on the planet.”**

speed they offered and was soon responsible for 20 percent of Eurex’s volume in German treasury futures.

Eurex would provide Brumfield with another industry-changing suggestion, pointing him to a small software provider called Trading Technologies, which had relocated from Germany to Evanston, Illinois. Founder Gary Kemp, a technology whiz who had helped build the system that would become Eurex, needed money, and Brumfield had both the cash and the guts to jump in big. By 2000, according to published reports, he had invested more than \$25 million. In all, he is believed to have plowed \$40 million into TT, and he has yet to get a single cent back.

It wasn’t long before Brumfield, as majority owner, replaced Kemp, eventually hiring Chris Derossi, a former Apple engineer and Silicon Valley veteran. With Derossi as CEO, TT turned a corner and became profitable. According to an individual who worked for TT at the time, Derossi and Brumfield disagreed over the direction the company should take. The CEO saw TT as a software company; the majority owner envisioned a larger industry role. After just five months, Derossi was out, and Brumfield took charge.

**DESPITE REQUESTS,** Brumfield would not agree to an interview with *Trader Monthly*, citing his ongoing legal battles. But amid his open letter, his legal filings and the scuttlebutt from his defenders, one can find a four-pronged strategy, each prong recalling Brumfield's onetime trading techniques.

First, Brumfield moves from a position of strength. "[TT is] the best way to trade," says Martin Duncanson. "TT knows it, they've patented it and are rattling their saber at everyone else who has copied their idea." Brumfield has long contended that TT's systems and its goodwill have helped drastically lower costs over the years, though the company doesn't get credit for it. "Exchange fees have gone from 50 cents down to 20 cents because of exchange competition for like products that can be listed on multiple exchanges," says one TT defender.

Second, Brumfield shows no fear. Some companies flex patent muscles by going after a small fish they can fry up in court and serve as a filet of precedent. Not TT. It has set its sights primarily on eSpeed, run by the infamously litigious Howard Lutnick, who wields the legal system the way a samurai does a sword. (Asked if this dispute would be going to court, one connected London-based industry professional, who has advised Lutnick on the case, says, "For sure — Cantor Fitzgerald are old hands at this.") Of the three customers TT has sued, the first two settled, agreeing to pay 10 cents for each trade executed on platforms that resemble TT's.

Third, when it comes to price, Brumfield has proven to be a tough-as-nails negotiator. In December 2003, when his old friends at Eurex mounted a U.S. expansion campaign, Brumfield browbeat the German-Swiss exchange into a highly favorable flat-fee deal for Eurex to lease TT's front-end software, according to a Eurex official. TT threatened to refuse to facilitate any Eurex orders unless the exchange accepted this lease deal — an action that would have kneecapped Eurex's expansion efforts, the official says.

Finally, Brumfield has always had luck behind him. As *Trading Technologies International, Inc. v. eSpeed, Inc.* slowly made its way through the court system last fall, the growing consensus was that things didn't look sparkling for TT. By early February, anyone laying a bet on TT would have received seriously favorable odds.

Then came a stunning development: The presiding judge issued

## THE WAGNER WAR

**TT ISN'T THE FIRST** patent holder to take on the exchanges. The company's current battle stems from another famous fight over electronic-trading property: the Wagner Patent.

In 1983, on behalf of the now-defunct World Energy Exchange Corporation, a woman named Susan Wagner applied for a patent on a system that automatically matched bids and offers. Wagner's patent was granted in 1990, but her exchange folded. The rights wound up with some of its backers, who called themselves Electronic Trading Systems. In 1999, they sued Cantor Fitzgerald, the owner of eSpeed, as well as the CBOT, the CME and NYMEX, for infringement.

A judge ruled Cantor had not infringed; however, the firm went ahead and bought the patent from ETS for \$2 million, plus a taste of licensing fees. ETS evaporated, and eSpeed took the lead in battling the exchanges, eventually settling. All told, eSpeed will have wrangled more than \$45 million out of the various exchanges. Not surprisingly, eSpeed has been busy applying for new patents, while software companies such as TT have also hitched their wagons to the virtual monopoly that a patent offers.

an opinion on a small portion of the case whose bottom line, in the words of one patent attorney, was "a bloodbath for eSpeed." TT had requested a preliminary injunction to prevent its rival from continuing to market and license its front-end platform. In his February 9 opinion, Judge James Moran declined to grant the order.

That might sound favorable to eSpeed, but preliminary injunctions are rarely granted. More telling was the judge's opinion. "If the defendant chooses instead to confront plaintiff in the marketplace," Moran wrote, "then this court will have to reconsider its present belief that there has not been sufficient showing of irreparable harm." One patent attorney says that given this opinion, eSpeed should seriously consider a recall of the software under dispute or conduct a "guerrilla redesign" to circumvent the patent. Meanwhile, a source says that Brumfield is "ecstatic" over the judge's opinion.

**TT MIGHT BE** small compared to its antagonists, but Brumfield can afford this fight. Besides the \$250 million Chicago traders estimate he made from his pit days, he should pocket several hundred million more when the sale of another of his investments, Advanced Stent Technologies, to Boston Scientific closes imminently. So can Harris Brumfield actually win this high-stakes battle?

For starters, don't expect the exchanges to roll over. According to lawyers who have advised a number of them, their bottom line is that they aren't the ones infringing the patent. "The CME is not planning to write him a check," says Jerrold Salzman, an attorney with Freeman, Freeman & Salzman, which represents the exchange. Sources close to the CBOT and Euronext.liffe express similar sentiments. A Eurex insider says there has not, to his knowledge, been any serious discussion of capitulating to TT's demands, which could end up costing the four exchanges more than \$100 million a year combined.

The CME, which is publicly traded, and the CBOT, which is looking to go public, will not want to submit their shareholders to a massive recurring expenditure in perpetuity, insiders claim. Also, attorneys pointed out, if the exchanges agree to TT's terms, what will happen when the next Harris Brumfield comes along? The exchanges risk being literally half-nicked and quarter-dimed to death.

For their part, screen-based traders worry that any 2.5-cent charge could ultimately come out of their pockets. Conversely, if the exchanges *don't* take the deal and TT ends up being sold to a large company, that too would translate into higher fees. Whoever buys TT would likely wage a nuclear patent war that would wipe out most players — until ultimately one firm controls this crucial software.

Perhaps this offer to the exchanges, just as Brumfield's eSpeed patent war gets underway, constitutes hedging a bet, not making one. Even if the exchanges don't bite, a legal victory over eSpeed would still upend the electronic-trading industry.

One possible outcome: TT wins the eSpeed case but is still left vulnerable to competitors who will try to circumvent the patents simply by redesigning their products. More litigation would likely follow.

As one source close to TT puts it, "The only part of the [trading] industry not making money is the [software] industry, yet their work created the golden goose for the exchanges." Brumfield has made his move for a seat at the table, inserting software companies into the exchange/clearing company/trader chain that has existed for decades on transaction-based costs. The journey remains fraught, but Brumfield's track record says don't bet against him. ■