We have a reputation for being pretty nice people, astute but nice," says Arman Glodjo, co-founder and CEO of Forexster. “But this could blow up in a bad way for quite a lot of people if they force Forexster to seek justice.”

This is fighting talk, and it is pretty audacious for the founder of a forex platform that is not yet up and running. Up to now, most of the big arguments in online forex have centred on which of the major platforms – FXall, Atriax or Currenex – has got the best banks, the most dealers or the highest volumes. But now Forexster, the new kid on the block, says that not only is it going to change the way that forex is executed but is also going to patent its technology, blocking any of its rivals from trying to do the same.

Forexster claims that by linking clients to each other through the credit lines they have with their banks it can provide a network to allow them to make and take forex prices from each other. So the banks are sidelined, becoming no more than one of many links in a credit chain. Glodjo says: "The only thing holding back our business model becoming a reality is banks' greed and fear of disintermediation, even in light of the fact that almost all the banks we have spoken to have said ‘This is the future of FX’.”

Though banks may accept that they will eventually be disintermediated, they know that they are needed to set up the platforms to do it. So for them, and for other platforms, the mere idea of excluding banks from forex transactions in the near future is far-fetched.

Forexster has always known it has a battle on its hands. It has to challenge the banks and existing multibank portals just to get established. But it knows that rivals like the idea of linking clients directly to each other, so it has brought in its intellectual property lawyers.

Forexster has filed a patent application with the US Patent & Trademark Office, as well as an international application under the Patent Cooperation Treaty, which covers more than 100 countries, to protect the use of implicit credit lines. It says its claims range from the very broad to the very narrow, covering business methods as well as software programmes, so prime brokerage models, such as Currenex’s Enhanced Market Access (EMA), would fall under the patent.

These claims are not yet publicly disclosed. The application was filed in November 2000, which means it is too early to allow for its publication. Should the patent be issued in two or three years’ time, possible infringement would be enforceable from the date of publication.

Banks and other platforms dismiss Forexster’s use of intellectual property law. Jim Kleckner, vice-president of products at Currenex, says: “There’s a big difference between filing a patent and one being granted.” Karen Steele, Currenex’s vice-president of global marketing, adds: “It’s a little out of step to file a patent before they [Forexster] have a live product.”

But Forexster’s lawyers at Californian law firm Fenwick & West believe they have a strong filing with a good chance of approval. Ed Radlo, Forexster’s attorney, says: “When Forexster filed, its trading model was pretty well developed. A lot of software work had been done. We’re very happy with our patent position. I’m extremely impressed with it.”
The benefits of patent ownership are clear. An issued patent gives the owner exclusive rights to whatever has been patented for up to 20 years in the US. During that time, anyone wishing to use whatever has been patented, be it consumer products or business methods, must pay royalties or seek a licence from the patent owner. If they do not, they are in danger of infringing the patent, knowingly or unknowingly. If the patent owner chooses, this may result in long litigation to enforce the patent, including costly court fees, and a risk to the defendant of paying compensation.

Patents are designed to give their owners a monopoly on whatever is involved regarding the subject of their patent, which includes guaranteed market share. In Forexster’s case, if its patent claims are granted largely unchanged, it says it will have a monopoly over the use of “implicit credit” in online forex trading, encompassing client-to-client and prime brokerage models. If this proves to be true, it would take market share from the multibank portals, not only Currenex, but also Hotspot FXI, a prime brokerage model launched by Hotspot FX and AIG. It would also hit Atriax and FXall, both of which plan to launch prime brokerage services this year.

Forexster says that Currenex is already on its list of possible patent infringers, because of its EMA product. But until its patent is published, it has decided not to approach Currenex because it cannot claim infringement of a patent that is not yet published, let alone issued. Currenex is not taking Forexster’s claims seriously. Prime brokerage, it says, is not patentable – it is an existing way of conducting business that is not novel or non-obvious. Currenex says that if what Forexster is laying claim to is patentable, it is not the same as EMA. Steele admits Currenex does not know much about Forexster and its business model but that nonetheless it has no concern about its patents claims, or its competition. “It’ll be interesting to see what they have, when they have it,” she says.

Forexster’s intentions in filing a patent are twofold. First, it would help it to succeed in establishing a share of the new market it is trying to create. In addition, it would mean that, because Forexster is sure that client-to-client trading is inevitable, banks would be forced to work with it as the only option in providing what their clients want.

Seeking to dominate a new market
Forexster claims the trading model it has designed is in the best interests of buy-side clients. It will take the banks’ exclusive right to price from them and it will also create one, industry-wide forex exchange-type model. Atriax, FXall and Currenex all claim clients can trade with each other on their systems but they do not facilitate credit arrangements.

But Forexster is not necessarily doing buy-side clients a favour. First, the market is more than just buy-side clients wishing to close trades, deliverable or non-deliverable. Institutional investors and, to a much lesser extent corporates, speculate in the markets. Speculative trades, bank-to-client as well as bank-to-bank, constitute most trading and prices are referenced to interbank rates. Clients do not have access to this market, however, and would not be bound to use its prices as a reference when acting as market makers on Forexster.

It is also unlikely that interbank trading would migrate to Forexster, so interbank market rates would cease to act as a benchmark for speculative users dealing on Forexster’s exchange-type model. And the complete freedom to undercut prices that this would create could also generate a lot of volatility.

So if the patent is issued, and client-to-client trading takes off, Forexster will find it difficult to argue that enforcing the patent is in the best interests of the market. Rather, it is an aggressive way to try to dominate the market. Glodjo himself says: “FX won’t lose much if we’re the only ones doing client-to-client [trading].” But even then, existing platforms do not seem worried, because it is unclear that such a patent will be enforceable.

Forexster should be wary of underestimating the resources portals’ shareholder and member banks have for litigation. Like Currenex, the banks are not intimidated by Forexster’s bellicose talk and the prospect of court action years from now. To them, Forexster is a start-up attempting to change a whole industry, the chances of which are slim. But then no bank is going to publicly admit that client-to-client is a viable future model.

If Forexster is successful, it might make better use of a patent by flaunting itself as a takeover target. David Woods, managing director and head of e-commerce at ABN Amro, says: “The Forexster model is different to what anyone else is doing so far. They knew prime brokerage was coming elsewhere so they’re hoping to get a patent that sticks, saying ‘we have a different business model of some value’.” But that assumes they’re going to have a successful trading model. We’re
not so sure. [And if they do], it’s unrealistic to expect they would deter others. I wouldn’t see Forexster suing anyone.”

Most banks feel that patents are not a threat in e-commerce because technology is moving so fast that by the time a patent is granted, whatever has been patented is likely to be out of date. Alternatively, technology is so flexible that subtle ways could be found of doing something similar without infringing patents. But Forexster says its patent claims are extensive enough for this not to happen. So far, only EBS and Reuters have patents, which were issued some years ago. Woods at ABN Amro, which is a member of Currenex, Atriax and FXall, says these portals are looking into patenting issues. Atriax would not comment, except to say that it had “taken all appropriate steps to protect its proprietary information”. A simple internet search also showed that Currenex has four patents published already, though these do not appear to cover the EMA model. No results were found for any of the other multibank portals in the US or the UK.

Rather than dismissing patenting, the banks should make it their business to know what steps the portals are taking in the realm of intellectual property, especially if they are shareholders. Forexster claims that if its patent application is issued largely unamended, not only will the portals offering prime brokerage models risk infringing it but so too will all participating banks, knowingly or unknowingly. Forexster says it has sent a white paper to many banks active in forex, informing them of its business model, the front page of which states that patents are pending in the US. One of the banks Forexster contacted is Standard Chartered, whose name has been published as a supporter of Currenex’s EMA. Standard replied by email denying any involvement. Clive Laband, senior manager in forex and fixed income utilities at Standard Chartered, would not comment on this, saying he has no knowledge of the email, but also pointing out that while the bank intends to support EMA, it has not yet signed any binding documentation.

When such a time comes, however, Standard Chartered should examine the issue that Forexster has laid before it. It has already highlighted the problem of communication between bank divisions. Laband points out that he has not even seen the white paper sent by Forexster. He also points out that non-disclosure agreements, such as the one initially protecting the Forexter white paper, often act like Chinese walls within banks and prevent commercially sensitive material being widely discussed. But that may not prove to be a defence against knowing infringement of a future patent.

In an area as full of innovation and change as e-commerce, matters of intellectual property need to be explained to those responsible for developing and launching new products, and likewise between the portals and their members. One UK banker active in e-commerce says: “The issue of patents has not come up in any discussions, internally or with the portals, but it is an interesting one that we haven’t considered before.” He adds that it would be “irritating” to learn of patents filed by the portals when so many of the ideas they have developed have stemmed from their member banks and clients.

Banks may dismiss patent-related threats from a small company such as Forexster but already in the past three years, foreign exchange has changed as unprecedented levels of transparency have helped to vastly tighten spreads. Five years ago, banks were trying to ignore the change that threatened to squeeze their margins, but the momentum among their clients proved too great. The same may happen with client-to-client trading.

More than a mere irritation
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the claims to be granted or dismissed. During this time, patent claims are examined, often rejected, amended and resubmitted for approval.

The process is long and costly – the average cost of patent filings is about £30,000 ($42,275) to £40,000 in Europe, and about $25,000 in the US – but if successful worth the wait. In the US, patents issued grant their owners rights to exclude others from making, using or selling the patented product without a licence. Protection of this kind lasts for 14 to 20 years from the date of first filing the patent application, and infringement can incur costly court cases and the payment of damages for any potential loss of revenue.

Unfortunately for patent owners, enforcement is also costly. To sue for infringement can result in six-figure costs, only some of which might be recuperated if the plaintiff wins. Typically, the validity of a patent is also called into question by the defendant, which means risking a retrospective denial of the patent. Cross-jurisdictional rules are also ill defined, which, along with the often opaque wording in patent documents and the global nature of internet access, make enforcement yet more difficult.

Ari Laakkonen, UK patent lawyer at London law firm Linklaters, says: “If a start-up has the money to go for a patent filing, and it has a genuine key invention, it can get a huge amount of market power from the patent, if one is granted. The cost of getting equivalent market power or a sustainable technology lead by other means is likely to be far greater. But the cost of getting a patent plus the cost of enforcing it is a different matter.”

Statistics show that fewer patents are being enforced in the courts than are being granted, (in Europe there has been almost no e-commerce-related court action to speak of so far), which suggests the cost of enforcement is too great for start-ups. But all is not lost for a small company unable to enforce its patent. The right to exclusive use of a given product or business method may prove an invaluable source of revenue via licensing agreements. Alternatively, the patent may be a desirable commodity that can be sold to a bigger market player, or it may become a means by which the start-up becomes a viable takeover target.

An e-financial patent test case
In May 1997, MuniAuction, now known as Grant Street Group, filed a patent application with the US Patent & Trademark Office. In December 2000, after a typical application process with a usual amount of rejections and amendments of claims, a patent was granted giving MuniAuction ownership of “an apparatus and process for conducting auctions, specifically municipal bond auctions, over electronic networks, particularly the Internet”.

A month later, Grant Street announced that it would seek royalties/licensing agreements from companies found to be using its patented methods of online bond trading. At the time, Myles Harrington, president and co-founder of Grant Street, admitted that the company hoped to make up to 40% of its revenue this way.

One of the first suspected infringers of the patent to be contacted by Grant Street was Thomson Financial. By June 2001, discussions had led to a lawsuit filing against Thomson Financial because, Grant Street claimed, it had completed more than 350 auctions for municipal bonds using Grant Street’s patented methods. So far things are progressing slowly. After more months, still being subpoenaed in an attempt to substantiate the validity of the case. At best, Harrington hopes to get into court and conclude the case this year, at worst, next year. Simultaneously, out-of-court discussions, the progress of which Harrington is unsure of, also continue between Thomson Financial and Grant Street Group’s Chicago-based lawyers, Niro, Scavone, Haller & Niro.

Despite the time-consuming nature of the litigation, and the escalating expenses, Harrington remains convinced that Grant Street is undertaking the best course of action. It will only be liable to pay for its lawyers’ time if it wins, and this payment will come out of the large award hoped for, which has been accruing since the day the first letters were received notifying Thomson Financial of the infringement. Grant Street remains liable for expenses whatever the outcome, however.

“The verdict is not yet in,” says Harrington, “but the preliminary indications are quite favourable. I’m not worried about a retrospective denial of our patent because we went to great pains to disclose all

http://www.euromoney.com/contents/publications/euromoney/em.02/em.02.03/em-18592.html
our prior art and describe what we were patenting [when we filed the patent]. I like to think there’s not a lot of ambiguity in it that can be argued against.” Harrington adds that discussions are also under way with a number of other undisclosed companies suspected of being in infringement of the patent, and more court actions may follow.

In January of last year, Harrington told euromoney.com that aggressive use of its patent rights was the only way in which it could hope to compete with well-established names such as Thomson Financial. If Grant Street Group is successful in getting the verdict that it is seeking, or, alternatively a settlement, Harrington now says he expects Thomson Financial to become its biggest licensee. This would be no small achievement for a company that, beginning as MuniAuction only two-and-a-half years ago, could be described as a start-up.

Now the court case is under way, others operating in the online financial services industry are intrigued to see how things will turn out. “Everyone in this business is waiting to see if intellectual property in financial services can be protected,” says Harrington. But, he concludes, many are still not taking the issues of patents seriously, and as such new companies continue to enter the market unhindered.

Harrington adds: “It’s not commonly recognized that it’s difficult to get a patent – the vast majority are rejected – but I’d say that now, patents are an absolute essential part of technological innovation in financial services. Anyone developing [products in this space] should take the time to formally protect their property.”

Only time, and Grant Street Group’s final position, will tell if the effort, patience and cost is worth it.