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Intellectual Property

U.K. High Court of Justice Rules on Whether Software Written by Co-Founder of a Hedge Fund Manager Belongs to the Co-Founder or the Firm

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A decision recently handed down by the U.K. High Court of Justice involving a dispute over software created by a co-founder of a hedge fund manager highlights the risk of failing to clearly document intellectual property rights at the inception of a manager's business. The decision also emphasizes the importance of clearly delineating, in hedge fund manager partnership and employment agreements, ownership of software and other intellectual property developed or modified by principals, employees or contractors of the manager. This article summarizes the facts and legal analysis underpinning the court's decision. The case is *Coward v Phaestos Ltd & Ors* [2013] EWHC 1292 (Ch) (17 May 2013). See also "Protecting Hedge Fund Trade Secrets: What a Difference a Year Makes," Hedge Fund Law Report, Vol. 5, No. 16 (Apr. 19, 2012).

Summary

In this case, the U.K. High Court of Justice, Chancery Division, Intellectual Property (Court), ruled that the algorithmic trading software admittedly written by IKOS co-founder Martin John Coward belongs to IKOS, a fund manager. Given the absence of any unequivocal documentation regarding ownership of Coward's software, or the respective rights of IKOS and Coward to that software, the Court devoted nearly 70 pages to its consideration of all the evidence, the applicable legal principles and the rationale for its decision. For discussion of a lawsuit filed against two former IKOS employees who set up their own firm after their employment at IKOS was terminated, see "U.K. High Court of Justice Rules on Request by Hedge Fund Manager Affiliates to Search Computers of Two Former Employees," Hedge Fund Law Report, Vol. 5, No. 44 (Nov. 21, 2012).

Parties and Factual Background

The defendants in this case are IKOS Asset Management Limited (IKOS AM), which serves as investment manager to the IKOS Fund; IKOS CIF Limited (IKOS CIF), sub-investment manager to IKOS AM; Phaestos Limited (IKOS UK), a partner in IKOS Partners, a general partnership that is at the heart of this case; and Mindimaxnox LLP, which provided programming, research and

other services to IKOS CIF. Collectively, the IKOS defendants (IKOS) employ quantitative investment strategies that use computer models to make and guide their trading decisions. Plaintiff Coward holds a PhD in Control Theory Engineering from Cambridge University. Coward's spouse, IKOS co-founder Elena Ambrosiadou, has a degree in chemical engineering and an MBA from Cranfield University. Coward wrote IKOS' first trading software some time around 1992, when he and Ambrosiadou formed IKOS. Ambrosiadou is chief executive officer and a director of each of IKOS CIF and IKOS AM. She is also the sole owner of IKOS U.K. The sole significant issues in this case were whether Coward was the author of certain trading software used by IKOS (Software) and, if so, whether he owned the copyright to the Software.

The Court found neither Coward nor Ambrosiadou to be "an entirely satisfactory witness." Their "approach to giving evidence was tainted by their obvious and deep animosity and the extremely close correlation between their business and their personal affairs." The Court said Coward was evasive and cavalier, changed his testimony to suit his needs and showed a lack of attention to detail. Ambrosiadou was "extremely evasive and prone to making lengthy speeches in order to avoid answering questions which did not suit her, in what often appeared to be an attempt to obfuscate and confuse." Consequently, when their testimony conflicted with that of other witnesses, the Court generally accepted the testimony of those other witnesses.

Ambrosiadou began planning an investment business in 1990, while Coward was working at Investcorp. She formed IKOS UK in 1991 with a business school colleague who later left the company. Coward paid for the incorporation. He left his job at Investcorp in August or September 1992 to work full time with Ambrosiadou. According to the Court, "there was no dispute that it was intended that the investment business would be based upon computer software, the creation of which was within Dr Coward's rather than Ms Ambrosiadou's expertise and experience and that they would trade exclusively for [their first client, asset manager Paloma General Partners LP (Paloma)] in Japanese warrants, which was also within Dr Coward's expertise."

In or around September 1992, Coward, Ambrosiadou and Edwin Robertson (Coward's colleague at Investcorp) began working together in preparation for advising Paloma: Coward wrote trading software, Robertson wrote back-office software and Ambrosiadou worked on business and regulatory matters. Evidence of their collaboration at this time is critical because, as more fully discussed below, the Court found that they were acting as partners at this time – even before registering a formal partnership, IKOS Partners. At this time, Ambrosiadou advised her accountant that she, Coward and Robertson were partners and that Coward would sell all of the trading software to the partnership. Their business plan also referred to the three of them as partners. Consequently, the Court rejected Ambrosiadou's contention that the business was hers alone.

In December 1992, Coward, Ambrosiadou (through IKOS UK) and Edwin Robertson Ltd. (Robertson's wholly-owned corporation) filed a partnership deed establishing IKOS Partners, effective as of December 8, 1992. It provided that the partnership was the owner of all furniture, office equipment and other hard assets used in the business, but was silent as to software. IKOS UK had an 80% share of profits and losses; Coward and Robertson each had 10%. The agenda for a February 1993 partnership meeting included "Purchase of trading software." An item on the agenda for the following meeting was: "Software: How shall it be treated for accounting purposes (approx £400,000 worth of development by Martin [Coward])."

In March 1993, Coward signed an agreement between IKOS Partners and Paloma affiliate Mill Street Partners LP pursuant to which IKOS Partners would manage $50 million for Paloma (Mill Street Agreement). Critically, the agreement stated:

> Any software developed for use by the Account ('the IKOS Software') shall be used solely for the benefit of the Account during the term of this agreement and the parties shall keep the IKOS Software confidential. We represent and warrant to you that the use on behalf of the Account of neither the IKOS Software nor any other software will infringe the rights of third parties. *The IKOS Software shall be owned by IKOS Partners*. . . . (Emphasis supplied.)

After IKOS Partners' relationship with Paloma ended in 1994, Coward continued to develop trading software. IKOS UK also hired several programmers. At the same time, Ambrosiadou worked on launching a Cayman Islands-domiciled hedge fund, the IKOS Fund. Apparently in an effort to achieve a tax-efficient structure and keep profits offshore, she also established a Cyprus-based trust that was the beneficial owner of IKOS CIF and IKOS AM. Profits were directed towards IKOS AM. Coward was not an income beneficiary of the trust. According to the Court, Coward "considered himself to have an interest in IKOS AM and that the arrangements were convenient for tax purposes, but did not reflect the real state of affairs." He claimed that, as a result of their marriage, and by agreement with Ambrosiadou, everything was jointly owned. The Court rejected that contention.

Over time, Coward continued to write software as a partner of IKOS Partners, but the partnership's books reflected that he had only a nominal (0.004 percent) interest in that partnership. As part of a reorganization of IKOS' business structure, McDermott Will & Emery prepared a tax advice memorandum that referred to "intellectual property vested in IKOS Partners relating to the computer programmes used in the course of the equities and futures business. . . ." The Court concluded that Coward had knowledge of and had read this memorandum.

In 2006, apparently for compliance reasons, Coward moved to Cyprus and became chairman and chief executive officer of IKOS CIF. He did not have an employment contract. IKOS CIF replaced IKOS Partners as IKOS AM's sub-investment manager. An agreement among IKOS Partners, IKOS CIF and IKOS AM provided that "all Intellectual Property Rights [including software] discovered, created or arising out of the performance of their duties under this Agreement shall be the property of IKOS A.M. and the Company and Partners undertake to do all acts and things as may be thought by the Company and Partners to be necessary to vest any such property in IKOS A.M. and to register title in such property in IKOS A.M." and that the parties would "treat all Intellectual Property Rights as the property of IKOS A.M." IKOS Partners and IKOS CIF were granted revocable licenses to use that intellectual property. The Court considered it "more likely than not" that Coward was aware of the subject matter of the agreement. The Court also observed that, during the reorganization process, "he made no mention to anyone, including the IKOS Fund of which he was a director, of the fact that he contended that he owned the Coward Software upon which the business was founded." IKOS Partners was dissolved at the end of 2006. Its final accounts showed that Coward had a negative capital balance and, accordingly, was not entitled to any partnership assets. All partnership assets passed to Ambrosiadou's company, IKOS UK.

In 2007, Ambrosiadou retained law firm Dechert LLP to conduct an intellectual property audit for IKOS. Dechert considered whether IKOS' trading software was owned by IKOS UK, IKOS Partners or Coward, or some combination of them. The audit was inconclusive.

In 2009, business and personal differences between Coward and Ambrosiadou grew as Coward sought to change IKOS' business structure. Coward resigned at the end of 2009 and moved to Monaco to start his own hedge fund. He was joined by two former IKOS employees after the end

of their "gardening leave" (non-compete periods). Prior to leaving IKOS, Coward downloaded code from IKOS onto his own computers.

The Software

Despite the fact that Coward called the Software "the cornerstone of the success of the business," it was never valued and never appeared on the books of any IKOS entities. Programmers employed by IKOS UK had modified and added to the software as early as 1993. The modifications continued through 2006. Coward had always rejected the use of "versioning" for the Software, which might have helped to unravel which of the various contributors had authored various changes. The Court described the process of establishing authorship of the Software as "extremely difficult."

Coward and the IKOS defendants retained their own computer experts to review the code and try and determine its authorship. Their reviews were generally inconclusive, though they agreed that, at a minimum, Coward had written the "core" of the Software. Coward asserted copyright in three distinct elements of the Software: (1) the "mathematical and statistical algorithms underpinning the trading software" that he created prior to the formation of IKOS Partners in December 1992; (2) the software he wrote after the establishment of IKOS Partners; and (3) the software he co-authored with employees of IKOS UK after 1993. For the reasons discussed below, the Court concluded that, although Coward had written much of the Software, he did not own it and that the copyright had rested with IKOS Partners.

Analysis

Coward's Early Software Was the Property of a September 1992 Partnership Among Ambrosiadou, Coward & Robertson

Even though the partnership deed for IKOS Partners was not filed until December 1992, the Court concluded that, by September 1992, Ambrosiadou, Coward and Robertson had embarked on setting up a for-profit investment business. At that time they referred to Paloma as their client, signed an early version of the Mill Street Agreement and referred to themselves as partners in regulatory filings. That was sufficient to establish a common law partnership (September Partnership). Coward also admitted at trial that he was bringing his mathematical and programming skills to the business and that, in some sense, he was doing so as a partner in the course of that business. The Court concluded that "there can be no doubt but that the software written by Dr Coward prior to December 1992 was written by him as a partner in the course of the September Partnership. This is also consistent with the terms of the 1993 Mill Street Agreement and its 1992 version" [which indicated that IKOS Partners owned the Software].

The Court concluded that the Software had been an asset of the September Partnership for the following reasons:

- "The software was the foundation of the business without which there would have been no business at all." Coward admitted that a potential purchaser of the business would have required ownership of the software.
- If Coward could use the Software to compete with the September Partnership, it would "seriously prejudice the IKOS business, if not destroy it."

- Although the business could have been protected had Coward licensed the Software to the firm, there was "no indication that Dr Coward ever asserted ownership during the period 1992 to 2009. As Dr Coward put it, he considered himself and the business to be one and the same."
- Ambrosiadou had written to a tax advisor that the Software would be sold to IKOS Partners, evidencing intent "that the software be a partnership asset."
- The partnership had given "express permission" to Robertson to use the software he created for his own purposes, which suggested that software created for the partnership was considered to be a partnership asset.
- The Court also reasoned that, "if Dr Coward were keeping the copyright to the software for himself, it is difficult to see what if anything he was bringing to the partnership business particularly in its early days before December 1992." Moreover, retention of the copyright would have "conflicted with Dr Coward's duty of good faith to his partners."

The Software Became the Property of IKOS Partners

The filing of the partnership deed for IKOS Partners in December 1992 caused a "technical dissolution" of the September Partnership. The Court concluded that the Software had been transferred from the September Partnership to IKOS Partners, whose partners were Coward, IKOS UK (Ambrosiadou's company) and Robertson's company. Coward conceded on cross examination that nothing had changed in the business except for the filing of the deed for IKOS Partners. The Court reasoned that "[t]he software remained the bedrock of the business, and Dr Coward continued to develop and refine it for the purposes of carrying on the trading for the Paloma account." The minutes of the February 1993 partnership meeting referred to above supported the conclusion that the Software was intended to be a partnership asset. In short, the Court found "nothing post December 1992 which would warrant the rebuttal of the presumption that the software was brought in as common stock of the IKOS Partnership." This would be true even if the Court was wrong in ruling that the Software belonged to the September Partnership:

> Once trading under the Mill Street Agreement had commenced in early 1993, given that the software was the very foundation of the venture and continued to be modified by Dr Coward in his capacity as a partner, without differentiation in product, in order to meet the needs of that business, in my judgment, it was necessary that the copyright in the software should be owned by the partnership.

Coward conceded that, after December 1992, he continued to write Software "as a partner in the course of the IKOS Partnership business." The Court concluded that the Software was an asset of IKOS Partners for the same reasons that it had concluded that the Software had been an asset of the September Partnership: It constituted the "bedrock" of the business, and was consistent with Coward's duty to devote his "whole time and attention" to the partnership. Moreover, commencing in 1993, IKOS UK employees also contributed to, and modified, the Software, "in such a way that it was inextricably co-mingled." The Court reasoned that the commingling of software was "only consistent with an implied agreement that the software was an asset of the partnership." Finally, Coward never challenged the McDermott Will & Emery report that referred to IKOS Partners as owner of the Software and never asserted ownership of the Software. He also never challenged any of the IKOS business or trust structures. The Court observed that Coward "was content to take advantage of them whilst his relationship with Ms Ambrosiadou lasted and it is not now open to him to seek to circumvent their effect whilst accepting their

validity." Consequently, as indicated above, ownership of the Software passed to IKOS UK when IKOS Partners dissolved in 2006.

Other Grounds Supporting IKOS' Rights in the Software

The Court's decision rested on its finding that the Software was an asset both of the September Partnership and of IKOS Partners. The Court nevertheless gave its opinion on certain legal issues raised by the defendants as alternate grounds for defeating Coward's claims. If Coward appeals the decision and is successful, the Court's consideration of these issues might obviate the need for further proceedings.

- *IKOS Had a License to Use the Software.* The parties agreed that, even if Coward owned the Software, IKOS had a license to use it. Given the critical role the Software played in IKOS' business, the Court would have deemed the license to be exclusive. However, Coward could have terminated the license on "reasonable notice," which would have been "the period which it would reasonably take to re-write such lines of code and the parts of the remainder of the software the design of which relied upon the Coward Software."
- *Estoppel.* Coward had acted as though the Software belonged to IKOS, both by allowing it to be modified, by signing the Mill Street Agreement and by failing to correct third parties' statements to the effect that IKOS owned it. In reliance on that conduct, IKOS had hired programmers, expended substantial sums on improving the Software and had developed its entire business around the Software. Consequently, the Court would have barred Coward "from relying upon any legal rights he had to the copyright. . . ."
- *Coward Could Not Retain a Copy of the Software.* Even if Coward, as an executive of IKOS, had an implied license to have a copy of the Software, that license terminated when he left IKOS.
- *Coward Wrote the Software.* The Court ruled that "the balance of probabilities" was that Coward was the original author of about 200 software procedures that made up the Software. It did not rule on precisely when he wrote them.

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