

When To Establish A Software Or Technology Escrow Agreement

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Over the past thirty years, end users of technology have learned that software and technology escrow agreements offer protection for technology investments by providing the end user with access to source code or other critical information in the event of certain, pre-negotiated circumstances. In addition, in some situations, an escrow agreement can provide increased leverage for obtaining better support from a technology vendor when support services suffer.

Escrow agreements have long been popular among larger corporations when entering into software licensing transactions. However, on an increasing basis, smaller companies are now calling for escrow agreements as they have come to rely more heavily upon technology to operate their business and maintain their competitive advantage

As the technology escrow industry has grown, the Tier One, or full-service providers, have evolved and brought significant innovation to the industry. For example, Tier One providers offer specific technical expertise to perform tests on escrow deposits to ensure the materials are complete and accurate and incorporate cutting edge technology to allow clients to monitor and manage their account information electronically via web based tools. More progressive agents are now accepting escrow deposits electronically via FTP sites to expedite the process for all parties.

However, despite all the advances aimed at helping end users protect their technology investments, a few glaring errors by end users continue to occur when requiring escrow services as part of their technology transaction.

The most common error is determining when to establish the escrow agreement.

When to Require an Escrow

Our experience indicates there is a natural tendency for both the technology vendor and end user to delay the establishment of the escrow agreement and submission of the deposit materials. The common license agreement calls for the escrow agreement to be negotiated at some later date following the execution of the license agreement and the escrow deposit to be made some 90-120 days after that. In many cases, this practice causes the escrow agreement to be forgotten completely or the end-user leaves the bargaining table with the assumption that their vendor will establish the agreement on their own. While this does occur, in many cases the software vendor has a far less vested interest in making the escrow deposit and will only do so when forced to comply.

The rationale for delaying the establishment of the escrow agreement is essentially that the software is just being developed (or customized) now. We should wait until the technology is installed, tested and accepted before we require the escrow.

Yet, end users typically have begun paying, in some form, for the technology well before it is ever installed. There are license fees, legal fees, customization fees and additional costs already invested. Also, there are often key milestones that are negotiated into the license agreements that call for incremental payments to be made to the software vendor while the technology is being developed, customized or prepared for installation. This “pay as you go” relationship makes sense.

However, the logic behind the escrow agreement should also dictate that the escrow agreement be negotiated and executed at the same time as the license agreement. Then, each milestone that triggers a payment should also trigger an associated update to the deposit materials. This reciprocal type of arrangement keeps each party's "value" on equal footing during the development or installation period and provides a business continuance plan for the end user that increases in value with each milestone and associated update to the escrow deposit.

The High Cost of Procrastination

Software and Technology escrow agreements can be customized to provide protection for virtually any type of intellectual property. A short list of examples would include but would certainly not be limited to; source code, object code, Software as a Service (SaaS) applications, registrar data (RDE), hardware, hardware designs, manufacturing processes, customer lists, domain names, names and contact information for key employees and more.

Anytime a company, government entity or organization relies upon technology or intellectual property for critical applications, an escrow would help mitigate the risks associated with this reliance.

Far too frequently we receive a call from a rather desperate end user of technology that is trying unsuccessfully to have their technology vendor comply with their verbal commitment to establish and maintain an escrow agreement on their behalf.

The typical scenario is that of a company that relies heavily on technology from a key vendor and when they started working with this vendor there was a verbal commitment to escrow the technology for the project. The end-user took them at their word and assumed that the escrow had been established. In the meantime, the end-user's reliance upon this technology for their business operations has increased significantly. Then, during their course of business, they learn that the escrow was never established and that their software vendor is struggling financially and/or struggling to support the technology. In many cases the executives that had agreed to the escrow have now left the company and the current management refuses to even discuss the topic.

An escrow agreement established at the appropriate time and maintained over the course of the relationship would reduce these risks. Rather than trying to get the escrow established in the 11th hour, the end-user company could simply be requesting a technical verification of the deposit materials to determine the completeness and accuracy of the escrow deposit in their preparation for filing for a release of the deposit materials to support their application.

In summary, it is never too early to establish an escrow agreement but it can often be too late. The cost of the escrow service is nominal compared to the costs of most technology investments and the impact of lost productivity or lost profits that would result from the absence of the functioning application. If the transaction warrants an escrow agreement, require the escrow agreement to be fully negotiated and fully executed simultaneously with the license or service agreement. The escrow deposit materials can be and usually are deposited at a later date. In fact, the escrow agreement may be modified to require the escrow deposit by a certain, pre-arranged date. Proceeding in this fashion contractually obligates the software vendor to make the escrow deposit and the escrow agent's notifications will keep you informed as to if/when the escrow deposit was made.