

# Escrow Auditing: Building Stronger Client Relationships

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ESCROW ASSOCIATES  
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## **What you will learn**

- 1) How to understand the changing role of technology escrow for your clients.
- 2) That an alarmingly high percentage of technology escrow agreements are not in compliance with the legal terms agreed to in the license agreement.
- 3) How to address this issue through periodic auditing of both legal documents and escrow materials.

## **Executive summary**

This paper demonstrates the importance of technology escrow auditing for clients that rely upon licensed technology assets to conduct business. While the practice of implementing a technology escrow agreement has become common among enterprise software transactions, this paper also shows why and how those agreements and materials should be audited, to dramatically improve the quality of escrow services. In a step-by-step guide, we explain the steps of auditing IP escrow agreements, so that lawyers can strengthen client relationships and improve client positions in these turbulent economic times.

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## Introduction

Everyone is thinking about the economy. Your intellectual property clients are thinking about it, cutting budgets and wondering if they will need as much legal counsel this quarter. As developers also find themselves in financial difficulties, your clients should begin to prioritize IP protection with escrow agreements to protect against the increasing likelihood of software vendor failure. The good news is that IP lawyers can strengthen their client relationships and protect their clients at the same time, by performing regular escrow audits, and by informing clients about how the economy is changing the nature of the risk they face from their technology assets.

## Understanding the role of technology escrow

Technology escrow is not only a way for your clients to protect IT assets, but also a valuable legal decision made to protect your clients' operational future, in the event that their vendor ceases to be available, for whatever reason. In an escrow agreement, an agent, such as Escrow Associates, securely stores key components of licensed technology, ensuring that your clients will have the information and resources necessary to maintain or replicate licensed technology.

After surveying the market, research firm Forrester openly promoted escrow agreements in January of 2009, reporting that, to protect their licensed technology, firms would benefit from entering into agreements with “escrow, or escrow-like mechanisms<sup>1</sup>” since “most [licensing] contracts do not include the ... protection mechanisms found in on-premise contracts.”

### *Addressing the growth of SaaS*

One of the reasons that Forrester is openly promoting escrow is the growing prevalence of SaaS, or Software as a Service. In SaaS agreements, companies enter into an agreement with a software developer, who provides access to software services on a subscription-based model.

The explosive growth in this market, as shown by the sidebar, is just the sort of situation that calls out for escrow services. Since these software developers are not providing ownership of the technology in question, if they become unavailable, your client instantly loses a vital business operations mechanism. However, with an escrow agreement in place, they can secure access to their vital business software.

“... SAAS WILL GROW FROM MAKING UP JUST OVER 1% OF THE \$18 BILLION IT MANAGEMENT SOFTWARE MARKET IN 2008 TO 10% BY 2013, BY WHICH TIME MANY OF THE BRAND SAAS PROVIDERS COULD BE WELL-ESTABLISHED.” – FORRESTER RESEARCH

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<sup>1</sup> Any language in an agreement that mandates technology assets be held by an independent party, to be delivered to the customer in case the vendor becomes unavailable.

## *Knowing what your clients fear*

Your clients are worried about the following issues pertaining to their vital business technology license contracts—and if they are not, now may be an ideal time to bring up these potential scenarios:

- **Developer insolvency** – In a slower economy, some developers are having trouble collecting funds from clients and investors, which can lead to insolvency or bankruptcy.
- **Emergencies affecting the development team** – Emergencies and disasters are always a business risk.
- **License agreements** – Although licensing agreements outline ownership and other issues, they often do not contain language that delivers technology and materials in emergency situations.
- **Financial and operational stability** – Most companies will not be able to operate without all of their licensed technology. Ensure their operational future with regular auditing.

## Building your practice by protecting your clients

The escrow agreement is only half of the technology escrow equation. All legal agreements rely on independent verification that commitments are being met by all parties, and escrow agreements are no exception. Strengthen your client relationship, and your clients' position, by providing periodic escrow auditing services.

### *Know why escrow agreements fail*

To protect your client's best interest, you have an obligation to make sure that your client agreements don't fail. Although your clients may feel that they can trust their vendor or their licensing agreement, the fact is that they need your legal expertise to make sure they get the materials they need, when they need them. Through the escrow auditing process, you can mitigate the possibility of the top three problems with failed escrow agreements.

- 1) **Oversight** – Many depositors overlook escrow commitments made in license agreements. As legal counsel, you can help your clients spot oversights before they become problems for your client.
- 2) **Fidelity** – The fidelity of escrow deposits can drop over time, as developers and clients trust each other, and become lax about keeping materials up-to-date. Don't let your clients lull themselves into a false sense of security. Mandate and expect regularly verified deposits.
- 3) **Expertise** – Escrow agents lack the legal power to require escrow materials from the Depositor. Your clients need your legal expertise to help them fix broken commitments.

## Save clients from the common denominator

The statistic cited in the side bar illustrates the problem with most escrow agreements. While the legal commitment may be in place, the escrow agreement is significantly less valuable when the materials in the escrow account will not replicate the licensed technology. Gross negligence is not the only way that this happens. Often, depositors make simple mistakes along the way, unwittingly depositing less than perfect materials into escrow. To be fair, many developers feel their own internal systems are so robust, the escrow should never be in play—but that’s exactly why it exists: to protect against the unexpected and unforeseen.

Incomplete escrow materials can mean anything, from one missing source code file, to a page missing from documentation, to a lack of development environment application code to open the source material, to a lack of a database in place that the application can work with. But the problem is clear. Without all of the information, the operational future of your client is at risk, and yet the majority of escrow accounts are missing *something* important. An escrow audit addresses and discovers those missing files.

“ACCORDING TO IRON MOUNTAIN, 97.4 PERCENT OF ALL ANALYZED ESCROW MATERIAL DEPOSITS HAVE BEEN FOUND INCOMPLETE AND 74 PERCENT HAVE REQUIRED ADDITIONAL INPUT FROM DEVELOPERS TO BE COMPILED.”

—CIO.COM, FEBRUARY 2008

On December 9, 2008, Altman Weil released the results of a survey showing that “75% of responding General Counsel indicated that their law departments are facing budget cuts averaging 11.5% for 2009.” If your clients are facing budget and department cuts, give them the ammunition they need to fight for your services. Show them real results from the following step-by-step guide to performing an escrow audit.

## Use escrow auditing to strengthen relationships

What follows is our step-by-step guide to strengthening your client relationships with complete escrow compliance auditing.

### Follow the steps to safety

#### 1) Review client needs and commitments

Some agreements fail simply because the commitments outlined in the escrow agreement don’t match the real needs of the client. What documentation will your client need to make the technology work without the developer? Which staff members have special expertise vital to implementing the technology? Analyze your clients’ needs in detail, and make sure that those needs are met by developer commitments.

## 2) Obtain agreements and summaries

Request to see a copy of the escrow agreement and the escrow account summary. These should provide you with detailed information about the location and contents of the account, as well as deposit schedules.

## 3) Make sure agreements meet commitments

Go through the escrow agreement, line-by-line. Make sure that the language of the escrow agreement matches up with the commitments from the license agreement. Very often it does not. If there are any points of contention, present them to your client. Recommend amendments or offer to negotiate a new agreement that meets all their needs.

## 4) Review deposited materials against delivered technology

Compare the deposited materials against the current technology being used by your client. Having the right materials in escrow ensures that, in the event of dispersal, your client will receive useful materials and that vital operations will continue to operate as planned.

## 5) Provide a summary of enterprise-wide compliance

Address the agreement with each vendor individually, and then compile a master list of vendors that are in compliance. Make a separate list for vendors that are out of compliance. Make suggestions to your client about best practices with non-compliant vendors.

## 6) Consolidate escrow agreements with one provider

Help your client to design a master escrow agreement document which can be edited to fit the specific needs of each situation. Standardize their escrow terms and processes, making future agreements faster, easier, and more accurate.

# Conclusion

In today's economic climate, it's just good business practice to be more diligent with regards to operational continuance planning. As a vital part of that planning, escrow auditing ensures that your clients will be able to function if there are issues in their relationship with the developer down the road. By verifying their escrow agreements and contents, you strengthen your client relationships, ensuring that your IP practice is strong enough to weather the economic times with new, useful services.

## Contact information

Want to learn more about the importance of escrow auditing, and how you can use it to strengthen your client relationships and your practice? Contact Escrow Associates today.

We have the experts and services that it takes to ensure your clients' operational future.

<http://www.escrowassociates.com/contact.html>

1.800.813.3523

## Author Biographies

### *Chris Smith, President*

Chris is a founding member of Escrow Associates, LLC. With more than a decade of experience in the software and technology escrow industry, Chris is an expert on business services related to the protection of technology assets. He has spoken before dozens of organizations including Fortune 500 companies, legal conferences, and technology procurement coalitions and leading Intellectual Property law firms all over the world.

### *Christian Dodder, CEO*

Prior to co-founding Escrow Associates, LLC, Christian was instrumental in developing the standard of Technical Verification Services in the escrow industry for Fort Knox Escrow Services, Inc. His methods both streamlined the process as well as dramatically reduced the costs associated with testing an escrow deposit for completeness and accuracy.

Christian offers a decade of experience in the software and technology escrow industry. Christian has transformed many of the services that users of software and technology escrow services benefit from every day.

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