

The Ironic Twist of Software Escrow Agreements

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In the early 1980's the practice of forcing a software developer to place source code, build instructions and other documentation into an escrow agreement with a neutral third party became a part of business continuance planning for many licensees of enterprise or custom software. A "software escrow" agreement is designed to provide the licensee or "beneficiary" with access to and a license to use source code to support the licensed software application if the software vendor ever fails.

While this practice seems like good business planning for the licensee it often feels like an insult to the software developer. The developer is contractually obligated to deposit sensitive intellectual property with a third party and forced to update those materials each time the technology changes. Even though the practice of software escrow is wide spread and usually just part of a company's business continuance planning it often feels invasive to the depositor.

Now for the ironic twist. The party that typically benefits to most from having the escrow agreement in place is the depositor themselves! That's right! The depositor is often the party that benefits the most from having the escrow agreement in place.

First, the escrow agreement helps software companies gain additional clients. This is especially true for younger, start up software companies that do not have a track record, a large enterprise client base or significant revenue or profits. The escrow agreement helps them convince their prospective clients that they understand that any client would want protection for their investment in licensed technology. It also demonstrates a certain sophistication on the part of the software company proving that they have been down the escrow path before in other enterprise transactions.

Second, the escrow agreement provides the beneficiary with peace of mind that they would not have with out the escrow protection. In some cases this peace of mind will make beneficiaries more patient if a software company is struggling with support, faced with a financial crisis and etc. With the escrow agreement in place, the beneficiary already has a "plan B". They do not have to search for replacement software if their vendor experiences a down turn. They have the escrow agreement in place as their "plan B".

Finally, even in the worst case scenario of a software company's demise the escrow agreement may benefit the depositor more than the beneficiary. In some cases, the fact that the escrow agreement was in place kept the beneficiary "out of the market" for replacement software when a vendor failed. The beneficiary is often able to utilize the escrow deposit along with support from key personnel from the now defunct software company to support their application and derive the value from their investment. Key personnel are often hired directly by beneficiaries to support the technology on a contract or employee basis. In some cases, the beneficiaries actually become clients of the depositor again once they have cleared the bankruptcy process.

Certainly, the beneficiary to an escrow agreement receives the peace of mind they desire as well as a workable business continuance plan that addresses the all too real possibility that their software vendor may not make it long term in this dynamic industry. However, the depositor also derives significant benefit for having established the escrow agreement. Ironically, in the end the depositor is also a beneficiary.

