



# Protecting Intellectual Property Through a Best Practice Technology Escrow Program

---


*Frank Bruno*  
*Senior Business Strategist*  
*Iron Mountain*  
*February 23, 2005*

*Lisa M. Sotir Ozkan, Esq.*  
*Vice President and*  
*Associate General Counsel*  
*Blackboard*

# Learning Objectives

- 1 → **Create a Standardized Approach to the Escrow Process Using Best Practices**
- 2 → **Leverage Contract Language to Maximize Protection**
- 3 → **Escrow in Action**

# Grim Reality



***More than 30 formerly independent software companies disappeared last year in the flurry of over \$13 billion in M&A transactions. At least 100 venture-funded software companies closed their doors in 2003, never to be heard from again.\****

\*Bob Evans, *The Enterprise Software Company of the 21<sup>st</sup> Century*, Software Business, March/April 2004

# Learning Objective #1

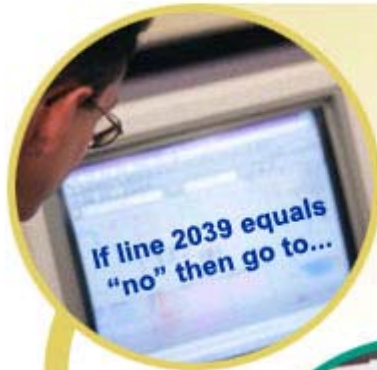
- 1 → **Create a Standardized Approach to the Escrow Process Using Best Practices**

# Technology Escrow Defined

- The practice of securing access to source code, maintenance and other proprietary materials for the benefit of all parties to a technology transfer (typically a license) agreement
- Parties include:
  - The **developer**, referred to in contracts as the depositor
  - The **licensee**, referred to in contracts as the beneficiary
  - The **escrow agent**, the neutral trusted third party



# Software Programming 101



Developer enters human readable **source code**

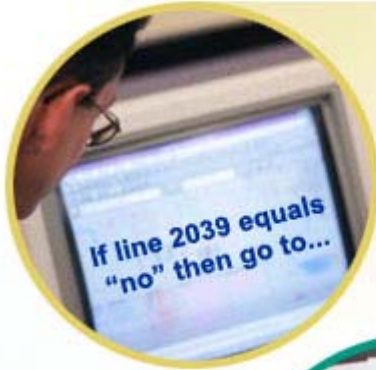


**Compiler** translates from source into computer readable language, **object code**



System reads the object code to run **program**

# Why Source Code Is So Critical...



Most vendors do not provide the source code



Since the compiler cannot convert object code back to source code...

Access to key development data is essential to support, upgrade or maintain the technology



...the licensee is unable to support the program

# Developer/Licensee Dilemma

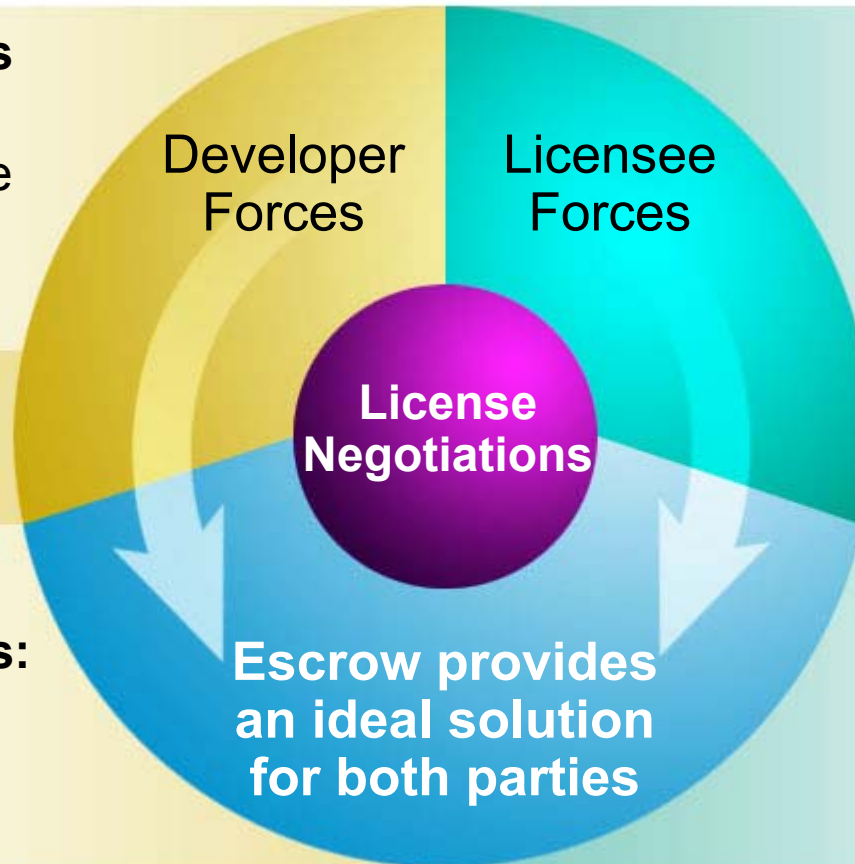
## Developer Desires

- Credibility
- Short Sales Cycle
- Satisfy Client

## Increased Competition

## Desired Outcomes:

- Close deals
- Market traction
- IP protection



Developer Forces

Licensee Forces

License Negotiations

Escrow provides an ideal solution for both parties

## Licensee Desires

- Risk control
- Avoid Litigation
- Satisfy Legal

## Business Pressures

## Desired Outcomes:

- Controllable budget
- Leverage/support
- Access to code



# Inconsistent Use of Escrow

Tom in Contracts  
always does his  
due diligence



Sam in Finance gets  
caught off guard  
without escrow



John in IT  
uses escrow  
100% of the time



Sara in  
Procurement  
uses escrow when  
she has the time



# How To Identify Your Risk

## Operational Dependencies

- Number of users
- Customer impact
- Lost productivity
- Lost revenue
- Public Safety

## Investment of Time

- Availability of substitute products?
- Time to recode
- Time to identify new product
- Time to negotiate new license

## Risk Factor

Determine what level of software escrow protection is needed and how serious you should consider your escrow agreement

## Costs

- Initial investment
- License fee
- Installation
- Retraining
- Customization
- Reprogramming
- Hardware

## Vendor Assessment

- Vendor stability
- Subcontractor partnerships
- Breadth of product lines
- Commitment of staff

# Create a Software Asset Management Team

## Legal Expertise

Focus on  
escrow contract

Ensures a release  
occurs when it should

## Technical Expertise

Focus on  
escrow deposit

Ensures the deposit  
contents are usable



**“Although only 10% of users have established centralized asset management capable of managing [escrow issues], this will grow to 50% by 2006...”**

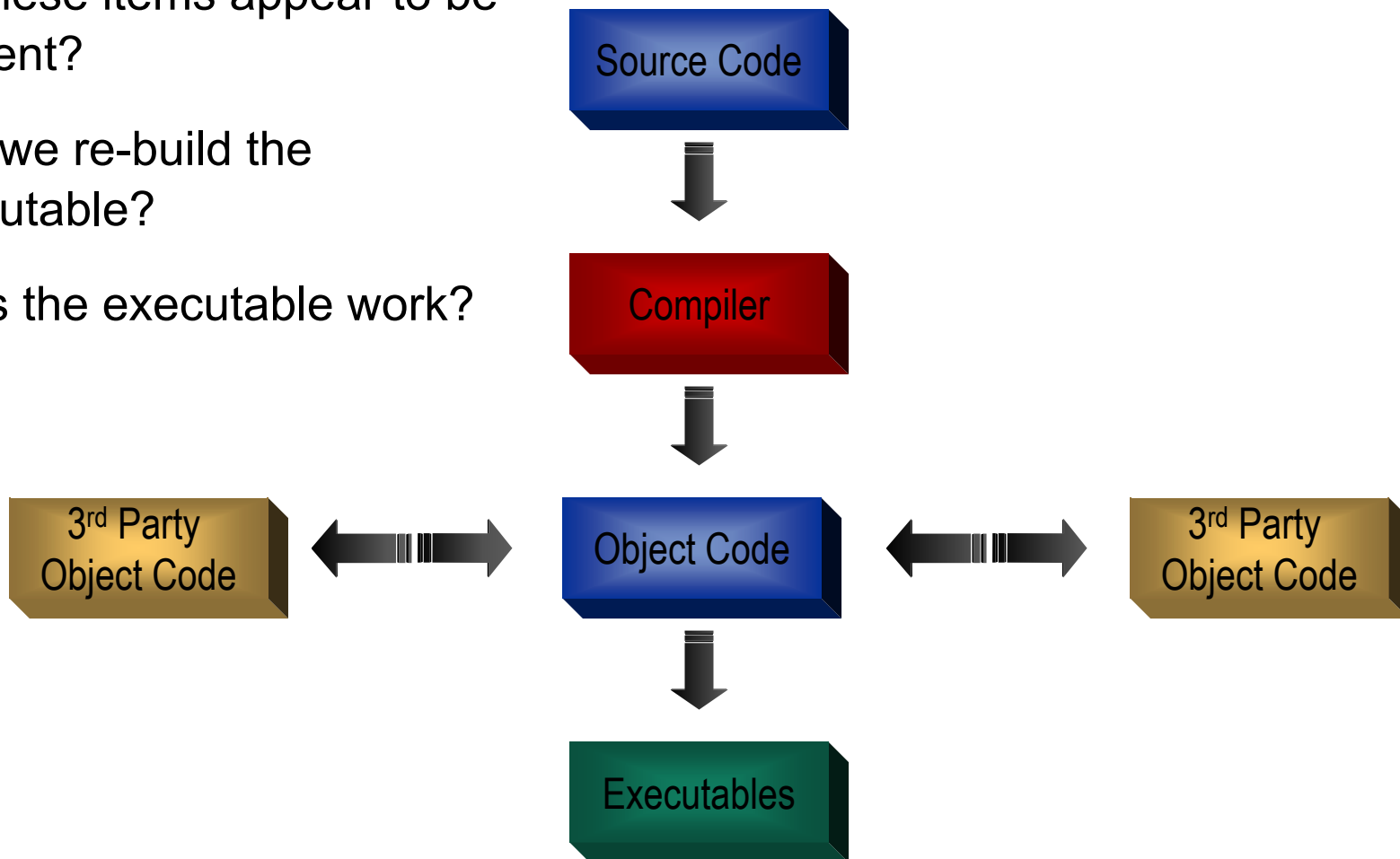
M. Egan, META Group, January 8, 2002, “Software Escrow: Avoiding Pitfalls”

# Deposit Content and Practices

- Create deposit requirements guidelines
- Include traditional/core contents
- Be aware of new deposit practices which include:
  - Maintenance Tools
  - Proprietary or third party system utilities
  - Instructions on “where to get third party utilities” and “how to deploy”
  - Descriptions of the system/program generation
  - Compilation and execution procedures
  - Names and home addresses of key technical employees of the developer
  - A list of any encryption keys or passwords used in the escrow deposit
  - A copy of the executable with database backup in ASP licensing arrangements

# Levels of Verification

- Do these items appear to be present?
- Can we re-build the executable?
- Does the executable work?





# Verification Is Best Practice

**An escrow arrangement is only as good as the quality of the deposit materials.**

**Verification** of materials provides assurance that, in the event of a deposit release, a licensee would be able to more quickly and effectively read, recreate and maintain the developer's technology in-house.

**15%** of **Level II verifications** could not be successfully built

**40%** of **Level I verifications** were determined to be incomplete

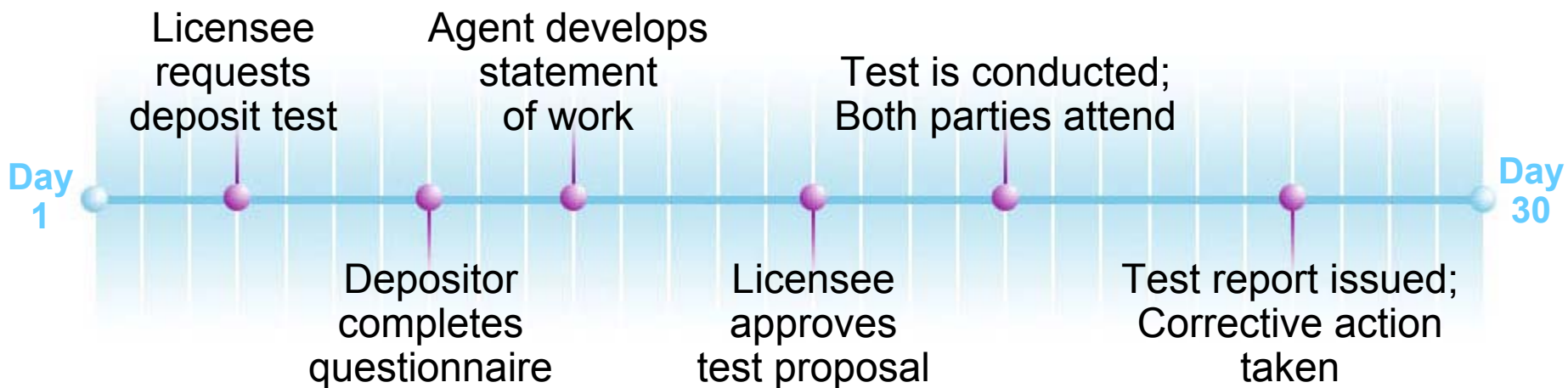
# Verifying the Escrow Deposit – Is it necessary?

## Iron Mountain Experience Indicates...

**73%** of incomplete Level I did not contain any build instructions

**60%** of incomplete Level I had corrupt media and/or missing files

**80%** of Level II required direct input from the depositor



## How Other Industries Verify

- **Sophisticated businesses reduce their risk when making significant investments**
  - A. Lenders examine collateral
  - B. Purchasers of real estate do environmental surveys and appraisal
  - C. Life insurance companies do physical examinations on every policy written!

# Select a Reputable Agent

## Qualitative Conditions

- Have a proven reputation as a trusted third party
- Have a strong background in internal verification testing
- Have experience in administering a significant number of releases and agreements

## Quantitative Conditions

- Carry professional liability insurance
- Operate their own IP media vault
- Have built in redundancy for operations and IT infrastructure
- Have in-house legal advisors to help advise on process

# What Makes an Ideal Storage Environment



- Suggested Criteria for Media Vault
  - Security systems throughout (video, motion sensor, biometric access, physical on-site presence)
  - Limited access
  - Bonded/insured vault administrators
  - Bar coding inventory
  - Technology-related materials only
  - Constant room temperature and humidity
  - Minimum of 4-hour rated firewalls
  - Non-water based fire extinguishing system
  - Documented process for handling deposits, problem resolution and disaster recovery.



# Learning Objective #2

## 2 → Leverage Contract Language to Maximize Protection

- Release Conditions
- Release Process
- Right to Use

# Know Your Terms & Conditions

- **The key to a successful escrow agreement is in the contract language**
- **Be aware of the major components of the contract:**
  - Release conditions
  - Objection period
  - Verification rights
  - Payment of fees
  - Deposit update process and frequency
  - Right to use
  - Dispute resolution
- **Think about protection for your organization**
- **Know what to expect from the other party**

# Release Conditions

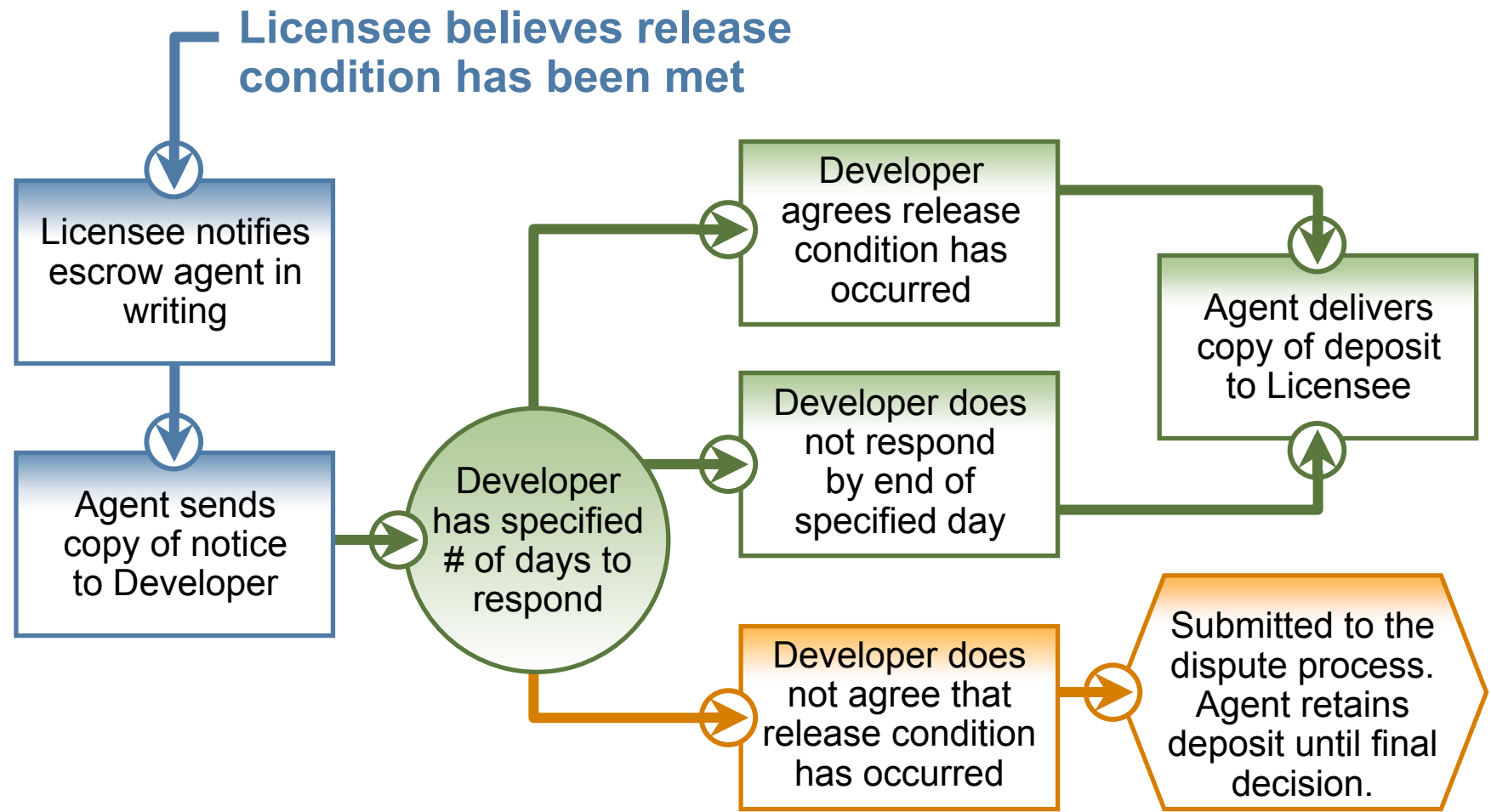
REASON FOR RELEASE	% OF TOTAL RELEASES
<b>Loss of support</b>	<b>30%</b>
<b>Cease business operations</b>	<b>22%</b>
Bankruptcy	20%
Depositor's request	9%
Demand release	6%
Payment	2%
Court order	1%
Breach of obligation	<1%
Merger	<1%
Transfer of assets	<1%

- Be specific and cover all possible circumstances
- Think beyond bankruptcy

# Sample Release Conditions

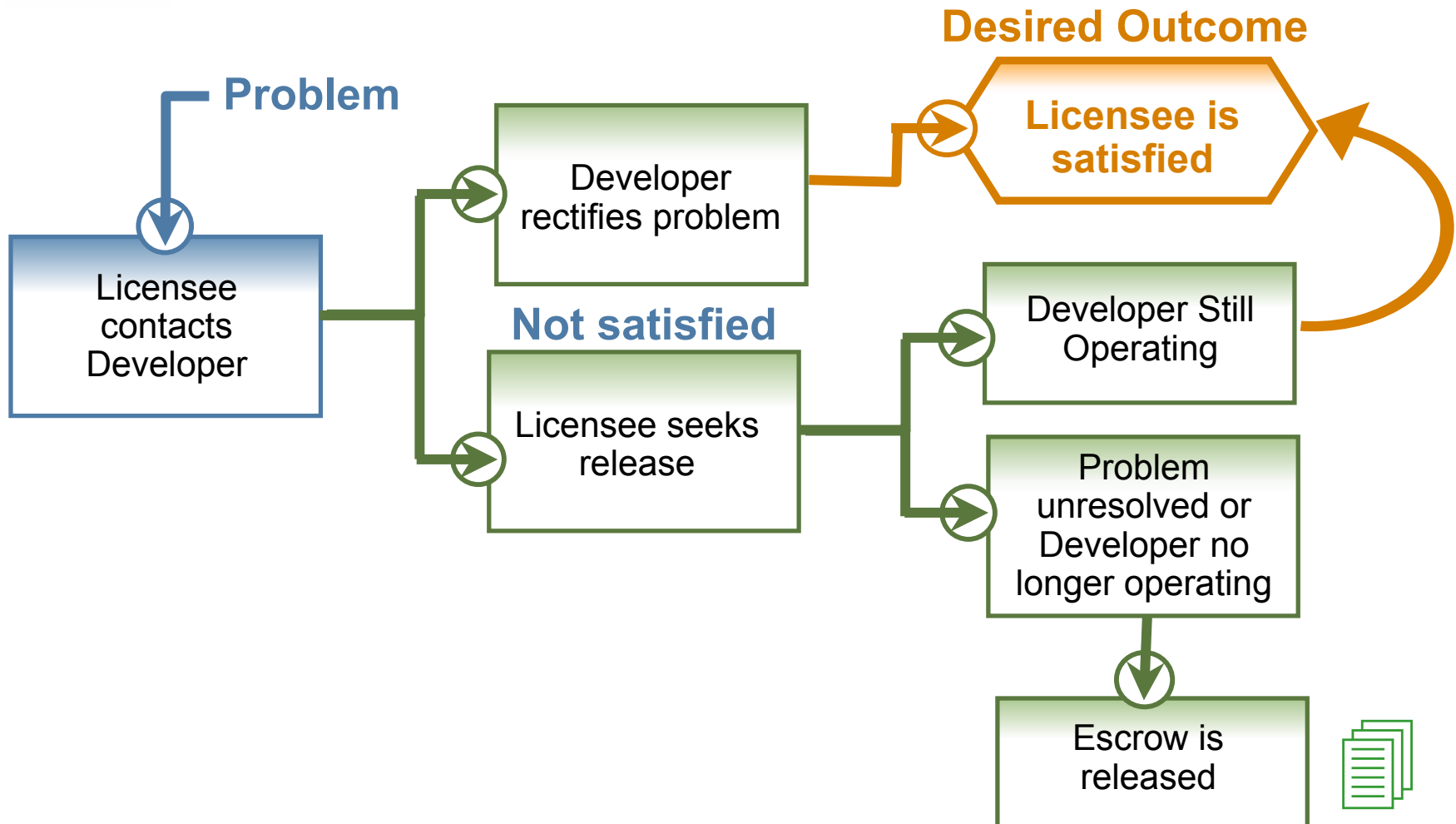
- Failure of the Developer to maintain and/or support the product
- Failure of the Developer to continue to do business in the ordinary course
- If Developer materially breaches its support and maintenance obligations and such breach remains uncured for thirty (30) days after delivery of written notice
- Developer's assignment of its maintenance obligations, whether through merger, acquisition, or other transfer of its assets, to a company considered by the Licensee, in its sole discretion, to be unsatisfactory to maintain the software
- Voluntary termination of employment by one or more of the Developer's key persons

# Standard Release Process



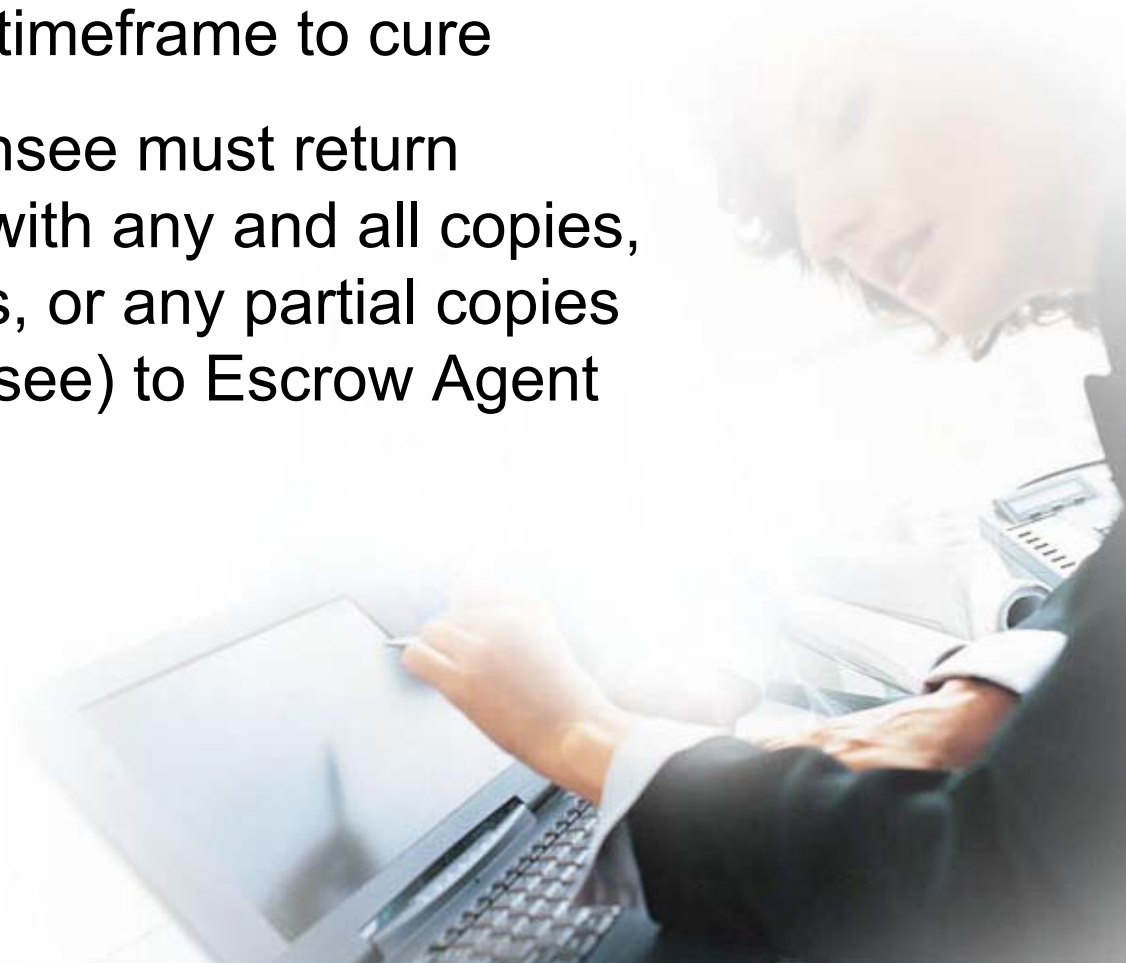


# The Leverage of the Escrow Process



# Protection for Software Developer

- Always include timeframe to cure
- Upon cure, licensee must return Deposit, along with any and all copies, derivative works, or any partial copies (made by Licensee) to Escrow Agent or Developer



# Right to Use

- Ask for the right to modify and otherwise maintain the technology upon release
- Include in license agreement and escrow agreement
- License agreement should include right to:
  - Use source code (not just object code)
  - Make a backup copy
  - Provide access to source code to an outsourcer or sister company, subject to appropriate controls
  - Move software to another location or computer

# Learning Objective #3

## 3 → Escrow in Action

- Technology Licensing
- Escrow Relationships
- Escrow Fees
- Update Process

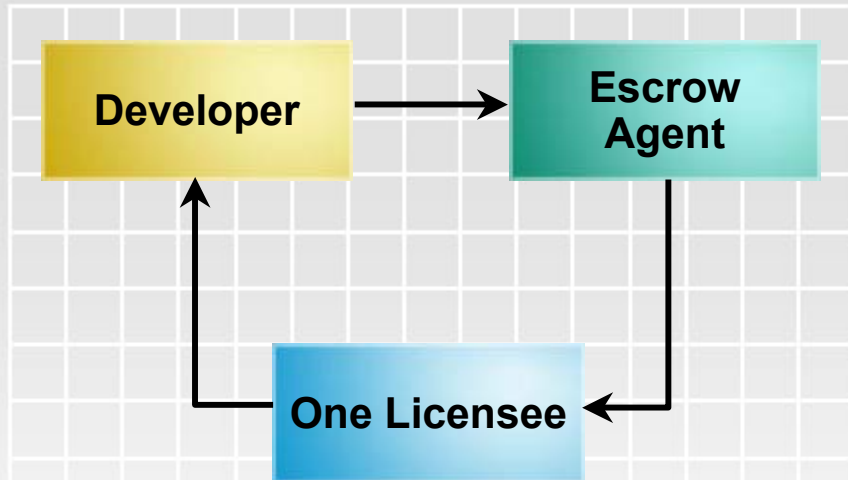
# Technology Licensing and US Bankruptcy Code

- Section 365n allows the Licensee to retain its right to use licensed technology in the event of a Licensor bankruptcy
- Structure license to fall within 365(n)
  - Recommend a US escrow agent and have US law control
  - Include continuing obligations so as to deem it an executory contract
  - Avoid contingent license grants
  - Include IP rights which fall within definition of the Code



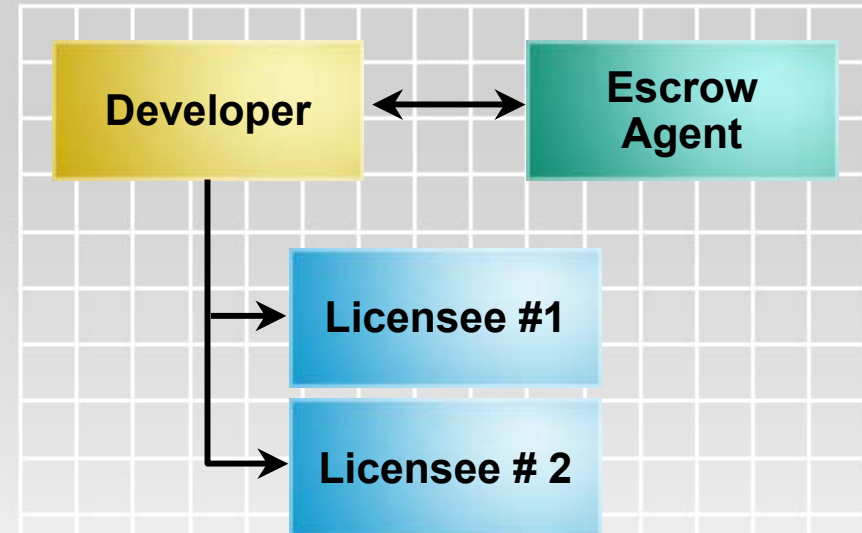
# Types of Escrow Relationships

## Three-Party



- All three parties negotiate and sign the escrow contract
- Terms are agreed to by all parties

## Two-Party



- Signed by the Developer and Escrow Agent
- Standard terms for all Licensees
- Multiple products are secured under one contract with multiple Licensees

# Escrow Fees

Escrow Fees Vary With Type of Escrow Agreement:

- Two Party Agreements are least expensive
  - Under \$200 per year per Licensee per deposited product code
  - Standardized & highly defined release conditions
- Three Party Agreements are more expensive
  - Depends on type of agreement provisions
  - Customized & highly subjective release conditions

# Deposit Update Process

- The key to the validity of the escrow process is updating source code on a regular basis
  - License agreement should include provisions for depositing updates and upgrades within a certain period of time after generally available
  - Licensor should develop process between the manager of the escrow relationship and the product development department to facilitate regular deposits
  - Licensor should make sure that source code of each product in escrow is separated and regularly updated

# Recap: What's Your Protection Strategy?

Craft a strategy and gain corporate buy in

---

---

A fair agreement with enforceable processes in place

---

---

Ensure a usable escrow deposit that is updated regularly

---

---

Periodic verification of the escrow deposit/updates

---

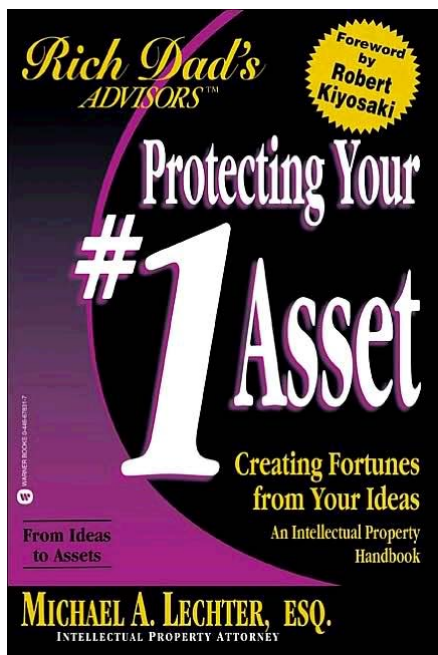
---

Work with a reliable agent to administer the service and stay involved!

---

---

# Thank you for attending!



## *Protecting Your #1 Asset*

Authored by Michael Lechter, an internationally known intellectual property attorney.

Click to receive your free book\*:

<http://forms.ironmountain-ipm.com/bookoffer>

\*Only webcast registrants or attendees will be eligible to receive this free book.  
Offer good while supplies last.



# Questions?

**Frank Bruno**

**770.225.8108**

**[Fbruno@ironmountain.com](mailto:Fbruno@ironmountain.com)**