

SOFTWARE ESCROW – INFORMATION BROCHURE[†]

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WHAT IS SOFTWARE ESCROW?

Software escrow is where a trusted, neutral third party stores a software developer's source code which is releasable to a licensee only upon the happening of certain triggering events.

Typical events that give rise to a release of the deposited material should have a direct correlation to the reasons that give rise to the deposit. For example, if the concern is continued support, then the triggering event should relate to unaccepted failures to support.

Should one of the triggering events occur, there will be a request to the escrow agent by the licensee for a release of the source code. Typically the agent will then contact the software developer. If there is no contest on their behalf, the agent will then release the source code to the licensee.

WHAT ALL COMPRISES AN ESCROW DEPOSIT?

In many cases, the source code is not the only product that must be escrowed. For the licensee to have a functional product, they must have all the information necessary to replicate the original product (e.g. design notes, documentation, written flow charts and instructions).

DEPOSIT VERIFICATION:

Why verify the escrow deposit?

From the licensee's perspective, verification of the product is vital to ensure that the escrow deposited is what it claims to be; otherwise the escrow deposit is useless in the event of a release.

Are there any disadvantages with verification?

Yes, there are disadvantages for both the software developer and the licensee.

For the developer, verification by the agent may impair his trade secret; because the agent or the agent's employees must handle the source code thereby increasing the risk of leakage through mishap, oversight or sloppy procedures.

For the licensee, verification significantly increases the costs associated with software escrow, especially when there are numerous updates.

What degree of verification is needed?

The range of verification is significant, going all the way from no obligation to verify to stringent procedures allowing validation of the integrity and completeness of the deposit. The level of verification that is necessary will change from product to product and depend upon the licensee's needs and willingness to pay for such stringent validation procedures.

DEPOSIT RELEASE:

Under what conditions can the escrow agent release the deposit to the licensee?

Typical escrow agreements contain certain boilerplate conditions for release, such as bankruptcy, unjustified disappearance or failure to further develop or support the software. Typically, the licensee will make a written demand to the escrow agent for release of the deposit. The agent, in turn, will be required to give notice of the demand to the licensor, who will have a certain amount of time to agree to the release or dispute it.

Questions that arise with respect to release of a escrow deposit include:

- how much time ought the licensor have to respond to a notice of a demand for release;
- how does a dispute, regarding whether a release condition was met, get resolved (arbitration, mediation, court);
- and who pays for this dispute resolution.

ESCROW COSTS:

What are the typical costs associated with the use of an escrow agent?

From a quick review of some of the fee schedules of Canadian escrow agents, costs vary widely including:

Escrow Agent #1:

Set up fee: \$1,200 - \$1,500
Annual fee: \$600 - \$800
Additional products: extra
Additional beneficiaries: extra
Verification: \$125/hr

Escrow Agent #2:

Set up fee: \$250 + \$100/hr for reviewing escrow agreement
Annual fee: \$750
Additional products: \$150 each
Additional beneficiaries: \$100 each
Verification: \$100/hr; minimum \$250

Escrow Agent #3

Set up fee: 0
Annual fee: about \$800
Additional products: included (up to a point)
Additional beneficiaries: included (up to a point)
Verification: discouraged, and a sworn statutory declaration procedure is recommended instead.

Who bears this cost?

Typically, the cost of *verification* is borne by the licensee. Further, since the licensee is rightly considered the beneficiary of the trust, the majority of source-code escrow agreements impose the *overall* cost on the licensee/beneficiary.

ESCROW AND YOUR LAWYER:

Can my lawyer act as an escrow agent?

An escrow agent should be a neutral third party who administers the escrow as agreed to by the parties for the benefit of both the licensee and software developer. A lawyer who has acted for one party and agrees to also act as agent may be in a potential conflict of interest.

Can my lawyer act in other ways?

Your lawyer can prepare an escrow agreement; although more commonly many escrow agents offer their own form contract. In such a case, both the software developer and the licensee may profit by having a lawyer review this form contract and suggest changes. For example, a review of the release conditions may reveal certain trigger events that are contrary to the developer's best interests, or the verification procedure is not adequate for the licensee's needs. *Considering what is at stake, review by a lawyer is a prudent move.*

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