

Best Practices: Technology Escrow—Who’s Using It and Why?

Technology escrow has long been a necessary component of any well-crafted technology license agreement. Software developers and licensees, as well as the attorneys who advise them, rely on escrow services to secure access to mission-critical technology under pre-determined release conditions. If a release condition occurs, the technology escrow agent processes the release of the deposited technology and other proprietary information as specified in the agreement, so that the licensee may continue using and supporting the technology.

Since 1982, Iron Mountain has been the leading global service provider of intellectual property management services, which include technology escrow, verification services and domain name records management. Each year, Iron Mountain invests in extensive market research to stay on top of the needs and plans of businesses using technology escrow services.

This paper is based on proprietary research performed by Iron Mountain including customer surveys, customer interviews, and detailed analysis using Dunn and Bradstreet’s market intelligence technology. We hope you find this information useful in planning your own approach to safeguarding your intellectual property.

This paper will discuss:

- **Profile of Software Licensees Using Technology Escrow**
- **Trends in Escrow Use Among Developers**
- **Why Businesses Establish Escrow Agreements**
- **How Businesses Choose Escrow Services Today**
- **Your Next Step: Evaluating Escrow for Your Business**

PROFILE OF SOFTWARE LICENSEES USING TECHNOLOGY ESCROW

Large companies lead the use of escrow: Iron Mountain's research reveals that the majority of licensees using technology escrow today are large companies, in many cases with over 500 employees and revenues in excess of \$100 million. These companies are more likely to rely on highly customized applications to run their business.

However, as the value of technology, or intellectual property, has increased, and escrow services have become easier to set up and manage (through real-time online customer portals, for example), more Small and Medium Businesses (SMBs) are also seeking the benefits of technology escrow to protect their dependence on and investment in technology. Small and medium licensees tend to be more concerned about protection against their vendors going bankrupt; large licensees seek insurance against termination of support that may or may not be caused by bankruptcy.

Business sectors where escrow is essential: Depository institutions comprise the largest single group of technology licensees seeking to protect their investments in technology. These organizations, including large financial companies like state, federal and commercial banks, rely upon technology to manage millions of transactions daily, moving vast sums of money globally.

The next four business sectors most concerned with ensuring access to mission-critical technology through the use of escrow services are: Business Services; Health Services; Engineering, Accounting, Research and Management Services; and Educational Services.

Who drives the search for escrow? Managers of Information Technology (IT), Information Systems (IS) and Management Information Systems (MIS) departments are the most common leaders in the search for technology escrow. However, leadership also comes from professionals in Contract Management, Legal Counsel, Procurement and Vendor or Source Management. In addition, the business unit that relies on the software is almost always involved in the process as well. Indicative of the increased value of technology, a significant trend is the establishment of a Software Asset Management Team that comprises expertise from Legal, Technical and Finance departments. These cross-functional teams are also better equipped to manage a broad range of compliance issues.

A SURPRISING TREND IN ESCROW USE AMONG DEVELOPERS

Small developers: Software companies with fewer than 20 employees and less than \$50M in revenue are the most frequent seekers of escrow services (often through outside counsel), as they offer it to reassure potential customers the investment in them is as safe as it would be with larger competitors. These companies account for over two-thirds of the developers setting up escrow agreements.

Large developers: While the majority of developers who use escrow tend to be smaller, it's important to note that about 20% are large development companies, with over 500 employees and over \$100 million in revenue. Since the bursting of the dot-com bubble, the business community is increasingly aware of the vulnerability inherent in companies' reliance on technology. Driving recent growth in escrow use by larger developers are 1) greater recognition of the value and mission-critical nature of technology and 2) recent increases in Merger and Acquisition activity.

In a report released by Gartner Research last year¹, Gartner reports:

“Mergers and product acquisitions have been prevalent among vendors of business applications software during the past year, and Gartner expects this to continue through 2005...this trend applies equally to large vendors and smaller, niche providers...For example: Peoplesoft bought J.D. Edwards, Calico, Cohera and Annuncio...Siebel Systems purchased Eontec, Upshot.com and Motiva...3M acquired Highjump...” The Gartner report suggests that escrow should be considered not only to protect against a vendor’s potential bankruptcy, “It should also be a required clause when protecting against merger, acquisition and divestiture. If the acquired, merged or divested vendor is unwilling to support your product, an escrow arrangement can be helpful as a short-term contingency plan while alternatives are evaluated.”

Outside the technology sector: Another surprising trend is the growth of companies with a core competency outside software development who seek escrow services to protect technology they develop in-house and then license out to their customers. A major utility service provider developed a set of IT applications that are licensed to customers to help them make adjustments in plant operations and inform their financial decision-makers on energy issues. This service provider sought escrow services for the same reasons commercial software developers seek escrow: to reassure customers, protect their intellectual property and maintain their competitive edge.

WHY DO BUSINESSES ESTABLISH ESCROW AGREEMENTS?

Licensees—educated consumers protecting their investment: Sixty percent of licensees surveyed set up escrow agreements to secure access to their technology if a vendor goes out of business. Given the rise of compliance regulations, it is no surprise that 37% seek escrow as part of an overall risk management strategy. In fact, attorneys increasingly report that they use escrow as part of a risk management strategy for their clients’ organizations.

Recently, a growing number of licensees have begun seeking escrow in case their developer stops support, or provides inadequate support, for the application being escrowed. This may occur formally through an announced product End-of-Life, or more informally, for example, when support suffers through acquisition by, or merger with, another party with different priorities. The rights of the licensee are less vulnerable when the technology is in escrow.

As investments in technology have grown, and the complexity of that technology has increased, licensees are paying more attention to ensuring that whatever is put into escrow can be successfully used to support their mission-critical technology if necessary. Technical verification minimizes the time needed to restore operations and protects business continuity, and this is becoming a best practice. Demand for verification services has increased 20% over the past two years as savvy users take extra precaution to maximize the pay-off from their investment in escrow deposits.

Gartner, Inc. notes: “If you don’t plan to do regular audits, or verification that the version of the software you are using is in escrow, the agreement may be worthless... if the vendor falls behind on source code deposits, and has incomplete or unusable deposits, the escrow agreement will be useless.”²

¹ Source: Bona, Alexa and Younker, Edward, “Management Update: How to Protect Yourself If Your Software Vendor is Acquired,” Gartner, Inc. Research Products, G00123815, September 8, 2004.

² Source: Disbrow, J. and Park, A., “Be Aware of Contract Issues When Negotiating Software Escrows,” Gartner, Inc. Research Note, G00125669, February 7, 2005.

Trans World Entertainment, one of the largest specialty music and video retailers in the United States, is an example of a licensee who insisted on verification services as part of its escrow agreement to protect the intellectual property in a key product developed for them by a software developer partner. This ensured the software could be accurately recreated and they could maintain their competitive edge should the need arise. And in their case, it did. The software developer that created their product went out of business—but thanks to their escrow deposits and verification of the source code, Trans World was able to recreate and maintain the technology for the popular product that brought customers into their stores.³

Developers—from reactive to proactive: Most developers surveyed indicated that more licensees are asking for technology escrow; it has become so commonplace that most developers anticipate the request and are prepared to accommodate it. With industry-leading analysts advising licensees that all software should be escrowed and the existence of industry associations promoting best practice licensing techniques, licensees are becoming more educated about the value and need for escrow and are demanding it.

Forward-looking developers set up escrow agreements and promote them as a competitive differentiator. As an example, Fluegge Consulting Group, a small start-up, established an escrow agreement for all its customers, encouraging them to choose the best solution based on the merits of the software, not the size of the software developer. Fluegge effectively anticipated a potential objection that could be raised by competitors and leveled the playing field before their size could become an issue.⁴

Others are using escrow to set up an audit trail to safeguard their intellectual property. Computrition, Inc. established an audit trail for original software development as well as an action plan for future support that demonstrates its customer assurance focus in the food-service and clinical nutrition management market. Each updated version of its software is date-stamped on a quarterly basis, documenting the genealogy of their product. Because this record is administered by an independent third party escrow service, competitors who may claim to have created the product first will find it difficult to substantiate their case.⁵

Attorneys—on top of their game and their clients' interests: Attorneys surveyed indicated that, increasingly, clients are requesting escrow, and are already educated on the value and need for escrow before the attorney brings it up. Attorneys commonly establish and maintain relationships with escrow service providers so that they remain current on trends and developments in technology escrow.

For those attorneys specializing in intellectual property or technology law, the ability to discuss escrow knowledgeably is essential to credibility and differentiation in a sometimes-crowded field—it also represents an additional area of opportunity as a value-added service. Consideration of escrow is not only driven by an attorney protecting the concerns of a client focused on a specific software license agreement—half the attorneys seeking escrow services for clients now do so as part of the client's risk management strategy.

³ Source: Trans World Entertainment Case Study

⁴ Source: Fluegge Consulting Case Study

⁵ Source: Computrition Inc. Case Study

HOW BUSINESSES CHOOSE ESCROW SERVICES TODAY

Quality customer service: It doesn't matter whether the party seeking technology escrow is a licensee, developer or an attorney. All agree that quality customer service is the most important factor in selecting an escrow agent—from the initial contact, through investigation and evaluation to execution of the agreement—and, if necessary, to a successful release of the technology.

They expect a comprehensive service that meets their specific needs—not a pre-packaged agreement that they must accommodate—as well as the attention of a diversified team of dedicated staff that responds with expertise and timeliness.

Integrity and reputation of the agent: Again, licensees, developers and attorneys agree that the second most important factor in evaluating an escrow service is making a decision that is safe—given the mission-critical technology at stake. The escrow agent needs to epitomize trust-worthiness with a track record that demonstrates its claims. Both licensees and developers need to know that the company who is protecting their intellectual property will themselves be around if and when they need to access the technology in escrow. Likewise, attorneys put their own reputation on the line with every recommendation they make and want to ensure they refer an agent they can trust.

Limited drain of personal time: Developers and licensees today are looking to limit the amount of time they spend on escrow-related tasks. Their requirements exceed the capabilities of fax and email interchanges with escrow service providers. They expect real-time online tools that assist them from the point of setting up an initial agreement to adding, editing and managing their agreements over time and educating themselves on escrow best practices as the industry continues to develop.

Flexibility of agreement language: For attorneys advising clients on escrow, a key factor is the degree to which the escrow service can accommodate the unique needs of their clients—without being so loose that it won't stand up in court. They look for a comprehensive service with options that will fit the needs of all parties.

The most common escrow arrangement is a 3-party agreement that is easily negotiated by licensees, developers and the escrow agent. The demand for 2-party agreements (involving only a developer or licensee and the escrow agent) has declined 32% over the past two years. Both licensees and developers realize the importance of having control over the terms and conditions of the agreement in order to protect their interests, and thus gravitate to the use of 3-party agreements.

Conversely, over the past two years there has been an increase (44%) in the popularity of “master” agreements where one party (licensee or developer) sets up an agreement that can be used for multiple deposit accounts or multiple depositors. On the developer side, since more customers are requesting escrow, it behooves the developer to have an established agreement in place (with terms and conditions already spelled out) so they can easily add subsequent customers onto the same agreement with little time and effort.

Licensees are also setting up master agreements—in fact, they are growing at a faster rate than those set up by developers as more businesses formalize their software asset and risk management processes and make technology escrow a routine consideration for all licensed applications. These master agreements not only save time and effort, they ensure consistent terms and conditions for all software licenses which meet the criteria for escrow. Increasingly, these criteria are established by an organization's Software Asset Management Team, comprising both legal and technical expertise who work together to ensure not only that a release occurs when it should, but also that the deposit contents are usable.

ABOUT IRON MOUNTAIN'S INTELLECTUAL PROPERTY MANAGEMENT SERVICES

Iron Mountain is the leading global service provider of intellectual property management services specializing in technology escrow and domain name records management. As the founder of the industry, Iron Mountain has the integrity, reputation, resources, and experience to ensure intellectual property is properly managed and protected. Iron Mountain's Intellectual Property Management services set the industry standard by providing quality customer service and unmatched solutions to three-fourths of the Fortune 500. Since 1951, Iron Mountain has provided service to over 200,000 customer accounts worldwide. For more information, visit the Company's Web site at www.ironmountain.com/ipm.

YOUR NEXT STEP: EVALUATING ESCROW FOR YOUR BUSINESS

We hope this summary overview of who is using technology escrow services today—and the reasons they are doing so—has provided insight into the best practices of businesses just like yours.

Whether you are a technology developer or licensee, large or small, you've seen that technology escrow offers similar companies significant benefits. Forearmed with awareness of the conditions that typically lead businesses like yours to consider escrow, you can now anticipate them for your own company. And finally, when you are ready to select an escrow agent, you will know the key criteria to use in making an effective evaluation of your options, as others who have successfully entered into escrow agreements have done.

For more information on Iron Mountain Intellectual Property Management Services, please visit our Web site at www.ironmountain.com/ipm.

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