

## **Dangers of not having software escrow arrangements**

**Given the financial difficulties facing many technology companies around the world, it is becoming increasingly important to consider mechanisms that provide protection for software users in the event a software licensor becomes insolvent, or is unable or unwilling to support its software. One such mechanism is requiring the source code for key software to be held in escrow.**

Generally if a customer has a licence to use software, it may not be given the source code for the software. Source code is the human-readable programming statements for software that must be compiled before the software can be run on a computer.

Access to the source code is required for a customer to modify, maintain or enhance (or, in other words, support) any software. Most software licences allow the customer to use the object code (the source code compiled into machine readable code) of the software, but not the source code.

Since the source code reveals exactly how the software works (being the essence of the software's value), it is in the licensor's best interests to keep it confidential. Restricting access to source code also protects the licensor's ability to control who may support and maintain the software (for a fee, obviously).

The issue, and the reason for escrow, is that there are circumstances when a customer needs to have access to the source code. For example, if the licensor goes into liquidation, the customer will need to have access to the source code so that it can take care of matters that would otherwise have been dealt with by the licensor, such as fixing bugs, and making improvements.

One solution is to have a software escrow agreement in place.

A software escrow arrangement is where the licensor of a software product agrees to place the source code and certain materials relating to that software product with an independent third party (the "escrow agent"). The escrow agent agrees to hold the source code and materials for the benefit of the licensor and will only release the source code and materials to a licensee of that software product upon the occurrence of a release event.

Most escrow agents have standard terms on which they agree to hold source codes and materials. These normally provide that:

- the escrow agent agrees to hold the source code and materials in confidence and in a secure location; and
- subject to complying with its obligations, the escrow agent has no liability in relation to the release and use of the source code and materials.

Escrow agents therefore provide a service which enables the licensee to have comfort that, when an appropriate release event occurs, the source code and materials will be released to them without having to seek this release from the licensor (who may be unwilling or unable to agree to such release at that time). However, in most cases the escrow agreement will provide the licensor with an opportunity to dispute the release where the licensor believes a valid release event has not in fact occurred.

With an escrow agreement, the licensor's concerns are addressed because, with a trusted escrow agent, its valuable information/materials are safe. From a customer perspective, its concerns are also addressed in that it should be comfortable that it will have the information/materials released to it in appropriate circumstances.

The escrow arrangement will be documented by an escrow agreement, which will be a tri-partite agreement between the escrow agent, the licensor and the customer.

Escrow arrangements will be negotiated at two levels: first in the agreement with the licensor, and second in the escrow agreement itself.

The importance of software escrow agreements is often overlooked or under-estimated during negotiations of software licences or system supply agreements.

The need for a software escrow agreement will need to be assessed on a case by case basis, but will be particularly important if a customer is acquiring high-value or business-critical software which will be maintained by the licensor for a reasonably long period. Without an appropriate escrow arrangement in place, a customer may face major operational (and subsequent financial) issues if the licensor becomes unable or unwilling to support its software.

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