ACC/Iron Mountain Webcast: "Implementing a Best Practice Technology Escrow Program for Your Organization's IP"

Q&A Follow-up

On March 1, the Association of Corporate Counsel (ACC) and Iron Mountain held a webcast on *"Implementing a Best Practice Technology Escrow Program for Your Organization's IP."* We had a great audience with many attendees and lots of questions. Due to time restraints, some excellent questions were left unanswered, so we would like to address them now. Be sure to download the pdf version of the slides used for this presentation. The link is located in the same box where you found the link to these questions. Iron Mountain's Customer Resource Kit for Technology Escrow Services – a guide to best practices for setting up and managing a technology escrow strategy for your organization, is also available to download.

INs and OUTs OF ESCROW

Q: Is source code escrow also used for hardware based programs, including design documents?

A: Yes, escrow agreements are used to protect everything from DNA sequences to paint formulas to robotics machines that stamp silicon wafers. This is why we prefer the term technology escrow to source code escrow. Intellectual property (IP) is the collateral that secures the buyer/seller relationship. This IP can be in the form of source code, trade secrets, process documentation, formulas, etc. These days, we do see a lot of software infused hardware, which includes more than source code. It includes design schematics, manufacturing processes, supplier information, third party tools, and whatever else is necessary to recreate the product in the absence of the supplier.

Q: What happens when Iron Mountain is not able to locate the developer when a release condition has been made?

A: This is a contingency that is planned for in all of our escrow agreements. We won't sign the agreement unless the process is well defined and it enables us to effectively do our jobs. Typically, we allot a certain amount of time from the day we mail the notice for the developer to issue contrary instructions (i.e. bring up any objections). If we do not receive a response from the developer in that specified period of time, then we will release the deposit materials to the licensee. There are also other provisions, such as a "demand" release or highly objective release condition such as "proof of bankruptcy," in which we will release the deposit materials to the licensee immediately upon request. It really depends on the language written into the agreement.

Q: What extra steps need to be considered when dealing with a software provider located in another country?

A: If the parties could agree to vault in the US and to execute an agreement governed by US law, no extra steps are necessary. If you must vault in a foreign jurisdiction and work with an agreement governed by the other country's law, then it is important to understand the laws of that land. We always

recommend engaging legal counsel familiar with that country's law. Iron Mountain leverages its global footprint to help escrow get set up in over half of the 26 countries in which we operate.

ESCROW FOR APPLICATION SERVICE PROVIDERS

Q: If you are being provided pre-developed software on an ASP-based model for delivery, is escrow still appropriate? This, of course, is very different from a traditional developer relationship where the developer creates the software based upon client specs.

A: Yes, the escrow is still as necessary as for a traditional software licensing arrangement. However, in a failure situation, you will need to recreate the application's production environment quickly. This is why you need "on-demand" access to the executable (the object code) as well as information about the platform and most importantly, how to get access to your data (according to the desired recovery point objective). Access to the source code is still necessary for the subscriber to recreate the application's development environment in order to perform bug fixes, introduce new functionality or enhance existing functionality.

The purpose of the escrow is to insure against this type of failure happening, but it can also represent the leverage you need to get the supplier to do what they promised when you signed up. In any ASP or SaaS (Software as a Service) situation, the licensee must consider both the source code and the data to make a workable arrangement.

Q: Should all ASP arrangements have escrow arrangements? Are you seeing this as a trend in the industry?

A: Yes, we believe that a technology escrow agreement should be put in place for all ASP arrangements as a best practice to protect against potential problems with the ASP. In addition to running your application, the ASP also has control of your data, so "on-demand" access to the executable, information about the platform and how to get access to your data are all critical. In terms of trends, we are starting to see a lot more requests for escrow from companies working with ASPs that are now tackling the data component of the escrow.

ESCROW VERIFICATION

Q: How much does a verification of source code generally cost?

A: A thorough verification of the materials in escrow 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 licensor's technology in-house. Iron Mountain offers three types of technical verification. The recommended level largely depends on the risk associated with licensing the technology.

On the low end, you can obtain a "File Comparison and Analysis" for $2,500. This is a minimum cost for determining that the media is not corrupt, that there are files present and that they are free of viruses. The more popular option is a "Deposit Compile" test, which means that our engineers actually recreate the application development environment and fill in all the blanks in the build instructions for you,

which is priceless. For this you can expect to pay between $10,000 - $15,000 (or more depending on the complexities involved.) All doubt as to the usability is removed when we perform a "Deposit Usability" test. This includes comparing the binaries and actually testing functionality. Many clients choose to do this on their own with the recompiled object code against what they currently support in production. However, we do a lot of these tests as well and you might spend anywhere from $15,000 - $30,000 (or more depending on the complexities involved). The costs quoted here include the previous level of testing. In other words the Deposit Usability test includes the File Comparison & Analysis and the Deposit Compile test. If there are sufficient funds budgeted for testing, then the recommended best practice is to perform a Usability test, which leaves no doubt that the technology can be re-deployed in the event of a release event.

Q: From what I remember in the last agreement I worked on - you had to contract for the verification process - you couldn't just pay for it as needed. Is that correct?

A: That is correct. Ideally, verification testing should be contracted for when the escrow agreement is put into place, and when any major change to the software occurs. However, due to a lack of awareness or planning, sometimes contract parties do not perform verification testing up front. In these cases, they can understand the associated costs and obtain the necessary funding for verification and then add this through a Statement of Work. The Statement of Work is the separate contract that you are referring to and it represents the scope of work that we intend to perform, and the time and resources that are necessary to complete the testing. It also contains the cost to complete the testing.

TIMING ISSUES

Q: What is the average time for recreating an application environment (from source code to a successfully working executable)?

A: Based on our experience, recreating the application development environment for the first time on a clean machine and with the help of the developer takes no less than one - two weeks and this includes the time it takes to go back and forth on email to fill in the blanks from the build instructions. Of course, more serious problems (such as deficiencies with the deposit) could extend this time considerably. However, if verification testing was done, potential problems could be eliminated.

Q: Can you recommend any expedited dispute resolution mechanism to get speedy access to source code?

A: A "demand" release condition is the fastest way to get to the code. This means that the escrow agent will release the source code on your demand. However, the developer may feel that this type of release condition gives too much power to the licensee, and both parties must be in agreement with this provision. In the negotiations, you can try to put the developer at ease with strong "right to use" language, stating that you will only use the source code for the stated purposes or even consider paying them for the use rights.

Q: Please discuss the best way to draft the license grant for the source code (in the License Agreement). Must it be drafted as present, rather than future grant (i.e., upon release)?

A: You're all familiar with U.S. Bankruptcy Code. In particular, Section 365(n) grants the licensee absolute entitlement to retain rights to intellectual property (even if the debtor-licensor rejects the license agreement.) Any license rights that arise on or after the petition date (i.e., effective upon bankruptcy) may not be included under the scope of Section 365(n). Therefore, best practice is to provide for a present grant of rights, broad enough to cover the needs of the licensor, but with a restriction to exercise these rights by the licensee until the material is released from escrow.

The use license should be made at the time the party is not in bankruptcy and simply affected when the release occurs. A bankrupt party can not grant anything. The deal has to be struck before the bankruptcy.

Q: We have several dozen licenses for mission critical software, but no escrow agreements. Is it too late to ask for some or all this software to be escrowed?

A: No, you have every right to ask the developer to protect their code in escrow and to link your company as a beneficiary via a three party agreement. Chances are, they already have their code in escrow and so, this should not be a problem. However, if the developer refuses to comply with this request, it may be time to start considering alternatives. Knowing this might cause them to respond differently.

Summary
Of course, technology escrow with verification is only one piece of a total compliance solution. Investing in a compliant records management program not only supports regulatory obligations, but also helps your organization better protect its corporate reputation and shareholder value. For more information on technology escrow and other intellectual property management services, visit www.ironmountain.com/ipm.