

Technology Escrow Agreements

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TECHNOLOGY ESCROW AGREEMENTS

The escrow agreement provides a vehicle for a service provider to deposit certain materials – traditionally source code – into escrow with a neutral third-party escrow agent who maintains the source code in a confidential depository, for the benefit of the customer. Common features of a typical escrow agreement are discussed below, together with a review of common drafting issues.

1. Introduction

In the IT contracting context, escrow agreements have traditionally been used as a hedge against the risk of bankruptcy of a software licensor. In a nutshell, as part of a traditional premise-based software license, a licensee would compel the licensor to deposit a copy of the software source code with an escrow agent. If the software licensor ceases business operations or experiences an event of bankruptcy, then the escrow agent releases the source code to the licensee, to permit the licensee to continue to make modifications, bug fixes and upgrades to the software.

Both software vendors and licensees have moved away from this traditional model as the software industry has adopted cloud-based or software-as-a-service (SaaS) distribution models. In a SaaS model, the software is not installed at the customer's premises, and the code is maintained on a server controlled by the software licensor, thus the software is one step removed from the customer. A number of factors have influenced the trend away from traditional source code escrow:

- Changes to bankruptcy laws in Canada worked in favour of licensees. Licensees maintain the right to use software of a bankrupt licensor, even after a bankruptcy on certain conditions. This factor mitigated some of the urgency associated with post-bankruptcy source code access, although the access to source code does address a slightly different risk – namely the ability to continue to support, maintain and troubleshoot errors in the code;
- In many cases source code access provides cold comfort since the licensee lacks the technical expertise to do anything useful with the source code which is released from escrow;
- Software licensors appreciated that the source code represented a valuable trade secret and that, in the event of bankruptcy, the release of source code to its customer base would have the effect of devaluing the software as an asset, potentially exposing trade secrets to competitors;