LEGAL STATUS AND LIABILITY OF THE SOFTWARE ESCROW AGENT
IT Lab task: an innovative study
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INTRODUCTION

Software creators\(^1\) often refuse to provide to their users\(^2\) all necessary documentation and linked source code\(^3\) because they want to exercise control over their innovation and protect valuable trade secrets the source code would disclose. Notably, it’s their wish to limit the users capacity to transfer the source code to another party. Beneficiaries, on the other hand, want the source code for their security. It’s obvious that without it they may face a very real risk when critical software support or enhancements are required and software developers are unable to devote the necessary resources to the problems.\(^4\) For instance, the software developer has gone out of business, but the user still needs the source code in order to be capable to improve software maintenance.

Therefore, having a third party to keep the source code in trust, is a good compromise to the issue. Taking into account the degree to which public and private entities have come dependent on their computer systems and how much the computer systems may control their critical systems, it is only logical that users wish to guarantee the consistent access to the software their computer systems run on.\(^5\) On the contrary, developers wish to guarantee that their most valuable asset, their research and development investment - the source code of the software which their customers’ computer systems run on - is kept in secret.\(^6\) This has led to the emergence of software escrow institution.

Software escrow\(^7\) in general is a means to guarantee access to source code materials in an agreed event. As said above, it includes at least three actors (licensor, licensee and escrow agent), escrow agreement and related license agreement, deposit material\(^8\) and the prescription of contingency for release of the deposit material as shown in figure 1 below.

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\(^1\) Software creators hereinafter also referred to as software vendors, licensors, software developers or programmers.

\(^2\) Users hereinafter also referred to as clients, licensees, beneficiaries.

\(^3\) Source code hereinafter also referred to as deposit materials, software code, escrow.


\(^7\) It is also interesting fact that as a legal device, escrow agreements were developed in the United States primarily as a tool of safeguarding party interests in real-estate transactions. See also Sarshar, M, p. 4.

\(^8\) Deposit material hereinafter also referred to as the escrow, source code, software code.
The aim of this paper is to analyse and make a comprehensive study on the legal status and liability of the software escrow agent. In order to achieve our goal, it’s necessary to analyse what concrete duties and responsibilities an escrow agent has in an escrow agreement, with special focus on software escrow institution and its peculiarities. Likewise, we see that it’s important to give an overview of what technical solutions and requirements an escrow agent should provide and what are the most fair-spreaded technological solutions in the field. Thus, the purpose of this paper is to also provide de lege ferenda propositions in order to regulate this institution more thoroughly in the escrow agreements. This paper does not provide insight in relation to licensor, licensee or the license agreement between them. Instead, as already noted, it focuses on the software escrow agent and briefly touches the related parts of the software escrow like software agreement, deposit materials and release event (as marked in figure 1).

The analysis mostly contains USA-based examples, with spotlight on California’s legal framework, as this is home to Silicon Valley where many high-tech companies and startups, for which new software is a crucial element of business – are located.

This research paper is divided into four chapters. To achieve our aim, in the first chapter we analyse the legal aspects of an escrow institution like the role and duties of an escrow agent. Due to this, it’s also necessary to provide an overview of the deposit materials and typical escrow agreement, which is an integral and important part of the escrow institution. With this in mind, in the second chapter we see that it’s relevant to continue toanalyse in detail legal status and other important functions that escrow agent has - like aspects of technical requirements and solutions; verification of the deposit materials; license concerns; and terms of release event. Thus, in the third chapter we analyse regarding issues that may arise with escrow agent’s liability and in the final chapter provide de lege ferenda propositions that we thought to be relevant.
1. ESCROW INSTITUTION

1.1. Escrow agent

1.1.1. Role of an escrow agent

An escrow agent is a person or entity that holds a deed, money, property or something else in trust for third parties until satisfaction of a contractual contingency or condition. The role of an escrow agent is somewhat similar to the role of a trustee. However, a trustee has a duty towards the beneficiary (or beneficiaries) of the trust and must act in their best interest, whereas an escrow agent's duty, is towards both parties to a transaction (i.e. licensor and licensee), and is tightly bound by the terms of the escrow agreement. An escrow agent may be agent for the specific duties concerned, but a trustee for the material deposited placed in its care.

The actual legal status of an escrow agent is atypical and courts have stated that an escrow agent fills a “definite niche in the body of law” as it has distinct legal character. Hence, the descriptions of the legal status of an escrow agent have been in terms of many well-defined legal principles, never attaining an independent character - the US case-law describes the escrow agent as an agent of both parties, a limited or special agent, a trustee of an express trust, both an agent and a trustee, and a custodian or stakeholder.

Due to the fact that an escrow agent is well-aged and ever-expanding concept of law and as the escrow institution has proved to be a permanent one, an escrow agent should be accorded its proper status as a sui generis doctrine.

1.1.2. Legal requirements of escrow agent

Escrow institution and especially software escrow institution, is most used and has most rooted legal and court practise in the USA. However, for historical reasons, in Europe it is only gaining its popularity and therefore, has no firm established regulations or case law.

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In the USA, an escrow agent can be either an attorney or an officer of a title insurance company or an escrow company. Many states in the USA, in general, require for an escrow agent to obtain a license to provide escrow services. To obtain the license there are several corporate and other requirements that must be fulfilled beforehand and during the validity of license. For example, in California, to get the license:¹⁵

1. the escrow agent’s articles of incorporation must include a clause that states the primary purpose of the corporation is "to engage" in business as an escrow agent;

2. the escrow agent must file with the California Department of Business Oversight a fidelity bond which provides fidelity coverage on each officer, director, trustee and employee of not less than $125,000 for the purpose of indemnifying the escrow agent (or the escrow agent's successor in interest) for loss of trust obligations held by the escrow agent as a result of fraudulent or dishonest abstraction, misappropriation, or embezzlement of trust obligations by an officer, director, trustee, or employee of the escrow agent;

3. the escrow agent must file with the California Commissioner of Business Oversight a surety bond of at least $25,000 (up to $50,000 depending on the escrow liability of the company), which is intended to be used to pay to the state or any person any amount that is due to the state or such person under the provisions of the Escrow Law;

4. all stockholders, officers, directors, managers and employees of the escrow agent must have background checks (including, among other things, obtaining criminal history information through the Department of Justice and conducting civil court checks for activities that would indicate previous involvement in fraud, embezzlement, fraudulent conversion, or misappropriation of property) performed by the California Department of Business Oversight;

5. each stockholder, officer, director, manager and employee of the escrow agent will be required to file fingerprints cards, which must be cleared through the California Department of Justice;

6. the escrow agent must have a manager who possesses a minimum of five years of responsible escrow experience to be stationed at the licensed location during open office hours;

¹⁵ California Department of Business Oversight. Frequently asked questions. Available at: http://www.dbo.ca.gov/Licensees/Escrow_Law/FAQS.asp#HowToApply. For more details see also California Financial Code Division 6 (commencing with section 17000) which contains Escrow Law. Available at: http://leginfo.legislature.ca.gov/faces/codes_displayexpandedbranch.xhtml?tocCode=FIN&division=6.&title=&part=&chapter=&article= (09.01.2018).
7. the escrow agent must provide a signed affidavit certifying that it has read and is familiar with the applicable Escrow Law and regulations.

After the escrow agent has obtained a license, it must submit regular reports to the California Department of Business Oversight. Any stock transfer, issuance of new shares or cancellation of shares regardless of the percentage of the shares being transferred or issued to new or existing owner needs a prior consent from the California Department of Business Oversight and the escrow agent must also maintain at all times liquid assets in excess of current liabilities of $25,000 and tangible assets in excess of total liabilities of $50,000.16

1.1.3. Duties of escrow agent

The primary duty historically imposed upon an escrow agent is to act in strict accordance with the escrow agreement.17 Over time the courts have expanded and specified escrow agent’s duties and resultant liabilities. Now, the common law imposes distinct fiduciary duties on escrow agents: (1) duty of loyalty, (2) the duty of full disclosure and (3) duty of care.18 This means that an escrow agent must exercise “scrupulous honesty, skill and diligence” in carrying out its principal’s instructions.19

An escrow agent’s duty of loyalty means that an escrow agent must act loyally to the licensor and licensee and avoid placing its personal interest in conflict with its obligations to licensor and licensee.20 Thus, in the context of an escrow agreement, the escrow agent essentially serves as a neutral middleman.21 The key-word here is “neutral” as it is expected that an escrow agent is neutral to all parties to the escrow agreement. To be a truly neutral party, an escrow agent must not have a conflict of interest, either actual or perceived.22

The neutrality of an escrow agent includes being unbiased in relations with the licensor, with the licensee and also with any other third party. An escrow agent should not act as an advisor or

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16 California Department of Business. Requirements after an Escrow license has been issued. Available at: http://www.dbo.ca.gov/Licensees/Escrow_Law/Requirements.asp (09.01.2018).
21 See reference 9.
However, the fact is that many escrow agents provide other services such as logistics, data storage, disaster recovery, consulting or litigation support to one of the other parties, creates a strong commercial incentive for the escrow agent to favour the customers buying those other services, which are often big ticket items compared to the escrow. In case of dispute, there would be a risk of the escrow agent “sacrificing” the software escrow in favour of its more lucrative clients.

An escrow agent’s duty of full disclosure comes from US court practice and means that an escrow agent’s compliance duties may be broadened beyond the escrow instructions themselves to the deposit material, e.g. in a case where an escrow agent receives notice of change in circumstances equivalent to new instructions, and in case of fraud an escrow agent’s duties may also include obligation to speak. The latter refers to disclosure of facts that a reasonable escrow agent would perceive as evidence of fraud being committed on a party to the escrow.

The fiduciary duty of care of an escrow agent means that an escrow agent must be diligent and prudent in managing the escrow, with emphasis on “due care”, “good faith” and “a rational business purpose”.

Due to competing interests of licensor and licensee and escrow agent’s fiduciary duties to both of them, it is unreasonable to further expand escrow agent’s duties beyond what’s described in this paper, as it would result in unnecessary increased liability, increased escrow fees and an increase in occurrences where escrow agent simply cannot act because of the dilemma forced upon an escrow agent by the courts’ insistence on disclosing all material facts to the parties. However, pursuant to certain types of software escrow agreements (active escrow agreements), the escrow agent may take upon itself a duty of verification of deposit material.

24 See reference 22.
1.2. Escrow

Another key aspect in the escrow institution is about the escrow itself - what does is exactly entail. In general, the licensor, the licensee and the escrow agent must agree in detail what should be included in the material under escrow and handed to the escrow agent, which is called an escrow.

This is essential for two reasons. Firstly, the material is handed over to the escrow agent and the licensee has no access to it unless release event occurs. That means the licensee cannot verify whether the handed material is adequate and in accordance with the contract. Also, whether the licensee can use the material after all, in case of release event. Secondly, the escrow agent does not usually have the necessary expertise, capability and necessity to deeply understand, whether the deposited material is in correspondence with the licensee’s expectations. The licensee requires the software for his essential business or other activities and thus, has ‘personal touch’ with it. That is not the case with the escrow agent.

Usually, the deposited material does not only contain the software code, but it should also include programming documentation, configuration information, and any other documentation used by the licensor's programmers in order to understand the source code or to develop, compile, maintain, or update the software. Deposit materials should further include any software development tools, compilers, libraries, and other resources used by the licensor's programmers and needed for maintenance or enhancement of the software. The actual definition or description of deposit materials used in a software escrow agreement should be drafted on a case-by-case basis after discussion with technical personnel of both the licensor and licensee. For instance, to illustrate this, one way to define the deposit materials might read as follows:

‘The "Deposit Materials" will consist of the source code and "Development Environment" for the Software. The "Development Environment" consists of the programming documentation, build instructions, configuration information, schematics, designs, and flow charts and any proprietary software tools, libraries, linkers, utilities, compilers, and other programs used by Owner's programmers to develop, maintain or implement the Software, including instructions for compiling and linking the source code into executable forms or for building an executable version of the software. If any of the foregoing are commercial products of other companies
and are readily available to Licensee from third party market sources, then such commercial products do not need to be included if a list identifying them is included by the Licensor in the Development Environment. The "Deposit Materials" will further include a list of the primary programmers involved in the development and maintenance of the Software and their home addresses and telephone numbers. This list will not be available to the Licensee unless released as part of a release of Deposit Materials in accordance with this Software Escrow Agreement.30

1.3. Escrow agreement

Based on the information above, the contract that sets into place this legal mechanism and instructions to a third party depositary of an escrow is called an escrow agreement. Importantly, it is an agreement made for the aim of preserving deposit materials31 and to help secure satisfactory performance in order to supposedly avoid legal battles32 between the parties of an escrow agreement: licensor, escrow agent and licensee.33

Hence, in general the escrow agreements regulate certain conditions such as what is exactly deposit material, technical requirements to keep it safe, release conditions and permitted use of it (for instance what licensee can do with the deposit materials).34 Also, what are the escrow agent’s duties (like fiduciary duty).35 Likewise, with respect to escrow agent’s compensation, the matters of it and reimbursement of expenses should also be clearly set forth in the escrow agreement. In this case it is important to understand that an escrow agent cannot be compensated through the interest of the escrow property as it would be in breach of the fiduciary duty.36

As this paper is analysing in detail the software escrow agreements, it is necessary to explain that there are two main parts of such an agreements: (i) single beneficiary or multiple beneficiary contracts, which has (ii) active software escrow or passive software escrow.37

31 Yeomans, D. R., p 1.
34 Software Escrow services. Types of software escrow agreements. Available at: http://www.escrowlondon.co.uk/software-escrow-services/#_software (07.01.2018).
35 See also Chapter 1.1.
36 Sarshar, M, p 5.
37 Software Escrow services. Types of software escrow agreements. Available at: http://www.escrowlondon.co.uk/software-escrow-services/#_software (07.01.2018).
Provided that, single beneficiary escrow agreement is typically three party agreement and signed between licensor with a single licensee and escrow agent.\textsuperscript{38} This type of contract is used when there is exactly one owner (licensor) and one beneficiary (licensee).\textsuperscript{39} Thus, the main difference with multiple beneficiary escrow agreement is the fact that it is three-party agreement and signed between beneficiary (\textit{i.e.} licensee), licensor and escrow agent. In multiple beneficiary escrow agreement any number of licensees may be added to the contract any time according to the licensor’s wish.\textsuperscript{40} However, both single or multiple beneficiary escrow agreements include active or passive software escrow obligations.

In light of that, active software escrow agreement provides to ensure that the deposit materials (like software source code and technical documentation) related to the services provided by the licensor are not only kept safe by the escrow agent, but are also professionally verified and updated on a routine basis.\textsuperscript{41} Therefore, escrow agent is the active part of the agreement. On the contrary, passive software escrow agreement only provides to confirm that the deposit materials are kept in a secure place and doesn’t assure that the materials provided by the licensor are the ones as promised in the agreement.\textsuperscript{42}

Thus, it is clear that in the interest of licensee, active software escrow agreements should be much more preferred, because in case of the release event, the materials deposited by the licensor won’t theoretically turn out to be useless. Therefore, subsequently within next chapter it is necessary to analyse in detail what is the legal status and other important functions of an escrow agent.

\textsuperscript{38} National Software Escrow. Single beneficiary escrow agreement. Available at: https://nationalsoftwareescrow.com/single-beneficiary/ (07.01.2018).
\textsuperscript{39} The EscrowTech. About single beneficiary escrow agreement. Available at: http://www.escrowtech.in/sb.htm (07.01.2017).
\textsuperscript{40} The EscrowTech. About multiple beneficiary escrow agreement. Available at: http://www.escrowtech.in/mb.htm (07.01.2018).
\textsuperscript{42} Hanse Escrow. About active escrow. Available at: https://www.hanse-escrow.de/en/active-escrow/ (07.01.2018).
2. LEGAL STATUS AND FUNCTIONS OF ESCROW AGENT

2.1. Technical requirements

Technical requirements are essential part of the escrow agreement and thus, part of escrow functions. That said, this is exactly about the fact how the escrow should be kept safe by the escrow agent. To provide the security that the licensees are expecting, the escrow agent is expected to burden itself with several technical obligations regarding technical solutions, platform and safekeeping of the escrow etc.

From the side of the licensor, the escrow agent is expected to keep the delivered code safe and secure. This requirement is of great importance for the reason that the delivered code might most likely contain the licensor’s trade secret, i.e. a specific way of coding (handwriting) elaborated by the licensor. Therefore, for the licensor, the delivering of the code should be made as effortless, automated and hassle-free as possible.

On the contrary, the licensee expects the keeping of the code in a safe and secure way as well. In addition, it is of the licensee’s utmost expectation that once the code is released to him by the agent, it is indeed the same code with the same functionality and rights as agreed with the licensor. It has to be borne in mind that up to the occurrence of the release event, the licensee has no knowledge of the code’s substance, whether it has the agreed functionality and other properties. It is only escrow agent that can secure it. Therefore, the licensee has no alternative but to trust the escrow agent that the code it is keeping is the code that the licensor is obliged to deliver. In order to guarantee that upon the release event, it is first necessary to analyse the technical requirements and solutions that the bigger escrow agents have developed, as well as other concerns regarding to it.

2.1.1. Platform and safekeeping of the code

The main issue in the field is the fact that the escrow agent’s function in keeping the code is stipulated in agreements rather vaguely, e.g. the agent shall “retain the latest deposit of the Material in a safe and secure environment.”43 Notably, the licensee cannot be aware of what are the methods, processes, technical solutions etc. that provide the secure keeping of the code that the licensee signed up for.

Therefore, it should be written in the escrow agreement in detail how exactly the escrow will take care of the source code. Today, it is estimated that more than 50 percent of the world’s applications are held in the cloud and SaaS models are becoming increasingly prevalent for the escrow agents to follow. It is common that the software escrow agent provides a special platform for the parties to communicate in a secure way and keep the code safe. More advanced solutions arrange that the whole process is done in the agent’s platform - composing and signing of software escrow agreement, submitting of code updates, notifying of code’s updates and release events etc.

That said, escrow agent’s responsibilities of how to secure the platform for the parties to the agreement, should also be described well in the escrow agreement. For example, such a solution is provided by the UK company Caytons Cyber, who assure that it is in accordance with the ISO 27001 standard requirements (information security management system) and thus, is widely entrusted by an array of clients from different fields. They also promise that a licensee will not be left at the end of a long queue to receive their business data and provide that release events can be reported on their platform as well as deliver the escrow. This is definitely a good example of how an escrow agent can carry on their crucial duties in a responsible way.

Additionally, developers often use recognised online code repositories like GitHub, Bitbucket, GitLab, SourceForge, which some of the escrow agents have taken steps to adapt their platforms to these repositories. For example, this solution is provided by UK company Escrow London, which allows its clients to deposit their source code automatically to their data-centre. This ensures that up-to-date source code deposits are present all the time, as well as removes the burden from the developers of having to make manual escrow deposits. Automated system is definitely a comfortable solution for the parties to follow, but on the other hand, it may cause additional security issues like what happens when the developer is out of the Internet, but

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45 Software as a Service.
46 ISO27001. The international information security standard. Available at: [https://www.itgovernance.co.uk/iso27001](https://www.itgovernance.co.uk/iso27001) (09.01.2018).
48 This paper chapter 2.2 describes in more detail about the release event.
49 For example, once escrow agent has recorded the event and the terms of release procedure are applicable, licensee may start downloading deposit materials immediately. See also Caytons Cyber, reference 47.
50 Escrow London. Automated deposits. Available at: [https://www.escrowlondon.co.uk/automated-deposits/](https://www.escrowlondon.co.uk/automated-deposits/) (09.01.2018).
believes that it has uploaded the source code. This is something that the parties must include in their contract.

Importantly, there exist also fully automatic escrow agent service providers like Escrowault. Their platform provides that all notification sending, including breaches of contract terms, updating of code and occurring of release events is fully automatic. The licensor can install a script for automatic code uploads from its computer and even select suitable release conditions. The licensee is guaranteed to be notified of every step. It is evident that such a solution provides a competitive advantage regarding the pricing of the service.51

Above all, these platforms may definitely raise a question of how the escrow agent assures that its platform doesn’t deliver the deposit materials before the release procedure is correct and keeps the deposit materials in a safe place. Thus, the security of the escrow should be analysed.

2.1.2. Security of escrow

Similarly to banks, the escrow agents’ services are largely based on trust. It is highly unlikely that the licensors are going to hand over their codes that mostly contain trade secrets and intellectual rights to an institution which lacks high ethical and security standards. Strict duty of confidentiality by the escrow agent must be followed.

Successful escrow agent provides real-time, web-based account management and incorporates chain-of-custody best practices. A client knows that any deposit is being safely stored and is easily monitored. Security is key, and it must be part of the entire process, from the storage of the assets to the procedures for access and retrieval.52

Depending on the type of escrow and the escrow agent, both offline and online vaults are provided in the sector for safekeeping the code and accompanying materials. For instance, offline escrow vaults are physical locations with high levels of security often including subsidiary services like 24-hour armed security and electronic surveillance, natural disaster resistant properties, fireproof, environment controls for ideal long-term storage (happens offline), a remote location. This type of vault provides the highest assurance that critical and sensitive materials are kept safe and is available in the event of a release.53

51 Escrowault. How it works. Available at: https://www.escrowault.com/how-it-works (09.01.2018).
On the other hand, online escrow vaults are usually located in the cloud and hosted internally by the escrow agent. It could be argued that such way of keeping the materials contains higher level of risk but this is mitigated by using encryption technologies, regularly scheduled penetration testing and audits of access logs.\(^{54}\)

Hence, one of the biggest USA escrow agents Iron Mountain Inc. differentiates levels of security as follows:

1. Deposit security, which tracks the chain of custody from the time of receipt to the release of the deposit. A licensor encrypts and transfers electronic media deposits using secure transfer protocols;

2. Storage and facility security, which prevents unauthorized access to storage vaults. A professional escrow service provider will store all escrow media and documents at secure offsite facilities that include uninterruptible power supplies, non-combustible construction, fire protection and access-control security systems;

3. Deposit retrieval security, which establishes ground rules for the release of escrowed materials. Storage administrators won’t move the materials from their storage location until they complete a comprehensive internal review and material inventory.\(^{55}\)

Regarding online vaults, it is common that the platform allows for a whole cloud installation to be mirrored, not just individual applications and data. This level of disaster recovery means that a catastrophic event at the client’s hosting company can be negated by a timely rebuild on escrow agent’s own cloud service if required.\(^ {56}\)

Therefore, as the secure keeping of the code and its accompanying materials is often done in online vaults, the encryption of data is essential to keep the deposit materials safe. In addition to the communication being encrypted, it is common that the escrow agent keeps the data itself encrypted at rest, a.k.a. ‘zero knowledge privacy.’\(^{57}\) However, it should be noted that usually it is not required that the licensor encrypts access to the deposited software, as secure platform is

\(^{54}\) EscrowTech. Where are escrow materials stored. Available at: https://www.escrowtech.com/software-escrow.php#storedSoftwareEscrowDetails(09.01.2018).

\(^{55}\) Caytons Cyber, reference 47.

\(^{56}\) Ibid.

\(^{57}\) Caytons Cyber, reference 47.
provided by the escrow agent. Still, if licensee so requires, the licensor must hand over the private keys to the licensee.

Having analysed the solutions offered by the different service providers as well as their clients’ feedback, it is evident that the market expects automatized but simple solutions and better pricing including easy-to-understand contracts. As all market leaders offer essentially similar services and high level security, Escrowtech is preferred over Iron Mountain and NCC Group.58

2.2. Other activities regarding deposit materials

2.2.1. Deposit materials’ adequacy, testing and verification

Testing and verification of deposit materials is recommended and can be performed in conjunction with a software escrow or as a separate service. Due to the escrow agent’s unique position, the testing and verifying of the deposit material is left in the most escrow agreements to be conducted by it. Fortunately major escrow agent service providers offer this service as well.

Full or complete verification is the only assurance that a party can actually ‘step into the shoes’ of the developer in the event of a release. There is no other reasonable way to protect investment in critical technology or intellectual property. Without full verification, a party is placing its full trust in the developer to make deposits that actually contain all the necessary ingredients.59

Verifying and testing of materials can be done in numerous levels. This could include a basic inventory of the deposited materials, confirmation that no viruses are present on the medium on which the materials are provided (CD, DVD, USB stick) and that the materials can be de-encrypted (if encrypted), decompressed and read, to a full compilation of the code at the licensee's (or an independent) site to ensure that what is deposited can accurately reproduce the application.60

From the technical aspect the quality of the deposited material is tested to assure whether the data on delivered media can be read; the material, referred to in the contract, is present and

complete; the deposit is free of viruses; the deposit is executable (transmissible); the deposit is well documented; the deposit is up to date.\textsuperscript{61} This is definitely one of the most important duties by the escrow agent to follow.

Moreover, companies that are experts in providing verification and testing services have developed different services and verification levels. For example, UK company DataSpace UK Ltd. (Escrow London) has gone an extra mile and introduced levels of testing with different comprehensiveness:

1. File Integrity Test. Basic level and always included testing when using escrow services. This contains checking and ensuring that data exists on the deposit media that resembles source code data;\textsuperscript{62}

2. Full Verification. It is a complete and independent test to ensure that the software can be compiled into a working system. A software expert observes that the software can be compiled using the supplied source code.

3. Isolated Rebuild Verification. It is in essence a simulated release where a third party is rebuilding the code. This is a two part process that includes a full verification at the developer’s site and then a rebuild on a clean environment following the steps of the verification report.

4. Simulated Release Verification. This test is similar to the previous one but here the simulation is performed with a condition that the licensee should rebuild the code. It is a two part process that includes a full verification at the developer site and then a rebuild on a clean environment following the steps of the full verification report.\textsuperscript{63}

5. SaaS Verification. It is a simulated release of a SaaS environment. It is a two part process that includes a full verification of the source code and the run-time environment at the developer site and then a rebuild of the run-time environment on a simulated virtual machine in the lab of the escrow agent.\textsuperscript{64}


\textsuperscript{62} Also, if the data is encrypted, a working encrypted key is included in the documentation; if the data is compressed it can be decomposed into a logical file structure; documentation exists detailing the required components needed to compile the software.

\textsuperscript{63} This test also ensures that the code may be rebuilt at the site of the end user (license) away from the developers’ environment.

The question of testing and verification raises even more concerns due to the fact that usually licensees lack expertise to use the released source code and that most escrowed source code is defective. According to Iron Mountain, 97.4 percent of all analysed escrow material deposits have been found incomplete and 74 percent have required input from developers in order to be complete.65

It is obvious that the testing and verification serves licensee’s interests. The licensee needs to assess its own risks in order to choose the necessary and sufficient level of testing. For any escrow agreement to be effective, the obligations to deposit software need to be policed and there needs to be follow-up action to ensure that any failures of testing or repeat testing are rectified.

2.2.2. Copyright and proper licensing concerns

But the testing and verification services do not stop here. It is important to understand that within the escrow agreements, the developed software might also raise copyright issues or legal matters, that the escrow agent must take into account. Importantly, for the software vendors it is necessary that their trade secret is kept safe and is only used by the party that has the right to do so. Furthermore, the software product for which the escrow function is established may also include third-party software that is not even owned by the licensor. This may also raise license issues.66

Thus, the permitted use license should be granted at the time of entry into the escrow so that the licensee can elect to retain the license in the release event. If the escrow includes third party source code, then that granting should be included as well. For these reasons, the escrow agreement should include a license granted by the licensor and/or third party to the escrow agent to copy and release the source code and other escrowed materials and to otherwise take any action needed for the escrow. This way, the escrow agent can also elect to retain its license in the event the trustee or debtor-in-possession rejects the escrow agreement.67

66 For example, a spell checker in a program may come from another party rather than from the software developer of the program. Thus, the licensor himself may not have the right to grant a permission of the license to the escrow agent and the licensee and the escrowed materials may become unsuitable. See also Christiansen, J. Doing Software Escrows Right. Licensing: The computer and Internet Lawyer, Vol. 21, Nr. 6, June 2004, p. 18.
67 See reference 30.
2.3. Release event

2.3.1. Release conditions

As said before, under an escrow agreement, licensor obligation is to supply an up to date copy of source code to a trusted escrow agent, who is instructed to release the source code to the licensee in the event that the licensor is unable to perform its contractual obligations. That said, the escrow agent holds the source code unless a release event occurs (sometimes called trigger event), in which case the escrow agent is obligated to deliver the source code to the licensee.\textsuperscript{68}

Thus, release conditions are typically based on some failure, or threat of failure, of the licensor to meet the expectation interest of the licensee under the license agreement.\textsuperscript{69} Following a release event, the promise of an escrow agent is that the licensee can obtain the deposit materials in order to maintain the software without the original developer (licensor) involved.\textsuperscript{70}

Therefore, release conditions are designed to ensure the continued operation of a piece of software that may be critical to a licensor’s business.\textsuperscript{71} Notably, one could also say that release conditions are in place to protect licensee and provide them the help to protect their rights.

That said, in drafting an escrow agreement, it is very important to describe the release conditions, which are just as important as the deposit materials. The occurrence of a release condition entitles the licensee to receive the deposit materials from the escrow agent.\textsuperscript{72} With this in mind, escrow agent’s main duty here is to protect the software licensee and to ensure that licensee will get permission to the deposit materials.

Some of the most common release conditions that are used in escrow agreements are:

1. the licensor goes out of business like bankruptcy, insolvency or liquidation;
2. the licensor discontinues support of the licensed software and breaches maintenance obligations, or some other release condition occurs;
3. in case of \textit{force majeure};

\textsuperscript{68}Burbidge, K. Meaning of the source code escrow agreements. Available at: \url{http://ipkitten.blogspot.com.ee/2015/03/giving-meaning-to-source-code-escrow.html} (09.01.2018).


\textsuperscript{70}Shawn, C.H., reference 65.

\textsuperscript{71}Burbidge, K., reference 68.

\textsuperscript{72}Christiansen, J., p. 22.
4. change in licensor’s shareholding – for instance, licensor is acquired by or merges with a competitor of licensee.\textsuperscript{73}

Moreover, those release conditions are mostly a subject matter of an escrow agreement between the licensor and the licensee, in discussion with their legal advisors. However, for the licensee it is important to get access to the deposit materials because licensee is not considered as the owner of the source code (in Europe) and thus, reverse engineering is not permitted either. Pursuant to article 6 of the Directive 2009/24/EC of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs,\textsuperscript{74} decompilation is not permitted for maintenance purposes.

In conclusion, it is obvious that escrow agent does not care too much how the release conditions are actually defined, but is much more worried about the release procedure itself,\textsuperscript{75} which is described in the next chapter.

2.3.2. Release procedure

The escrow agreement should specify how the escrow agent is\textsuperscript{76} to be informed when a release event occurs\textsuperscript{76} and describe the release procedure for a release of deposit materials to the licensor. These terms are definitely one of the most important duties for an escrow agent to follow.

Typically, the release procedure is either (1) a procedure with a waiting period and a right for the licensor to object or (2) a procedure for a mandatory or immediate release.\textsuperscript{77}

The first procedure is called a standard release process that includes an objection period,\textsuperscript{78} which can be described as follows: if the licensee believes that a release condition has occurred, the licensee will deliver a written request or demand to the escrow agent that the deposit materials should be released. The escrow agent will not then release the deposit materials at that time and instead, will notify the licensor. The licensor will then have a right to object to the release if the licensor believes that the release condition did not occur. If the escrow agent

\begin{itemize}
  \item Christiansen, J., p. 22.
  \item Smedinghoff, J. T., p. 84.
  \item Boruvka, J. 6 keys to a successful escrow agreement. Technology Escrow, 2017. Available at: \url{http://infogoto.com/6-keys-to-a-successful-escrow-agreement/} (07.01.2018).
\end{itemize}
receives the objection (within right time, e.g. two weeks), then the escrow agent will hold the deposit materials and the dispute will be resolved by agreed dispute resolution method. An escrow agent’s duty then is to release or continue to hold deposit materials as decided by the court (or arbitration).\textsuperscript{79}

The second release procedure is called a demand release process which requires the escrow agent to deliver the deposit materials completely to the licensee, without an objection period, and if the licensor contests, it is normally resolved after the release itself.\textsuperscript{80} Thus, this procedure provides for a mandatory release of the deposit materials after licensee\textsuperscript{81} has notified the escrow agent. Hence, it means that there is no waiting period and there is no opportunity for the licensor to object to the release before it is made.\textsuperscript{82}

Moreover, some experts say that even in this case the licensor is generally given an opportunity to challenge the validity of the release through agreed dispute resolution because the licensor must have a right to know whenever the licensee requests to access the deposit materials under mandatory release is legitimate. The aim of this is to assure that licensor has a right to object if it thinks that the request may be inappropriate.\textsuperscript{83} Therefore, licensor may still look an order (court or arbitrator) that the deposit materials must be returned to escrow.\textsuperscript{84} However, under the demand release process, the escrow agent is still obligated to release the deposit materials to the licensee even if the court finds later that they must be returned.

Thus, in both cases, when a licensor objects to a licensee’s request to release deposit materials, the intent of an escrow agreement can be threatened in the short term.\textsuperscript{85} Moreover, if a release condition occurs, the licensee may be damaged by the delay of getting the deposit materials.\textsuperscript{86} Furthermore, delays in the release of the software may also be problematic because licensors may not keep the software properly updated during the period of time that the parties are disputing the release of the software.\textsuperscript{87}

With this in mind, it is necessary to analyse in the next chapter whether escrow agent may be liable if it doesn’t fulfil its duties.

\textsuperscript{79} The EscrowTech. Release procedures. Available at: https://www.escrowtech.com/article.php (07.01.2017).
\textsuperscript{80} Boruvka, J., reference 78.
\textsuperscript{81} It is up to the escrow agreement to regulate who is the notifier and in some cases it can be even licensor. In general it is licensee interest to get the source code and thus, he is normally the notifier as well.
\textsuperscript{82} Smedinghoff, J. T., p. 84.
\textsuperscript{83} Ibid.
\textsuperscript{84} Christiansen, J., p. 21.
\textsuperscript{85} Smedinghoff, J. T., p. 84.
\textsuperscript{86} Christiansen, J., p. 23.
\textsuperscript{87} These questions are further analysed in the chapter 3.2. See also Shawn, C.H., reference 65.
3. LIABILITY OF ESCROW AGENT

3.1 Liability of escrow agent in general

Taking into account the escrow agent’s duties, the possible claims against an escrow agent include (1) liability for breach of contract, (2) liability for breach of fiduciary duty, (3) tort liability and (4) negligence and fraud.88

One of the key elements of contract law is that a party to an agreement must act in accordance with the prescribed terms and conditions. Hence, in case of breach of contract, the breaching party should generally be held liable for contract damages and actual economic loss. The same goes for escrow agreements, and as already described, to act in strict accordance with the escrow agreement is the most important duty of an escrow agent. An escrow agent is held in strict compliance with the terms of the escrow agreement and is liable for all damages resulting from any deviation.89

As described in paragraph 1.1.3 above, common law imposes fiduciary duties on escrow agents. Therefore, it should come as no surprise that an escrow agent can be held liable for breach of its fiduciary duty, in case the escrow agent breaches its fiduciary duty to either licensor or licensee, e.g. the duty to disclose facts that a reasonable escrow agent would perceive as evidence of fraud being committed on a party to the escrow, to either licensor or licensee.90

There have been a few cases, where tort liability has arisen for escrow agent for the breach of escrow agreement in bad faith. Availability of tort damages, however, requires a special relationship between the parties, e.g. special relationship between the parties arising from elements of public interest, adhesion, and fiduciary responsibility, and those relationships undertaken for something more than or other than commercial advantage, such as the procurement of service, professional help, security, or other intangibles.91 The assessment of tort damages for breach of contract is a device most often allowed in situations in which the

91 Ibid.
rule restricting recovery to contract damages would promote breach of the contract rather than its performance.  

Lastly, in special circumstances, an escrow agent may be held liable for negligence or fraud. Escrow agent’s liability for such claims requires a particularly egregious set of facts - much more than a failure of an escrow agent to follow escrow instructions. For example, a fraud-based liability would arise if an escrow agent, for personal gains, also acts as a licensee to an escrow agreement using a fictitious name or shell partnership.

As for a software escrow agent, it is not liable for the correctness, completeness, accuracy or usefulness of the deposit material (i.e. source code), unless it has specifically agreed otherwise.

Next is described in more detail certain liability issues that are specific to software escrow institution.

3.2 Liability regarding release procedure

3.2.1 Delay of releasing deposit materials

It is definitely in interest of the escrow agent not to delay releasing the deposit materials. But sometimes licensor has the possibility to prevent the timely release of the deposit materials (for instance start a dispute), while licensee has limited possibilities to get the source code. Therefore, it’s critical for licensee to prevent such a delay, because it may cause further damage for its company. Hence, licensee’s may find that it’s an escrow agent’s duty to assure that there is no delayance of releasing the deposit materials and when the mandatory release terms occur it’s an escrow agent’s duty to follow them and release the deposit materials.

Moreover, a commonly disputed issue is whether a clear release event has actually occurred and escrow agent is liable to deliver the deposit materials. A good example of this can be found in the court case (USA) between Vemics, Inc. and Radvision, Ltd. In this dispute the licensee, Vemics Inc., requested the release of the deposit materials from the escrow agent, Iron

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92 Ibid.
93 See reference 87.
95 It is clear from the chapter 2.3.2 that under standard release terms escrow agent may refuse to release the deposit materials if the licensor objects to release the software.
Mountain, because the licensor, FVC, filed for bankruptcy. However, Radvision Ltd., the successor in interest to FVC’s rights and obligations, obstructed the release because it did not agree that a valid release condition (bankruptcy) had occurred. This case shows clearly that even though parties typically enter into escrow arrangements to, at a minimum, protect the licensor’s interest in the deposit materials, in the release event of the licensor’s bankruptcy, one party may still argue that this release event is not a valid basis for release of the source code.98

Thus, as for the escrow agent’s liability, this case shows exactly that it’s an escrow agent’s duty to question whether mandatory release event has occurred and to refuse to deliver the source code. One could argue that it doesn’t matter if licensor starts dispute over release event or not because as far as licensee requests the deposit materials under mandatory event, Iron Mountain had to follow the contract terms and deliver it. On the other hand, an escrow agent may argue that there is no requirement for it to follow the agreement if the parties have started dispute over release event.

In light of that, escrow agents may still be liable under the negligence principle. The California Supreme Court has explained that “it is the duty of an escrow agent to obey the instructions of his principal and exercise in his employment reasonable skill and ordinary diligence, and, if an escrow has violated instructions or acted negligently, it would ordinarily be liable for any loss occasioned by its breach of duty”.99 It is also found that “no liability attaches to the escrow holder for his failure to do something not required by the terms of the escrow or for a loss incurred while obediently following his escrow instructions”.100 Furthermore, it is also stipulated by the California Courts of Appeal that “it is the duty of an escrow holder to exercise reasonable skill and ordinary diligence in its employment, and if the escrow holder acts negligently, it is ordinarily liable for any loss occasioned by its breach of duty.”101

Those cases are good analogue examples to show that the escrow agent should exercise its fiduciary duty and take into account the interests of licensee and the escrow agreement itself. Even if the licensor starts dispute over mandatory release terms, as far as the court hasn’t

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98 The dispute still goes on and at the moment there is no available information whether Vermices, Inc. got the deposit materials. See also: Shawn, C.H., reference 65.
requested the escrow agent to not release the deposit materials, escrow agent should act under the escrow agreement and not delay releasing deposit materials. This means that escrow agent should not question whether the mandatory terms are applicable or not. If escrow agent decide to act on the contrary, it may be liable for any loss arisen by its breach of duty, including damage caused for the licensee. By the California Court practise it is clear that an escrow agent can be held liable for negligence conduct when it fails to follow his contractual introductions.  

3.2.2 Deposit materials are not up to date

Some licensees may also view an escrow agent as an insurance agency who protects itself when a release event occurs. Thus, licensees may believe that when they have a right to get deposit materials, those are always up to date. Unfortunately escrow agents may fail to assure adequate protection because, upon release, the deposit materials may be outdated, defective or otherwise fails to meet the licensee’s needs.

It is clear that if the parties have signed an active escrow agreement, escrow agent is obligated to make sure that the deposit materials are up to date. Likewise it can be seen under passive escrow agreement, where escrow agent’s obligation is to assure that all of the materials have been escrowed on time. Therefore, in both agreements escrow agents may be liable if the deposit materials are not delivered up to date.

Generally, escrow agent should be obligated to verify that all of the necessary materials are received and the source code is “compatible”. It should be one of the escrow agent’s main obligation to report what it is told it received as well as what visual inspection reveals.

Thus, if the escrow agent doesn’t fulfil its duty to control that the deposit materials are received in terms of escrow agreement, it may be liable for a breach of an escrow agreement. An escrow agent is held to rigorous compliance with the terms of the escrow agreement, and may be liable for all damages resulting from any deviation. Therefore, escrow agent may be liable if the deposit materials are not up to date either.

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102 Talkov, S. Escrows can be negligent, even while following an escrow instructions. Available at: http://www.rhlaw.com/blog/escrow-negligence/ (07.01.2018).


104 It means that escrow agent is not obligated to make sure that the source code works, but he has to assure that the materials itself has delivered under the escrow agreement to them on time.


106 See reference 88.
3.3. Liability regarding technical and security matters

One of the keys elements in rendering escrow agent’s services is to guarantee confidentiality, provide trust and high security. An escrow agent must guarantee that the deposit materials which are handed over to him, do not leave his domain to any third party that is not strictly stipulated in the contract.

The escrow agent is liable to keep the deposit materials in a safe and secure environment, as assured in the agreement. Depending on the contract and the essence of the deposit materials, this might mean keeping the materials in a distant vault. Or most commonly, providing the best security using electronic means, e.g. best and most suitable encryption technology, avoiding online access etc.

These concerns are especially high regarding SaaS agreements and keeping the code in the cloud. Depending on the material and its value, it could be even argued that public cloud services are unsuitable. Nevertheless, the appropriate means should be unanimously agreed upon and the escrow agent as the keeper of the code remains liable before the licensor and the licensee. In the end, it is the escrow agent who has to provide the secure keeping of the code.

In conclusion, it is clear that in some cases escrow agent may become liable if it doesn’t follow the escrow agreement. As escrow agent is critical party for the escrow agreement and in most cases, licensor or licensee can’t control whether escrow agent follows all the criteria that are agreed in the contract, it may be necessary to regulate this institution in the legislative acts in more detail. In the following chapter we will continue analysing this matter.
4. DE LEGE FERENDA

4.1. Standard requirements

Our study has shown that escrow agent information systems like platforms play an important role for the contract parties in the escrow agreement, therefore it is strongly advisable that escrow agents are at least ISO27001 and/or ISO 9000 certified\textsuperscript{107} or required to get a special license in order to work in the field. As it was mentioned before, some escrow agents already follow the terms of ISO27001 - the international information security standard. On the contrary, ISO 9000 is the standard that lays out the fundamentals of the quality management systems.\textsuperscript{108}

In our opinion the standard certificate or license requirement in the escrow agreements or even regulated in the legislative act are essential in order to assure for the parties that the escrowed materials are kept in a safe place and followed by the higher rules, which is confirmed by specific certificate authority like ISO or even regulated under the law. If the escrow agent is required to have a higher security standard in the field, it would definitely make them more trustworthy and most importantly, assure it for the contract parties.

It is good to give here an analogue example from California, where the internet escrow agents \textsuperscript{109} are required to get a specific license, issued by the California Department of Business Oversight, as already described above. Those escrow agents are required to follow the security and other necessary requirements in order to get the license and work in the field.\textsuperscript{110} This is definitely a valuable method of how to secure for the parties that their deposit materials are well protected.

Another great example in Europe is NIS Directive,\textsuperscript{111} which stipulates that a service provider plays an essential role in the market if the cyber incident against their information systems would seriously harm the specific union market. Thus, it is required that member state (\textit{i.e.} member state in the directive’s context) regulate such a service and outlines special security terms.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{107} Classen, W.H., p. 136.
\item \textsuperscript{108} ISO 9000 standard series. Available at: \url{http://asq.org/learn-about-quality/iso-9000/overview/overview.html} (07.01.2018).
\item \textsuperscript{109} “Internet escrow agent” is any person engaged in the business of receiving escrows for deposit or delivery over the Internet.
\item \textsuperscript{110} California Department of Business Oversight. About the Escrow Laws. Available at: \url{http://www.dbo.ca.gov/Licensees/Escrow_Law/about.asp} (09.01.2018).
\end{itemize}
\end{footnotesize}
With this in mind, it is a good example here because an escrow agent can also be seen as the important service provider - if any cyber incident happens against their systems, it may cause a major damage to the economic and generate substantial financial loss. Therefore, it would be advisable to analyse for the member states that maybe escrow agents should also be regulated by the NIS Directive and/or required to follow the specific standard technical terms, regulated by the law.

4.2. Liability insurance

The escrow agent is the keeper of a very high value asset, most likely even a trade secret. Leakage or losing it might have fatal impact to the licensor or the licensee, perhaps even put an end to a company. Once such event occurs it cannot be reversed and to pay colossal damages might be impossible for the escrow agent. Keeping that in mind - the occurrence of the worst case scenario - a liability insurance of an escrow agent is one of the key-solutions here. There are insurers who actually offer specific liability insurance for escrow agents, but currently it is not compulsory.

The authors of this paper suggest that a compulsory liability insurance of the escrow agent should be introduced to mitigate the risk. A compulsory insurance would help mitigate the possible escrow agreement related damages to the parties, for example the insurance should cover damages related to the breach of escrow agreement by an escrow agreement, e.g. in case the deposited material gets damaged or destroyed due to either faulty hardware or other circumstances while being deposited in escrow.

However, one of the preconditions for prescribing compulsory liability insurance of the escrow agent would be to incorporate the escrow institution into laws and regulations and inter alia define the escrow agent. Otherwise it would be practically difficult, if not impossible, to apply the compulsory liability insurance requirement. As the escrow institution (especially software escrow institution) is gaining popularity and becoming more and more relevant, such incorporation of software escrow into laws is probably bound to happen sooner or later in continental law states as well.
4.3. Legal status in bankruptcy proceedings

One of the key factors in software escrow is that the customer does not take title to the source code, but gets a license to use for their internal purposes only. The source code is a very valuable asset and when the licensor goes bankrupt that asset can then be for example sold to pay off creditors. In fact, licensor’s bankruptcy is on top of the list when it comes to software escrow related disputes.

The software escrow's probable invalidity under bankruptcy law may be exposed in the context of the following issues:¹¹²

1) Whether the deposited materials constitute "bankruptcy estate" under bankruptcy law;

2) Whether the "automatic stay" (transfer of management authority and right of disposal from the debtor i.e. licensor to the bankruptcy trustee) prevents any action by the licensee to force the escrow agent to deliver the deposited material;

3) Whether, if delivery is made, the delivery is a "preference" (preference of licensee over other debtors) under bankruptcy law or a "post-petition transfer" (i.e. transfer that prompts recovery of the deposited materials);

4) Whether the bankruptcy trustee can use, sell, or lease the deposited material; and

5) Whether the software escrow is an "executory contract";

6) Whether escrow is in essence similar to a pledge or security which would allow preference in the bankruptcy proceedings.

The authors of this paper propose to define in bankruptcy law the legal status of materials deposited in escrow and prescribe that the deposited materials do not constitute a part of the "bankruptcy estate" under bankruptcy law. The licensor should not have proprietary interests in relation to the software which it has licensed to a licensee using software escrow agreement. Thereafter the licensee should be free to receive the source code and skip the lengthy bankruptcy proceedings. However, the precondition for this should be that it’s reflected in the licensor's balance sheet.

SUMMARY

In our research paper we were analysing the software escrow agent’s legal status and liability. Accordingly, our aim was to provide comprehensive overview of the escrow institution, of which framework is very slim and depending mostly on the conditions set forth in an escrow agreement.

In the context of an escrow agreement, the escrow agent in principle acts as a neutral middleman. The actual legal status of an escrow agent is anomalous and should be regarded as *sui generis*. Although an escrow agent’s most important duty is to act in strict accordance with the escrow agreement, an escrow agent also has fiduciary duties to licensor and licensee which include duty of loyalty, duty of full disclosure and duty of care.

It is evident that escrow agent’s services are wanted both from the side of the licensor and of the licensee. Licensees seek security in case the licensor might become insolvent or in other way incapable of performing its duties the parties have agreed. Licensor on the other hand can demonstrate to clients and potential clients that it acts proactively in relation to the licensee’s interests. At the same time the security for the licensor’s source code or even trade secret must be maintained. Thus, to engender, the existence of a neutral party like software escrow is necessary.

The fact that source code might be triggered and it might get out of the licensor control, is a reason for the parties to take their responsibilities much more seriously. For the escrow agent, it is important to follow agreed release procedure and deliver the source code only when the release event has happened.

Moreover, our study found that it is not solely the software that is put into escrow. In the interest of the licensee, the escrow should definitely include also materials like build instructions, programming documentation, configuration information, and any other documentation used by the licensor's programmers to understand the source code or to develop, compile, maintain, or update the software. As well as developer’s and third party copyright licenses.

Thus, it is the obligation of the escrow agent to then verify and in the active escrow contract even test whether the materials deposited by the licensor are in accordance with the escrow
agreement. As the licensee gets access to the materials only in the release event, it does not have control over the deposit materials and their accuracy. Therefore, it is the duty of escrow agent to assure that the deposit materials are up to date. In case that the licensee receives materials that are not uploaded in accordance with the agreement or are not usable by it, the software escrow agent may become liable of breach of escrow agreement.

Therefore, we found that it is very important for the escrow agent to follow the terms of the release procedure and not become the judge of interpreting it. It is clear that if a licensee request the deposit materials under mandatory release event, the escrow agent should not question whether this is applicable or not. An escrow agent should always act under its fiduciary duty, in their best interest and take into account the terms of an escrow agreement. If he decide to act on the contrary, escrow agent may become liable under negligence principle and be responsible for any loss arisen by its breach of duty, including damage caused for the licensee. For instance, we found that by the California Court practise the escrow agent can be held liable for negligence when it fails to follow its contractual introductions.

Furthermore, the unique position of the escrow agent puts high security and trustworthiness expectations on it. To provide that, the escrow agent must use the latest possible security measures, whether it is physical vaults, etc. or encryption technologies.

To avoid disputes and major economic loss and damage for the contractual parties, the security conditions of how to keep the deposit materials, should also be stipulated in detail in the agreement. In our opinion it is advisable that the escrow agents introduce a universal standard in their services - e.g. ISO 27001 or 9000 regarding information security and quality management. Also, it is advisable that legislators take into account the importance of the escrow institution and regulate the technical standards that such a service must follow.

Furthermore, it is highly advisable that the escrow agents have obligation or at least common practice to be covered by a liability insurance. This would help mitigate the risk of damages in case something happens to the escrow agent or the deposit material in escrow as software source code can be very valuable and highly priced asset to a company.

And lastly, another way to solve some uncertainties and prevent software escrow related disputes, is to define the legal status of software deposited in escrow so that it clearly would be excluded from the bankruptcy estate.
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