Commercial Software Licensing

CHAPTER 8:

Source Code Escrow

Prepared by DoD ESI | January 2013

Chapter Overview

- Source Code is the human readable form of software as written by the Publisher while Object Code is the machine readable form delivered to customers.

- Object Code protects the Publisher's IP. Source Code may be needed by Customers under certain circumstances (e.g., Publisher goes into bankruptcy) to maintain licensed software.

- An escrow agreement with a neutral third party gives Publishers and Customers assurance that their respective interests are protected.

- The escrow agreement specifies the events which could trigger a release of the Source Code to the Customer.

- The license Customers obtain to released Source Code is usually limited to a right to use it for maintenance and enhancement of their production system.

Source Code Defined

What is Source Code?

- As the name implies, Source Code is the original software code written by the author of a software application.
- Source Code embodies the "source" of the intellectual property created by the author.
- Source Code, although written in one of many available programming languages, is in a "human readable" format.

Source Code & Object Code

- Licensed software is delivered in "object code" format, which is only understandable by a computer—referred to as "machine readable".
- Human readable Source Code is required to understand the logic, instructions and structure of an application.

Source Code Defined

Why Publishers Need Object Code

- The Publisher wants to maintain control over its Intellectual Property (IP) rights (i.e. source code).
- Giving access to Source Code risks unauthorized use of the author's IP.
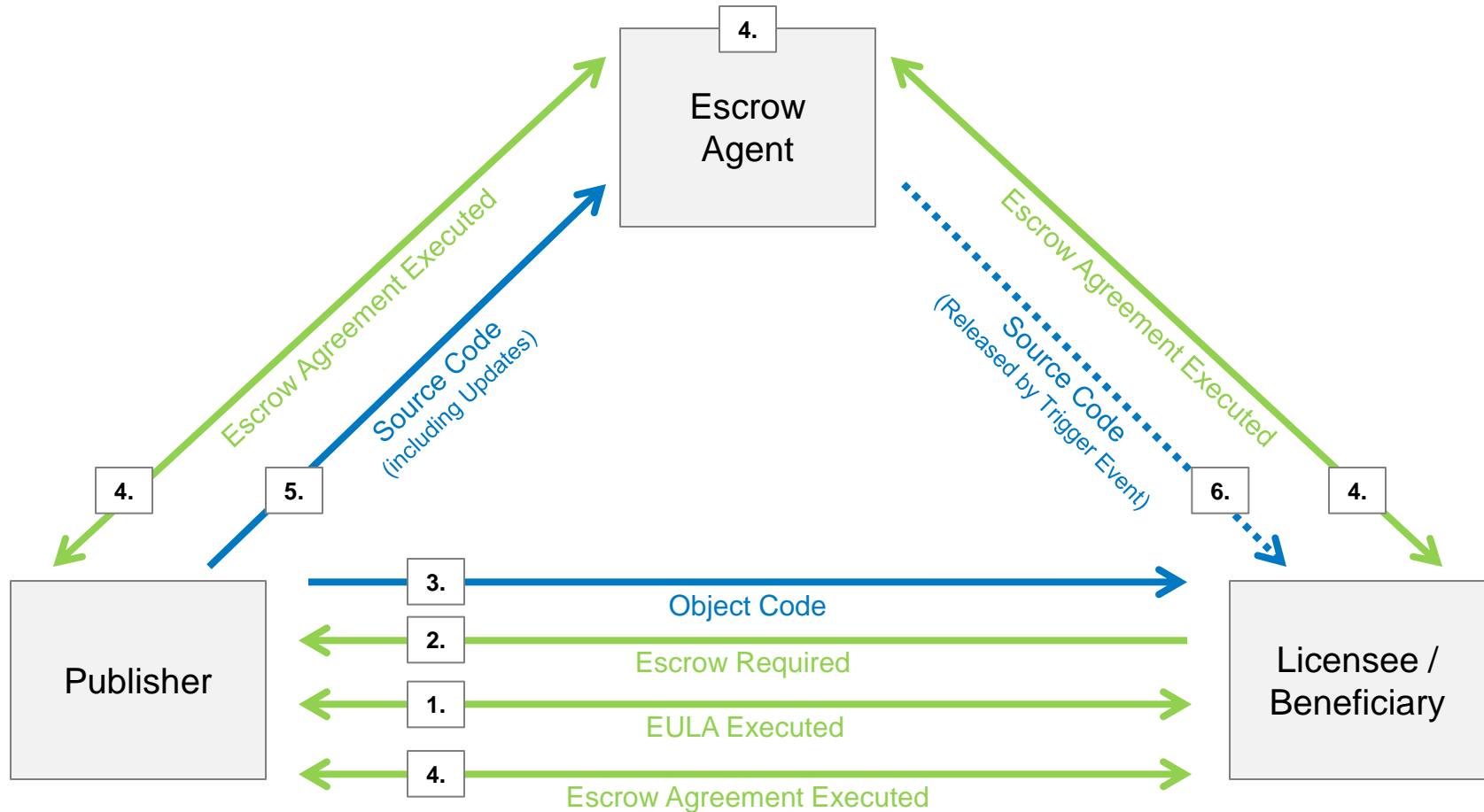
Why Customers Need Source Code

- Source Code is necessary for development of new functions, reports, etc.—AND for creating fixes to software errors (bugs).
- The government wants the ability to maintain and upgrade its software application in the event something prevents the Publisher from supporting it.
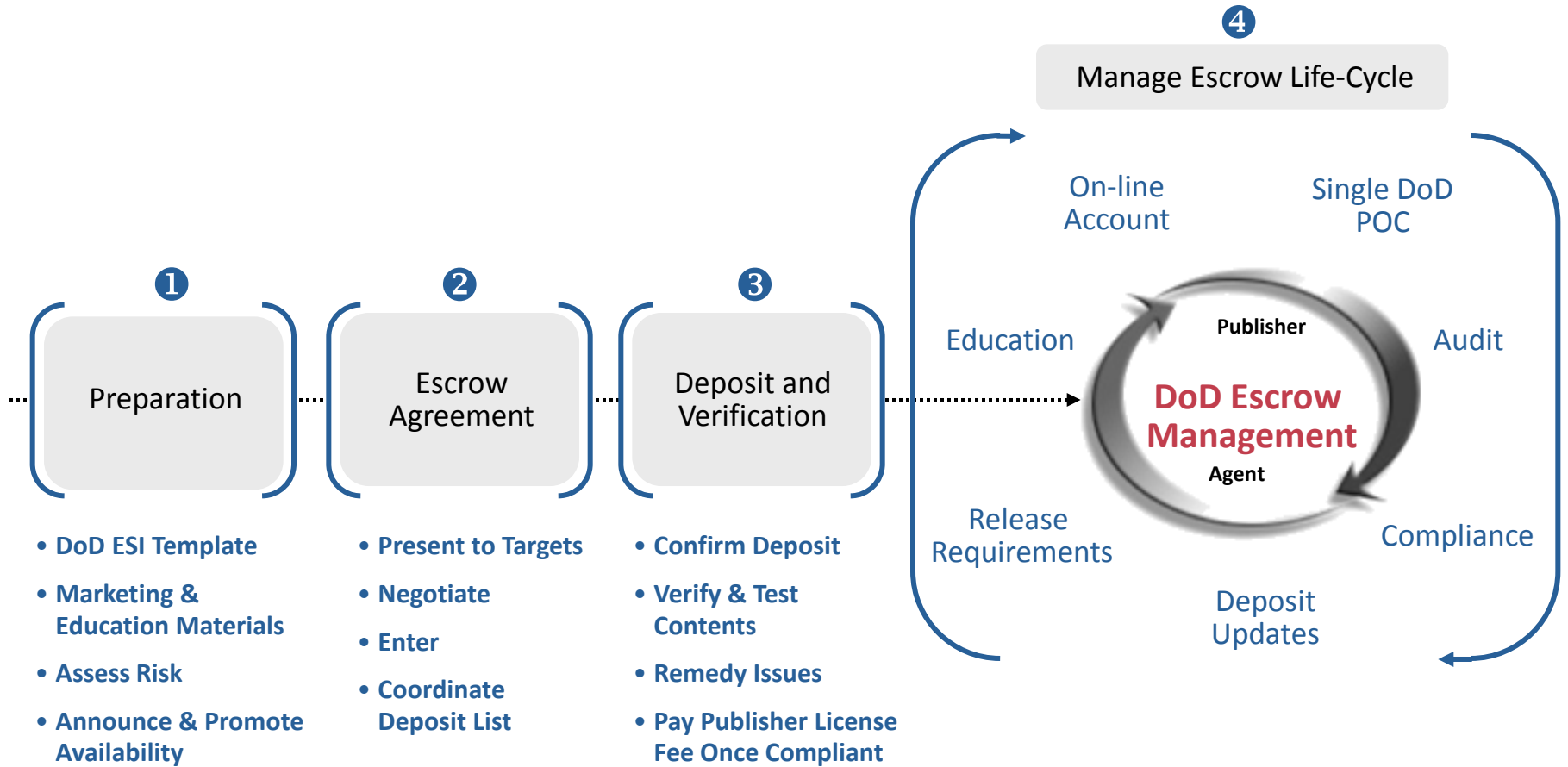
Third-Party Escrow

- An independent third-party Software Source Code Escrow company serves as an insurance policy to protect the interests of both parties.
- That company maintains a copy of the original source code and periodic updates in escrow, releasing them to the user only if a triggering event occurs. Each deposit should be validated and tested to ensure it is a functional version.

Source Code Escrow—Balancing Interests

DoD ESI Software Source Code Escrow Process

❹ Manage Escrow Life-Cycle

On-line Account

Single DoD POC

Education

Publisher

DoD Escrow Management

Agent

Audit

Release Requirements

Compliance

Deposit Updates

❶ Preparation

- **DoD ESI Template**
- **Marketing & Education Materials**
- **Assess Risk**
- **Announce & Promote Availability**

❷ Escrow Agreement

- **Present to Targets**
- **Negotiate**
- **Enter**
- **Coordinate Deposit List**

❸ Deposit and Verification

- **Confirm Deposit**
- **Verify & Test Contents**
- **Remedy Issues**
- **Pay Publisher License Fee Once Compliant**

$2,500	$1,700 per deposit	$_____ per xyz	$1,700 annual fee per deposit

Escrow Release Triggers

Escrow Source Code Release

- Escrow Source Code, including any copies thereof, will be released to Customer in accordance with the terms and conditions of the Escrow Agreement. For the purposes of the Escrow Agreement, a "Release Event" shall mean that Customer has terminated this Agreement for cause pursuant to Section 8.2 on account of any one or more of the following occurrences:

Triggering Events

- Publisher has ceased all business operations in the ordinary course for any reason other than a merger or transfer of substantially all of its assets, or its successor in interest following a merger or a transfer of substantially all of its assets does not assume and perform all of Publisher's obligations under this Agreement;
- Publisher has a petition filed by or against it under any state insolvency laws or under Article 7 of the federal Bankruptcy Code and such proceedings have not been vacated or set aside within sixty (60) days from the date of commencement thereof;
- Publisher has a Change of Control as defined in Section 8.2(b); or
- Publisher is in breach of any material term or condition of this Agreement.

Source Code Escrow Considerations

| Software Type	Mission Criticality	Stability of Developer/Publisher
• COTS or Custom. • If COTS, degree of customization (0 – 95%). • # of years specific software has been available. • Market share of COTS software. • Number of COTS installations. • Number of Fortune 500 installations.	• Nature of Application *(back office, combat, etc.).* • Criticality of the software to the mission.	• # of years in software business. • % of corporate revenue S/W licensing. • % of corporate revenue S/W services *(including maintenance).* • Dun & Bradstreet rating. • # of commercial customers. • # of Federal installations. • Last five years Net Income as a percentage of Sales *(Net Profit).* • Last five years EPS. • Last five years P/E.

Source Code Escrow Considerations

- Custom Software
- < 2 Years in the market
- Mission Critical
- Low market share
- Low number of installations

Software Type & Mission

- COTS
- > 5 years in the market
- Not mission critical
- High market share
- Large number of installations

High Risk

Escrow Recommended

Low Risk

Escrow Not Required

High Risk
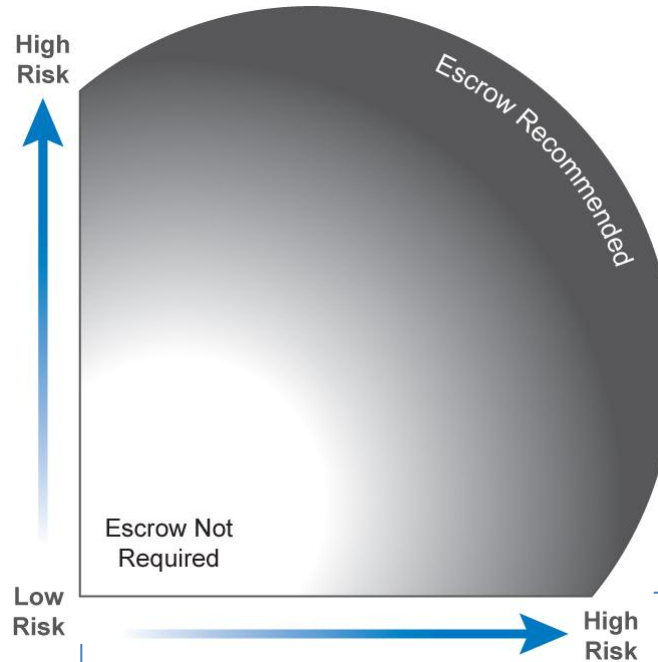
Publisher Longevity & Stability

	Years in Business	
>5 years……….	Years in Business	..…......< 2 years
>15% of Sales….	Net Income	.....< 5% of sales
High……..…..…	Earnings per Share	.……..…… Low
Moderate……….	Price-to-Earnings Ratio	.……….… High
High.…….………	D&B Rating	.…….….. Low
Balanced............	License v. Service Revenue	….. High license v. service

Sample Escrow License Rights

Rights Upon Release

- Upon the occurrence of a Release Event described in the contract, the Customer shall have the right to receive the Escrow Source Code from the Escrow Agent.

- **Publisher shall grant to Customer, at no additional charge, a non-exclusive, non-transferable, worldwide, perpetual, fully paid-up license**, to install, display, use, perform, modify, and create and distribute internally and to its affiliates the Source Code and any derivative works of the Escrow Source Code delivered by the Escrow Agent under this Section **for the sole purpose of allowing Customer to install, support, maintain, and allow its End Users to continue using the Software** under the terms of any executed license or subscription agreements entered into up to the date of a Release Event.

Discussion Guide

Describe and discuss the definitions and differences between source code and object code.

Why do Publishers need object code and why do Customers need source code?

Discuss some of the events which might trigger the release of source code from escrow.

List and discuss the factors which might lead the Government to seek a Source Code Escrow Agreement with a Publisher.

Describe the typical rights associated with obtaining source code—what are the standard rights and limitations?