

Case Study

Case Study: How a Speech Recognition Software Company Used Escrow Agreements to Maintain Client Confidence During Chapter 11 Bankruptcy

Background

A mid-sized speech recognition software company, VoiceTech Solutions (a fictitious name for privacy reasons), developed AI-driven voice recognition solutions used by healthcare providers, call centers, and enterprise businesses. Despite its innovative technology, the company faced financial difficulties due to increased competition and a costly legal dispute. In an effort to restructure its debts and continue operations, VoiceTech Solutions filed for Chapter 11 bankruptcy protection under the U.S. Bankruptcy Code.

Client Concerns & The Bankruptcy Code's Role

Upon the Chapter 11 filing, enterprise customers of VoiceTech Solutions—many of whom had integrated the software into mission-critical workflows—expressed serious concerns about service continuity, access to updates, and long-term software viability. Clients feared that if the company were to liquidate or be acquired, they would be left without access to critical software updates, security patches, and ongoing technical support.

Under 11 U.S.C. § 365(n) of the Bankruptcy Code, intellectual property (IP) licensees are protected in bankruptcy proceedings, allowing them to continue using licensed software despite the licensor's financial distress. However, this protection does not automatically extend to source code, updates, or support services, leaving enterprise customers vulnerable.

The Role of Software Escrow in Mitigating Risk

To reassure its enterprise clients and maintain business continuity, VoiceTech Solutions implemented an escrow agreement strategy with PRAXIS Technology Escrow. The escrow agreement included:

1. Automated Source Code Deposits – Ensuring all software updates, patches, and versions were stored in escrow in real time.
2. Licensee Beneficiary Rights – Giving enterprise clients the right to access and use the source code if the company ceased operations or failed to meet support obligations.
3. Third-Party Verification – Validating deposits to ensure that the stored source code was complete, functional, and could be compiled and deployed if needed.
4. Release Conditions Triggered by Bankruptcy – Under 365(n), clients had the right to continue using the software, and the escrow agreement provided access to the source code and related documentation if VoiceTech Solutions ceased operations.

How Escrow Agreements Help the Bankruptcy Trustee Fulfill Their Fiduciary Duties

In addition to protecting enterprise customers, the implementation of a software escrow agreement also served the interests of the bankruptcy trustee. The trustee, tasked with maximizing the value of the debtor's estate and ensuring the company's successful reorganization, recognized that source code escrow, SaaS escrow, and software escrow agreements were essential in preserving the company's revenue streams during the restructuring process.

However, most bankruptcy trustees have legal and accounting (LAS) backgrounds rather than technical expertise. They are accustomed to managing tangible assets like real estate and equipment rather than intellectual property (IP). Therefore, educating trustees on the value of software and IP assets is crucial. This includes explaining what escrow is, how it protects IP, and why it is essential in bankruptcy scenarios.

By maintaining client confidence through secure software escrow, the trustee was able to:

- Ensure Continued Revenue – Enterprise customers, reassured by the escrow agreement, continued paying for services rather than terminating contracts.
- Enhance Marketability for Potential Buyers or Investors – A company with secure SaaS escrow protections in place was more attractive to acquirers, making liquidation less likely.
- Reduce Legal Challenges from Clients – With structured escrow agreements, clients had fewer legal grounds to challenge license agreements or demand refunds due to software accessibility concerns.
- Support a Stronger Reorganization Plan – By protecting contractual relationships and ensuring a pathway to sustained operations, escrow agreements played a critical role in the company's recovery strategy.
- Highlight IP as a Revenue-Generating Asset – Trustees, who are financially motivated to sell off valuable assets, needed to understand that IP can be as valuable—if not more—than the hard assets they traditionally rely on for liquidation or revenue recovery.
- Position Technology Escrow as a Best Practice – Demonstrating that tech escrow is an industry standard for protecting software IP in bankruptcy scenarios further strengthened its credibility as a necessary component of a company's restructuring process.

Legal and Business Impact

By implementing source code escrow agreements, VoiceTech Solutions was able to:

- Retain Key Customers – Enterprise clients were reassured that they would not be left stranded if the company failed to exit Chapter 11.
- Support the Restructuring Process – With escrow agreements in place, the company maintained revenue streams from existing clients, strengthening its bankruptcy reorganization plan.
- Improve M&A Prospects – Potential acquirers saw escrow agreements as an asset, making the company more attractive for acquisition rather than liquidation.

Additionally, 11 U.S.C. § 365(c)(2), which limits a debtor's ability to assume or assign certain contracts involving financial accommodations, was considered when structuring the escrow agreements to ensure compliance with bankruptcy court oversight.

Outcome

VoiceTech Solutions successfully restructured under Chapter 11, emerging with a new ownership structure. The software escrow, SaaS escrow, and source code escrow agreements remained in place post-bankruptcy, providing long-term stability for enterprise clients.

This case highlights the critical role of escrow agreements in safeguarding enterprise software investments, particularly when vendors face financial distress. For any business reliant on third-party software, code escrow can provide essential protection against bankruptcy disruptions, acquisitions, or unexpected shutdowns.

Key Takeaways

- Escrow agreements mitigate risks associated with software vendor bankruptcies.
- 365(n) of the Bankruptcy Code protects software licensees, but not always access to source code or updates.
- Well-structured escrow agreements ensure business continuity, protecting enterprise investments in mission-critical applications.
- Escrow agreements help bankruptcy trustees fulfill fiduciary responsibilities by maintaining company revenue and stability.
- Educating trustees on the value of IP as an asset ensures better financial decisions in reorganization efforts.
- Tech escrow is a best practice for protecting IP in bankruptcy scenarios, strengthening customer confidence and financial recovery.

About PRAXIS

At PRAXIS Technology Escrow, we combine innovation with security to protect your most critical software and technology assets. As innovators in the field, PRAXIS offers the most advanced solutions in the industry, ensuring your deposits are always up to date and never lost, thanks to our Automated Escrow™ solution and Infinite Retention Policy™. Providing services worldwide from our U.S. headquarters, we pride ourselves on delivering flexible, tailored escrow agreements that meet each client's unique needs, backed by PRAXIS' unmatched personal service. Our team of experts provides trustworthy and responsive support, ensuring your business continuity is always protected.

PRAXIS Technology Escrow, LLC

(800) 213 9802 / (770) 459 1202
www.praxisescrow.com or info@praxisescrow.com

Thank You

PRAXIS Technology Escrow, LLC

Chris Smith

Founder & CEO