Connected and protected
An interactive guide to data center law for data center providers
Welcome and introduction

Over the last 20 years, the demand for digital data has grown explosively. Data centers now underpin our digital economy, including for corporate IT services, digital media, financial services, mobile computing, social networking and internet access. The legal challenges facing data centers are unique, requiring a distinct blend of specialist legal advice and industry knowledge. Our team of advisors are fully immersed in the sector, not only understanding the legal issues but also having a deep understanding of the data center market.

We work with the owners and operators of data centers, the funders of them, and enterprises that need or use them, providing swift, commercial and cost-effective advice.

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The blend of legal skills and disciplines needed to advise the owners and operators of data centers, or the funders of them, is broad. The advisors in our data center team are not only expert in their respective fields but have a thorough understanding of how the advice that they give in one context (for example, the terms of a MSA or colocation services agreement) can have implications for the operator in another (for example, the likely operational undertakings given in a funding agreement).

We offer strategic, commercial and effective advice, providing a fully comprehensive and integrated solution.
Real estate

There are many factors that can affect the ability to build or operate a data center which affect owners and operators. An early assessment of specific jurisdictional risks should be undertaken as part of any data center strategy to ensure they are consistent with your business’ risk tolerance. Some key points are briefly outlined below.

Location
A combination of legal and commercial considerations affect the potential location of the data center:
- end needs of the data center, such as the need for proximity to customers, business districts or telecommunications hubs or to be located in areas convenient to IT staff. Proximity may be more of an issue for an owner/operator facility than a third party facility.
- political/geographical stability of the region/actual land
- availability and cost of infrastructure including power, water and connectivity
- sustainability and security of the physical location and energy resources
- jurisdictional regulatory, planning, taxation, incentive regimes

Ownership structure
Consideration needs to be given to the speed and ability to build and operate a data center as opposed to acquiring an existing data center which is readily adaptable for use. The basis of the owner or operator occupation will differ between jurisdictions with varying implications:
- freehold/fee simple: the most flexible form of land ownership, but most costly (and sometimes the slowest route to market)
- leasehold: gives ownership for a limited period (though often long terms, with options to renew) and therefore can be an attractive proposition for landlords, subject to extensive restrictions and conditions. On expiry of the lease, all interests revert back to the landlord, including ownership of buildings constructed on the land. Care needs to be taken in negotiating the terms of the lease to ensure the owner/operator (and its financier) has sufficient flexibility in the use and occupation of the land and buildings for the purposes of its operations, that the period of the lease is sufficient to enable full recovery of any capped costs, and that sufficient protections are incorporated into the lease for funders and key customers.
Finance

We have extensive experience in advising on domestic and international real estate finance transactions involving the construction, redevelopment and acquisition of data centers. Clients include the whole range of institutional lenders, private equity lenders and borrowers. Through our work for them, we have developed a deep understanding of each party’s needs and requirements in financing data center transactions and give robust advice on all lending matters including:

- assistance in negotiating term sheets
- negotiating the facility agreement and related security/finance documentation
- preparing and advising on property due diligence
- post completion registrations and formalities

We understand the unique aspects involved in the development, leasing, operation and financing of data centers, and always ensure that the finance documents dovetail with the property management and operational requirements.

“For those investors looking at European alternatives outside the UK – which remains the largest data center market in Europe – there are many options and eager investment agencies.”

Broadgroup

“Brexit and the implementation of GDPR could strongly influence investor decisions.”

Broadgroup

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Commercial and contracting

As a data center owner and operator, your service offerings will include some, or possibly all, depending on where you are positioned in the IT services spectrum, of the following:

- data halls, caged space or racks/cabinets
- power, cooling and humidity control
- physical security
- connectivity/cross connects
- backup/data restoration
- smart/remote hands services
- cloud, managed hosting, including SaaS/IaaS or PaaS

With that in mind, we advocate a straightforward and pragmatic approach to drafting and negotiating your terms with prospective customers that take into account the following key drafting/negotiation considerations:

- restricting liability for outages (power, cooling, humidity, security): customers often require assurance from their data center operators that they are aware of the business norms in this area and that there is huge potential for large claims to be brought against data center operators for loss of business or profits or data arising from outages. What are you clear about your regulatory obligations around data, interception of data or otherwise (see also Privacy & cyber security below)?

- enabling fee variation where power costs (and emissions levies) change significantly: power and carbon emissions costs can change considerably over the terms of a typical data center agreement and your ability to pass on any cost increases periodically is crucial (particularly in long term contracts). Have you considered how changes in these types of costs will be dealt with?

- flexibility and maintenance: it is important to ensure you have flexibility to carry out planned maintenance in your data center (including any equipment used to provide services to customers) and, where required, temporarily reduce the redundancy of infrastructure serving your customer’s rack space in order to allow for upgrades. Have you considered how liability for damage to customer equipment, or outages occurring in such periods of reduced resilience, will be dealt with when maintenance is being carried out?

- smart/remote hands: to what extent are you authorised/required to reset or make changes to your customer’s equipment? Customers often require data center providers to carry out resets and/or changes to their equipment. If you offer such services do your terms sufficiently cover the scope? And to what extent are you willing to accept liability for the actions of your personnel? Should such liability fall within an overall cap on liability, or be ring-fenced?

- backup/data restoration services: it will be important to clearly set out in your terms with customers the scope of the backup/data restoration services. What is the extent/scope of such services? How much liability are you willing to take on as part of the provision of such services? Do you require the opportunity to rectify any data loss prior to financial claims being made by customers?

- are you providing more than co-location space?: In addition to the provision of co-location/rack space to customers, some data center operators also provide a range of other commercial offerings (for example connectivity and installation services, office and de-boxing facilities). The terms applicable to these services will need to be carefully considered. Areas to think about will be your approach to service levels, service credits and liability, security and recoverable losses

- are you clear about your regulatory obligations around protection of and/access to data and how they should be dealt with in your contracts with your customers, including in relation to data privacy and protection of data, fair use of data, interception of data or otherwise (see also Privacy & cyber security below)?

- customer obligations: have you ensured your customers have the rights they need to utilise the data center in the way they wish to, for example in relation to any software usage or other commercial offerings (for example connectivity and cloud: For detailed cloud considerations and recommended approaches to contracting, please visit our global cloud study

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Privacy & cyber security

An understanding of the application of privacy laws is crucial for data center owners and operators. Although at the most basic service provision you may only be providing the physical infrastructure in which your customers locate servers, those servers may be processing and storing personal information or PII which is otherwise under the control of your customers. The laws applying to your customer therefore – in their home jurisdiction as well as yours – often determine your customers’ – and prospective customers’ – demand for security, resilience, space and power capacity in their data centers, and will often explain their approach to contracting.

For European customers, for example, this means the introduction of the new General Data Protection Regulation (GDPR) is often one of the first topics raised. In the US, laws such as the Health Insurance Portability and Accountability Act (HIPAA) or the Gramm-Leach-Bliley Act (GLB), as well as the laws of individual states, are often driving factors in a customer’s technology and security needs and what they expect from a data center owner and operator. If customers accept card payments, then a data center’s ability to comply with the Payment Card Industry (PCI) Data Security Standards is of utmost importance.

Processing of personal information relates to any activity that touches that information, including simply storing it. Where “processing” is taking place, non-compliant practices (which may be determined by the local law of the customer) can give rise to material liability, and so key issues that will influence your prospective customers’ buying decisions are:

- **location**: many countries have restrictions on whether data can be stored, transferred or accessed outside of their jurisdiction, with separate rules applying if it does. Data centers within the European Economic Area - and those on the “white list” of countries deemed to have adequate safeguards in place from the European Commission - prove increasingly attractive for European customers and those with similar laws. US operators may want to consider the new EU-US Privacy Shield, or have proactive solutions to customers concerned with such issues.

- **physical security**: the security requirements for customer data varies from country to country, but the general trend is that requirements are getting stricter, and customers are looking for audit rights and breach notifications. This is consolidated by the changes made in Europe under the GDPR. Informed customers will expect comfort in this regard, including in relation to government/third party access, to ensure that they are not in breach of their legal obligations across multiple jurisdictions.

Operators of data centers can use their position in relation to these privacy issues as a real differentiator in a market that is being increasingly driven by customer concerns.

“While data breaches continue to garner the majority of security-related headlines, security has become a data center availability issue as well. The 2016 Ponemon Institute Cost of Data Center Outages study revealed that cyber-attacks accounted for 22 percent of the data center outages studied.”

Vertiv

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Construction

When procuring the construction of a new data center facility, you should consider:

**Procurings the design and construction team**

Appointments of the design and construction team should address:

- **programme certainty:** ensuring that space is available for occupation when required, providing for phased occupation where appropriate
- **clarity of cost:** choosing an appropriate pricing mechanism, which delivers the required level of cost certainty, whether that be fixed price or target cost
- **quality:** required standards of delivery and performance should be clearly set out in the construction documents, and you should retain appropriate inspection and testing and commissioning rights to ensure quality is maintained
- **flexibility:** a structured regime to allow for changes in requirements during the construction phase, whether driven by your choice, changing circumstances or your customers’ requirements
- **security for performance:** appropriate security should be provided by each member of the team through appropriate use of parent company guarantees, performance bonds and professional indemnity insurance for those undertaking professional and design services

**Securing relevant equipment**

A key element of the development will be the design, supply and installation of mechanical and electrical equipment. Often this equipment will have a long lead time. To ensure delivery, these need to be identified early, and secured advanced orders placed with the right to transfer to your construction team when appointed

**Interface with utility providers**

Your arrangements with utility providers (in particular power and telecoms) will be critical to delivery of the data center. You will need to engage early with these providers, and clearly allocate responsibility between you and your design and construction team for their management and performance, also bearing in mind third party consents that those providers may require

**Rights for relevant third parties**

The needs of third parties, including customers, funders and purchasers need to be considered and addressed (and any prospective third parties), and the hierarchy of the rights enjoyed by them anticipated in preparing the construction contracts

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Energy

Reducing costs of supply, ensuring security of supply and improving green credentials.

Even the most efficient data centers consume massive amounts of electricity, making energy-related strategic decisions key to successful development and operation. Interconnecting with the local grid and procuring electric service at the most advantageous rates, including any economic development incentives, requires in-depth knowledge of the applicable regulatory framework and practical experience in the relevant energy markets. Mission critical tier IV and tier III facilities requiring full or partial redundancy often must develop additional onsite generation facilities to support continued operations in case of a blackout, introducing owners and operators to a host of additional risks and requirements. In some jurisdictions energy services management agreements with either the local utility or a third party may be possible to enable the maximization when using both onsite and grid resources. Financial energy hedging arrangements also may help reduce the exposure to energy market volatility for long-lived assets.

In determining available energy options and managing the operational and transactional risk inherent to the process, owners and operators should carefully consider the energy market structure, access to renewable energy, rate classes and economic incentives (where applicable), independent power producers experienced in the region and any major hurdles to economic incentives, regulatory framework and practical experience in the relevant energy markets. Mission critical tier IV and tier III facilities requiring full or partial redundancy often must develop additional onsite generation facilities to support continued operations in case of a blackout, introducing owners and operators to a host of additional risks and requirements. In some jurisdictions energy services management agreements with either the local utility or a third party may be possible to enable the maximization when using both onsite and grid resources. Financial energy hedging arrangements also may help reduce the exposure to energy market volatility for long-lived assets.

In determining available energy options and managing the operational and transactional risk inherent to the process, owners and operators should carefully consider the energy market structure, access to renewable energy, rate classes and economic incentives (where applicable), independent power producers experienced in the region and any major hurdles to energy project development (whether for wholesale purchases or onsite production), the proximity of both electric and gas infrastructure, and the local regulatory perspective on major utilities and large customers. Agreements should be drafted with the overall energy strategy in mind so that risks are appropriately covered off by credit-worthy counterparties through adequate insurance, performance guarantees and indemnification provisions.

In addition, the PUE of data centers and other IT industry participants, as well as the Green Energy Coefficient, Energy Reuse Factor, Carbon Usage Effectiveness and other metrics, are closely monitored and publicized by environmental NGOs such as Greenpeace, requiring careful consideration of public statements on renewable energy procurements and overall operational sustainability.

We have experience of the following structures and issues arising from the procurement of and use of energy that should be considered at the outset of any data center project:

- **security of supply**: to mitigate against grid outages - having firm connections, multiple grid connections and/or onsite emergency generators and/or batteries
- **green credentials**: in the form of renewable forms of energy supply. In addition, in the US we advise companies on all outward facing statements and other marketing materials regarding the use of renewable energy to ensure compliance with guidelines on potentially deceptive claims and responding to inquiries from environmental NGOs.

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As the data center industry has grown over the last 10 years it has also become an extremely large consumer of energy (consuming about 3% of the global energy supply). By 2020, carbon emissions from data centers are predicted to be higher than carbon emissions from the airline industry. As high energy users data centers are coming under increasing pressure to reduce their emissions.

Governments around the world will not be able to meet their climate change commitments unless this issue is addressed. But equally demand for the services offered by data centers has never been higher and one can only see this increasing as end-customers increasingly adopt IoT (Internet of things) technologies. Data center owners and operators should become familiar with how climate policy in the relevant jurisdictions is evolving and may impact present and future operations. Any data center operators which have not entered into climate change agreements should consider the benefits of doing so.

Environmental permitting and compliance considerations vary by jurisdiction, as will the critical path items to be addressed in the applicable construction and service level agreements. Each will be subject to their own environmental permitting risks to be anticipated, which must be properly addressed in the applicable construction and service level contracts.

- those data center operators with leasehold premises in the UK need to be mindful of the Energy Efficiency (Private Rented Property) (England and Wales) Regulation 2015 (known as the “MEES Regulations”). From 1st April 2018; property can only be let if the energy performance certificate for the premises is of a certain standard. This requirement applies to existing lettings from 1 April 2023.

- data centers using diesel- or gas-fired generation to maintain reliable backup power must anticipate jurisdictional variation in costs, regulatory timelines and risk of delay associated with air permitting requirements. Because the power and environmental profiles of generation units can vary widely, owners often test multiple units during the design phase. The permitting for generator testing can often take longer than expected, and is in addition to final permits for construction and operation.

- data centers, often rely on third parties and other service providers to construct infrastructure to serve the facility. These might include electric transmission lines and substations, as well as potable water and wastewater services. Each will be subject to their own environmental permitting risks to be anticipated, which must be properly addressed in the applicable construction and service level contracts.

- energy efficiency: irrespective of the legal requirements, the cost of energy means it is now common place for data centers to strive to become more energy efficient. This may involve upgrading older components to more power efficient components. Increasingly, there is a focus on renewable energy including solar power. However, there have been difficulties in finding suitable geographical locations that will service the needs of the data center. Location; energy considerations are now driving the location of new data centers and we are seeing colder parts of the world looking more attractive since the majority of the energy consumed is used to keep the equipment cool.
Telecommunications

Are you providing “additional services”? 

In addition to the provision of rack space and the core infrastructure services in a data center, service provision can also include a range of different additional services that may be subject to additional regulation, such as the provision of:

- internet connectivity
- leasing of cables or lines
- rooftop licences for transmitter equipment

There are a number of implications arising from the provision of such services and/or permitting third party operators to connect to your data center:

- reselling additional services: as an operator, you need to be aware that the reselling of internet connectivity and other communications services, as well as the use of transmitter equipment, is likely to be a regulated activity that may require licensing and compliance with local requirements. Do you provide such services to your customers or are they required to enter into separate agreements with third party providers?

- installation of transmitter equipment: if you would like to permit customers to use or install wireless equipment on your roof or in your data center, it is important to understand the frequency at which the customer proposes to transmit. You should also check that the customer has a licence to use that frequency and equipment, or that the frequency or type of equipment has been exempted under applicable law. This due diligence is important before permitting a customer to place wireless equipment on your building as, in some jurisdictions, the owners or operators of the building could be found liable if breaches occur.

- rights of Telecommunications Providers: as an operator, enabling connectivity to your data center will almost always require you to permit access from a third party telecommunications provider. Some of these providers have a special regulatory status which grants them rights to keep their equipment on your premises beyond the period you may intend for them to be on site. Before enabling such connectivity to be installed at your data center, it will be important to establish whether the third party holds such powers and incorporate appropriate contractual provisions to mitigate the effects of such powers being used. This may have additional implications for you where your data center is leasehold, given the covenants that you may have given as tenant under that lease.

We have an experienced Telecoms team (a number of whom have worked in-house for telecoms providers) who understand the regulatory landscape. They can offer pragmatic and commercial advice on the terms you will need to put in place when providing and entering into arrangements with providers of such additional services.
Corporate

No matter where you are on your strategic business plan, we are able to advise you on all aspects of your data center business including:

Corporate finance

Do you have enough capital in order to scale up your operations? Whether through institutional debt finance or equity funding, investment in data center businesses is capital intensive. However, the good news is that the understanding of the data centers sector is maturing in both the debt and equity markets, and so access to capital is easier now than it was just a few years ago. To ensure you get the right investment for your business as swiftly and cost effectively as possible, without hampering your ability to operate your business and remain flexible in your dealings with customers, you will need to get advice you can trust from both your corporate finance advisers as well as your legal team.

Acquisitions

There are many considerations when looking to grow your business by acquisition rather than organically. All the elements in this guide will be relevant in one way or another when acquiring a data center business, and whether the target is in one of the usual tier 1 data center markets, or elsewhere in the world, our global reach means that we can assemble the right team with the right skills to handle your acquisition.

Realisation events

Whether you are looking to restructure and sell off non-core assets or to fully exit to trade, investors or equity capital markets, you will want to deal on the right terms for you. Often the best way to generate or extract value is to identify and leverage strategic goals; whether your own, those of the market or those of a key counterparty. Identifying underperforming business units may drive disposal activity. Identifying integration, harmonisation and economy of scale risks and opportunities are typical considerations when positioning the broader business for exit.

Corporate governance considerations for data center businesses

Company directors have various legal duties and obligations. Directors in many jurisdictions are required to act in the best interests of the company, its shareholders, creditors and staff. For any company engaged in data center operations, the board will particularly want to satisfy itself that it has robust policies and procedures in place regarding information security, data sovereignty, combatting bribery and corruption and regulatory compliance, not least due to the regulatory structures that are often imposed via your customer contracts.

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Businesses that operate across borders have always had to contend with intricate and wildly differing tax systems. In today’s global economy, tax authority scrutiny of the cross-border arrangements between data center operators and their customers and extraterritorial tax and disclosure obligations has increased dramatically. Our tax group is on hand to help you navigate this complex web of laws.

Our lawyers will assist in reducing unnecessary tax leakage and preventing or mitigating tax controversy across the jurisdictions in which you operate.

**Data center operators should be aware of the following:**

- many jurisdictions offer tax and other incentives which can be very relevant. Tax authorities want to ensure their tax systems remain competitive to international businesses, with differing headline corporate tax rates, “patent box” regimes for qualifying intellectual property and participation exemptions for dividend payments and on share disposals. Thin capitalisation and transfer pricing agreements can also be negotiated with tax authorities to ensure deductibility of finance costs for tax purposes. The complexity is increased by the double tax treaty network, with some countries providing different benefits and protections within their treaties. Incentives and tax exemptions may also be available for employment taxation, setup costs, purchase of qualifying IT equipment and capital investment.

- data centers require significant capital expenditure on equipment. The equipment installed may qualify for tax depreciation allowances, and the availability of such allowances and how they are maximised should be verified and any transaction documentation entered into should be consistent with this.

- the supply of services to customers must also be analysed correctly to ensure appropriate VAT/sales tax registrations are made, particularly where there are inter-jurisdictional supplies. Contractual documentation should correctly reflect the agreed VAT/sales tax position. Tax withholdings on payments should also be identified and addressed in contractual documentation wherever possible. Data center operators also need to consider real estate taxes such as stamp duties when they acquire a site for a data center operation.

Our legal skills and joined-up approach with our cross-disciplinary team enable us to ensure your tax strategy is implemented and documented correctly. In our experience, this is crucial to the success of all tax planning.
If your customer is regulated by a financial services regulatory body or subject to regulatory or industry regimes such as payment card industry (PCI) rules, the Statement on Standards for Attestation Engagements (SSAE) No. 16 and The International Standard on Assurance Engagements (ISAE) No. 3402, they may take a view that those regulations are applicable to the services being provided by you to the customer, even where those services are in the nature of “infrastructure” services (e.g., power, cooling, humidity control and security). Therefore they are likely to request that certain provisions are included in your data center services agreement or lease to address those regulatory obligations.

Key drafting/negotiation considerations:

- Impacts of default: consider what the impact could be on the business of a customer if there is a default in relation to the data center services, as the resulting losses can be significant and the customer will look to pass those losses onto its data center operator. For example, a failure of the premises’ power or cooling system, or a breach of security could impair the compliance of a regulated customer with its obligations under the applicable regulatory regime.

- Knowledge of regulatory requirements: it is important to be aware of the typical provisions that a financial services regulated customer may wish to be inserted into its data center services agreement. This could include requirements in regard to audit and access, security, oversight and continuity and business planning. You must be able to respond to those requests in a way that acknowledges the regulatory constraints that the customer must operate under. However, you must also ensure that the regulations are not “gold-plated” when being applied to the data center terms and resist changes that go over and above what the regulations require, and that the customer meets your costs of compliance with their regulatory regime to the extent that, for example, the frequency of audits exceeds those that you would typically offer to your customers.

- Changes in regulatory requirements: your regulated customers are likely to also seek your adherence to future changes in the regulatory regime that applies to their operations in their data center (including a right to terminate the relevant services agreement or lease where you are unable or unwilling to do so). You should consider the financial implication of this, not only in the context of the return on your capex in fitting out the relevant data hall for that customer, but also the implications for any banking covenants that you may have given to fund your business.

We have a deep understanding of the regulatory rules applicable to the data center sector, and so can lead you through where adherence to these rules is critical to the customer and so must be passed on to you as the operator, and where the risk of compliance should legitimately remain with the customer. We can advise you on the provisions that a regulated customer may request to be inserted into your data center services agreement and whether such provisions are appropriate.
Dispute resolution

Having specialist legal advisors that understand the data centers sector ensures that, when dealing with disputes with contractors, suppliers or customers, there is no wasted time or effort in educating those advisors about the context in which the dispute has arisen. This can be critical to mitigating losses, and also ensuring that customer relationships are not damaged.

Three examples of where commercial disputes can arise are listed below. Considering these sorts of issues at the outset should allow you to reduce risk, avoid the issue altogether or manage it to best effect:

- **outages**: outages can have significant financial implications for customers and they will likely seek recompense. Operators may be exposed to such claims, depending on their obligations, including support and maintenance, and their exclusions and limitations of liability. Do you have the protections you need?

- **power**: power is a key cost to the operator and the customer. Ambiguity, in terms of how usage is priced, charged to the customer and reviewed, can lead to significant disputes. Moreover, this may not just affect one customer but the entire customer base and across multiple locations. The full scale of the issue can therefore be significant. Are your terms clear?

- **data and system security breaches**: the financial and reputational impacts of a breach can be huge for customers. These include business interruption, loss of confidential corporate data, remedial costs and compensation. Group litigation from customers is on the rise. Assessing the extent of your potential exposure to customers’ commercial claims and the protections you need is therefore critical.

For more information please contact:

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