

IN THE SPOTLIGHT

A Practical Guide To Negotiating Data Center Leases

By Aaron L. Pawlitz

Leases of real property are rarely good candidates for a one-size-fits-all approach. Although people have been leasing real property for centuries, the proposed uses of that property, the requirements of lenders who finance the acquisition and operation of that real property — and the negotiating techniques of landlords and tenants — change from year to year. Avoiding a one-size-fits-all approach is especially critical when attorneys are preparing or reviewing leases of real property that will include space that will be used as a data center.

DATA CENTERS

Data centers are, roughly stated, space in which computer network hardware and the equipment that supports that hardware are located. This hardware and equipment often includes storage hardware, telecommunications equipment, power supplies, and environmental controls (such as cooling equipment). Because the operation of the data room might be critical to the tenant's business and because the information stored on the servers might be sensitive [including that access and use of such information might be regulated by law (such as HIPAA)], a data center often houses security equipment designed, *inter alia*, to record and limit access to the data center. Data centers often also include redundant systems such as back-up storage capabilities, back-up data communications equipment, and back-up power supplies.

Data centers range in size from a small

Aaron L. Pawlitz is a Member in the St. Louis office of Lewis, Rice & Fingersh, L.C. Since 2005, he has been the primary U.S. real estate counsel to an international data services provider for whom he has negotiated agreements regarding the construction, leasing, operation, improvement, and disposition of data center space. He also counsels clients on other real estate transactions, tax-exempt and bond finance, mergers and acquisitions, and corporate law.

“server closet” to more than 500,000 square feet of space within one building. Data centers might be part of a multi-use building (such as where a tenant has office, warehouse, and data center uses all under the same lease and within the same building) or might be the only use within a single-tenant building. Common themes prevail no matter the size of the data center, however. The requirements for each data center appear straightforward:

- Continuous power;
- Continuous connectivity;
- Continuous access for operating personnel;
- Appropriate security;
- Controlled temperatures; and
- Controlled humidity.

POTENTIAL TENANTS

Potential tenants that desire to lease data center space not only must locate space that satisfies the elements listed above, but also must obtain and populate that space with a data center's equipment. That equipment can be expensive and will be tied into some of the leased building's most critical systems (such as power and communications utilities and the cooling, plumbing, and security systems). Moving in and out of data center space is not as simple as a typical move from one office space to another, for the data center equipment must be taken “offline,” moved into new space, and reconfigured. Furthermore, the restoration obligations for space from which a tenant is departing might be particularly burdensome if the existing lease requires the departing tenant to return the data center space to a configuration suitable for typical office use or to remove wires, cables, and other data-center-related improvements. Also, because a data center's redundancy resources might be located at a different site, a data center tenant needs to coordinate its lease of a data center site with its lease of the site for the redundant resources (for instance, some thought must be given to when the terms of both such leases expire).

LANDLORDS

Landlords also face risks when considering entering into data center leases. If a landlord fails to account for the heavy utility load that will be placed upon its building or fails to

obtain competent engineering counsel to assist with evaluating tenant proposals for alterations or expansions, the landlord might become overwhelmed with the technical aspects of the data center operation. Also, if the landlord fails to appreciate fully the critical nature of the data center to its tenant and to apply commensurate diligence when negotiating the lease, the landlord might expose itself to enormous liability. Among other covenants that a landlord might breach that might result in such liability are those covenants related to maintenance, repair, and replacement or to securing the premises.

For all these reasons, a lease of data center space should not be entered into lightly by landlords or by tenants. Properly negotiating a lease of data center space requires a data-center-specific focus on almost every provision within the lease.

THE LEASED PREMISES AND APPURTENANT RIGHTS

The parties must identify not only the floor space necessary for the tenant's data center, but also appurtenant rights that will be needed to support the data center (such as rights related to rooftop access, satellite and other communications equipment, cabling, access to the building's HVAC systems or cold water “chiller” systems, installing back-up generators, and storing fuel for those generators).

The Lease Term

Due to the substantial investment the tenant likely is making in the data center, it is common for tenants to request multiple options to extend the initial lease term for multi-year periods. The parties also should select realistic notice periods related to the exercise of an option or termination of the lease on account of the substantial work that might be required to remove a large data center or to comply with the lease's restoration provisions.

Initial Improvement Obligations

The landlord and tenant should reach agreement regarding the tenant's plans for initially improving the data center space, installing the data center equipment, and arranging and improving all appurtenant areas (such as the roof) prior to executing the lease. The parties should not leave such critical issues to a post-signing review and

approval process. The approved plan for these initial improvements also should address the coordination of equipment delivery and installation and the supervision and input rights of the landlord's technical advisers.

Future Alterations

Each discussion of improvements or alterations (including the discussion of initial improvements) must address which party is deemed the owner of the data center improvements and whether the tenant will be required to remove them at the conclusion of the lease term. The parties also should reach agreement on whether updating equipment will be deemed an "alteration" for which the landlord's review and consent is required.

Permitted Uses

The parties should expressly list the data center and all the appurtenant right uses (such as rooftop satellite dish or underground back-up generator) as permitted uses. The parties also clearly should address the proposed data center equipment in light of typical overloading prohibitions, and the landlord should consider any effect the vibrating equipment might have on adjacent tenants.

Security and Privacy-Related Obligations

The parties will need to balance the tenant's need to control access to the data room with the landlord's desire to inspect and observe the operation of the leased premises. The tenant might need a range of parties to access the data center, including engineers, architects, and other consultants, and these parties might need to perform inspections or other work with respect to the data center outside normal business hours. The landlord should consider whether these parties entering upon the premises and working during such hours will impermissibly disturb other tenants. Both parties should be vigilant about compliance with law as to privacy matters and how their respective indemnifications are drafted with respect to potential violations of such law. Apart from the indemnification clauses, the parties should consider placing other affirmative confidentiality related obligations upon each other.

Operating Expenses

The use of all or a portion of the leased premises as a data center will certainly impact operating expenses. The parties should consider segregating certain operating expenses that arise directly from the presence and operation of the data center (such as increased security personnel, increased electricity usage, and more frequent HVAC system maintenance or repairs).

Alternative Electricity Sources

If the tenant's data center operation is substantial enough, the tenant might consider purchasing electricity from an electricity source other than the local electrical utility. If this occurs, that alternative electricity provider, the tenant, and the landlord might need to

coordinate the delivery of electricity from that alternative electricity provider to the leased premises. The parties should consider such matters in advance of signing the lease and should agree on a procedure for managing such situations. The operating expense provisions also should account for the fact that the tenant might obtain its electricity in this manner.

Maintenance, Repair, and Replacement Obligations

Because the operation of a typical data center requires an intimate connection with the landlord's building's systems, the parties must diligently consider and precisely define where the landlord's maintenance, repair, and replacement obligations end and where the tenant's maintenance, repair, and replacement obligations begin. A typical construction (though not one I recommend) of maintenance, repair, and replacement obligations allocates responsibility for "the building's exterior, structural portions (including the roof), and systems" to the landlord and allocates responsibility for the leased premises to the tenant. Such a construction could lead to substantial disputes about whether the tenant has the authority to perform certain repairs to data-center-related appliances that are closely tied to the "building's systems" or about why the landlord has not maintained certain plumbing-related equipment within the leased premises that the landlord has determined is a portion of the data center equipment rather than a part of the building's "systems." In single-tenant buildings where the tenant bears all maintenance, repair, and replacement obligations, the likelihood of these disputes might be diminished. Nonetheless, in all cases, attorneys counseling data center landlords or tenants regarding a proposed lease must focus upon the allocation of the maintenance, repair, and replacement obligations.

TENANT'S RIGHTS UPON A LANDLORD DEFAULT

A tenant should demand a self-help right that arises if the landlord fails to perform its obligations under the lease. This right should arise more quickly in the case of an emergency, and the parties should devote appropriate effort to accurately defining an "emergency." The tenant and landlord also must consider and account for the requirements of the landlord's lenders related to default notices, cure periods, and remedies. For this reason, the parties should consider attaching a form of Subordination, Non-Disturbance, and Attornment Agreement to the lease rather than leaving the negotiation of the topics typically covered in such an agreement to the future.

Casualty

In the event of a casualty, a data center tenant might need the landlord to act quickly when determining whether the landlord will restore the building, and when ultimately restoring

the building. Or, if the tenant has sufficient redundant resources at another location, the tenant might prefer that the casualty provision provide the tenant a termination right.

Indemnification

A tenant with critical data center operations at a leased premises will desire to have strong indemnification protections with corresponding insurance obligations for the landlord. A landlord with a data center tenant should attempt to minimize its exposure to liability resulting from any interruption to the tenant's data center-dependent operations, not only by vigorously negotiating the primary obligation provisions of the lease, but also by diligently crafting the landlord's indemnification obligations. The parties should consider the availability of business interruption insurance, and also should deliberately craft a process by which certain delays or failures might be deemed to have been caused by *force majeure*.

LIMITATION OF LANDLORD'S LIABILITY

Many landlords require a tenant to agree to strict limitations on the landlord's liability by describing the substantive matters for which the landlord may not be held liable (such as lost profits or other consequential damages) and by limiting the pool of assets from which any liability might be satisfied (such as the landlord's interest in the building in which the leased premises is located). Due to the high stakes of many data center operations, these provisions are likely to be hotly negotiated between landlords and tenants.

ASSIGNMENT/SUBLEASE

Tenants should attempt to obtain substantial flexibility to assign their rights and obligations under the lease or to sublease all or a portion of the leased premises to another party. Another party might find the current tenant's existing data center relationship with the landlord appealing. Landlords should attempt to retain the right to a typical review of the proposed transferee's financial wherewithal and should attempt to obtain a right to recapture the leased premises if the tenant desires to assign the lease or sublease all or a portion of the premises.

CONCLUSION

Data center leases are not appropriate for a one-size-fits-all lease form. Both parties should carefully consider the provisions discussed above to avoid problems that would otherwise arise.

