

Factors To Consider When Structuring Data Center Contracts

By **Emily Naughton, Whitney Smith and Sarah Mernin** (August 17, 2023, 1:04 PM EDT)

Data-intensive applications, remote working and learning, cloud migration, and the rise of artificial intelligence, among other technologies, have led to a surge in demand for data center capacity.

As the data center industry continues to evolve, providers of data center services and customers have become increasingly sophisticated in their contracting practices.

Throughout this evolution, data center customers have contracted with providers for data center space and services using one of two key contracting structures: (1) the lease or (2) the services agreement.

In many instances, data center leases and services agreements grant very similar rights and impose similar obligations on the parties entering into them; however, there are notable differences between the two structures, as well as a range of factors that are important for any data center provider and customer to consider when selecting which form of data center agreement to use.

Factors To Consider

Whether to use a lease or a services agreement should be considered on a case-by-case basis. The analysis should weigh multiple factors, of which no one factor is determinative.

Among the key factors to consider include whether the customer will have exclusive rights to particular data center space, the legal protections sought by the parties with respect to the data center space, the size of the data center deployment, the extent of the services being provided, and whether the data center agreement will be global or site-specific in nature.

A brief overview of each of these factors is set forth below.

Rights to Physical Space

Under a lease, a data center provider grants a customer an exclusive right of possession to certain space at a data center facility; whereas, under a services agreement, the data center provider typically grants the customer a license to use data center space.



Emily Naughton



Whitney Smith



Sarah Mernin

In analyzing this factor, key considerations include whether the customer's equipment will be located in a data center space that is shared with other customers, and the extent to which the data center provider's access to the particular data center space will be restricted.

Legal Protections

The customer under a lease, as a tenant with a property interest to space within the data center, i.e., a leasehold interest, generally has more legal protections to the particular data center space as a matter of law than a customer under a services agreement.

In most jurisdictions in the U.S., tenants have rights that are protected by statute, including processes that must be followed by the landlord before the tenant can be evicted and certain remedies in the event the premises are damaged because of a casualty, among other rights.

Additionally, absent an express contractual agreement to the contrary, tenants generally enjoy priority over future mortgages that may be placed on the data center property, i.e., future lenders must recognize the lease in the event of a foreclosure.

In contrast, customers under a services agreement typically have no or very limited statutory protections with respect to its use of the data center space.

We caution, however, that the parties' characterization of a particular agreement as a lease or a services agreement is not dispositive — the express language of the data center agreement will ultimately determine the rights granted to, and obligations imposed upon, the parties.

Size of Deployment

Historically, large deployments, e.g., those measured in megawatts and consisting of entire data halls or a building, tended to be structured as leases and small deployments, e.g., those measured in kilowatts and consisting of cabinets, used the services agreement structure.

However, the size of the particular deployment is no longer a definitive factor in determining whether a data center agreement will be structured as a lease or a services agreement, with many large full building deployments currently being structured as services agreements.

Nonetheless, the size of the deployment tends to correlate to other factors — for example, a customer with a large data center deployment is more likely to require exclusive rights of possession to the particular data center space and to desire to restrict the provider's right to access the particular space — characteristics of a lease.

Extent of Services

Both a lease and services agreement can cover a variety of services, including the provision of critical power, maintenance of the data center environment (most notably, temperature and humidity), physical security and, in some instances, remote hands and other services.

If a provider will furnish only limited operational services to the customer at a particular facility, the scales may weigh in favor of using a lease. However, this is again not dispositive since data center leases

can also include the same variety of services covered by a services agreement.

It is worth noting that where a provider furnishes key operational services to the customer at the particular facility, i.e., power, maintenance of environment and security, the lease or services agreement may include a service level agreement.

The service level agreement sets forth the key performance metrics that the provider must meet during the term of the agreement and includes the remedies available to the customer in the event the provider fails to meet those metrics.

Typically, these remedies take the form of a credit against the customer's monthly fees or rent and, in certain instances, may include a limited termination right for chronic failures.

Global or Site-Specific

Leases are by nature site-specific agreements, i.e., they relate to specific real property, whereas a services agreement can be either site-specific or global in nature.

Services agreements in the data center industry commonly consist of a master agreement that may, in certain instances, set forth the terms and conditions that will apply to the contracting parties' relationship over multiple geographic locations and deals.

A master services agreement can streamline the contract negotiation process between the provider and customer by establishing the general terms and conditions of the current and future data center deals between the parties.

The customer and the provider may then enter into site-specific orders incorporating the key commercial terms of each specific deal and the terms and conditions of the master agreement, thus removing the need for the parties to engage in extensive renegotiation on every data center deployment.

The parties should take great care when using a master services agreement structure, however, to ensure that the master agreement structure is properly drafted to avoid creating a potential for cross-default or cross-termination across orders for different data center facilities, and unintended transferability issues.

Emily Naughton is a partner, and Whitney Smith and Sarah Mernin are associates, at Mayer Brown LLP.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.