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Behind the Cloud Negotiating Data Center and Communications Contracts

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INTRODUCTION¹

Cloud and mobile computing, together with “big data,” is fast becoming the new ecosystem for enterprise and small business communications, rapidly displacing the traditional premises-based models of computer processing and information delivery. But deploying cloud solutions still requires heavy reliance on infrastructure – data centers and fiber networks – to push that data to end users and mobile devices.

For telecom attorneys and other professionals, however, the negotiation and drafting of data center contracts presents different -and often unfamiliar - issues and concepts more akin to commercial real estate transactions than to buying and selling traditional telephone and data services. Fiber optic contracts, on the other hand, those provided under so-called “IRUs,” first emerged on the telecom scene in the early 1990’s, and have evolved along with advanced photonic technologies such as wavelength-division multiplexing (“WDM”). Following the burst of the Internet bubble, the spectre of telecom bankruptcies presented a new - and often unforeseen - dimension to these transactions, especially the protection of infrastructure rights when the provider is distressed. Taken together, this conceptual framework underlying data center and fiber optic transactions is thus arcane, multi-disciplinary, and obviously complex. It becomes even more so when the data center is located abroad - and the transaction involves cross-border jurisdictions and application of foreign (as well as U.S.) laws.

In addition, the focus on cloud computing has brought with it a host of new and renewed requirements to protect consumers’ privacy, imposed by law, regulation and consumers’ expectations. Compliance with privacy laws is thus becoming increasingly important for the practitioner when dealing with broadband and telecommunications contracts.

To assist the practitioner, the following is a compendium of publications from our Firm on these complex topics, including materials presented at tele-briefings sponsored by Law Seminars International. They include “nuts and bolts” discussions and practice pointers, largely based on our transactional experience, that we hope you find useful. For more information, please do not hesitate to contact us.

¹ THE FOLLOWING MATERIALS ARE PROVIDED TO CLIENTS & FRIENDS OF SAPRONOV & ASSOCIATES, P.C. FOR TUTORIAL PURPOSES ONLY AND ARE NOT TO BE CONSTRUED AS A LEGAL OPINION OR LEGAL ADVICE. PLEASE CONTACT US AT (770) 399-9100 OR AT info@wstelecomlaw.com IF YOU HAVE SPECIFIC QUESTIONS.

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Negotiating Infrastructure Contracts
(Part I: Data Centers)¹

May 12, 2011

According to industry studies,² infrastructure companies – those providing data centers and fiber networks – are once again in vogue. For the first time since the “Internet bubble” of the 1990’s, private equity and strategic investors are looking at telecom targets. This time their interest is on those companies that own either data centers or fiber networks; in other words, companies that own the pipes that deliver broadband data or the facilities that store it. Both traditional providers (AT&T, Verizon, Level 3, AboveNet) and relatively new ones (Equinix, Fibertech, Zayo) are all players. Increasingly, there are roll-ups (Centurylink, Savvis) as infrastructure companies consolidate. Meanwhile, commercial infrastructure transactions are likely increasing.

This is unsurprising. The explosive growth of broadband Internet, cloud computing, smart mobile devices, and video has brought new demand for the infrastructure supporting both broadband traffic and its storage. The providers of data centers and fiber networks are becoming major players in this new broadband marketplace – one that includes infrastructure providers, customers, and “middlemen” (*e.g.*, a data center lessee that subleases the rights to use the space to third parties).

This nuts-and-bolts discussion (the first of two) is about data center contract negotiation. (The second will discuss fiber network contracts.) Here is an overview of how these transactions work and some of the key deal points to watch for in negotiations.

¹ This discussion, while accurate to the best of our knowledge, is provided on a complimentary basis to clients and friends of Sapronov & Associates, P.C. for tutorial purposes only and is not to be construed as a legal opinion or legal advice. Please contact us at 770-399-9100 or 202-223-0646 or at info@wstelecomlaw.com if you have specific questions about this alert – or if you wish to be removed from our mailing list.

² C. Nolter, “Moving and Storage,” *The Deal Magazine*, January 21, 2011.

1. What's in the Data Center?

To ensure that the data center becomes the content provider's fortress, in much the way a man's home is his castle, a data center must have all the comforts of, well, a data center: adequate space, environmental controls, ample power supply, *etc.* It is thus axiomatic that a content provider housing its database at a data center - and using Internet, or extranet service to deliver it - must be assured that its rights to the data center and the services to be provided are protected. This requires physical preparation, of course, along with assurances of (among other things) building access, diversity, carrier connections (multiple), uninterrupted power supply, security controls, and - when emergency strikes - a quick means of moving elsewhere. To ensure all this (and much more), a well-drafted data center contract is of utmost importance to the provider.

2. Data Centers: Commercial Leases by any Other Name?

A data center contract is, by its nature, a commercial lease. Whether it is a true leasehold interest, or a mere license or usufruct, is a matter of negotiation. But however characterized (*e.g.*, collocation, space license, "services agreement"), the agreement necessarily addresses the use, occupancy and other rights of a "tenant" (here the data center provider) to space in a commercial building. That tenant will then sublease, sublicense, or otherwise make the data center facility available to its retail customers (*e.g.*, content providers). Long familiar to real estate practitioners, these agreements involve deal points customarily raised in commercial lease negotiations.

The negotiation is to some extent controlled by well-established property laws and to some extent by local custom. For example, negotiation of a data center agreement in Manhattan will differ from one in, say, London. For the practitioner charged with drafting data center contracts in unfamiliar jurisdictions, local counsel is a must.

Among the negotiated terms, rent and space considerations are foremost. But also important are the landlord's obligations, maintenance, utility services and the like. Use of telephone closets, risers, building cable (not to mention rest rooms and other common facilities) and building security measures must all be addressed. So too must the occupant's rights to gain entrance to the facility, and to occupy and use it (without "use restriction") for the intended commercial purpose - be it for content storage, broadband services, cloud computing, wireless "apps," or innumerable other offerings. Importantly, the contract must also address what happens when disaster or unforeseen events makes the data center unusable, including when and at what price the occupant may leave.

Recently, as increasing electricity demands have strained utilities' supplies, the availability of power has become all the more important. While power disruption has customarily been treated as a force majeure event, *i.e.*, an excusable one outside the parties' control, that trend is changing. Data center occupants are now seeking redundant power sources ("feeds") and on-site, back up generating capacity. As utility companies are unable to keep up

with demand, option rights to additional power (along with stricter remedies when it goes out) are now more commonplace. Silence in the contract about these contingencies is an invitation to dispute.

In recent years, the economic downturn has raised another disturbing possibility to consider when negotiating these arrangements: the distressed data center landlord. The commercial real estate industry has been especially hard hit by the recession. Whether that has passed is still uncertain. Even so, in today's market, a landlord's possible financial distress is a risk that "telecom tenants" must consider when entering into a commercial lease or similar building access agreement.³ This risk does not go away when dealing with a landlord who has title to the data center facility. Most commercial buildings are mortgaged, with the lender/mortgagee having a first priority security interest in the building as collateral. A missed lease payment or other landlord default – for example, a breach of the financial covenants prohibiting an excessive building vacancy rate – could trigger acceleration or other lender remedies.

With a distressed landlord, the nightmare scenario for the data center occupant would be a foreclosure sale of the building to an unknown buyer, say, hypothetically, one that wishes to convert the building to a retail furniture outlet. Protecting data center rights in the event of a landlord's financial distress (however seemingly remote) should be part of the data center contract issue list.

All this is easier said than done. A landlord's financial difficulties raise complex, overlapping issues of state real property and federal bankruptcy law. Among these is what happens to the rights of a tenant to remain in the facility when the landlord files for bankruptcy protection. In other words, in the event that the debtor commercial landlord files a ("Chapter 11") petition for bankruptcy relief, does a lender's right to exercise foreclosure remedies under state law trump the right of a non-debtor lessee under federal bankruptcy law to remain on the property if it continues to pay rent and otherwise perform its lease obligations?⁴ For providers (and users) recognizing this possibility and conducting due diligence on the landlord's financial status is one half of the battle. What to do about it in the contract is the other half.

3. Negotiating Data Center Agreements.

Protection of an occupant's rights to use a data center, whether in the (hopefully remote) event of landlord bankruptcy or numerous (more likely) other contingencies, will be a topic addressed by our Firm in the first of two tele-briefings sponsored by Law Seminars International ("LSI"), titled "Negotiating Data Center Contracts." The briefing, scheduled for May 17, 1:00 PM EST, will focus on deal points and practice pointers when negotiating commercial data

³ See Sapronov & Associates, P.C. Client Alert: *Telecom Tenants at Risk* (March 6, 2009), available upon request.

⁴ See *id.* Compare 11 U.S.C. § 365(h)(1)(A)(ii)(permitting a non-debtor lessee of real property to retain its rights under a lease to the extent enforceable under applicable non-bankruptcy law) with GA CODE ANN. §§ 44-14-180 to 44-14-191 (2011)(granting the mortgagee foreclosure rights and disallowing third persons to interpose defenses against foreclosure on behalf of the mortgagor).

center agreements. Perspectives from the provider, the landlord, and the consulting community will be shared with the audience. Among the topics discussed will be:

- How do you evaluate a good data center deal? (What numbers do you run?)
- Data center license or lease? (Why does it matter?)
- Term and termination. (When can you walk?)
- Planning for adequate power supply. (What if you need more?)
- Services, service levels, occupancy, and improvements. (What's included?)
- Building access: risers, ducts, wiring, and common areas.
- Use restrictions on the space. (How strict? Do they matter?)
- Assignment; building sale; landlord bankruptcy.
- Dealing with risk: casualty, security, indemnification, and insurance.
- Pricing, adjustments, and inflation indices. (What deal protections are available?)
- Foreign locations. (Dealing with foreign property laws.)

4. Negotiating Fiber Transport Contracts.

We will talk about these next time. Meanwhile, we hope to see you at the tele-briefing. For more information, please visit www.lawseminars.com.

If you have any questions about this discussion, please contact Andrew Glazier (aglazier@wstelecomlaw.com), Walt Saprnov (wsaprnov@wstelecomlaw.com), Guy Stremback (guy@strembacklaw.com) or Tony Thompson (tthompson@wstelecomlaw.com), call us at the telephone number above, or visit www.wstelecomlaw.com.

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Negotiating Infrastructure Contracts
(Part II: Fiber Networks)

June 24, 2011

I. The Fiber “Glut”: Is It a Buyer’s Market?

In our last alert¹ on infrastructure topics, we discussed some key elements of data center contract negotiation, a topic made timely by the explosive demand for broadband storage and delivery.² This alert focuses on the latter: negotiation of fiber optic network contracts with carriers (suppliers), including the familiar ones (AT&T, Verizon, Level 3) and those that own and provide just the facilities (AboveNet, Zayo). But first, some observations.

Is there a fiber glut? Maybe. In its report on Level 3’s planned acquisition of Global Crossing, the Wall Street Journal notes that only fifty percent (50%) of fiber optic network capacity is being used, up from only three percent (3%) during the Internet bubble collapse a decade ago.³ This post-bubble era has been marked by supplier struggle as Global Crossing, XO and others sought bankruptcy protection while Level 3 has been saddled with huge debt load. Meanwhile, prices are still declining, roughly twenty-five percent (25%) a year over the last three years.⁴ This is probably not only a hangover effect of the frenzied fiber build out in the bubble years but also a result of the efficiencies created by dense wavelength division multiplexing (“DWDM”) - a technology that permitted an exponential increase in data throughput of fiber facilities by permitting traffic to be carried on wavelengths or lambdas, not just over digitized photons.

Or maybe not. Large enterprise (nationwide, global) procurement contracts with major carriers often include subcontracted fiber made available by cable companies, CLECs, or other regional suppliers with facilities in remote areas not served by AT&T, Verizon and the like. There is no oversupply of fiber in those remote areas. Further, even as the U.S. economy has

¹ See Sapronov & Associates, P.C. Client Alert: *Negotiating Infrastructure Contracts (Part I: Data Centers)* (May 12, 2011), available upon request.

² C. Nolter, “Moving and Storage,” *The Deal Magazine*, January 21, 2011.

³ Roger Cheng & Spencer E. Ante, *Connecting the Fiber Glut*, *WALL ST. J.*, April 12, 2011.

⁴ *Id.*

flattered, the market for smart mobile phones has exploded, suggesting an eventual huge upswing in demand for fiber facilities to carry mobile voice and data (including “app”) traffic. Capacity bottlenecks can lead to degraded mobile experience - ask any iPhone user - thus suggesting that any glut (if indeed there is one) will be short lived.

Strategic investors appear to agree, taking interest once again in fiber suppliers, especially those with access to emerging markets such as Latin America. The demand for Cloud access, mobile apps and broadband Internet access, it would appear, will eventually extend to fiber networks as well. No surprise then that Level 3’s offer valued Global’s shares by more than a fifty percent (50%) premium.

So yes, this may well be a good time to buy. For enterprise buyers, the oversupply from the Bubble years coupled with DWDM efficiencies has created (at least for the time being) a welcome drop in prices and an array of new choices (Gig-E Ethernet). For wholesale buyers seeking to build out their networks, develop new routes, and secure their own fiber strands (or swap capacity with others) at attractive terms and conditions, the time may be even better.

II. If So, Caveat Emptor: Some Lessons in Fiber Shopping.

For the buyer, lessons here include the need for deal and price protection (especially if fiber prices continue to drop), technology change (“upgrade”) rights, supplier bankruptcy and control transfer protections. As with any network procurement, there are familiar deal points such as installation guaranties, service level agreements (“SLAs”), remedies, payment and dispute resolution.

And, as with data centers, there are issues of occupancy and property rights. A contract – typically for decade long terms – to use fibers in a network may be structured in various ways, some of which provide greater occupancy assurance than others.⁵

For the large buyer, say one planning a regional or nationwide fiber network build-out, things are more complicated still. Various installation schedules – for example for a next generation broadband wireless (3G/4G) build-out in different “NFL” cities - suggest that some deadlines may be met while others perhaps not. Fashioning a remedy for such partial defaults is not easy – especially if suppliers are few. If the build-out project is financed by a third-party lender, things are even more complicated. For example, if a credit facility may be drawn upon subject to meeting milestones, then a supplier installation failure could conceivably trigger a default under the buyer’s credit agreement with the lender – a potentially serious problem for which the seller’s SLAs are no help.

For this and more, please tune in to our second installment on Infrastructure Contract Negotiations through a Tele-briefing sponsored by Law Seminars International (“LSI”): see <http://www.lawseminars.com/detail.php?SeminarCode=11DATA2TB>

As with our last Tele-briefing (negotiating data center contracts), there will be a nuts-and-bolts discussion of how to approach fiber optic network transactions from both buyer and seller

⁵ See discussion, *infra*..

perspectives – keeping in mind that fiber use rights are often bartered or “swapped,” thus sometimes blurring these commercial identities. Here is a preview.

III. Illustrative Example: How to Structure an IRU Transaction.

Fiber usage today is ubiquitous, with enterprises purchasing Gig-E circuits, small businesses accessing Clouds, and carriers leasing and swapping fiber strands from one another. The acquisition of an interest in fiber capacity is sometimes termed an “Indefeasible Right of Use” (“IRU”). While the term’s etymology goes back to an old FCC decision addressing undersea cable,⁶ its use today connotes a grant of an irrevocable right to use fiber facilities for essentially over their useful life, whether as capacity (*e.g.*, “wave IRU”) or the fibers strands themselves (so-called “dark” fiber with electronics supplied by the Buyer). IRUs are drafted in various ways, but the conveyance can be characterized as a purchase, a lease, a license or other property interest.⁷

Keeping that in mind, consider the following hypothetical dark fiber IRU transaction by a carrier (“Customer”) seeking to build out its fiber network through use of fibers supplied by another wholesale supplier (“Supplier”). Again,⁸ as with our last discussion, the focus is on protecting the Customer in the event of the Supplier’s bankruptcy.

In our hypothetical, the transaction calls upon the Customer to acquire (i) discrete strands of fiber optic cable (“Fibers”), (ii) access to and use of the Supplier’s collocation facility (“Space”), and (iii) network maintenance and related services, all at various locations within the fiber network facility. Assume further that the Supplier is operating under a heavy debt load, thus requiring the transaction to take into account its possible bankruptcy.

In that event, the Customer would be faced with the possibility that a bankrupt Supplier (as debtor in possession) could reject the transaction as a so-called “executory contract,” and the Customer’s advance payment – often a whopping one for say a 20-year IRU - could be lost as an unsecured claim against the bankrupt estate. Other risks would include (i) the possible rejection of the maintenance agreement, (ii) the recovery (as fraudulent transfers or preferences) of rights to the fibers that had been granted by Supplier to Customer, (iii) the loss of access rights to the fiber (*e.g.*, easements, rights-of-way, collocation space) that had been granted by third parties (“Third Party Rights”) to the now bankrupt Supplier (but not to the Customer), and (iv) the subordination of Customer’s claims against the Supplier’s estate (if any) to those of secured creditors - all fiendishly complicated by the bankruptcy process.

So what is our Customer to do? The answer begins with a very brief review of relevant bankruptcy code sections.

⁶ In re American Tel. & Tel. Co., 37 F.C.C. 1151, 1161 (1964). See generally AMERICAN BANKRUPTCY INSTITUTE, BANKRUPTCY TELECOMMUNICATIONS MANUAL (H. Jason Gold et al. eds., 2nd ed. 2006)

⁷ See generally, Charles A Rohe & Richard H. Agins, *Indefeasible Rights of Use in a Revived Telecommunications Industry: Revisiting the Treatment of IRUs in Bankruptcy Proceedings*, NORTON ANNUAL SURVEY OF BANKRUPTCY LAW (2008).

⁸ See Sapronov & Associates, P.C. Bankruptcy Alert: *Fallout From the Crisis: Telecom Tenants At Risk* (2009), available upon request.

1. Effect of Bankruptcy on the IRU Transaction

Upon the filing of a petition for relief in bankruptcy under so-called “Chapter 11,”⁹ the bankruptcy trustee or debtor in possession (here the Supplier) must determine whether each “executory contract”¹⁰ or lease should be assumed or rejected. If assumed, the debtor’s obligation becomes an administrative expense of the estate, as opposed to an unsecured claim ranking lower in the priority of distribution. If rejected, the rejection constitutes a breach of the contract or lease, the damages for which have the status of an unsecured claim against the bankruptcy estate relating back to the date immediately preceding the filing of the bankruptcy petition.¹¹

2. Customer’s Rights Upon Supplier Rejection of the IRU Transaction

While no two IRUs are alike, bankruptcy law provides some clues as to how a Buyer may structure the transaction to mitigate the rejection risk. First, some bankruptcy case law supports the proposition that rights in a specific asset created by state law are not avoidable by rejection.¹² In *WorldCom v. PPLPrism*,¹³ the Bankruptcy Court for the Southern District of New York found that a debtor, Cambrian had conveyed a property interest – not merely a contractual one - in an IRU to WorldCom, the grantee and itself a debtor in the famous WorldCom bankruptcy proceeding. The Court thus upheld WorldCom’s right to the IRU fibers, identified as a property interest in specific assets, as surviving both rejection and assignment to a third party by the grantor/debtor.

There is a further question of whether a simple Fiber lease, if separated from the bankrupt Supplier’s other obligations (*e.g.*, maintenance, build-out) under the IRU Transaction, would be executory within the meaning of the Bankruptcy Code. One could perhaps argue that, inasmuch as all of Supplier’s material obligations under the lease - specifically, to provide the Fibers – would have been performed, the “naked” Fiber lease would not be executory, and hence not subject to Supplier rejection.

That said, even if the Buyer’s right to the fibers were to survive rejection, there remains the question of maintenance and Third Party Access rights. Upon bankruptcy of the Supplier, the maintenance obligations would almost certainly be executory (and thus almost certainly be subject to rejection) while the Third Party Access rights are granted to the Supplier, not to the

⁹ 11 U.S.C. §§ 101 et seq. (2010) (the “Bankruptcy Code”).

¹⁰ The Bankruptcy Code does not define the term “executory contract.” An “executory contract” has been defined under case law as a contract “on which performance remains due to some extent on both sides” and where “obligations of both parties are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.” *Mitchell v. Streets (In Re Streets & Beard Farm Partnership)*, 882 F.2d 233, 235 (7th Cir. 1989); *Griffel v. Murphy, (In Re Wegner)*, 839 F.2d 533, 536 (9th Cir. 1988); *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 522 (1984). See generally Countryman, *Executory Contracts in Bankruptcy* (pts 1 & 2), 57 Minn. L. Rev. 439 (1973), 58 Minn. L. Rev. 479 (1974).

¹¹ 11 U.S.C. § 365(g)(1)

¹² *In Re Neil Bergt*, 241 B.R. 17 (Bankr D Ala 1999); *Sawashee Venture v. Austin Development Co., (Matter of Austin Development Co.)*, 19 F.3d 1077 (5th Cir. 1994); *In Re Storage Technology Corp.*, 53 B.R. 471 (Bankr D Colo 1985); *CASC Corp. v. Milner (In Re Locke)*; 180 B.R. 245 (Bankr CD Cal 1995). But see *In Re Gillis*, 92 B.R. 461 (Bankr D. Haw 1988); *In Re Hawaii Dimensions, Inc.*, 39 B.R. 606 (Bankr D Haw 1984), *aff’d*, 47 B.R. 425.).

¹³ *In re WorldCom, Inc.*, 343 B.R. 430, 46 Bankr. Ct. Dec. (CRR) 160 (Bankr. S.D.N.Y. 2006).

Buyer. All of these point to the need to structure the IRU transaction in anticipation of these risks.

3. Structuring the IRU Transaction:

First, as indicated, it is important that the IRU Transaction be characterized as the conveyance of a lease or other property interest (*e.g.*, a capitalized lease that is really a disguised secured transaction under the Uniform Commercial Code).¹⁴ The Buyer should insist that the IRU conveyance documents grant it a beneficial ownership or equitable title to specific fibers.

Second, the Customer should consider separating the maintenance (or build-out) agreements from the Fiber conveyance (and from the Space occupancy agreement if there is one).

Third, the Customer may also consider seeking “step-in rights” to ensure continued maintenance of the Fibers. One way to do this is to appoint the Customer as agent and attorney in fact, coupled with an interest, of the Supplier, for the purpose of perform maintenance and repairs in the event that the Supplier does not. The idea here would be to allow the Customer to engage in self-help (with Bankruptcy Court approval of course), especially during the period of the automatic stay prior to the Supplier’s rejection or assumption of the maintenance agreement. Importantly, the Customer, as the Supplier’s agent, would also arguably have a colorable right to access third-party real property where the Customer Fibers and Spaces are located.

Fourth, as for the Third Party Rights, the Customer, under any circumstances, should insist on receipt of copies of all related third-party documents, including municipal rights-of-way agreements and authorizations, together with contact information for each of the third parties. This information will assist the Customer in obtaining separate access agreements with the Third Party Rights holders. As an additional deliverable, the Customer may also wish to insist on a “non-disturbance agreement” from the third-party owners of real property on which the Customer Fibers or Spaces are located.

Sounds complicated? That’s because it is. Do not try this at home. Instead, be sure to attend our Tele-briefing: <http://www.lawseminars.com/detail.php?SeminarCode=11DATA2TB>

This alert provided only a brief glimpse of the bankruptcy issues associated with negotiating Fiber Contracts. The many other contractual and regulatory issues, no less important, will be the topic of the Tele-briefing discussion. We hope to see you there.

If you have any questions about this discussion, please contact Mark Del Bianco (mark@markdelbianco.com), Andrew Glazier (aglazier@wstelecomlaw.com), Walt Saprnov (wsaprnov@wstelecomlaw.com), Tony Thompson (tthompson@wstelecomlaw.com), call us at the telephone number above, or visit www.wstelecomlaw.com.

¹⁴ Uniform Commercial Code § 1-201(37).

**Resolving International Data Center Disputes:
Diplomacy by Other Means**

Walt Sapronov

Originally Published in YEARBOOK ON INTERNATIONAL ARBITRATION, VOL. III¹

Abstract

As data centers proliferate in the U.S. and abroad, questions of international law arise with respect to dispute resolution under data center contracts - especially when the parties are domiciled in different countries. This discussion shows that, unlike those arising under international telecommunications service contracts, data center disputes do not lend themselves to international arbitration. The usual factors favoring such arbitration remedies over litigation in telecommunications transactions are outweighed by other factors. Most importantly, the multi-national company that occupies a foreign data center must protect its occupancy and access rights: especially when the data center supports mission critical applications such as a cloud computing platform, financial service transmission, health care records, global Internet access, and others. The discussion examines the uncertainty and delay associated with international arbitration - topics discussed at this year's Symposium - and concludes that litigation (with the availability of injunctive relief) is a preferred remedy for such international contracts.

¹ Walt Sapronov, *Resolving International Data Center Disputes: Diplomacy by Other Means*, in YEARBOOK ON INTERNATIONAL ARBITRATION, VOL. III 73-81 (Marianne Roth & Michael Geistlinger eds., 2013).

Walt SAPRONOV¹

Resolving international data center disputes – diplomacy by other means²

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Abstract

As data centers proliferate in the U.S. and abroad, questions of international law arise with respect to dispute resolution under data center contracts – especially when the parties are domiciled in different countries. This discussion shows that, unlike those arising under international telecommunications service contracts, data center disputes do not lend themselves to international arbitration. The

1 Isaac Dolgovskij, Esq., associated with Sapronov & Associates, P.C., assisted in the preparation of this discussion.

2 This views expressed in this discussion are the author's own and not those of any client or other party. The observations are based, in part, on various presentations and discussions at the Center for International Legal Studies, International Arbitration and Dispute Resolution borrows, 2012 Biennial Symposium. <http://www.cils.org/conferences/conference.php?ConferenceID=251&>. The discussion also borrows from our presentation at Law Seminars International, "Negotiating Data Center Contracts", Telebriefing., May 17, 2011. See Sapronov & Associates, P.C. Client Alert: Negotiating Infrastructure Contracts (Part I: Data Centers) (May 12, 2011), available upon request at info@wstelecomlaw.com. While accurate to the best of our knowledge, this discussion is provided for tutorial purposes only and is not to be construed as a legal opinion or legal advice. Please contact us at 770-399-9100 or at info@wstelecomlaw.com if you have any specific questions about this topic or the disclaimer.

usual factors favoring such arbitration remedies over litigation in telecommunications transactions are outweighed by other factors. Most importantly, the multinational company that occupies a foreign data center must protect its occupancy and access rights, especially when the data center supports mission critical applications such as a cloud computing platform, financial service transmission, health care records, global Internet access, and others. The discussion examines the uncertainty and delay associated with international arbitration – topics discussed at this year’s Symposium – and concludes that litigation (with the availability of injunctive relief) is a preferred remedy for such international contracts.

Keywords

Data centers, multi-national tenants, occupancy rights, lease, license, real property law, arbitration, award vacatur, uncertainty, litigation, injunctive relief, New York Convention, *Kompetenz Kompetenz*

I Introduction

A Data center proliferation – in the U.S. and abroad

According to industry studies,³ infrastructure companies – those providing data centers and fiber networks – are once again attracting investors. For the first time since “Internet bubble” days, strategic and financial buyers are looking at companies that own either data centers or fiber facilities: in other words, those that own either the pipes that deliver broadband data or the facilities that store it. Both traditional infrastructure providers (AT&T, Verizon, Level 3/Global Crossing, AboveNet) and relatively new ones (Equinix, Fibertech, Zayo) are examples. And as emerging markets develop (e.g., Russia, Brazil, India), investors’ interest is increasingly focused on the providers’ international capabilities.

This is unsurprising, as the explosive growth of broadband Internet, cloud computing, smart mobile devices and video has increased demand for global infrastructure supporting broadband traffic and storage. The providers of data centers and fiber networks are becoming major players in this new broadband marketplace – one that includes infrastructure providers, customers and “middlemen” (e.g., a cloud computing operator that sells the rights to access and use the data center to third parties).

Data centers have thus proliferated, both in the U.S. and abroad. Among other complications, the trans-border aspect of data center transactions naturally raises the question of how to resolve disputes and, in anticipation thereof, how to craft effective dispute resolution provisions in the data center contract – especially when the parties are domiciled in different countries.

3 Chris Nolter, Moving and Storage, *The Deal Magazine* (January 21, 2011).

B Dispute resolution – diplomacy by other means⁴

In a prior publication for this Symposium, we discussed the benefits of U.S. controlled arbitration for resolving international telecommunications contract disputes.⁵ Others share the view that international telecommunications transactional disputes lend themselves to international arbitration – albeit not necessarily under American tribunals.⁶ So should disputes arising under “international” data center contracts, i.e., where a U.S. corporate tenant occupies a data center in a foreign country, also be resolved by arbitration?

We think not. Our experience suggests that international data center contract disputes – unlike those arising under international telecommunications service contracts – should *not* be controlled by arbitration. The usual factors favoring arbitration remedies over litigation in telecommunications transactions (e.g., lesser expense, technical subject matter, selection of subject matter experts) are outweighed by other factors.

Among these – from the corporate tenant’s perspective – is the paramount importance of protecting occupancy and access rights, especially when the data center supports mission critical applications such as a cloud computing platform, financial service transmission, health care records, global Internet access, and others. Admittedly, a well drafted data center contract will provide opportunity for extensive informal dispute resolution, mediation or both before occupancy is lost or even threatened. But when such diplomatic measures fail, the tenant must have enforceable rights that can be readily pursued by other means: in a word, through expedited litigation and, if needed, with the prompt availability of injunctive relief.

International arbitration, ideal though it may be for many other transactions, carries with it much uncertainty, possible delays, questionable enforcement, at times coercive pressure on arbitrator decision-making, lack of finality, and possibly inconsistent arbitral award recognition among nationally diverse forums. For the multi-national, corporate occupant, for whom loss of data center occupancy or access is draconian – and without a back-up facility, perhaps catastrophic – such uncertainty precludes arbitration as a dispute resolution mechanism almost out of hand. The remainder of this discussion addresses first, how data center contracts work and second, how the complexities of international arbitration today carry too much risk for the parties to rely upon it.

4 Carl von Clausewitz, On War, Berlin 1832 (famously observing that “war is the continuation of *Politik* by other means”).

5 Walt Saprnov/Robert J. Butler, Pax Americana: U.S. Dispute Resolution of International Telecommunications Contracts, in: Dennis Campbell (ed.), The Comparative Law Yearbook on International Business, Alphen aan den Rijn 2010, 337-350.

6 Daniel E. Gonzalez/Maria E. Ramirez, International Arbitration – Telecommunications: Outside Counsel Perspective, in: Horacio A. Grigera Naón/Paul E. Mason (eds.), International Commercial Arbitration Practice: 21st Century Perspectives, LexisNexis 2010, chapter 37.

II International data center contracts

A What is in the data center?

A content provider housing its database at a data center – and using Internet or other broadband services to access and deliver it – has certain rights to that facility that must be protected. This requires physical preparation, of course, along with assurances of adequate space, security, environmental controls, building access, diversity, multiple carrier connections, uninterrupted power supply, and (when emergency strikes) a quick means of moving elsewhere. All this and much more are customarily reflected in the data center contract.

B Data center contracts – commercial leases by any other name

A data center contract is in the nature of a commercial lease. Whether it is a true leasehold interest or a mere license or usufruct is both a matter of negotiation and, in the international context, a function of local property law. But however characterized (e.g., co-location, space license, “services agreement”), the agreement necessarily addresses the use, occupancy and other rights of a “tenant” (here the data center occupant) with respect to space in a commercial building. That tenant will either use the data center for its own retail services (e.g., online financial services, reservation systems) or perhaps it will sublease, sublicense or otherwise make the data center facility available to its wholesale customers (e.g., as a cloud computing platform). Such agreements involve deal points, long familiar to real estate practitioners that are customarily raised in commercial lease negotiations.

When the data center is located abroad, things get more complicated. For example, take a contract between a data center landlord in one EU country, whose parent corporation is based in another, and a corporate tenant that is an affiliate of a U.S. corporation. Complex questions of choice of law, forum and remedy enforcement immediately arise. For the U.S. practitioner, matters are further complicated as the contract will implicate issues of foreign real property law, differing local practices for protecting occupancy rights and for dealing with arcane telecommunications deal points such as cable-cross connection, carrier “meet-points”, power consumption, and equipment storage. Treatment of such issues in a data center agreement in Manhattan will differ from one, say, in London. For the practitioner charged with drafting data center contracts in unfamiliar jurisdictions, local counsel is a must.

C A few deal points

Among the negotiated terms, rent and space considerations are foremost. But also important are the landlord's obligations: maintenance, utility services and the like. Use of telephone closets, risers, building cable (not to mention rest rooms and other common facilities) and building security measures must all be addressed. So too must the occupant's rights to gain entrance to the facility, and to occupy and use it (without “use restriction”) for the intended commercial purpose – be it for content storage, broadband services, cloud computing, wireless

“apps” or innumerable other offerings. Importantly, the contract must also address what happens when disaster or an unforeseen event makes the data center unusable, including when and at what price the occupant may relocate.

In recent years, as increasing electricity demands have strained utilities’ supplies, the availability of power has become all the more important. While power disruption has customarily been treated as a force majeure event, i.e. an excusable one outside the parties’ control, that trend is changing to require redundant power feeds and on-site back up generating capacity. As utility companies are unable to keep up with demand, option rights to additional power (along with stricter remedies when it goes out) are now more commonplace. Silence in the contract about these contingencies is an invitation to dispute.

D More risks

Still more recently, the global economic downturn has raised other disturbing possibilities to consider when negotiating foreign data center contracts.

In EU countries, this is of course the possible demise of the Euro as a currency and, worse still, the possible unraveling of the European Union itself. The recent elections in Greece (that barely preserved its EU participation), the pending financial bailout of Spain’s financial institutions, the increasingly fractious views of German, French and other EU officials on the merits of austerity, taxation, growth and financial stimuli, all indicate that the crisis continues. Anticipating such events in the contract – including that of a Euro currency demise (e.g., by an automatic conversion of rent payments from Euros to, say, English pounds) – is prudent. Permitting such an event to trigger a “force majeure out” that excuses the landlord’s obligations is not.

In certain EU jurisdictions, taxation is another complicating factor. In some countries, treatment of a data center contract as a “lease” rather than a “license” may trigger adverse tax consequences that, as a business proposition, can override the tenant’s general preference for a lease to the occupied space. But the rights conveyed by a tenant license, as a rule, are merely contractual: unlike a leasehold interest (under Anglo-American jurisprudence), they do not create a property right. Consequently, while avoiding the harsher tax treatment, a breach of the tenant’s license rights to the space (e.g., by wrongful contract termination, lender foreclosure) – without more – leaves only a remedy for damages, hardly adequate for a dispossessed corporate tenant. Unlike a lessee, the licensee customarily does not have an underlying property interest (i) that can be perfected by notice (recording of lease memorandum or accompanying easement), (ii) preserved through a building sale (through non-disturbance and attornment covenants) and (iii) that, at least under U.S. bankruptcy law, generally gives the non-debtor commercial lessee a right to continue occupying the property so long as it performs (i.e., pays rent) under the lease.⁷

Another disturbing possibility is the distressed data center landlord. The U.S. commercial real estate industry has been especially hard hit by the great recession. In today’s markets both here and abroad, especially with economists predicting a European recession, a landlord’s possible financial distress is a risk that “telecom tenants” must consider when entering into a commercial lease or similar

7 11 U.S.C. § 365(h)(1)(A)(ii). But see *infra* note 9 and accompanying discussion.

building access agreement.⁸ Nor does the risk necessarily go away when dealing with a landlord who has title to the data center facility. Most commercial buildings are mortgaged, with the lender/mortgagee having a first priority security interest in the building as collateral. A missed lease payment or other landlord default – for example, a breach of the financial covenants prohibiting an excessive building vacancy rate – could trigger acceleration or other lender remedies. The nightmare scenario for the data center occupant would be a foreclosure sale of the building to an unknown buyer, say, hypothetically, one that wishes to convert the building to a retail furniture outlet.

E And what to do about them

Protecting data center rights in the event of landlord's financial distress (however seemingly remote) should be addressed early on in negotiations. Enforcing them, however, is easier said than done. In the U.S., a landlord's financial difficulties raise complex, overlapping issues of state real property and federal bankruptcy law. Among these is what happens to the rights of a tenant to remain in the facility when the landlord files for bankruptcy protection. In other words, if the commercial landlord files a ("Chapter 11") petition for bankruptcy relief, does a lender's right to exercise foreclosure remedies under U.S. state law trump the right of a non-debtor lessee (our corporate tenant) under federal bankruptcy law to remain on the property if it continues to pay rent and otherwise perform its lease obligations?⁹ The answer varies by state.

In the international context, this is still more baffling. The bankruptcy laws of foreign jurisdictions may or may not protect a non-debtor lessee upon foreclosure. Further, when the tenant is a mere *licensee* (not a non-debtor *lessee* within the meaning of 11 U.S.C. § 365), there is no underlying right to continued occupancy under the U.S. Bankruptcy law. How this lessee/licensee distinction is treated in foreign jurisdictions may vary. Again, consultation with local counsel in the foreign jurisdiction is necessary and alternative solutions should be reviewed. These can include, for example, notice of "early warning" distress signals such as the landlord's default of bank or bond covenants, affiliate guaranties, cross-default triggers (e.g., data center contracts between the parties' affiliates in other countries), and – where possible – through a subordination, non-disturbance, and attornment agreement between the tenant and the lender.

For prospective tenants, recognizing all these risks and conducting due diligence on the landlord's financial status is only half of the battle. Mitigating them in an enforceable contract is the other. Here is a brief checklist of some key issues to consider when negotiating an international data center contract.

- License v. lease (What is the difference and how does it matter?)
- Term and termination (When can you walk?)

⁸ See Sapronov & Associates, P.C., Client Alert: Telecom Tenants at Risk (March 6, 2009), available upon request at info@wstelecomlaw.com.

⁹ See *id.* Compare 11 U.S.C. § 365(h)(1)(A)(ii) (permitting a non-debtor lessee of real property to retain its rights under a lease to the extent enforceable under applicable non-bankruptcy law) with GA Code Ann. §§ 44-14-180 to 44-14-191 (2011) (granting the mortgagee foreclosure rights and disallowing third persons to interpose defenses against foreclosure on behalf of the mortgagor).

- Services, service levels, occupancy, improvements (What's included?)
- Building Access: risers, ducts, wiring, common areas (How do you access the space?)
- Use restrictions on the space (How strict? Do they matter?)
- Assignment; building sale; landlord bankruptcy (Protecting your right to remain)
- Dealing with Risk: casualty, indemnification, insurance (Who is responsible?)
- Pricing, adjustments and inflation indices (Protecting the deal value)
- Foreign Locations (Dealing with non-U.S. property laws)

All of these can be the subject of dispute – which brings up the enforcement of rights and remedies, choice of law, forum and adjudication.

III Data center dispute resolution

A The perils of international arbitration

So to repeat, while international telecommunications service contracts may lend themselves to arbitration (controlled by U.S. substantive law), data center contracts do not. The reason, simply stated, is that international arbitration carries the risks of uncertainty and delay that in our experience are unacceptable to a multi-national tenant faced with a possible loss of occupancy to a mission-critical data center. The absence of a practical solution (e.g., a hot back up facility elsewhere) in such a circumstance could be disastrous – especially when the data center supports cloud computing, financial transactions, or global Internet access.

The uncertainty accompanying international arbitration stems from a number of factors.

First, a data center contract, as it creates rights under real estate law, is necessarily controlled by *lex loci rei sitae*: by the law of the place where the realty is situated.¹⁰ Thus, familiar rights under U.S. real property law cannot be simply exported to a data center abroad, any more than, for example, a real estate contract made in California can be controlled by New York real property law. For the U.S. multi-national occupant, this leaves the grant of property rights to a foreign data center a conveyance controlled by largely unfamiliar law in that jurisdiction. To some extent, the scope of these rights can perhaps be ascertained by U.S. practitioners with the help of local counsel and corresponding protections crafted accordingly (perhaps with an accompanying legal opinion). But the practical enforceability of such rights in a foreign jurisdiction necessarily may well remain – in a very real sense – unfamiliar territory.

Second, if one seeks to resolve disputes over such (again probably unfamiliar) foreign property rights through international arbitration, the uncertainty deepens. The New York Convention, a treaty ratified by the United States and

¹⁰ See generally, United States Supreme Court, *McCormick v. Sullivan*, 23 U.S. 192, Decision of 1825; United States Supreme Court, *Darby's Lessee v. Mayer*, 23 U.S. 465, Decision of 1825; United States Court of Appeals for the Sixth Circuit, *Timber-Lee Evangelical Free Church Christian Ctr. v. Baraga County Road Commission*, 1998 WL 228044, Decision of 29 April 1998.

codified in Chapter 2 of the Federal Arbitration Act (FAA),¹¹ sets forth numerous grounds for a tribunal in one country to refuse to recognize or enforce an arbitral award issued in another. These include *inter alia*, invalidity of the arbitration agreement, an improperly constituted arbitral tribunal, lack of due process, a tribunal's decision on matters not submitted to arbitration, and – importantly – a competent tribunal's finding in the jurisdiction where enforcement is sought that the award is “contrary to the public policy of that country.”¹²

This last criterion for setting aside an award is especially worrisome. It suggests that a tenant's rights under a data center contract subject to international arbitration, regardless of its stated occupancy protections, could conceivably be set aside on public policy grounds. For example, one can envision a financial service provider's rights to a data center being revoked – irrespective of contractual provisions to the contrary – if the stored data includes personal information acquired in violation of notoriously broad EU privacy laws.

Third, adding to the uncertainty is that some jurisdictions permit judicial intervention in arbitration as well as broad grounds for arbitral award vacatur.¹³ There is also the complex question as to whether the arbitral forum has the authority to determine both its own jurisdiction and the validity of the agreement itself, a doctrine known (in German) as “Kompetenz Kompetenz” that both varies from country to country and that necessarily introduces uncertainty into the international arbitration process.¹⁴

B Conclusion: for data center disputes, litigation is preferable

In short, the inherent uncertainty of international arbitration is one reason why it is not well suited for international data center disputes. Delay is another risk, including, importantly, whether a corporate tenant facing a (potential or actual) loss of occupancy rights may seek injunctive relief. That largely depends upon the laws of the country serving as the seat of arbitration and perhaps upon its

11 The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards was signed in New York on June 10, 1958 (codified at 9 U.S.C. §§ 201-208 (2006)). See generally, Mark R. Joelson, OBE, The Interplay of International, Federal and State Law in United States Arbitration, *Journal of International Arbitration*, 24 (2007) 4, 379.

12 Joelson, *supra* note 11 at 380-381 (citing New York Convention, Articles V(1), V(2)).

13 But cf. United States Supreme Court, *Hall Street Associates, LLC v. Mattel, Inc.*, 552 U.S. 576, Decision of 28 April 2008 (holding that arbitral awards under FAA may be reversed on limited statutory grounds expressly stated in the FAA and implicitly curtailing “manifest disregard” [of the law by the arbitrators] as grounds for arbitral award reversal).

14 This principle is based on Article 16(3) of the UNCITRAL Model Law: “If the arbitral tribunal rules as a preliminary question that it has jurisdiction, any party may request, within thirty days after having received notice of that ruling, the court...to decide the matter, which decision shall be subject to no appeal; while such a request is pending, the arbitral tribunal may continue the arbitral proceedings and make an award.” See generally, Adrianna Dulic, First Options of Chicago, Inc. v. Kaplan and the Kompetenz-Kompetenz Principle, *Pepperdine Dispute Resolution Law Journal*, 2 (2002) 1, available at <http://digitalcommons.pepperdine.edu/drlj/vol2/iss1/3> (20 July 2012).

interpretation of *kompetenz kompetenz* (i.e., whether a court in that jurisdiction must first await the arbitral forum's decision before making its own).

To summarize, there remain issues, many varying from country to country, regarding the finality, the timeliness, and the enforcement of arbitral awards.¹⁵ None of these appear favorable for speedily resolving international data center data disputes – especially for the foreign tenant. The simple solution is to rely on litigation – with the availability (if needed) of prompt injunctive relief. While local counsel assistance and familiarity with local litigation custom remains of course necessary, the decision will likely be reached more quickly, will be controlled by local property law,¹⁶ and will presumably be less burdened by policy and possible arbitrator subjectivity. To paraphrase Von Clausewitz, better in such circumstances to resolve the dispute not by arbitration but by other means.

15 See www.cils.org. Selective materials available upon request at info@wstelecomlaw.com.

16 See supra note 9 and accompanying discussion.

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BANKRUPTCY ALERT

**Fallout from the Crisis:
Telecom Tenants At Risk¹**

March 6, 2009

I. Synopsis:

As the economic crises unfold, many expect that commercial real estate markets may soon be distressed, with bankruptcies and foreclosures to follow. If so, many telecommunications entities (both customers and providers) with collocation, hosting or lease agreements may find their possessory rights threatened by the prospect of a landlord's bankruptcy or foreclosure. This discussion examines the threat facing such "telecom tenants" along with possible protective measures available under the U.S. Bankruptcy Code. The discussion concludes with some practical steps that telecom tenants might consider taking both before and after a landlord's bankruptcy to mitigate these risks.

II. Introduction: Fallout from the U.S. Economic Crisis:

1. Telecom Tenants At Risk.

With much of the world in a recession or worse, the telecom industry will no doubt feel its share of the pain. Nortel Network's sudden decision to seek bankruptcy protection² – and Charter Cable's anticipated one³ -- may be just a prelude. With the benefit of hindsight and a few lessons learned from the WorldCom era, this discussion identifies some implications of the crisis for buyers of telecommunications products and services, especially in light of possible

¹THIS IS A SPECIAL, COMPLIMENTARY ALERT ON THE IMPLICATIONS OF THE ECONOMIC CRISIS FOR THE TELECOM INDUSTRY. IT IS PROVIDED TO CLIENTS AND FRIENDS OF SAPRONOV & ASSOCIATES, P.C. FOR TUTORIAL PURPOSES ONLY. THIS ALERT IS NOT TO BE CONSTRUED AS A LEGAL OPINION OR LEGAL ADVICE. PLEASE CONTACT US IF YOU HAVE SPECIFIC QUESTIONS REGARDING THE ISSUES RAISED HEREIN. TO OPT OUT OF RECEIVING OUR ALERTS, PLEASE EMAIL US AT INFO@WSTELECOMLAW.COM.

² Ian Austen, *Nortel Seeks Bankruptcy Protection*, N.Y. Times, January 15, 2009, at B2.

³ *Charter Communications Reaches Agreement in Principle with Certain Debt Holders to Reduce Debt*, Business Wire, at <http://www.businesswire.com/news/home/20090212006003/en> (Feb. 12, 2009).

(likely?) bankruptcies of carriers, broadband and cable providers, telecom equipment suppliers⁴ and, notably, their commercial landlords.

We have all been here before: telecommunications (telecom) industry veterans recall the Internet bubble and the collapse of all but the most solvent providers that followed in the late 1990's. Then as now, buyers of telecom, Internet and related goods and services were faced with the "travesty" of having to deal with a seller under protection of the U.S. Bankruptcy Code.⁵

Ominously, however, events this time may be more problematic. Many telecom providers of that era did indeed seek bankruptcy relief. But they, together with their Internet cohorts, were victims of an industry specific collapse. Today, the whole economy is threatened with a crisis not seen since the Great Depression. While we all hope that the recently enacted stimulus package will jumpstart the economy, bankruptcies will almost certainly follow in the near term – including, many predict, in the commercial real estate market.

2. Commercial Real Estate Bankruptcies: Telecom Implications.

While bankruptcies of telecom providers present grave problems for their customers, they are at least not unprecedented in many users' experience. Sophisticated buyers, both enterprise and wholesale, of telecommunications equipment and services know the rules of that game. The consequences of rejection (of customers' "executory contracts"⁶), the automatic stay, unilateral assignment rights, and other statutory protections enjoyed by carrier/debtors are all familiar and not discussed here.⁷ In a word, sophisticated customers know that such protective measures, whether in the form of "pre-bankruptcy protection clauses" or backup suppliers, must all be taken before – not after – the carrier/debtor files a petition for relief under the U.S. Bankruptcy Code.⁸ Less familiar, however, is the following scenario.

If the forecasters are correct, the next wave of bankruptcies and distressed properties will particularly affect commercial landlords. Should that prove to be the case, the implications for telecom customers are potentially harrowing. Virtually all telecom providers – and many collocated customers – have commercial leases for equipment placement, other hosting arrangements and/or other collocation agreements. All such telecom tenants thus rely, directly or indirectly, on the landlord's continued solvency and on their access rights to the building in order to enjoy the benefits of uninterrupted telecom services.

⁴ See *In re Nortel Networks Inc., et al.*, No. 09-10138(KG), (Bankr. D.Del. 2009). See also *In re Hawaiian Telecom Communications, Inc., et al.*, No. 08-13086(PJW), (Bankr. D. Del. 2008).

⁵ See W. Sapronov & E. Holdrege, "Telecom Travesty: What a bankruptcy can mean for customers," 12 A.B.A. Sect. Bus. Law (2002), available at <http://www.abanet.org/buslaw/blt/2002-09-10/sapronov.html>. ("Telecom Travesty"). The pre-bankruptcy protections discussed in that article are now familiar and not repeated here. These protections may or may not be available to telecom tenants, depending upon specific circumstances.

⁶ 11 U.S.C. § 365 ("Section 365") (Debtor has right to assume or reject executory contracts).

⁷ See generally, Robert J. Butler & Kalina B. Miller, American Bankruptcy Institute: Bankruptcy Telecommunications Manual (2nd ed. 2006) ("ABI Manual").

⁸ 11 U.S.C. § 101 et. seq. (2009). The Bankruptcy Code was amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8 (2005) ("BAPCPA"). Section references, unless otherwise indicated, are to Sections of the U.S. Bankruptcy Code (as amended).

But what happens to such agreements if the landlord or building owner files for bankruptcy? Alternatively, what happens if the landlord defaults on its mortgage obligations and the lender/mortgagee forecloses on the property? And what happens when the building is sold in a bankruptcy sale? Unfortunately, the tenant- whether a true lessee or merely an occupant having a license to use the collocation space - may face eviction with little recourse.

III. Telecom Tenant Beware.

Veterans of the WorldCom era may find aspects of a landlord bankruptcy eerily familiar.

First, case law supports the treatment of so-called carrier interconnection agreements as executory contracts under Section 365,⁹ and (although there appear to be no reported cases) that reading could arguably be extended to telecom tenants' collocation agreements.¹⁰ A telecom tenant could thus be faced with the possibility of rejection of collocation agreement by a bankrupt landlord. Second, the prospect of a telecom landlord's bankruptcy is somewhat reminiscent of similar predicaments faced by non-debtor customers (grantees) of so-called "indefeasible rights of use" (IRUs) upon the IRU seller's (grantor's) bankruptcy.¹¹ IRUs are essentially long term lease agreements for access to and maintenance of fiber optic facilities. When Global Crossing and other IRU providers sought bankruptcy relief, many of their customers were left with uncertain IRU access rights - even if they had paid in advance for the facility. A landlord bankruptcy for a telecom tenant presents a similar scenario - but with an added, more frightening dimension.

1. Is the Telecom Tenant a True Lessee?

As with collocation agreements and IRUs, whether or not the telecom tenant has rights to access the bankrupt landlord's property depends upon the nature of its interest: specifically, whether the tenant's interest is a leasehold interest in real property or some other possessory right (*e.g.*, a license to use the space under a collocation agreement).

Upon a bankrupt landlord's rejection of an unexpired lease, Section 365(h)(1) of the Bankruptcy Code, a statutory holdover right, permits a non-debtor lessee of real property to either treat the lease as terminated or occupy the property and otherwise "retain its rights under such lease...to the extent such rights are enforceable under applicable non-bankruptcy law."¹² A tenant having a mere license to be on the premises (as is common in many collocation agreements) has no such occupancy rights. In contrast, if such an entity had the rights of a true lessee under, for example, an equipment/collocation lease agreement in a tele-hotel, then it could survive the rejection of that lease agreement by a bankrupt landlord so long as it continued to make lease payments and otherwise perform its obligations.

⁹ See *ABI Manual* at 88-89, nn. 314-316 and accompanying discussion.

¹⁰ Such collocation agreements may be true leasehold interests or merely space licenses. Federal law permits telecommunications carriers and incumbent carriers controlling that space to negotiate the terms of collocation agreements. 47 U.S.C. § 251(c)(1)(6). Enterprise customers typically negotiate the terms of their collocation and hosting agreements under commercial rates, terms and conditions with carriers, who either lease or own the collocation space.

¹¹ See *ABI Manual* at 90-91 and cases cited therein.

¹² 11 U.S.C. § 365(h)(1)(A)(ii).

But even a true lessee may continue to occupy the premises only to the extent permitted “under applicable non-bankruptcy law.” Therein lies the problem. A true lessee does not have such occupancy rights when the landlord defaults on its building loan/mortgage agreement and the lender/mortgagee exercises foreclosure remedies. Absent a subordination or non-disturbance agreement binding upon the lender/mortgagee, the latter’s foreclosure rights supersede those of the lessee. In such circumstances, even if the landlord files for bankruptcy, Section 365(h)(1) does not protect the telecom tenant lessee as the lender mortgagee’s senior rights arise under “applicable non-bankruptcy law”:¹³ specifically, state law foreclosure remedies.¹⁴

2. Foreclosures and Bankruptcy Sales: What Happens to the Telecom Tenant When the Property is Sold?

Thus, while a telecom tenant that is a true lessee has a right of occupancy under the Bankruptcy Code upon the lessor’s bankruptcy, that right is probably extinguished if a lender forecloses on the building. This is because the lender/mortgagee will have a security deed securing its mortgage that takes priority over any rights that a tenant might obtain from the debtor/landlord.¹⁵ The lessee’s rights under the lease, even if recorded in a memorandum of lease, would typically be junior to that of a senior mortgagee. Consequently, even a recorded lease would not alone (at least under some state laws)¹⁶ protect the tenant/lessee from a foreclosure sale by the senior lender/mortgagee and a “kick-out” by the subsequent purchaser. In such circumstances, unless the lessee were to have a non-disturbance or subordination agreement that is binding upon a senior mortgagee, a lessee’s possessory rights under 365(h)(1) would not survive a foreclosure sale.

As a practical matter, most lenders would typically prefer to keep good paying tenants in the foreclosed property rather than evicting them. Even so, there is a possibility that the lender may force the tenant into *in terrorem* renegotiation of its lease agreement - especially one negotiated at “below market” rates prior to the foreclosure. Moreover, there is still another kick-out threat facing the telecom lessee in such circumstances: the sale of the debtor’s building under section 363 of the Bankruptcy Code (a so-called “363 sale”).¹⁷

Section 363(f) of the Bankruptcy Code permits an entity to purchase property of the estate, under conditions approved by the Bankruptcy Court, “free and clear of any interest” in

¹³ *Id.*

¹⁴ See generally, M. Barter, “Section 363 Sales,” 59 Business Lawyer 2 (2004) at 479-480 and cases cited therein (discussing Indiana law granting mortgagee foreclosure rights as applicable non-bankruptcy law within meaning of Section 365(h)(1)) (“363 Sales”).

¹⁵ Where there is a clause in the lease making the rights of the lessee “subject to” a subsequent security deed, the foreclosed security deed has priority. See *Trust Co. Bank v. Atlanta v. Atlanta Speedshop Dragway, Inc.* 208 Ga. App. 867, 432 S.E. 2d 608 (1993).

¹⁶ Under Georgia law, for example, a prior mortgage or security deed recorded on the date of the lease takes priority, and a foreclosure leaves the lessee as a mere tenant at sufferance, subject to dispossessory proceedings. *First Federal Savings & Loan Assn. v. Shepherd*, 131 Ga. App. 692, 206 S.E. 2d 571 (1974). See also *363 Sales supra* at 479-480.

¹⁷ 11 U.S.C. § 363 (allowing a trustee to sell property of a debtor’s estate outside the ordinary course of business).

such property. While the judicial circuits appear to be split on this issue,¹⁸ at least one Circuit Court of Appeals has held that such a 363 sale wipes out not only existing liens but also leasehold possessory interests under Section 365(h)(1).¹⁹ True, under Section 363(e) of the Bankruptcy Code, a telecom tenant/lessee whose rights are extinguished under a 363 sale would have the right to seek adequate protection from the Bankruptcy Court.²⁰ But such protection would typically be some form of monetary compensation and, probably insufficient to compensate the lessee for the loss of building access and other possessory rights.

3. And a Scary Outlook for Enterprise Customers.

In short, if the commercial real estate market does indeed become the next “bubble,” it will present ominous implications for telecom tenants – including the threat of eviction even under a well-negotiated lease. In such circumstances, the outlook for enterprise customers is also scary. Enterprise customers have contracts with carriers who are telecom tenants, with their own collocation, hosting, and central office lease agreements all subject to the landlord bankruptcy risks described above. A carrier/lessee providing hosting or collocation services whose landlord undergoes foreclosure or bankruptcy could perhaps exercise force majeure or other rights to excuse obligations to serve or perform obligations to the enterprise customer. Moreover, many enterprise agreements make enterprise customers’ occupancy rights expressly subject to compliance with the conditions of the carrier’s lease and the landlord’s rights.

Worse still, if a foreclosure resulted in the lender’s termination of the carrier/lessee’s right to be on the property, then the enterprise customer could conceivably be stuck – possibly without any right to retrieve their property (having no access rights to building) or other remedies (since the carrier’s obligations may well be excused by force majeure). If that were to happen in, for example, a “tele-hotel”, a collocation facility shared by multiple carriers, the consequences could be unthinkable – but that’s what they said about Lehman.

¹⁸ See generally *363 Sales supra*.

¹⁹ *Precision Industries v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. Ind. 2003) (“*Precision Industries*”). See *id* and cases cited therein. In *Precision Industries*, the Seventh Circuit explained that section 363(e) provides a mechanism for lessees to protect their interests: it directs the bankruptcy court to “prohibit or condition [any sale of the underlying property] as is necessary to provide adequate protection of such interest.” *Id.* at 545. The court reasoned that the lessee had a remedy available to it, and while it was not guaranteed continued possession of the property, the lessee was entitled to adequate protection and could seek to “be compensated for the value of its leasehold-typically from the proceeds of the sale.” *Id.* at 548.

²⁰ Section 363(e) of the Bankruptcy Court provides, in relevant part, that “...on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing shall prohibit or condition such use, sale or lease as is necessary to provide adequate protection of such interest.” See, e.g., *Precision Industries v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. Ind. 2003) (“*Precision Industries*”). But see *363 Sales, supra* at 490-491 (arguing that *Precision Industries* was wrongly decided).

IV. What Should Telecom Tenants Do?

So what should telecom tenants do to protect themselves? The answer depends, in part, upon the time left on their lease, their negotiation leverage, the financial stability of their landlord, and (where their collocation space is on their carrier's premises) that of their carrier and its landlord.²¹ Due diligence can perhaps put to rest – but in some cases may raise – concerns about the longevity of the lease and the lessor.

If there are such concerns, then the tenant's efforts should start with an examination of the lease and the mortgage or security documents. Its right to be on the premises must be a leasehold interest protected by subject to Section 365(h)(1), not just a license or other terminable access right in the event of the landlord's bankruptcy. The tenant should then file a memorandum of lease providing record notice of its leasehold interest in the property. All of these considerations are of scant value, however, if the tenant is not in a position to negotiate them. That goes to the status of the lease. Protections may be sought during the negotiation of the lease or its renewal: thereafter, there is little incentive or consideration for the landlord to make such concessions.

Second, the tenant should seek to have its rights protected by a non-disturbance and subordination agreement between the landlord and its mortgagee or other lien-holder of the property. Here, for example, is sample language from such an agreement:

“Lender may require any and all tenant leases for any portion of the Mortgaged Property hereafter executed to be subordinate to its mortgage; provided, however, that Lender shall agree that so long as any tenant is not in default of its lease, possession of the premises leased to it will not be disturbed in the event of foreclosure of the mortgage or conveyance in lieu of foreclosure. All tenants shall agree to attorn to lender.”²²

Importantly, Section 510 of the U.S. Bankruptcy Code provides that valid subordination agreements negotiated outside of the landlord's bankruptcy are enforceable in the bankruptcy case.²³

Third, in the event of a landlord's bankruptcy, a telecom tenant should both file a proof of claim and carefully monitor the bankruptcy proceedings. Among other things, a telecom tenant that is a non-debtor tenant/lessee should participate in (and if necessary object to) a Section 363 Sale that would convey the property “free and clear” of its lease.²⁴ Finally, the telecom tenant, again in its capacity as a lessee, should also seek “adequate protection” of its possessory interest under Section 363 of the Bankruptcy Code.

²¹ For a discussion of pre-bankruptcy protections in dealings with carriers, see *Telecom Travesty*, *supra*.

²² *In re: 641 Associates, Ltd., Debtor v. Balcors Real Estate Finance, et al.*, Bankruptcy No. 91-11234S Chapter 11, Adversary No. 93-0363S, Adversary No. 93-0456S, U.S. Bankruptcy Court (E. Dist. Pa.) 1993 Bankr. LEXIS 1191.

²³ 11 U.S.C. § 510(a) (“A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable non-bankruptcy law.”).

²⁴ See *363 Sales* at n. 156 *ff.* and accompanying discussion.

In conclusion, telecom tenants, among other worries brought on by the economic crisis, must add the possibility of commercial real estate bankruptcies to that list. This is an unusual time for these markets and, eventually, it too will pass. But for now, taking some of the above-discussed pre-cautionary measures may well be worth the effort. Please contact Walt Saprnov, Thomas E. Austin, or Andrew S. Glazier at Saprnov & Associates, P.C., (770) 399-9100 (or info@ www.wstelecomlaw.com) if you have any comments or questions about this alert.

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CLIENT ALERT¹

April 10, 2013

Cloud, Privacy, and Mobility: A Transactional Perspective

1. Introduction.

Recently, our Firm was privileged to participate in a number of public briefings on cloud and mobile computing, two trends rapidly reshaping the communications industry. One was a timely discussion, along with executives from Verizon/Terremark and IBM, on “Cloud and Mobility,” sponsored by the Wireless Technology Forum.² The other was a presentation on legal issues associated with location-based marketing in the mobile environment, sponsored by the Atlanta chapter of the Location Based Marketing Association (“LBMA”).³

In this alert, we share the highlights of those discussions, our distributed materials and, upon reflection, some additional thoughts. As always, our focus is a transactional one: negotiating, crafting and drafting contracts for cloud and mobile services in the new environment – with practice pointers set out below.

Importantly, a pervasive theme throughout such discussions is privacy - one exacerbated by recent governmental actions both here (California)⁴ and abroad (pending EU privacy

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²This Alert includes our attached materials presented at the Wireless Technology Forum event “What’s Up With Cloud and Mobility”, March 21, 2013, Atlanta, Georgia. For more information on the Wireless Technology Forum, please visit <http://www.wirelesstechnologyforum.org>.

³ This Alert also includes our attached materials presented at the LBMA event “The Implications of Mobile Tracking”, February 28, 2013, Atlanta, Georgia. For more information on the LBMA, please visit <http://www.theLBMA.com>.

⁴ See Atty. Gen. Kamala D. Harris Announces Expansion of Cal.’s Consumer Privacy Protections to Social Apps as Facebook Signs Apps Agreement, Office of the Atty. Gen., STATE OF CAL. DEPT. OF JUSTICE (June 22, 2012), <http://bit.ly/YZZpMi>. See also Complaint, California v. Delta Air Lines, Inc., No. CGC-12-526741 (Cal. Super. Ct.

legislation).⁵ Thus, we have attached to this alert our prior alert on “Drafting Privacy Protection Clauses in Technology Contracts.” Additional details on these privacy law developments follow as well.

2. Cloud and Mobility.

Cloud and mobile computing, together with “big data,” is fast becoming the new ecosystem for enterprise and small business communications, rapidly displacing the traditional premises-based models of computer processing and information delivery. This is coupled with a behavioral shift: as their workforce becomes mobile, enterprises increasingly accept - and at times subsidize - a proliferation of mobile pads, smart phones, air cards, thumb drives and other BYO (bring your own) devices for corporate communications. Among other disruptive effects, this trend is displacing the traditional, "command and control" paradigm of corporate information technology (“IT”) procurement.

Historically, corporate management (not employees) controlled all such devices, as well as their procurement. Increasingly, that is no longer the case. Cloud computing benefits, *e.g.*, substantially lower total costs of operation (“TCO”), are compelling. Add to this the ability of mobile employees to communicate with their devices as a collaboration tool for unified communications (“UC”) - and the marriage of cloud and mobility becomes pre-arranged.⁶ That said, along with its benefits, the combination of mobile and cloud computing presents some very serious risks for the enterprise - privacy and security chief among them.⁷

3. Legal Issues and Deal Points.

The combination of mobile and cloud computing - especially given heightened privacy concerns - creates major concerns when negotiating communications and IT procurement contracts. Along with other deal points, the parties to UC, mobile, and cloud computing procurement contracts must now contemplate the use (and allocate the risk) of employee-supplied mobile devices accessing sensitive corporate data residing outside the four walls of the enterprise.

Dec. 06, 2012). Note that California state legislators have also recently introduced a draft “California Right to Know Act of 2013” (Assembly Bill 1291) (extending disclosure obligations and other privacy protections on companies' use of "personal information").

⁵ See <http://www.spiegel.de/international/europe/the-european-union-closes-in-on-data-privacy-legislation-a-877973.html>. The European Parliament is currently considering draft amendments to EU Data Protection Law.

⁶According to the Unified Communications Interoperability Forum (UCIF), a non-profit alliance of technology vendors states, that “one important driver for the growth of UC ... is mobility and the remote worker. No segment is growing faster than mobile communications, and virtually every smart phone will be equipped with video chat, instant messaging, directory, and other UC features within a few years.” See http://en.wikipedia.org/wiki/Mobile_collaboration. (Citations omitted).

⁷ On this topic, see "Negotiating Privacy and Broadband Contracts," Sapronov & Associates, P.C., (available upon request at info@wstecomlaw.com).

Some of these important new developments are discussed in the attached materials that we hope you find of interest. In particular, see our overview of some of the legal issues and deal points when negotiating mobile/cloud contracts.

For questions or comments about this alert, please contact Walt Saprnov at wsaprnov@wstelecomlaw.com or Andrew Glazier at aglazier@wstelecomlaw.com.

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Attachments

1. Materials Presented at Wireless Technology Forum Event – “What’s Up with Cloud and Mobility” (March 2013).
2. Materials Presented at LBMA Event – “The Implications of Mobile Tracking” (February 2013).

Cloud & Mobility

WIRELESS TECHNOLOGY FORUM
Atlanta, Georgia

March 21, 2013

Outline of Remarks

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Enterprise Acceptance

- Rapid growth of cloud (Public, Private, & Hybrid) & mobile computing
 - Suggests increased enterprise acceptance
 - With Benefits over Premises -based applications
 - But issues still remain
 - Security is Primary Enterprise Concern
 - Especially with Expanding Mobile Workforce

Cloud Acceptance - Some Benefits

- Lower total cost of ownership (TCO)
- Faster application deployment
 - Storage Area Networks
 - Disaster Recovery
- Reduced IT staff requirements
- Reduced up-front “cap ex”
- Just-in-time / add-as-you-go purchasing

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Cloud and Mobility – Raises Issues

- Privacy and Security
 - Especially in Financial / Healthcare Industries
 - Even Less Control over Mobile Access
- Extended Outage / Loss of Data Center
 - No control (knowledge ?) of data location
- Service Level Agreements (“SLAs”)
 - Credits/ Termination Rights / Warranties (?)
 - Difficult to Craft for Mobile Access
 - Even More So with Cloud

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Some Legal Issues

- Privacy and Security
 - Contractual Protections a Must
 - Best Practices / Legal Obligations
 - Compliance with Law
 - Mobile Privacy Policies recommended /required [?] by
 - FTC; State Agencies (e.g., California “CalOPPA”)
 - Cyber-security
 - Obama Administration Executive Order
 - Data Ownership
 - No transfer of title to data
 - Reclamation right upon termination

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Some Legal Issues

- Hosting Considerations:
 - Similar to data center agreements
 - But without access rights or location control
 - Service only – no leasehold rights
 - Address power supply / outage/ “force majeure”
- Remedies for Failure
 - Termination (Walk-away) May Be Ineffective
 - SLA Credits
 - Damages:
 - Cover Damages
 - Liquidated damages (Not same as credits)
 - Escalation procedures

Conclusion:

– Final Key Issue

- Do not try this at home
- Call your lawyer
- ☺

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PRESENTATION FOR LOCATION BASED MARKETING ASSOCIATION (“LBMA”)¹

FEBRUARY 28, 2013
ATLANTA, GEORGIA

LOCATION BASED SERVICES (“LBS”): SOME LEGAL ISSUES

Outline of Remarks

I. LBS Applications

A. Overview

1. Navigation and Travel
2. Tracking and social Networking
3. Retail and Real Estate
4. Advertising
5. News and Weather
6. Device Management
7. Public Safety

B. Some Legal Issues

1. Privacy Violations (federal and state)
2. Agency Enforcement (FTC, FCC, DOJ)
3. Industry Specific: Graham-Leach Bliley Act; HIPPA
4. Civil Actions
 - a. Some privacy laws create a private cause of action (e.g., ECPA)
 - b. Breach of contract
 - c. Class action
 - d. Common law privacy invasion
 - e. Cable Act²

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5. Defenses to e.g., FTC enforcement, state action
6. Best Practices (disclosure and "opt-in" consent)

II. Privacy Laws

- A. Generally scattered - codified in multiple federal and state statutes
- B. U.S.
 1. Electronic Communications Privacy Act (ECPA)³
 2. State Wiretap Laws
 3. Federal Trade Commission Act⁴ (Fair Business Practices)
 4. Customer Proprietary Network Information (CPNI)⁵
 5. Children's Online Privacy Protection Act (COPPA)⁶
 6. State Specific Laws:
 - a. California Online Privacy Protection Act (CalOPPA)⁷
 7. Cable Act (Personally identifiable information)⁸
- C. Industry Specific
 1. Gramm-Leach-Bliley Act (GLB)⁹
 2. Health Insurance Portability and Accountability Act of 1996 (HIPAA)¹⁰
 3. Other:
 - a. Auto Records
 - b. Fair Credit Reporting
- D. European Union (EU)
 1. EU Privacy Directive
 2. Pending Legislation

²47 U.S.C. § 605 (prohibiting, with some exceptions, the publishing or divulging of transmitted or received communications by wire or radio).

³18 U.S.C. §§ 2510-2522 (prohibiting unauthorized interception of communications)(adding provisions of 18 U.S.C. §§ 2701-12 (Stored Communications Act) prohibiting access to stored communications).

⁴15 U.S.C. § 41, et. seq.

⁵47 U.S.C. 222

⁶ 15 U.S.C. § 6502; 78 Fed. Reg. 3972, 4005 (Jan. 17, 2013).

⁷ Cal. Bus. & Prof. Code §§ 22575-22579.

⁸ 47 U.S.C. §§ 338(i), 551 "Personally identifiable information" is not defined in the statute, but can be assumed to include "all individually identifiable information collected by a cable operator over a cable system regarding its subscribers." (Location Based Services, FCC Wireless Telecommunications Bureau (Report, May 2012)

⁹ Pub. L. No. 106–102, 113 Stat. 1338 (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.).

¹⁰ Pub. L. No. 104–191, 110 Stat. 1936 (codified as amended in scattered sections of 29 U.S.C. and 42 U.S.C.).

III. Enforcement

A. Government Action

1. Federal Trade Commission (FTC)
2. Federal Communications Commission (FCC)
3. Department of Justice (DOJ)
4. State Attorneys General¹¹

IV. Privacy Protections for LBS Applications

A. Consent ("Opt In" v. "Opt Out")

B. Notice / Disclosure

C. Privacy Policy

1. Defense to e.g., FTC enforcement, state action
2. Best Practices (disclosure and "opt-in" consent)

D. Acceptable Use Policy (AUP) (e.g., found on carrier websites)

E. Contractual¹²

F. Industry Standards - e.g., CTIA "Best Practices"¹³

1. Privacy notices
2. Categories of collected personal information / Intended use
3. Opt-in / Opt-out
4. Third party access and sharing
5. Security / breach notification
6. Retention ("right to be forgotten")
7. Contact information for questions

¹¹ Attorney General Kamala D. Harris Announces Expansion of California's Consumer Privacy Protections to Social Apps as Facebook Signs Apps Agreement, Office of the Atty. Gen., STATE OF CAL. DEPT. OF JUSTICE (June 22, 2012), <http://bit.ly/YZZpMi>.

¹² See Saprnov & Associates, P.C. "Drafting Privacy Clauses in Technology Contracts", Presented at Law Seminars International, Tele-briefing (August 16, 2012),

¹³ Best Practices and Guidelines for Location-Based Services, CTIA-The Wireless Association (Mar. 23, 2010) http://www.ctia.org/business_resources/wic/index.cfm/AID/11300

Additional References

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 - i. *Internet Privacy: The Views of the FTC, the FCC and NTIA: Hearing Before the Subcomm. on Commerce, Manufacturing, and Trade and the Subcomm. on Communications and Technology of the H. Committee on Energy and Commerce*, 112th Cong. (July 14, 2011), <http://democrats.energycommerce.house.gov/index.php?q=hearing/joint-hearing-on-internet-privacy-the-views-of-the-ftc-the-fcc-and-ntia>;
 - ii. *Protecting Mobile Privacy: Your Smartphones, Tablets, Cell Phones and Your Privacy: Hearing Before the Subcomm. on Privacy, Technology and the Law of the S. Comm. on the Judiciary*, 112th Cong. (May 10, 2011), <http://www.judiciary.senate.gov/hearings/hearing.cfm?id=e655f9e2809e5476862f735da16bd1e7>;
 - iii. *ECPA Reform and the Revolution in Location Based Technologies and Services: Hearing Before the Subcomm. on the Constitution, Civil Rights, and Civil Liberties of the H. Comm. on the Judiciary*, 111th Cong. (June 24, 2010), http://judiciary.house.gov/hearings/printers/111th/111-109_57082.PDF;
 - iv. *The Collection and Use of Location Information for Commercial Purposes: Hearing Before the Subcomm. on Commerce, Trade and Consumer Protection and the Subcomm. on Communications, Technology, and the Internet of the H. Comm. on Energy and Commerce*, 111th Cong. (Feb. 24, 2010), <http://democrats.energycommerce.house.gov/index.php?q=hearing/hearing-on-the-collection-and-use-of-location-information-for-commercial-purposes-subcommitt>.
 - v. *Privacy and Data Security: Protecting Consumers in the Modern World: Hearing Before the S. Comm. on Commerce, Science, & Transportation*, 112th Cong. (June 29, 2011), <http://www.gpo.gov/fdsys/pkg/CHRG-112shrg71313/pdf/CHRG-112shrg71313.pdf>.

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CLIENT ALERT¹

“Drafting Privacy Clauses in Technology Contracts”

The digital age has come with a price: the loss of privacy as we knew it. Identity theft is among the fastest growing crimes, and Big Data has staggering implications for “online privacy.” So too with cloud computing. As more private information is sent to the “cloud,” the possibility of its loss escalates.

For the corporate steward of private information – whether a retail business, a financial institution, a hospital, an information service provider, or other custodian of personal data - the obligation of protecting such information entrusted to its care is now a priority. Recent, much publicized losses *en masse* of social security numbers and personal financial records stored in clearing house and other databases (mistakenly) thought secure all show the hazards of inadequate privacy protection measures.

So what is to be done? Within limits, the U.S. Congress for some time has tried (and continues) to legislate protections against the unauthorized use of private information. An alphabet soup of privacy laws - the Gramm-Leach-Bliley Act (GLB), the Health Insurance Portability and Accountability Act of 1996 (HIPAA), Children’s Online Privacy Protection Act (COPPA), Electronic Communications Privacy Act (ECPA), and the customer proprietary network information (CPNI) provisions of the Telecommunications Act of 1996 - are codified in the U.S. Code. Many states have enacted their own privacy and data security laws - and Congress regularly considers new privacy legislation affecting consumer online and mobile privacy. Meanwhile, across the Atlantic, expanded EU privacy protections, with serious implications for multi-national companies, will soon become law.

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The result is a patchwork of scattered privacy laws, all of which create instant potential liability for corporations engaged in the storage, use and retrieval of private information. There are no “one size fits all” privacy safe harbors. When a corporation shares private information with third parties, protecting it is largely a matter of self-help. The corporation disclosing data must ultimately reduce the recipient’s obligations to protect that information to binding and enforceable contractual obligations.

And that brings us to the topic of this alert. Law Seminars International is pleased to put on a 90 minute tele-briefing on “Drafting Privacy Clauses in Technology Contracts.” It will include a primer on U.S. and EU privacy laws and a workshop on drafting privacy clauses in corporate technology contracts (using the financial industry as an example). Here are a few of the discussion topics.

1. Some Privacy Issues Arising Under Enterprise Technology Contracts.

As mentioned, there are a number of domestic² privacy laws that create privacy protection obligations for corporate enterprises. These include - but (importantly) are by no means limited to - the Electronic Communications Privacy Act (“ECPA”),³ including the Wiretap Statute (Title III) and the Stored Communications Act, state wiretap laws (imposing prohibitions on interception of telephonic and other communications under state law), and industry-specific privacy laws such as GLB and HIPAA.

While the formulations vary, these statutes prohibit, in varying degrees, the loss or misuse of individuals’ private information that is within the possession or control of the corporate entity entrusted with its safekeeping, and impose substantial obligations if such a loss or misuse occurs.

For example, federal laws limit the ability of financial institutions and certain other entities to share personal private information with others for marketing purposes, as well as impose obligations that bear on vendor contracts. Similarly, the interception of telephonic or electronic communication without the consent of at least one of the parties is generally a violation of the ECPA - that carries potential criminal and civil liability - as well as the laws in many states.⁴ Affirmatively permitting a third party vendor to do so (*e.g.*, for security reasons) in a hosting or managed service contract could conceivably trigger aid and abet liability for the corporate party. While the ECPA contains certain carrier exemptions from interception liability for purposes of network protection, those exemptions may or may not be available to a corporation that grants a third party vendor the contractual right to “snoop” on its employees or customers.

² A discussion of foreign privacy laws such as the EU directive and pending EU privacy legislation, no less important to the multi-national enterprise, are beyond the scope of this discussion but will be addressed in a future alert.

³ 18 U.S.C. §§ 2510-2522 (amending Title III of the Omnibus Crime Control and Safe Streets Act of 1968).

⁴ 18 U.S.C. § 2511(2)(c)-(d) (prohibiting interception of telephone communication unless by or with consent of one of the parties). Most states have either a similar “one party consent” exception to such interceptions or require “all party consent” to such interception.

A related quandary arises with CPNI. Under the statute and related FCC rules, disclosure of CPNI by a telecommunications carrier to a third party requires subscriber consent. A corporation's contractual grant of such consent to a carrier that includes CPNI of its employees or customers (who do not know that their proprietary network information is disclosed) is problematic. For example, assume that an enterprise customer grants a carrier a contractual right to share CPNI with that carrier's affiliates for marketing purposes. Assume further that the enterprise contract gives the carrier an unfettered assignment right – for example, to a successor in interest following a merger or acquisition. In that case, query whether the enterprise customer inadvertently grants the carrier the right to share CPNI with a third party assignee (and with that assignee's marketing affiliates)?⁵

2. Protecting Private Information in the Contract.

Assume that an enterprise customer, such as a financial institution, is entering into an agreement with one or more technology vendors for the lease or purchase of voice, data (*e.g.*, Ethernet, IP, MPLS, SIP trunking), Internet access, hosting, cloud computing or managed services. How can that customer protect itself from a (perhaps inadvertent) disclosure of private information – and thus a potential violation of privacy laws?⁶ How should the customer contractually obligate the vendor to protect private personal information as GLB requires?⁷ Here are a few practice pointers.

a. Confidentiality.

A “confidentiality” clause stating the parties’ respective obligations to protect confidential information is a staple of virtually every technology contract. Customarily, the agreement obligates the parties to protect information that is either clearly marked or presumed by law (*e.g.*, trade secrets) to be “confidential.” The contract will usually describe the degree of effort required of the recipient to protect such information - no less than the care with which the recipient treats its own confidential information or a reasonable care standard, an obligation to return or dispose of it upon termination, and covenants not to use or disclose it except as the contract permits. There are customary carve outs for information whose confidential status is vitiated by a third party disclosure, independent discovery, and the like. Finally, confidentiality clauses typically will survive for some period of time following the contract expiration or termination.

One approach to privacy protection is to sweep CPNI, GLB, or other legally protected private information into the “including but not limited to” ambit of the “Confidential Information” definition. Note, however, that this may prove insufficient as confidentiality clauses typically include carve-outs (*e.g.*, information disclosed without fault of the parties, independently developed). Such clauses also typically permit the sharing of such information

⁵ The FCC's rules permit sharing of a target carrier's CPNI upon consummation of a merger or acquisition but only with prior (blanket) notice to the affected subscribers. *See* 47 C.F.R. § 64.2008 (a)-(b).

⁶ While this discussion reflects the enterprise customer's perspective, much of it applies to wholesale agreements entered into by carriers or other providers with one another.

⁷ *See* 15 U.S.C. §§ 6801-6809, 6821-6827 (requiring financial institutions to provide consumers with privacy notices and opt out rights, develop a written information security plan, and to implement safeguards against pretexting).

with third parties - *e.g.*, with subcontractors on a need to know basis. Careful review of these carve-outs is of course essential.

b. Entire Agreement (Merger Clause).

The parties' agreement - together with its confidentiality provisions - probably consists of multiple documents. Most carriers incorporate terms and conditions on their website (*e.g.*, "Service Guides," Acceptable Use Policies) as well as (where applicable) state tariffs, all typically incorporated into the master services agreement. Importantly, the customer should ensure that these are both consistent - and that its negotiation of confidentiality protections is not superseded by "hidden" provisions elsewhere. For example, carrier treatment of CPNI may also sometimes be buried in such hard-to-find terms and conditions. An order of supercedence in the master agreement should ensure that it does not override privacy protections agreed to in the master.

c. Compliance with Laws.

The agreement will typically call upon the parties to comply with applicable law(s), sometimes qualified as to materiality or knowledge. The customer should ensure that this obligation is mutual - and perhaps expressly include within its scope the vendor or carrier's obligation to comply with CPNI, GLB, or other applicable privacy laws: for example, the EU Privacy directive as applicable to international telecom service contracts. Note, however that while CPNI compliance is the carrier's obligation, GLB compliance is that of the financial service provider. GLB specifically requires covered entities to have agreements with third party providers that have access to or use of protected information.⁸ This obligation - and the penalties for non-compliance - attaches to the customer, not to the vendor.

d. Liability, Indemnification, and Remedies.

A contractual remedy, however, is just that: it gives the non-breaching party a right to seek relief but it does not undo the damage. Thus, in addition to damages, remedies for a threatened or continued confidentiality breach will typically include injunctive relief. But that is of little use as to the information that has been disclosed. Where the disclosure causes liability or damages for the disclosing party, then other remedies should be considered.

This raises the question of damages. While most vendor contracts typically disclaim consequential, indirect or other extraordinary damages, the draconian consequences of a privacy breach may compel a thoughtful consideration as to what kind of damages are recoverable for a recipient's breach of statutorily protected information may well be advisable. The standard contract remedy of actual money damages as a result of a breach may be inadequate since the bulk of the loss may be suffered by third parties whose data may have been compromised. If that is true, the proper drafting of the indemnification provisions will be even more important.

⁸ See 16 C.F.R. § 314.4(d)(1)-(2) (requiring companies to reasonably select service providers that are capable of maintaining appropriate safeguards for customer information and contracting with those providers to require them to implement and maintain such safeguards).

Another remedy to consider is indemnification. Again, there are practical limits: notably the solvency of the indemnifying party. Similarly, indemnification from statutory (and possibly criminal) liability for a customer for a privacy violation is difficult to craft. For example, it may cover legal defenses but not the damage to good will and other adverse consequences that are difficult but not impossible to quantify. Liquidated damages are another possibility – but most state laws will enforce them only if actual damages are difficult or impossible to quantify, the liquidated amount is a reasonable pre-estimate, and the payment is not a penalty.

All of these considerations and more make the drafting of privacy protection clauses a challenge, one taking on increased importance as privacy protection becomes more elusive. For more on this timely topic, please attend Law Seminars International tele-briefing on “Drafting Privacy Clauses in Technology Contracts”:

<http://www.lawseminars.com/detail.php?SeminarCode=12BROADTB>

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Firm Summary

Sapronov & Associates, P.C., an AV Peer Review Rated Law Firm, has decades' long experience in the representation of corporate - including some of the largest in the U.S. and abroad - telecommunications and broadband transactions and regulation. The Firm was recently named the 2013 Georgia Communications Law Firm of the Year by Global Law Experts. For more information, please visit us at www.wstelecomlaw.com.

Broadband/Telecom Transactions - The Firm represents clients in a wide variety of telecom transactions, including complex commercial transactions for enterprise and wholesale sourcing, *e.g.*, managed service, equipment, wireless backhaul, data center, fiber buildout, satellite, IP networks, Internet and broadband access agreements. Our experience dates back to the AT&T Consent decree, spans a wide variety of wireless and wireline technologies, and covers negotiations with every major domestic telecommunications carrier - and with many abroad. We have successfully negotiated telecom contracts with a cumulative deal value of well over a Billion Dollars.

Telecom Regulatory - Firm attorneys' regulatory experience - that goes back to the 1980s - includes client representation before the Federal Communications Commission ("FCC"), all public utility commissions throughout the U.S., and numerous other state and local governmental authorities affecting telecommunications related matters. We routinely assist clients with domestic and international entry, rate regulation, financing, administrative (including Universal Service Fund reporting and payments) and other compliance. Clients include DSL, cable, and broadband wireless providers as well as "traditional" local and long distance, operator service and public communications providers. We also have extensive experience in local exchange interconnection negotiations, tariff and service guide preparation. The Firm also handles complex dispute resolution, settlement negotiations and complaint proceedings before the FCC, state commissions, and other forums.

Privacy - Our Firm has extensive experience in representing clients in compliance with the Electronic Communications Privacy Act, state wiretap laws, and the EU directive. In recent years, we have advised clients on privacy implications in transactions requiring protection of personal information and other U.S. and foreign privacy rights.

Enterprise and Wholesale Sourcing; Procurement; Voice / Data / Managed Services / IP Telephony - The Firm's procurement practice includes complex commercial agreements for voice, data, managed services and other enterprise and wholesale sourcing agreements. In recent years, our experience has encompassed emerging IP technologies such as VOIP, MPLS, wireless and Broadband Internet access - with emphasis on crafting "SLAs" and other buyer protections when purchasing new technologies. We have represented clients in "state of the art" nationwide broadband wireless backhaul and fiber buildout transactions - as well as in large data center agreements, both in the U.S. and abroad.

Broadband / Cable / Wireless - The Firm's broadband, cable, and wireless practice includes building access, pole attachments, rights-of-way, cable telephony, fiber builds, DSL and wireless interconnection/access transactions - with leading edge experience in emerging broadband technologies: Voice-over-IP, Video (IPTV), Broadband Wireless access (Wi-Fi, WiMAX) and wireless backhaul.

Building Access / Multi-Tenant / Real Property - We have represented some of the largest landlords in the U.S. in building access transactions and regulation. Among these is a nationwide Wi-Fi agreement for the largest domestic corporate apartment manager. We routinely represent clients in rooftop and building access, riser cable, and "forced access" issues for both telecommunications and cable. On the provider side, we have represented broadband wireless providers in hub-and-rooftop access and lease agreements. We have represented shared tenant service providers in regulatory and transactional matters since the 1980s. Our experience also includes numerous "in the ground" transactions such as fiber leasing, indefeasible rights-of-use, pole attachments, rights-of-way franchises, easements, and dealings with municipalities.

Finance / M&A / Bankruptcy - The Firm has represented numerous clients in telecommunications finance, transfer of control and related transactions. Clients include private equity firms and hedge funds, as well as borrowers. Matters include multi-party telecom contracting for private equity portfolio companies; regulatory approvals for financing, securities, mergers and acquisitions; carrier build out and vendor financing; distressed asset and claim purchases and other bankruptcy matters.