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insights

TYPES NOT MAPPED YET March 07, 2018 | TTR not mapped yet | Matt I. Hafter

Data in the cloud: What if the cloud provider goes bankrupt?

"In God we trust. All others must bring data."

— W. Edwards Deming

With data being the new "coin of the realm," those who control and exploit data have a winning advantage over competitors. This piece focuses on control of data in the unique situation of a cloud hosting provider's bankruptcy.

Data is a strategic asset with enormous value. For example, in Caesars Entertainment Operating Corp. Inc.'s Chapter 11 bankruptcy, creditors argued that the data from Caesars' "total rewards customer loyalty program" was the bankruptcy estate's most important asset with a valuation of $1 billion.[1]

Storing and processing data on the "cloud" has been a crucial tool to exploit data. Cloud storage enables multiple users to take advantage of a hosting company's servers and physical locations to store data, which users access over the Internet. In turn, this allows developers (customers of the cloud provider) to develop "software (or infrastructure, or platform) as a service" platforms that otherwise would be cost-prohibitive since each platform would require its own physical infrastructure.

But what happens to the data when the cloud provider becomes subject to bankruptcy proceedings? Does the automatic stay imposed at the beginning of the bankruptcy case prevent customers of cloud providers that host data from accessing or retrieving their data? This is not an academic question – there are several recent examples of cloud providers at or near failure.

The filing of a petition for bankruptcy invokes the automatic stay, under Section 362(a) of the Bankruptcy Code, which prohibits all adverse actions taken against the debtor. All collection or litigation against a company must stop, and any company doing business with the debtor may not take any actions that would be adverse to the debtor's viability. When a company files for bankruptcy under Chapter 7, all management of the business shifts from the shareholders or board (with a corporation) or its members and managers (with a limited liability company or partnership) to the appointed Chapter 7 trustee, who takes control over the debtor's assets.

In a Chapter 11 case, the debtor generally remains in control of its own assets. The question then, is whether the data is the "property of the estate" under Section 541 of the Bankruptcy Code, or whether data belong to the users or customers? If the data is property of the estate, the automatic stay prohibits any attempt to regain control over the data without first seeking relief from the automatic stay. With a cloud provider, customers are going to want to continue to have access to their data. However, if the debtor "owns" the data or information, what happens to the data in the event of a bankruptcy?

For the answer, we leave the 21st century world of bits and bytes and return to the 16th century and the growth of the mercantile economy and chattel, where it seems that the concept of a "bailment" first appears. In essence, as an Illinois Supreme Court case in 1899 states, a bailment is "the delivery of goods for some purpose, upon a contract … that after the purpose has been fulfilled [the goods] shall be redelivered to the bailor, or otherwise dealt with according to his directions, or kept till he reclaims them.[2]" Today, rather than wagons or cattle, the cases deal with automobile tires and data. Building on the bailment concept, a customer may want to discuss with its attorney and data security professional steps to help protect its cloud data. These steps could include:

Diligence. Perform thorough financial diligence, including assessing the risk to the provider from a concentration of customers and its ability to access capital.

Contract Provisions. Negotiate contract terms providing that:

- The delivery of data to the host does not transfer any element of ownership; and, as between the customer and data host, the customer retains all right, title and interest in the data.
- The provider's role with respect to the data is limited to a storage function to fulfill its obligation to provide hosting services, and the provider will not interfere with the customer's access.
- The provider is a "bailee for hire" with respect to the data (that is, a person compensated for holding the property as bailee).
- The provider (or any successor, *i.e.*, a bankruptcy trustee) will delete, or will return the customer's data in an agreed-upon format, at any time at the user's request.

Contingency Planning. Plan for provider insolvency:

- Address the potential loss or interruption in access to data from a provider's bankruptcy or failure in the disaster recovery plan, to the same extent as a natural disaster.
- Identify bankruptcy counsel who can be activated to promptly get into court and prepare a motion to obtain relief from the automatic stay.
- Determine whether business interruption insurance protects the customer from a provider's inability to make data available.

Arguments. If seeking relief from the automatic stay, possible points to argue[3]:

- Even without express language in the agreement, the relationship between the host and user is that of bailee/bailor, and the host possesses the data solely for purposes of storage with no ownership stake.
- The data should be subject to a constructive trust in favor of the user, so that the host does not obtain property to which it is not entitled and which would result in unjust enrichment without such a trust.
- Ultimately, the argument should focus the concept that the data is not "property of the estate" under Section 541 of the Bankruptcy Code.

If the contract specifies that customers retain ownership of data, it is still wise to proceed with caution. In Chapter 11, the debtor is still in business and continues to operate, so any attempt to disrupt the business will be viewed unfavorably. This is one instance where it may be better to "ask for permission" than for forgiveness, and seek relief from the automatic stay, even if the data is technically not "property of the estate." During the course of the Chapter 11 case, close attention should be paid to disposition of the contract. If there is a sale of the debtor's assets under Section 363 of the Bankruptcy Code, the contract may be assumed and assigned to the purchaser of the assets under Section 365. However, the rules governing the ability to "assume and assign" executory contracts do not extend to patent and copyright licenses. So the intellectual property lawyers should be consulted as well.

Data privacy may also become an issue in the bankruptcy case when the business assets are being sold and those assets include private consumer data. When the Bankruptcy Code was dramatically changed in 2005, Section 332 was added to the Code to address concerns over the sale of private consumer data in bankruptcy sales. Section 332 allows for the appointment of a "consumer privacy ombudsman" to represent consumer's interests before the court. The bankruptcy court may order the U.S. Trustee to appoint a "disinterested" individual to serve as a consumer privacy ombudsman, and provide the court with information to consider the facts and circumstances of the proposed sale or lease of personally identifiable information. Such information may include 1) the debtor's privacy policy; 2) the potential losses or gains of privacy to consumers if the sale is approved by the court; 3) the potential costs to consumers if the sale is approved by the court; and 4) the potential alternatives that would mitigate potential privacy losses or privacy costs to consumers.

In the rough and tumble of a bankruptcy, the focus is to protect the assets of the debtor for the eventual benefit of creditors. Ideally, though, customers of hosting companies can stay out of the skirmish altogether or quickly escape with careful planning. Above all, it is critical that customers not lose the value of their data.

"*If we have data, let's look at data. If all we have are opinions, let's go with mine.*"
– Jim Barksdale, former Netscape CEO.

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1 "Big Data at Caesars Entertainment – a One Billion Dollar Asset?," Forbes, May 18, 2015

2 *Knap, Stout & Co. v. McCaffrey*, 52 N.E. 898, 899 (Ill. 1899).

3 See, generally, *In re: Mississippi Valley Livestock, Inc.*, 745 F.3d 299, (7th Cir. 2014) (citing Illinois law in a bankruptcy involving cattle, proving that some things never go out of style).

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