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Virtual Warehouses and Potential Assertion of Article 7 Liens

R. Stephen McNeill December 6, 2017

Cloud-based storage systems, which allow customers to use the Internet to store their data at an off-site location, are an increasingly important part of an ever-digitizing economy. The off-site locations, or data centers, consist of a number of servers storing customers data. When a customer wishes to save data to a vendor s servers, the customer sends copies of the files over the Internet to the data center. The user can then retrieve or access the information via a web-based interface. The use of the external storage systems allows customers to increase their storage capacity, simplify their IT tasks, and easily back up data. *See* Jonathan Strickland, *How Cloud Storage Works* , *How Stuff Works* (Apr. 30, 2008).

Like other vendors, cloud-based vendors have to contend with nonpayment. Traditional vendors who possess the goods of others can rely on a warehouseman s lien under article 7 of the Uniform Commercial Code (UCC) as a recourse in the event of nonpayment. As the use of cloud-based storage systems increases, the likelihood of a cloud storage vendor asserting a warehouseman s lien on data stored for its customer is likely to increase as well.

Warehouseman s Liens: An Overview

Warehouseman s liens are possessory liens arising under article 7 of the UCC. U.C.C. § 7-209 10 (2003). They allow a bailee (an individual or entity entrusted with goods) to assert a lien on goods in its possession when a bailor (an individual or entity who entrusts goods to the bailee) fails to pay the fees incurred in the storage or transportation of those goods. These liens allow the warehouseman to detain and eventually sell the goods up to the value of the outstanding charges. Under section 7-209(c) of the UCC, the warehouseman has priority over (1) the bailor, (2) any party that entrusted the goods to the bailor such that the bailor could have effectively transferred rights in those goods to another, and (3)

anyone who acquiesced in the bailor s procurement of a document of title covering the goods.

Warehouseman s Liens: Assertion by Cloud Storage Vendors
Although no court has analyzed the ability of a cloud storage vendor to assert a warehouseman s lien on data stored in the cloud, the UCC provides that such a lien may be asserted by any entity that (1) is a warehouse and (2) has a valid warehouse receipt or storage agreement covering the goods. Thus, a cloud storage vendor should be able to assert a warehouseman s lien if (1) data is a good under article 7 of the UCC, (2) cloud storage vendors are warehouses under article 7, and (3) data is stored on the cloud vendor s servers pursuant to a storage agreement or warehouse receipt. Each of these issues is examined below.

> **Is data a good?** Article 7 defines *goods* as all things treated as movable for the purposes of a contract for storage and transportation. U.C.C. § 7-102(7). Despite being intangible, data is likely a movable thing because it can be transmitted from one place to another and contained in a tangible medium.
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> Electronic data consists of two separate elements: (1) the knowledge about the customer and (2) the embodiment of that knowledge on a computer. Knowledge may not be a movable thing because it exists as a form of intangible intellectual property. However, the embodiment of the data is a movable thing because once the data is embodied and stored in a computer, it has an existence distinct from the knowledge. This separate physical existence can be transmitted over the Internet to a vendor s servers and therefore is movable. *See Advent Sys. Ltd. v. Unisys Corp.*, 925 F.2d 670, 674 75 (3d. Cir. 1991) (describing software as consisting of intangible intellectual property and the embodiment of that property in a tangible medium). Thus, data could be considered a movable thing under article 7. *See Rottner* v. *AVG Techs. USA, Inc.*, 943 F. Supp. 2d 222, 230 (D. Mass. 2013).
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> Moreover, regulations restricting the sale or transfer of data likely would not affect the classification of data as a good. Several statutes prohibit business entities from selling or transferring their data to third parties when a company s privacy policies prohibit the sale of that information. *See, e.g.*, Report of the Consumer Privacy Ombudsman, Case No. 15-10197 (BLS), at 17 23 (2015) (Docket No. 2148) (discussing statutes limiting the sale or transfer of personally identifiable information); *see also* Press Release, Fed. Trade Comm n, FTC Announces Settlement with Bankrupt Website, Toysmart.com, Regarding Alleged Privacy Policy Violations (July 21, 2000) [hereinfter FTC Press Release], https://www.ftc.gov/news-

events/press-releases/2000/07/ftc-announces-settlement-bankrupt-website-toysmartcom-regarding. Other statutes require data recipients to follow certain security procedures before they can receive data. *See* 78 Fed. Reg. 5565, 5572 (Jan. 25, 2013) (codified at 45 C.F.R. § 160.103) (stating that cloud storage providers must comply with certain HIPAA standards).

Because data s movement is restricted in terms of who may purchase, sell, and access it, some people may argue that data is not a movable thing under article 7. However, the Toysmart bankruptcy proves otherwise. In the bankruptcy, the FTC sued Toysmart under the Children Online Privacy Protection Act, seeking to prevent Toysmart s estate from selling its customers information because Toysmart s privacy policy stated that it would not sell its customers data. Ultimately, the parties agreed to a settlement that prohibited an independent sale of the data and only allowed the sale to a buyer that agreed to be Toysmart s successor in interest with respect to the data and abide by Toysmart s privacy policies. FTC Press Release. This case demonstrates that the restrictions on transfers do not change the fact that data can still actually be transferred. The only thing that has changed is to whom it can be transferred, a restriction that necessarily admits data s movability.

Article 7, however, limits the universe of movable things that may be considered goods to things that are considered movable for the purposes of a contract for storage or transportation. U.C.C. § 7-102(7). The addition of this limiting language demonstrates that the primary policy question under article 7 is whether the thing movable should be subject to the rights, obligations, and duties . . . in a contract for storage or transportation. Linda J. Rush, *Article 7 [Rev.] Documents of Title*, *in* 7 Uniform Commercial Code Series § 7-102:9 (rev.) (West 2010). The drafters of article 7 did not intend to limit these rights and duties to traditional warehouse storage situations, though. *See Bank of N.Y. v. Amoco Oil Co.*, 35 F.3d 643, 653 (2d. Cir. 1994). Rather, whether something should be subject to the rights, obligations, and duties that attend a contract for storage or transportation depends on whether article 7 analogically applies to the situation. *See id.* at 649 53 (applying article 7 to a situation that was not commercially widespread at the time article 7 was adopted).

The only case to examine the extent of this limiting purpose on what may be considered a good is *Bank of New York v. Amoco Oil Co.* 35 F.3d 643.In *Amoco*, Bank of New York (BNY) sued Amoco Oil (Amoco) to recover

industrial grade platinum that Amoco leased from Drexel Burnham Lambert Trading (DBL) and that DBL used as collateral to secure a loan from BNY. The central issue was whether holding certificates given to BNY by DBL after DBL received them from Amoco were documents of title under article 7 and whether they were documents of title depended on whether Amoco was a bailee and therefore whether the platinum stored with Amoco was a good under article 7 of the UCC. *Id.* at 649. Amoco argued that the platinum was not a good under article 7 because Amoco was not holding the platinum for thepurposes of transportation or storage but was leasing the metal for use in oil refining. *Amoco*, 35 F.3d at 652.

The appellate court rejected Amoco s argument because the authors of the UCC did not intend to limit its applicability to warehousing and shipping. *Id.* at 652 53. Although the drafters of article 7 were primarily concerned with legal problems in warehousing and shipping, the court noted, the UCC drafters expressly stated they could not fully anticipate all technological developments but intended the UCC to be a semi-permanent piece of legislation that could be applied analogically to changing technology. *Id.* at 652 53; U.C.C. § 1-102 official cmt. 1. Therefore, the UCC had to be expanded by analogy to commercial practices that may not have been in widespread use at the time of the code s drafting. *Amoco*, 35 F.3d at 653. Applying this theory of interpretation, the appellate court held that the limiting phrase *for the purposes of a contract for transportation and storage* did not limit article 7 from encompassing goods that were commercially leased. *Id.*

In sum, data stored on a vendor s servers should be considered a good under article 7. Data, like prototypically warehoused goods, is stored by a third party at an off-site location. Data may be transmitted, like typical goods, and both require physical storage space. These factual similarities, combined with the principle that the UCC should be liberally construed to adapt to modern circumstances, indicate that data should be considered a good under the policy considerations of article 7.

Are cloud storage vendors warehouses? If data is a good, cloud storage vendors are likely warehouses. A warehouse is any person that is engaged in the business of storing goods for hire. U.C.C. § 7-102(13). Whether an individual qualifies as a warehouse depends on whether he has accepted the responsibility of safekeeping the property of others entrusted to him. *Enerco, Inc. v. SOS Staffing Servs.*, 52 P.3d 1272, 1275 (Utah 2002) (quoting *Barlow Upholstery & Furniture Co. v. Emmel*, 533 P.2d

900, 901 (Utah 1975)). The location where the goods are stored does not affect the analysis as the goods can be stored in any structure or location. *See Fireman s Fund Am. Ins. Co. v. Captain Fowler s Marina, Inc.*, 343 F. Supp. 347, 350 (D. Mass. 1971) (holding that a marina owner was a warehouseman even though the yachts were stored outside).

The requirement that the storage be done for hire generally means that the warehouseman cannot be storing its own goods or storing the goods for free although the fact that a fee is not being applied specifically for storage is not dispositive. *Ins. Co. of N. Am. v. NNR Aircargo Serv. (USA), Inc.*, 201 F.3d 1111, 1115 (9th Cir. 2000) (finding that holding a container of golf balls while preparing it to be picked up for delivery did not qualify an entity as a warehouseman because there was no evidence that the entity was actually storing goods for profit). *Contra Ferrex Int l, Inc. v. M/V Rico Chone*, 718 F. Supp. 453, 457 (D. Md. 1988) (Simply because there is not a separately billed charge for warehousing does not mean that [a terminal operator] is not paid for storing goods.).

Cloud storage vendors can therefore be considered warehouses under article 7 because they store a customer s data, the good, for a fee that is, for hire. That a server is not a typical warehouse is inconsequential because the location in which the data is stored does not matter.

Is the data stored pursuant to a warehouse receipt or storage agreement? Contracts between cloud storage vendors and their customers likely qualify as storage agreements; therefore, the vendors could assert a lien on data stored on their servers. For a warehouse to assert a lien on goods in its possession, the goods stored in the warehouse must be covered by a warehouse receipt or storage agreement. While a warehouse receipt must comply with two requirements U.C.C. § 1-201(15); Rush § 7-101:2 (rev.) a storage agreement is simply an agreement for storage of goods established in fact by a bargain between the parties. U.C.C. § 1-201(3).

The 2003 revisions to article 7 make it likely that a cloud storage contract will satisfy the requirement that goods be stored pursuant to a warehouse receipt or storage agreement. Prior to the revisions, article 7 required a warehouse receipt with specific information for a lien to be asserted. Post-2003, a lien may be asserted on items stored in a warehouse pursuant to a storage agreement. *Agreement* is liberally defined in article 2 of the UCC, and thus the requirements for documentation have been

significantly reduced. Rush § 7-209:1 (rev.). Due to this liberalization, any cloud storage contract likely would qualify as a storage agreement or warehouse receipt.

Therefore, if data is a good, it is likely that cloud storage vendors could assert a lien because they would qualify as warehouses storing customers data pursuant to a storage agreement.

Effect of Other Laws and Regulations

Although a cloud storage vendor may be able to assert a warehouseman s lien on data stored on its servers, the process for satisfying those liens remains unclear. Section 7-210 of the UCC enables a warehouse to enforce its lien through a private or public sale of the goods covered by the lien. The warehouse may sell goods that are stored with it in the ordinary course of business in any commercially reasonably manner as long as all people who have a claim of interest in the good are notified. For goods other than goods stored in the ordinary course of business with the warehouse, the warehouse must comply with additional requirements to sell the goods. These requirements are fairly straightforward for most goods, but government regulations, especially those regarding data privacy, may limit how, or even whether, cloud storage vendors could sell a client s data to satisfy its liens.

Conclusion

The current framework of article 7 likely would permit a cloud storage vendor to assert a lien on data stored on its servers.

For a cloud storage vendor to assert a warehouseman s lien, data would have to be considered a good under article 7 of the UCC, the vendor would need to be considered a warehouse under article 7, and the data would need to be stored on the vendor s servers in accordance with a warehouse receipt or storage agreement. While the first requirement is the toughest of the three to meet, data likely would be considered a good for the purposes of article 7 because it is an intangible thing that can be transmitted from one location to another, and the purpose of article 7 indicates that the definition of *good* should be adapted to changing technological circumstances. If data is a good, cloud storage vendors would likely be considered warehouses because they are engaged in the business of storing data for hire. Finally, under the latest amendments to article 7, any contract entered into by a storage vendor and a client likely would qualify as a storage agreement.

Although various governmental regulations would likely limit the cloud storage vendor s remedies with respect to these liens, the liens would still provide the vendor with priority of payment over other creditors, not to mention significant leverage in seeking payment from its client.

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