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# Best Practices for Security and Perfection of Digital Infrastructure Assets

## I. INTRODUCTION

The structured finance sector has seen an expansion of digital infrastructure asset classes and related financings. Digital infrastructure asset classes have grown to include data centers, wireless towers, distributed antenna/network systems, and fiber optic networks and installations. As digital assets will continue to evolve and the asset class further expands, there are multiple aspects that should be carefully analyzed in financing and securitizing these asset classes. One of the most important considerations for investors in any structured financing is the method of perfection of the security interest in the collateral being securitized. In more traditional types of securitization, it is sometimes easy to take this for granted—it is clear, for example, that in a securitization of residential mortgage loans, the mortgages themselves perfect the security interest in the underlying real property collateral.

Given the nature of digital infrastructure assets, however, and the newness of many types of collateral in this developing asset class, the method of perfection is not always obvious and often requires careful consideration. In fact, real-vs-personal property determinations can vary by state, may be influenced by local tax considerations, and can—for many complex asset classes—be effectively “hybrid” in nature.

## II. TYPES AND METHODS OF PERFECTION

In order to ensure that a secured party obtains a properly perfected security interest in its collateral, it is important to assess how the asset(s) which comprise the collateral may be treated from a perfection perspective. For perfection purposes, digital infrastructure assets typically will fall under one (or more) of the following categories: personal property, fixtures or real property. Depending on the classification, different methods of perfection are required. However, given the relative novelty of the state law treatment of many of these items of collateral, the determination as to whether a particular item of digital infrastructure



collateral falls into one (or more) of the above categories requires careful analysis. As a rule of convenience, personal property generally encompasses all tangible, intangible and moveable assets other than real property. Perfection of security interests in personal property is governed by the rules and requirements of Article 9 of the Uniform Commercial Code (UCC). “Fixtures” are defined as goods that have become so related to a particular parcel of real property that an interest in them arises under the real property law.<sup>1</sup> Article 9 of the UCC also governs perfection of security interests in fixtures, subject to the priority rules set forth below with respect to competing real estate record filings. Real property refers to land and immovable property permanently attached to land. While the UCC governs security interests involving personal property and fixtures, it does not, however, cover real property.<sup>2</sup> In addition to the classification of the property being perfected, the status of the debtor itself can also affect the appropriate form and location of collateral perfection.

#### **a. Personal Property.**

To perfect a security interest in most types of personal property, the UCC provides that a UCC-1 financing statement may be filed at the state-level—typically in the state of organization of the debtor for a debtor that is a registered organization.<sup>3</sup> A UCC-1 financing statement is a short form, which indicates the legal name and address of the debtor/grantor of the security interest and the secured party and must sufficiently describe the collateral.<sup>4</sup> The filing is typically filed with the secretary of state in the state where the debtor is “located,” which, in most cases for debtors who are registered organizations under state law, is the state under whose laws the debtor/grantor was organized.<sup>5</sup> Note that in order to maintain perfection in the collateral over time, a UCC-3 continuation financing statement must be filed before expiration every five years.<sup>6</sup>

#### **b. Fixtures.**

With respect to security interests in fixtures, it is important to remember that there are two ways to perfect. Under the UCC, fixtures include “goods that have become so related to particular real property that an interest in them arises under real property law.”<sup>7</sup> In practice, fixtures typically mean goods which have been attached to real property, been adapted for the use the real property, or are intended to be permanently attached to the real property.<sup>8</sup> A UCC-1 filing similar to that used for personal property may be filed at the state level indicating that such filing relates to fixtures. However, alternatively or additionally, a local-level filing may be made in the local county records where mortgages and deeds of trust in respect of the related real property would be filed. Both types of filings must sufficiently describe the property to be perfected, though a fixture filing at the local-level must also sufficiently describe the real property to which the collateral is related such that it would provide constructive notice of a mortgage if it was in a record of the mortgage of the related real property—i.e. in practice, collateral descriptions in fixture filings in the local real estate records are often necessarily more detailed in nature than UCC fixture filings at the state level.<sup>9</sup> Secured parties may opt to file both types with respect to the same collateral for added protection. The state-level filing provides a valuable notice function as well as technical perfection, while the local-level fixture filing provides perfection and protection against subsequent mortgage filings on the underlying real property; a security interest perfected by a local-level fixture filing also receives higher priority than a security interest perfected by state-level filing without a real estate description. At the most basic level, if there is not a local-level filing on record, and a subsequent mortgage or deed of trust is filed, that mortgage filing could prime the security interest in the fixture, as a security interest in a fixture, if not perfected at the local level, runs with the security interest in the real estate. But it is important to realize—especially in digital infrastructure transactions—the distributed nature of the collateral may lead to a more practical approach where the costs and complexity of local-level filings arguably outweigh the “small incremental benefit” of those filings. In fact, we believe this to be the case for most distributed digital infrastructure assets such as fiber, many wireless tower portfolios and distributed antennae networks.



### **c. Real Property & Title Insurance.**

To perfect a security interest in real property, a security instrument pledging the real property as collateral to the mortgagee must be filed with the appropriate local authority where the real property is located. Typically, this means filing the security instrument—a mortgage or deed of trust—with the local county clerk’s office or such other office that maintains land records. In addition to the filing of a mortgage or a deed of trust, when perfecting a security interest in real property, many investors also expect that the borrowers have obtained title insurance. While the security instrument establishes a lien and perfection, title insurance addresses ownership and lien priority. Insuring against potential ownership and lien priority issues further bolsters investor confidence that their interests in collateral cannot be undermined. There are two types of title insurance which indemnify an insured against losses associated with real property title defects: owner’s title insurance and lender’s title insurance. An owner of real property may obtain an owner’s title policy, which generally covers risks of title being vested in someone other than the insured, any defect in or lien/encumbrance on the title, lack of access and unmarketable title. A lender with an insurable interest in the related real property may obtain a lender’s title policy to protect itself. A lender’s title policy generally covers the risks associated with an owner’s title policy in addition to indemnifying a mortgagee from losses resulting from invalidity of its mortgage lien or lack of priority thereof. A lender’s title policy insures the lender up to a set dollar amount, usually set at the lesser of the value of the real estate so mortgaged and the original loan amount. While covering similar risks, the time of incurring losses/recovery differs between owner’s and lender’s title policies and should be weighed.

### **d. Transmitting Utility Status.**

The UCC has separate rules for entities that qualify as “transmitting utilities”, which generally include entities primarily engaged in the business of “transmitting communications electrically, electromagnetically, or by light.”<sup>10</sup> Given that certain providers of fiber optics transmit data in the form of light, this status can be applied to perfection of assets in securitizations of certain fiber optic networks, to the extent the applicable state(s) have adopted the transmitting utility provisions of the UCC. The UCC notes a to-be-designated filing office for transmitting utilities, which in many cases is the central filing office for the state or any office in the state in which the property is located.<sup>11</sup> Thus, if a debtor qualifies as a “transmitting utility” in the applicable jurisdictions, it can become clearer as to the appropriate place to file in order to perfect collateral.

## **III. APPLICATION TO DATA INFRASTRUCTURE TRANSACTIONS**

### **a. Pledges of Equity Interests.**

Often in securitizations, the equity interests of the securitization entities themselves—i.e. the special purpose entities that hold the underlying collateral—are pledged as collateral in addition to the assets pledged as the primary collateral.

Typically, limited liability company interests are classified as “general intangibles” or “securities”<sup>12</sup> under UCC Article 9 and may be perfected by filing a UCC-1 financing statement. Regardless of the type of property that constitutes the primary collateral, an equity pledge is valuable because it is straightforward, and often easier and quicker for the securitization trustee to foreclose on following an event of default—and, following a foreclosure on the equity—can also give the lender an “indirect” interest in an owner’s title policy<sup>13</sup>. An “equity pledge” is particularly advantageous in the real property context. For example, if an entity owns all of the real estate for a given securitization and the trustee forecloses on that entity, it will—by operation of the equity pledge—gain control of all property held by that entity without having to effectuate a foreclosure of the underlying real property. In a transaction with mortgages in different states, rather than having to go to different local courts to foreclose, the trustee can take control of the equity interest in the real estate holder, and effectively assume control of the related collateral and institute a remedies strategy at a deal-wide level. This is particularly relevant in digital infrastructure transactions given the distributed nature of the collateral and potential for “network effects” across the collateral pool—i.e. the whole can be worth more than the sum of the parts for certain types



of digital infrastructure assets. One important issue to note, however, is that in certain instances, underlying ground leases or other agreements may have “change of control” provisions that make such a pledge of equity impractical or would trigger a default under the lease. This can be an important diligence point when considering the best way to think about pledging collateral in data infrastructure transactions but is typically more relevant in collateral pools with relatively fewer properties with form leases with a landlord with higher negotiating power.

#### **b. Wireless Towers.**

Wireless towers have traditionally been treated as real property for perfection purposes, mostly without debate, given their relatively settled characterization as “real property” in most states. As such, investors in rated securitizations have typically required that security interests in wireless towers (or at least a substantial percentage of wireless towers in a given securitization) be perfected by the filing of a mortgage or deed of trust. That being said, wireless tower securitizations involve large numbers of towers, often thousands, distributed across multiple legal jurisdictions. As such, the time and expense required to file mortgages on such large tower portfolios have sparked discussions and analysis regarding potential alternatives—and it should be noted that the prevailing market in non-securitized financing of wireless tower assets is to rely on equity pledges of the entities holding the wireless tower collateral. In the future, investors and rating agencies in securitized transactions may become more comfortable with the replacement of mortgages with other structural mitigants such as filing of memoranda of lease and fixture filings coupled with the existing option of equity foreclosure through equity pledges and the related “indirect” benefit of an owner’s title policy, given the highly-distributed nature of the collateral and the relatively limited value of any individual site.

#### **c. Data Centers.**

Data center securitizations have been growing rapidly in volume and complexity in recent years. Similar to wireless towers, data centers are nearly always classified as real property given they are often fee simple or leasehold interests in a large building and the related ground interest. Due to the nature of data centers, there are typically far fewer data centers included as collateral in a securitization than there would be cellular towers—i.e. the collateral is less distributed and the value of any individual piece of collateral is much higher as a proportion of the entire transaction. Therefore, while rated wireless tower securitizations under the current methodologies may have a mortgage threshold requiring a majority of the collateral to be mortgaged (with significant exceptions), data center securitizations typically require mortgages over each data center included in the collateral, and we do not expect this practice to change given the high value of each item of collateral in a data center securitization.<sup>14</sup> Similar to wireless tower securitizations, data center securitizations typically include title insurance policies, which are closely reviewed at closing.

#### **d. Distributed Antenna Systems and Fiber.**

While not settled by courts in all states, rating agencies and investors in securitizations that include distributed antenna systems (“DAS”) as collateral have tended to treat the related DAS equipment as personal property, and the security interest therein has been perfected by the filing of UCC financing statements. The fact that DAS can be relatively easily uninstalled (as opposed to dismantling a large, affixed wireless tower) and do not typically remain once the underlying contract is terminated has lent itself to such treatment. Similarly, the treatment of optical fiber has not been settled by the courts, and we are aware of differing treatment amongst the states, but conventional wisdom is that the fiber itself should likely be treated as a fixture or personal property, and some states have treated it as such (including in certain tax rulings).<sup>15</sup> Because fiber networks typically span great distances and the network works as a whole unit, rather than blocks of individual operative units, such as cell towers, data centers or DAS networks, however, it could be difficult to file a fixture filing in each individual county office, especially for larger fiber networks. Because fiber networks cover so much distance, issuers have taken the position that such local level filings are not necessary, given that any one piece of fiber is not material to the network, and could likely be moved, if it was lost due to foreclosure on a mortgage of an



underlying piece or real property currently giving an easement or right-of-way to the fiber run. We have seen investors and rating agencies support this analysis in rated securitization transactions, given the pledge of equity interests and UCC fixture filings that can be made in such transactions. That being said, given the relative novelty of securitized fiber financings, at this time, such an analysis is expected to remain highly state- and jurisdiction-specific. Similarly, depending on the size and concentration of easements and related rights-of-way, it may make sense to record and/or perfect the borrower's interest(s) in certain of these easements and rights-of-way in the local filing offices for particular transactions where moving the fiber to an alternative parcel would be impracticable—but such an analysis should be made with a careful weighing of the costs and benefits of such recording. Issuers in fiber securitizations should also consider whether they qualify as a “transmitting utility” in their applicable jurisdiction, in which case the appropriate place of filing may be different than it would be for an issuer that did not qualify as a “transmitting utility”.

#### IV. CONCLUSION

While the views in this article reflect our observations and experience in the data infrastructure market to date, we note this remains an active and developing market, and it is possible that investors and rating agencies will continue to consider collateral protection as they evaluate these transactions. Therefore, there is no guarantee that issuers will continue to approach collateral perfection in the same way that they have to date. In addition, new types of digital infrastructure will undoubtedly present new questions with respect to collateral perfection. King & Spalding will continue to monitor developments in this area.



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<sup>1</sup> See U.C.C. § 9-102(41).

<sup>2</sup> See U.C.C. § 9-109(d)(11).

<sup>3</sup> Note that filing procedures vary by states. In certain states, including Georgia, all filings can be made at the local level, but are effective statewide.

<sup>4</sup> See U.C.C. §§ 9-502, 9-516.

<sup>5</sup> U.C.C. § 9-307.

<sup>6</sup> U.C.C. § 9-515.

<sup>7</sup> See U.C.C. § 9-102(41).

<sup>8</sup> See *T-Mobile Ne., LLC v. DeBellis*, 143 A.D.3d 992, 992, 40 N.Y.S.3d 164, 166 (2016), *affd*, 32 N.Y.3d 594, 118 N.E.3d 873 (2018).

<sup>9</sup> See U.C.C. § 9-502(b).

<sup>10</sup> U.C.C. § 9-102(a)(81).

<sup>11</sup> See, e.g. Fla. Stat. §679.5011(b)(2), O.C.G.A. 11-9-501(b).

<sup>12</sup> To the extent the issuer has opted-in to Article 8 of the UCC. See U.C.C. § 8-103(c).

<sup>13</sup> It is important to diligence any change of control provisions in the title policy.

<sup>14</sup> Given the importance of mortgages in perfecting collateral in data center securitizations, as a diligence matter, it is important to review the underlying leases to ensure there is no mortgage prohibition included.

<sup>15</sup> See *In re Litestream Techs., LLC*, 337 B.R. 705 (M.D. Fl. Feb. 17, 2006); *Level 3 Commc'ns, LLC v. Chautauqua Cty.*, 148 A.D.3d 1702, 50 N.Y.S.3d 202 (2017).