

Article Title: ARCHIVE | Legal Criteria: Revised Article 9 of the Uniform Commercial Code: New Standard & Poor's Criteria Data: (EDITOR'S NOTE: —This criteria article is no longer current. It has been superseded by the article titled "Legal Criteria For U.S. Structured Finance Transactions: Appendix III: Revised UCC Article 9 Criteria," published on Oct. 1, 2006.) On July 1, 2001, a substantially revised version of Article 9 of the Uniform Commercial Code will become effective in approximately 40 states. Article 9 governs the creation, perfection, and priority of security interests in most types of property (other than real estate). As a result, understanding and complying with the procedures set forth in Article 9 is important to protect the rights of investors and lenders involved in most types of asset-based lending, including asset-backed structured finance transactions rated by Standard & Poor's. Revised Article 9 is broader in scope than current law. It covers more types of transactions (for example, sales of promissory notes and payment intangibles) as well as additional asset types (such as deposit accounts and commercial tort claims). In addition, revised Article 9 simplifies the procedures for perfecting security interests in most types of collateral. However, the rules for determining priority of security interests under revised Article 9 are more complex than under current law. A rating is Standard & Poor's opinion of the creditworthiness of the debt being issued. The rating is based on information provided by the issuer and its advisors, including representations and warranties included in the transaction documents. Some of these representations and warranties contained in structured finance transaction documents address legal matters. Currently, Standard & Poor's requests legal opinions from transaction counsel to provide further comfort on some of these legal matters, for example on true sale and security interest issues. Regarding enforceability issues, however, Standard & Poor's generally assumes, without reviewing a legal opinion, that the transaction documents are legal, valid, and binding and that the provisions will have their intended legal effect. As a consequence of revised Article 9, Standard & Poor's will follow the approach used for enforceability matters and will no longer review security interest opinions. Standard & Poor's will continue to review true sale and nonconsolidation opinions. Standard & Poor's is not expressing any view as to whether legal opinions regarding security interest matters should be requested by any participants in a transaction. The New Criteria Security Interest Opinions No Longer Reviewed Given the limited scope of the security interest opinions typically delivered in structured finance transactions (see "FPPSI Opinion Primer" below), and in light of the revisions to Article 9 becoming effective beginning July 1, 2001, Standard & Poor's has concluded that these opinions will not add significant value to the structured finance rating process for many types of assets, including, among others, credit card receivables, mortgage loans, equipment leases, and automobile loans/leases. With respect to the legal conclusions expressed in the "creation" and "perfection" opinions (see "FPPSI Opinion Primer" below), Standard & Poor's believes that, generally, for purposes of the rating process, it is appropriate to assume that counsel for the transaction has drafted a security agreement and one or more financing statements that are effective to create and perfect, respectively, a security interest in collateral subject to Article 9. With respect to "priority" issues, this "opinion" typically is based on an officer's certificate of the borrower. Standard & Poor's recognizes that law firms are increasingly reluctant to deliver this type of "opinion" because it does not in fact provide a legal conclusion as to the priority of the trustee's or collateral agent's lien. Accordingly, for most structured finance transactions, Standard & Poor's will not request legal opinions regarding the creation, perfection, or priority of a security interest as a condition of issuing the rating. On a case-by-case basis, depending on the structure of the transaction and the nature of the asset, Standard & Poor's may request one or more of these matters to be addressed in a legal opinion. For example, Standard & Poor's may request security interest opinions for new types of assets or structures. As is current market practice, transaction counsel should contact Standard & Poor's legal department early in the rating process to determine what legal opinions will be requested by Standard & Poor's for the transaction. Reliance on Representations and Warranties Standard & Poor's believes that, subject to certain modifications and additions necessitated by the revisions to Article 9, the standard representations and warranties currently provided by the parties in structured finance documentation used in public securities offerings will, in most cases, adequately address security interest matters for purposes of the rating. While some of these standard representations and warranties are "legal" in nature, most relate to factual matters. When viewed in their entirety, they will provide sufficient comfort to Standard & Poor's that the trustee or collateral agent has a valid, perfected, first-priority security

interest in the assets supporting the transaction. To facilitate the timely review of the transaction documents, Standard & Poor's has prepared forms of model representations and warranties for the following Article 9 categories: accounts, tangible chattel paper, electronic chattel paper, instruments, general intangibles, securities entitlements/securities accounts, goods, and deposit accounts. These model representations should provide guidance to the market participants regarding what the Standard & Poor's analyst will be looking for in the transaction documents. Standard & Poor's encourages issuers to incorporate the model representations and warranties in substantially the published form; material changes will likely require review by Standard & Poor's legal department. The forms of model representations are provided below and may be directly copied. In each form, the representations and warranties are organized under the headings "General," "Creation," "Perfection," and "Priority" only to indicate the primary legal issue that they are intended to address. Of course, the representations and warranties may be located in a single section or in different sections of the transaction documents, as drafting considerations dictate. These representations and warranties should survive the closing, and their breach should not be waivable by any of the transaction parties while the rated debt is outstanding. Standard & Poor's encourages counsel for the transaction parties to contact Standard & Poor's legal department if there are issues regarding the applicability of the model representations and warranties to a particular transaction, as well as which Article 9 asset categories are relevant in a particular transaction. If it is not clear which Article 9 category is applicable, it may be appropriate to deliver a "characterization" opinion or, alternatively, to include the representations applicable to all relevant Article 9 categories. Additional representations and warranties may be appropriate for "new assets". These issues, as well as any other legal issues, should be discussed early in the rating process with Standard & Poor's legal department. Related Issues Transition Rules Revised Article 9 contains detailed rules that govern the transition of current Article 9 to revised Article 9. For outstanding transactions rated prior to July 1, 2001, Standard & Poor's assumes that servicers will take the necessary steps to maintain the perfection and priority of security interests perfected under current Article 9. Non-Article 9 Security Interest Matters To the extent that issues relating to creation, perfection, or priority of a security interest in a particular type of asset are not governed by Article 9 (e.g., real estate, aircraft, railcars, automobiles), Standard & Poor's existing legal criteria continue to apply. Standard & Poor's encourages market participants and their counsel to contact the legal department with questions regarding the appropriate legal criteria for a transaction. Revised Article 9 Not Effective in all 50 States Under revised Article 9, as well as current Article 9, transactions that involve multiple jurisdictions require an analysis of which state's law applies to creation, perfection, and priority matters. The relevant jurisdictions may include state of governing law of documents, state of chief executive office of borrower/seller, state of incorporation of borrower/seller, and state of location of collateral. This analysis will become further complicated by the fact that revised Article 9 will not be effective in all 50 states by July 1, 2001. Provisions of revised Article 9 that are more permissive than current law may not apply if choice-of-law rules dictate that the law of a state in which the revisions are not yet effective governs the issue. This applies, for example, to the ability to perfect a sale or pledge of promissory notes by filing a financing statement, rather than by delivering the notes. Standard & Poor's will rely on transaction counsel to structure the transaction in a manner that takes into account the applicable choice-of-law rules. Consultation With Counsel Like all other representations and warranties relating to legal matters, Standard & Poor's will assume that the representations and warranties relating to security interest matters are given by the seller/borrower after consultation with counsel. FPPSI Opinion Primer In a structured finance transaction, payments to bondholders or lenders rely on the cash flow from a discrete pool of assets. Generally, the seller's/borrower's counsel provides legal opinions which indicate (in the view of the lawyer giving the opinion) that the trustee or collateral agent acting for the bondholders or lenders has a first priority perfected security interest (FPPSI) in the assets supporting the payments on the bonds or the loan. However, the scope of these opinions is limited. They contain many factual assumptions, which are supported by the representations and warranties in the transaction documents, and qualifications (exclusions), which, in the aggregate, result in legal opinions that address a narrowly defined set of legal issues. To the extent the legal opinions in a structured finance transaction do not address certain issues, the transaction parties, as well as Standard & Poor's, may obtain comfort through a combination of credit support and reliance on the

representations and warranties in the transaction documents. In some cases, the lack of legal comfort may cause Standard & Poor's to conclude that the rating is linked to the Standard & Poor's corporate rating of one of the transaction parties. With respect to security interest matters, the legal opinions address the three main components of a FPPSI. The "creation" opinion expresses the lawyer's view that the security agreement has been drafted properly so as to create a valid security interest that is enforceable against the borrower. The "perfection" opinion expresses the lawyer's view that the security interest will be "perfected" if the borrower takes certain actions, which generally means the borrower will file (at a state government office) a financing statement, naming the trustee or collateral agent as secured party, that complies with the requirements of Article 9. (Under current Article 9, promissory notes need to be delivered to the trustee or collateral agent in order for the security interest to be perfected. Under revised Article 9, filing a financing statement will be a permissible alternative method of perfection for promissory notes.) For purposes of the Standard & Poor's rating, the significance of the security interest being "perfected" is that the security interest will be enforceable against the bankruptcy trustee of the borrower, in the event the borrower becomes a debtor in a bankruptcy proceeding. For entities structured as "bankruptcy-remote", perfection reduces the incentive of a third party, including the entity's owner(s), to cause a voluntary or involuntary bankruptcy proceeding in order to obtain access to the entity's assets. Lastly, the "priority" opinion, which sounds (incorrectly) like it is an opinion to the effect that no other liens will be prior to the trustee's or collateral agent's lien, is typically not a legal opinion at all, but rather a statement that the lawyer has reviewed copies of the financing statements filed against the borrower and has concluded that none of such financing statements describes the assets that are the subject of the transaction. Frequently, the lawyer's conclusion relies on a certification from the borrower because it is not possible for the lawyer to discern from the previously filed financing statements what assets they cover. "Priority" opinions typically address only the priority of the trustee's or collateral agent's security interest over liens that had been perfected by filing because, under Article 9, by operation of law, various liens automatically have priority over the trustee's or collateral agent's lien.

Appendix: Model Representations and Warranties

The Model Representations and Warranties for the Revised Article 9 collateral categories set forth below may be directly copied for use in transaction documents.

Instruments SideBarField001 Goods SideBarField002 Tangible Chattel Paper SideBarField003 Electronic Chattel Paper SideBarField004 Accounts SideBarField005 Securities Entitlements SideBarField007 Deposit Accounts SideBarField008 General Intangibles SideBarField009