



WISCONSIN COURT OF APPEALS HOLDS CERTAIN RIGHTS UNDER THE U.C.C. CANNOT BE WAIVED, EVEN BY MUTUAL AGREEMENT

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On August 5, 2009, the Wisconsin Court of Appeals issued a decision on whether parties may completely opt out of the Uniform Commercial Code (U.C.C.) through the use of certain terms in a security agreement. *Kraenzler v. Brace*, 2008AP1709, stands for the proposition that provisions of a security agreement may not completely set aside a debtor's rights under the U.C.C. in the event of default.

The legal analysis conducted by the Court of Appeals focuses on the language of a security agreement between Brace and Kraenzler. Kraenzler, the borrower, pledged stamping dies as security for a loan extended by Brace to fund a business venture. Kraenzler ultimately defaulted on his obligations under the loan, and Brace located and sold the stamping dies to a third party. Kraenzler sued Brace for violation of his rights as a debtor in default under Wis. Stat. §409.602, which requires a "commercially reasonable sale" by a secured party. The security agreement provided that the ownership of the stamping dies, which served as the collateral, transferred to Brace upon default. Brace argued, pursuant to Wis. Stat. §401.102(3), that upon default, Kraenzler did not have any additional rights beyond those identified in the security agreement. Kraenzler, on the other hand, argued that the rights listed in Wis. Stat. § 409.602 are an exception to the provision in §401.102(3) that permits the U.C.C. to be varied by agreement.

The Court evaluated the relationship between Wis. Stat. §401.102(3), which allows parties in mutual agreement to opt out of the standard provisions governing commercial transactions, and Wis. Stat. §409.602, which governs rights of a debtor upon the event of default. Section 409.602 imposes specific duties upon a secured party to the defaulting debtor, including the requirement that the secured party sell the collateral in a "commercially reasonable manner." Relying upon *National Operating L.P. v. Mutual Life Ins. Co. of N.Y.*, 244 Wis.2d 839, 630 N.W.2d 116 (2001) as precedent, the Court of Appeals classified §409.602 as an "exception to the exception" and held that a debtor can never contract away certain rights, regardless of whether the contracting parties agree to the waiver.

The court set forth the following rights as those which a debtor cannot waive:

1. The right to demand that the secured party use the collateral only in the manner and extent agreed to by the debtor;
2. The right to request an accounting from the secured party regarding the collateral and any surplus from the sale of the collateral;
3. The right to require that the secured party proceed in a commercially reasonable manner when enforcing the obligation against the debtor;
4. The right to receive application of the proceeds from the collateral to the debtor's obligation under the loan;
5. The right to receive timely notice upon disposition of the collateral by the secured party;
6. The right to receive a calculation and explanation of the surplus or deficiency on disposition of the collateral;
7. The right to redeem the collateral;
8. The right to pursue remedies under Wis. Stat. §§409.625 and 409.626 when the secured party fails to comply with ch. 409, subsection (13).

The holding in *Kraenzler v. Brace* was influenced by the official comment to the U.C.C. that the “legal system traditionally has looked with suspicion on agreements that limit the debtor’s rights and free the secured party of its duties....the specified rights of the debtor and duties of the secured party may not be waived or varied except as stated.” Official U.C.C. Comment 2, Wis. Stat. Ann. §409.602 (West 2003).

The lesson for banks to take from *Kraenzler v. Brace* is simple: Wisconsin courts will apply the written terms of the security agreement except where such agreement expressly waives rights protected by §409.602.

As a practical matter, even if a debtor has freely contracted away certain rights in the event of default, a secured creditor is not relieved of its duty under the U.C.C. to provide notice of the proposed disposition of the debtor’s collateral or to act in a commercially reasonable manner. In the event of a debtor’s default, secured creditors should familiarize themselves with the unwaivable provisions of §409.602 and think twice before relying upon contractual language that *Kraenzler* may have rendered unenforceable.