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ANNUAL REVIEW OF TEXAS LAW: COMMERCIAL LAW

*Sally McDonald Henry**

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I. INTRODUCTION

2021 was a year when legislative acts of importance in the Texas commercial law field outnumbered the emergence of important case law. For instance, the Texas legislature clarified how to perfect a security interest in virtual currency and amended the property law to grant a more effective lien to producers of oil and gas. In addition, the Texas Supreme Court overruled a disturbing case that had obligated one bank—and perhaps more, depending on potential ambiguity in their internal forms—to wire funds only from funds that had already been collected. Finally, the Texas Supreme Court reiterated the long-standing common law rule that compensatory damages for breach of contract must be foreseeable, and applied that rule to the case before it, vacating a generous compensatory damage award. This Article will discuss each of these developments.

II. VIRTUAL CURRENCY LEGISLATION

Just in time for the virtual currency crash of 2022,¹ the Texas legislature passed legislation to clarify how to perfect a security interest in virtual currency. The law became effective in September of 2021, but it may con-

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1. See, e.g., Corrie Driebusch & Paul Vigna, *The Crypto Party is Over*, WALL STREET JOURNAL (June 18, 2022, 12:00 AM), <https://www.wsj.com/articles/the-crypto-party-is-over-11655524807> [<https://perma.cc/HQ72-8B3W>].

tain a glitch.²

Until the spring of 2022, the virtual currency market had been booming. The popularity of these digital rights continued despite the difficulty in determining the actual value of cryptocurrency. Despite the problems associated with virtual currency,³ the fact remained that numerous entities held that asset in their portfolios, thereby creating a challenge. If a security interest in cryptocurrency could not be perfected and insured to be effective, lending might suffer. For that reason, states have begun to pass legislation designed to clarify how to perfect a security interest in Texas.

Notably, the problem was that it was not entirely clear as to how to perfect a security interest in virtual currency. Most commentators argued that virtual currency was likely considered a general intangible,⁴ and there was certainly a strong argument for that treatment. If it were a general intangible, perfection would be relatively easy: the security interest must attach⁵ and, to be enforceable in bankruptcy or have certain priority, the security interest must be “perfected” by giving notice to the world. In the case of a general intangible, this notice is given by filing a financing statement with the Texas Secretary of State’s office.⁶ Such a filing can be done electronically and costs \$5.00.⁷

But there were problems. If virtual currency were, in fact, a general intangible, it would be subject to all the rules relating to general intangibles. For example, if a lender has a security interest in a general intangible, the debtor may not transfer the collateral without consent of the lender.⁸ This meant that, despite the possibility that the lender never meant to restrict trading in virtual currency, the debtor had arguably de-

2. Sung Pak, Jennifer Taylor & Joshua Chow, *Texas Uniform Commercial Code Updated to Recognize Cryptocurrency*, O’MELVENY (Sept. 9, 2021), <https://www.omm.com/resources/alerts-and-publications/alerts/texas-uniform-commercial-code-updated-to-recognize-cryptocurrency/> [<https://perma.cc/328K-7EGR>].

3. Rebecca M. Bratspies, *Cryptocurrency and the Myth of the Trustless Transaction*, 25 MICH. TELECOMM. & TECH. L. REV. 1, 3 (2018).

4. Ronald J. Mann, *Reliable Perfection of Security Interests in Crypto Currency*, 21 SMU SCI. & TECH. L. REV. 159, 163–64 (2018) (stating that the only way to perfect security interest in cryptocurrency is by filing a financing statement); Kevin V. Tu, *Perfecting Bitcoin*, 52 GA. L. REV. 505, 517 (2018). See also Jeanne L. Schroeder, *Bitcoin and the Uniform Commercial Code*, 24 U. MIAMI BUS. L. REV. 1, 60 (2016) (discussing the notion that Bitcoin held directly is a general intangible but arguing that Bitcoin should not be held directly).

5. TEX. BUS. & COM. CODE ANN. § 9.203(a).

6. TEX. BUS. & COM. CODE ANN. § 9.310(a).

7. *Uniform Commercial Code – Fees*, TEXAS SECRETARY OF STATE, <https://www.sos.state.tx.us/ucc/formfees.shtml> [<https://perma.cc/PU2N-6M3B>] (last visited June 30, 2022). Electronic filings cost \$5.00; filing by fax or mail costs between \$15.00 and \$30.00 depending upon the number of pages in the filing.

8. TEX. BUS. & COM. CODE ANN. § 9.315(a) (“Except as otherwise provided in this chapter and Section 2.403(b): (1) a security interest . . . continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest . . . ; and (2) a security interest attaches to any identifiable proceeds of collateral.”); TEX. BUS. & COM. CODE ANN. § 9.308(a).

faulted on its obligations under the credit agreement if the credit agreement contained standard clauses limiting the disposition of collateral. Moreover, even though it seemed obvious to many commentators that virtual currency was a general intangible under the Uniform Commercial Code (UCC), the absence of case law so holding meant that lenders retained some risk. One challenge was that even the name of the virtual currency, “currency,”⁹ created a risk: if virtual currency were adopted as legal tender in any jurisdiction, it might no longer be a general intangible, but rather classified as a “money” under the UCC.¹⁰ A security interest in money may only be perfected by possession.¹¹ Of course, possession of virtual currency is impossible.¹²

The Texas legislation addresses these problems and makes it easier for lenders to be confident that they have a perfected security interest in most virtual currency. First, the legislation defines virtual currency. It:

- (1) means a digital representation of value that:
 - (A) is used as a medium of exchange, unit of account, or store of value; and
 - (B) is not legal tender, whether or not denominated in legal tender; and
- (2) does not include:
 - (A) a transaction in which a merchant grants, as part of an affinity or rewards program, value that cannot be taken from or exchanged with the merchant for legal tender, bank credit, or virtual currency; or
 - (B) a digital representation of value issued by or on behalf of a publisher and used solely within an online game, game platform, or family of games sold by the same publisher or offered on the same game platform.¹³

Under the new legislation, perfecting a security interest is as easy as it is for general intangibles: the security interest must attach, and a financing statement, in proper form, may be filed.¹⁴ That is not, however, the only way to perfect a security interest: a security interest may also attach

9. The clever marketers who came up with the term “currency,” and terms that include words like “coin” to describe virtual currency, may have been inspired by those who named “Greenland.”

10. U.C.C. § 1-201(b)(24) (“‘Money’ means a medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries.”).

11. TEX. BUS. & COM. CODE ANN. § 9.312(b)(3) (“[A] security interest in money may be perfected only by the secured party’s taking possession under Section 9.313.”).

12. Brian M. McCall, *How El Salvador Has Changed U.S. Law By a Bit: The Consequences for the UCC of Bitcoin Becoming Legal Tender*, 74 OKLA. L. REV. 313, 322 (2022).

13. TEX. BUS. & COM. CODE ANN. § 12.001.

14. TEX. BUS. & COM. CODE ANN. § 9.312(a) (“A security interest in chattel paper, negotiable documents, instruments, investment property, and virtual currencies may be perfected by filing.”).

and be perfected by “control.”¹⁵

What is control? It is defined in the statute:

- (a) A person has control of a virtual currency if the following conditions are met:
 - (1) the virtual currency or the system in which the virtual currency is recorded, if any, gives the person:
 - (A) the power to derive substantially all the benefit from the virtual currency;
 - (B) subject to Subsection (b), the exclusive power to prevent others from deriving substantially all the benefit from the virtual currency; and
 - (C) subject to Subsection (b), the exclusive power to transfer control of the virtual currency to another person or cause another person to obtain control of a virtual currency that derives from the virtual currency; and
 - (2) the virtual currency, a record attached to or logically associated with the virtual currency, or the system in which the virtual currency is recorded, if any, enables the person to readily identify the person as having the powers specified in Subdivision (1).
- (b) A power specified in Subsection (a)(1)(B) or (C) can be exclusive, even if:
 - (1) the virtual currency or the system in which the virtual currency is recorded, if any, limits the use to which the virtual currency may be put or has protocols that are programmed to result in a transfer of control; and
 - (2) the person has agreed to share the power with another person.
- (c) For the purposes of Subsection (a)(2), a person may be identified in any way, including by name, identifying number, cryptographic key, office, or account number.¹⁶

The legislation also addresses the question of whether the debtor can sell or transfer the collateral—with the answer to that question being yes.¹⁷ The transferee takes the security interest free and clear of the interest of the secured party unless the transferee has “notice” that the transfer violates the rights of a secured party.¹⁸ Knowing that a financing statement has been filed perfecting a security interest in the cryptocur-

15. TEX. BUS. & COM. CODE ANN. § 9.314(a) (“A security interest in investment property, deposit accounts, letter-of-credit rights, virtual currencies, electronic chattel paper, or electronic documents may be perfected by control of the collateral under Section 7.106, 9.104, 9.105, 9.106, 9.107, or 9.1071.”).

16. TEX. BUS. & COM. CODE ANN. § 12.004.

17. TEX. BUS. & COM. CODE ANN. § 12.003(e) (“In addition to acquiring the rights of a purchaser, a qualifying purchaser acquires the purchaser’s rights in a virtual currency free of any adverse claim.”).

18. *See id.* § 12.003(g) (“A person has notice of an adverse claim if: (1) the person knows of the adverse claim; or (2) the person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim.”).

rency is insufficient to constitute “notice of an adverse claim” under the statute.¹⁹

This provision of the law is striking when compared to other Article 9 provisions on the transfer of collateral. It is similar to the provision allowing for the free transfer of inventory to a buyer in the ordinary course,²⁰ because the UCC specifically provides that a transferee’s knowledge that a financing statement has been filed with respect to the inventory is insufficient to render the sale subject to the secured party’s security interest.²¹ That makes sense given that the objective of inventory financing is to allow the debtor to make money by selling the inventory. It also is similar to the provisions that provide that a transfer of cash or money in a deposit account is free of a security interest so long as the transferee does not act in “collusion with the debtor in violating the rights of the secured party.”²²

The provision is, however, much more liberal than the UCC provision with respect to the sale of consumer goods to a consumer. The so-called “garage sale” exception to the general rule, provides that a security interest continues in collateral sold to a third party without the consent of the secured party will not be free of the security interest if the secured party has filed a financing statement with respect to the collateral even if the consumer-purchaser does not know that a financing statement has been filed.²³ In short, the transferee of cryptocurrency collateral is more protected than is the consumer at a yard sale. (Watch out if you’re buying a piano from a consumer!).

Of course, this provision protecting the purchaser of virtual currency has implications. It suggests that in most cases in which a secured party perfects a security interest in collateral through filing a financing statement, the collateral is merely an “extra”: not something whose value the secured party can depend upon.

Despite the legislature’s step forward in clarifying the method for creating a security interest in virtual currency, the legislation is not without one question: the definition of “virtual currency.” As noted above, the term is defined to mean something that is not “legal tender.” However, after the Texas legislature passed this legislation, El Salvador and the Central African Republic adopted Bitcoin as legal tender.²⁴ Thus, the

19. *See id.* § 12.003(h) (“Filing of a financing statement under Chapter 9 is not notice of an adverse claim to a virtual currency.”).

20. TEX. BUS. & COM. CODE ANN. § 9.320(a).

21. *See id.* (“A buyer in ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer’s seller, even if the security interest is perfected and the buyer knows of its existence.”).

22. TEX. BUS. & COM. CODE ANN. §§ 9.332(a) & (b).

23. *See id.* § 9.320(b) (“Except as otherwise provided in Subsection (e), a buyer of goods from a person who used or bought the goods for use primarily for personal, family, or household purposes takes free of a security interest, even if perfected, if the buyer buys: . . . (4) before the filing of a financing statement covering the goods.”).

24. Oscar Lopez & Ephrat Livni, *In Global First, El Salvador Adopts Bitcoin as Currency*, THE NEW YORK TIMES (Sept. 7, 2021), <https://www.nytimes.com/2021/09/07/world/>

question arises: what did the Texas legislature mean by “legal tender”?

The primary issue is that the term “legal tender” is not defined in the UCC nor is it defined in any part of the Texas Code. However, there are sections of the Texas Code in which “legal tender” is limited to “legal tender of the United States” and sections of the Texas Code where it is not so limited and, in fact, clearly means something more than legal tender of the United States.²⁵ For that reason, the new statute may not apply to Bitcoin or, for that matter, any other virtual currency that is adopted as “legal tender” in any jurisdiction.

III. PRODUCER LIEN LEGISLATION

In perhaps a more important piece of legislation, the legislature moved to create enforceable liens under Texas law for oil and gas producers (the Producers). Producers are entities that extract crude oil and condensate (the Product).²⁶ Generally, these Producers sell the Product to “First Purchasers,” entities also known as midstream service providers, who then transport the Product and typically sell it to other entities, such as refineries or commodity traders.²⁷ The typical contract provides that the Producers will be paid on the twentieth day of the month following the purchase of the Product from the Producers to the First Purchasers.²⁸ Unfortunately for the Producers, the debtor First River Energy L.L.C. (FRE) filed for Chapter 11 protection after having taken delivery of the Product, but did so before the Producers had been paid.²⁹ A legal battle broke out between the Producers and Deutsche Bank Trust Co. Americas, the agent for a group of lenders.

The problem lies in the fact that Article 9 of the UCC has a general choice of law provision: Section 9.301. It provides that, with few exceptions, the perfection of a security interest is governed by the law of the place the debtor is located.³⁰ A debtor that is an individual is located where the individual resides;³¹ a debtor that is a “registered entity” is

americas/el-salvador-bitcoin.html [https://perma.cc/UN2T-H2A6]; Judicael Yongo; Bate Felix; Nellie Peyton; & Elaine Hardcastle, *Central African Republic Adopts Bitcoin as Official Currency*, REUTERS (April 27, 2022), <https://www.reuters.com/world/africa/central-african-republic-adopts-bitcoin-an-official-currency-2022-04-27>.

25. The term “legal tender” is not defined but is used to describe money in both the United States and foreign countries. *See, e.g.*, TEX. ADMIN. CODE § 3.336. (“(2) Currency—The coin and paper money of the United States or another country that is designated as legal tender and circulates and is customarily used and accepted as a medium of exchange in the country of issuance.”).

26. *In re First River Energy, LLC*, 986 F.3d 914, 917 (5th Cir. 2021).

27. *Id.*

28. *Id.* at 917–18.

29. *Id.* at 918.

30. TEX. BUS. & COM. CODE ANN. § 9.301(1) (“Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.”).

31. TEX. BUS. & COM. CODE ANN. § 9.307(b) (“Except as otherwise provided in this section . . . (1) A debtor who is an individual is located at the individual’s principal residence.”).

located where it is registered.³² Registered entities include corporations, limited partnerships, limited liability corporations, etc.³³

That is straightforward. Accordingly, unless there is a specific exception to the general rule, the law of Delaware controls the perfection—or lack of perfection—of a Delaware limited liability corporation, such as FRE, even when the collateral is located in Texas or when the debtor is headquartered in Texas.

While this legal concept is simple to grasp, it may have been an unpleasant surprise to some, including some Texas Producers. After FRE went into Chapter 11, the unpaid Producers, located in Texas and Oklahoma, sought to enforce their security interests in the proceeds of the Product. It turned out that Oklahoma had fixed its first purchaser problem sooner than Texas had.

The bank commenced an adversary proceeding seeking a declaratory judgment that its security interest in the proceeds was superior to that of the Producers.³⁴ The bankruptcy judge, Judge Gargotta, ruled that while the security interests of the Oklahoma first purchasers were perfected, the Texas first purchasers were not.³⁵ The U.S. Court of Appeals for the Fifth Circuit granted a direct appeal to the court of appeals, bypassing the district court.³⁶

The first issue the Fifth Circuit had to confront was what law should be applied in bankruptcy court. The Fifth Circuit had never decided that issue and, as it turned out, did not have to decide that issue in this case.³⁷ While the settled rule is that a district court sitting in diversity applies the substantive law of the forum state, including that state's choice of law, bankruptcy court jurisdiction is federal jurisdiction, and therefore the applicable choice of law rule in bankruptcy courts is an open question.

Every time the Fifth Circuit has addressed this conflicts of law issue, it has sidestepped an answer.³⁸ Here again, it was able to avoid answering the question. The court determined that both Texas, where the bankruptcy case was pending and the adversary proceeding had been com-

32. *See id.* § 9.307(e) (“A registered organization that is organized under the law of a state is located in that state.”).

33. TEX. BUS. & COM. CODE ANN. § 9.102(a)(71) (“‘Registered organization’ means an organization formed or organized solely under the law of a single state or the United States by the filing of a public organic record with, the issuance of a public organic record by, or the enactment of legislation by the state or the United States.”). *See also* TEX. BUS. & COM. CODE ANN. § 9.307 cmt. 4 (giving examples of registered organizations including corporations, limited partnerships, and limited liability companies). Note that the U.S. Court of Appeals for the Fifth Circuit regards the Official Comments to the Uniform Commercial Code as “instructive” in interpreting the code. *In re Dale*, 582 F.3d 568, 574 (5th Cir. 2009).

34. *In re First River Energy, LLC*, 986 F.3d at 919.

35. *Id.*

36. *Id.*

37. *Id.* at 923–24 (“We need not decide between the Texas forum’s law or federal law where both bodies of law reach the same result.”).

38. *Fishback Nursery, Inc. v. PNC Bank, Nat’l Ass’n*, 920 F.3d 932, 938 (5th Cir. 2019); *Woods-Tucker Leasing Corp. of Ga. v. Hutcheson-Ingram Dev. Co.*, 642 F.2d 744, 748 (5th Cir. 1981).

menced, and the federal independent judgment test, where the debtor was formed, applied the Restatement (Second) of Conflicts of Law. Under the Restatement, the law to be applied was the law of Delaware.³⁹

Once the Fifth Circuit applied Texas conflicts of law rules, there was little difficulty in determining that the Texas Producers were out of luck. True, Texas had a statute that provided that the Producers had a perfected security interest. However, that statute was in the Texas version of Article 9 of the UCC and did not have its own choice of law provision. Accordingly, the Fifth Circuit looked to Article 9, specifically sections 9.301 and 9.307, which pointed to Delaware law.⁴⁰ UCC section 9.301 thereby directed the Fifth Circuit to look to the “location of the debtor,” and the debtor, a Delaware limited liability corporation, was located in Delaware. For that reason, Deutsche Bank, which was perfected under Delaware law, had priority.⁴¹ Delaware has no special protection for First Purchasers. As a result, notwithstanding the Texas statute, the Texas Producers were only unsecured creditors.

The Oklahoma Producers were better off. In response to other recent litigation involving special security interests for Producers that had been initiated in the Delaware bankruptcy court, Oklahoma had amended its property law to avoid the U.C.C.’s choice of law provision.⁴² Accordingly, the Oklahoma Producers were secured creditors and, in accordance with the Oklahoma statute, had priority over the Deutsche Bank group.⁴³

A fix was necessary,⁴⁴ and the Texas legislature did not dally. Taking note of the Oklahoma statute, the legislature repealed the nonuniform Article 9 provision that had been included to protect first purchasers, Tex. Bus. & Com. Code Ann. § 9.343, and drafted a new chapter for the Property Code. To emphasize that Article 9 (and its choice of law provision) was not intended to apply to a Producer’s lien, the legislature amended Tex. Bus. & Com. Code Ann. § 9.109(d) to provide that Article 9 does not apply to “an oil and gas lien arising under Chapter 67, Property Code.”⁴⁵ The legislature also removed other references to Tex. Bus. & Com. Code Ann. § 9.343 that had been incorporated into the Texas version of Article 9 of the UCC.⁴⁶

In addition to removing the references to a Producer’s security interest in Article 9 of the UCC, the legislature created Chapter 67 in the Prop-

39. *In re First River Energy, LLC*, 986 F.3d at 924.

40. *Id.* at 926.

41. The court rejected the argument that the product was “as-extracted collateral” as defined in Article 9 of the UCC. *Id.* at 927.

42. *Id.* at 929.

43. *Id.* at 930.

44. Indeed, the Fifth Circuit called for the Texas legislature to amend the law. *Id.* at 917 (“The Texas legislature should take note.”).

45. TEX. BUS. & COM. CODE ANN. § 9.109(d)(14).

46. For example, the Texas legislature deleted section 9.310(b)(11), which had provided that “[t]he filing of a financing statement is not necessary to perfect a security interest . . . (11) in oil and gas production or their proceeds under section 9.343.” It also eliminated a reference to section 9.343 in section 9.324(b), which gave the section 9.343 Producer’s security interest priority in certain circumstances.

erty Code.⁴⁷ The new chapter begins with a multitude of broad definitions for critical terms, such as oil, gas, interest owner, first purchaser, oil and gas rights, permitted lien, and proceeds. The key definitions, of course, are “interest owner” (defined as “a person, including a transferee interest owner, owning an interest of any kind in oil and gas rights before acquisition by a first purchaser”)⁴⁸ and “first purchaser” (defined as “the first person that purchases oil or gas from an interest owner, under an agreement to sell”).⁴⁹ The chapter then establishes the lien:

Oil and Gas Lien.

(a) To secure the obligations of a first purchaser to pay the sales price, each interest owner has an oil and gas lien to the extent of the interest owner’s interest in oil and gas rights. The oil and gas lien exists as part of and incident to the ownership of oil and gas rights.

(b) An oil and gas lien:

- (1) exists in and attaches to all oil and gas before severance;
- (2) continues uninterrupted and without lapse in all oil and gas on and after severance; and
- (3) continues uninterrupted and without lapse in and to all proceeds from the sale of the oil or gas.

(c) Except as provided by Subsection (d), an oil and gas lien exists until the interest owner or representative first Entitled to receive the sales price has received the sales price for the oil or gas production, but the lien does not continue to attach to the production after the production is sold by the first purchaser, unless the first subsequent purchaser:

- (1) is an affiliate of the first purchaser; or
- (2) has actual knowledge, not constructive notice or inquiry notice, that the first purchaser has not paid the interest owner or representative first entitled to receive the sales price.

(d) As between an interest owner and a representative of an interest owner or any person claiming adversely to the interest owner or representative, the interest owner’s oil and gas lien continues uninterrupted and without lapse in proceeds in the possession or control of a representative until the interest owner on whose behalf the representative acts receives the proceeds in full.⁵⁰

The statute also protects the first purchaser, because it provides that the first purchaser takes free of the oil and gas lien if the first purchaser:

47. TEX. PROP. CODE ANN. § 67.001.

48. *See id.* § 67.001(6).

49. *See id.* § 67.001(4). Note that these definitions are somewhat circular.

50. TEX. PROP. CODE ANN. § 67.002(a)–(d).

(1) in good faith, paid the sales price for the oil or gas to an interest owner or representative otherwise apparently entitled to receive the sales price; and

(2) is without actual knowledge that the interest owner or representative is not entitled to receive the sales price paid.⁵¹

Because it is typical for the First Purchaser to sell the Product quickly, the new law emphasizes that “the oil and gas lien continues uninterrupted in the proceeds paid to or otherwise due the interest owner or representative,”⁵² and proceeds are defined broadly.⁵³ The security interest is “perfected automatically without the need to file a financing statement or any other type of documentation.”⁵⁴ The revised law additionally preserves the security interest in commingled product,⁵⁵ and, in the case of commingling, the “oil and gas liens rank equally in the proportion that the respective sales prices secured by each oil and gas lien bears as a percentage of the total of the sales prices secured by all oil and gas liens applicable to the production at the time production was commingled.”⁵⁶ The interest owner’s lien has priority over all other liens except for “permitted liens,” which are defined as certain liens related to storage or transportation charges.⁵⁷ Purchasers in the ordinary course of the first purchaser’s business that have paid the entire purchase price to the first purchaser take the product free of the interest holder’s lien.⁵⁸

IV. FASCINATING CHOICE OF LAW COMMENT

The law that should be applied in a bankruptcy case when the law of more than one state might apply is unsettled in the United States as well as in the U.S. Court of Appeals for the Fifth Circuit. It bears emphasis that *Erie* and *Klaxon* both related to the choice of law issue for courts that were sitting in diversity.⁵⁹ The Fifth Circuit has had the issue before

51. *Id.* § 67.002(e).

52. *See id.* § 67.002(f).

53. TEX. PROP. CODE ANN. § 67.001(13).

54. TEX. PROP. CODE ANN. § 67.004.

55. TEX. PROP. CODE ANN. § 67.005.

56. *See id.* § 67.005(c).

57. TEX. PROP. CODE ANN. § 67.001(11) (“‘Permitted lien’ means a perfected and enforceable lien created by statute or rule of a governmental agency for storage or transportation charges, including terminal charges, tariffs, demurrage, insurance, labor, or other charges, owed by a first purchaser in relation to oil or gas originally purchased under an agreement to sell. The term does not include a lien that is: (A) in favor of an affiliate of a first purchaser unless the lien is authorized by the statute or rule creating the lien; or (B) for charges incurred after the 90th day after the date the first purchaser delivers the oil or gas for storage or transportation.”).

58. TEX. PROP. CODE ANN. § 67.006(a).

59. *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941) (stating that the court sitting in diversity jurisdiction applies the choice of law of the forum state); *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938) (noting that the state law generally applied by federal courts sitting in diversity is the law of the forum state).

it on several occasions, but each time it has been able to avoid resolving this thorny issue.⁶⁰

This year, in dictum, Judge Edith Jones added a consideration of critical importance to the equation such that it should not pass without having attention brought to it. She wrote in yet another case in which the U.S. Court of Appeals for the Fifth Circuit had not resolved the issue.⁶¹ However, the issue before her was complicated by the bankruptcy case having been transferred from the District of Delaware, where the debtor had originally filed its case, to the Western District of Texas.⁶² She noted that the litigants who were arguing for the application of Delaware choice of law cited to U.S. Supreme Court case law holding that, in diversity cases, when a case is transferred from its original forum, the transferee court should apply the choice of law of the original forum.⁶³ She gave no indication about whether that *Klaxon* rule should be followed, however, she did note in passing that while the bankruptcy case had commenced in the District of Delaware, the adversary proceeding that was on appeal—a declaratory judgment action by Deutsche Bank seeking priority for its security interests—had commenced in the Western District of Texas after the bankruptcy case had been transferred. Therefore, she concluded in *dicta* that “[t]he Bank’s position is arguable, but unlikely: the Bank commenced this declaratory judgment action, which is an adversary proceeding within the bankruptcy case, in Texas bankruptcy court following the transfer. The adversary proceeding was never itself transferred from Delaware. Texas is the forum.”⁶⁴

V. THE TEXAS SUPREME COURT COMES TO THE RESCUE

This is an all too familiar story: a scammer tricks someone into wiring money abroad; scammer and money disappear.⁶⁵ Someone is left holding

60. *Fishback Nursery, Inc. v. PNC Bank, Nat’l Ass’n*, 920 F.3d 932, 936 (5th Cir. 2019); *Woods-Tucker Leasing Corp. of Ga. v. Hutcheson-Ingram Dev. Co.*, 642 F.2d 744, 748 (5th Cir. 1981) (applying the UCC Article 9 choice of law provision).

61. *In re First River Energy, LLC*, 986 F.3d 914, 924 (5th Cir. 2021) (noting that the choice of law rules of Delaware and federal common law are the same in the case before the court).

62. *Id.* at 924.

63. *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 243 (1981); *Van Dusen v. Barrack*, 376 U.S. 612, 613 (1964) (holding that the transferee venue was obligated to apply the choice of law of the original venue).

64. *In re First River Energy, LLC*, 986 F.3d at 924. See also, *Statek Corp. v. Dev. Specialists, Inc. (In re Coudert Bros. LLP)*, 673 F.3d 180, 191 (“bankruptcy courts should . . . look to the choice of law rules of the state where the underlying prepetition complaint was filed; complainant has commenced lawsuit in different state from where bankruptcy case was pending before bankruptcy case was filed).

65. *E.g., Perlberger Law Assocs., P.C. v. Wells Fargo Bank, N.A.*, 552 F. Supp. 3d 490, 492–93 (E.D. Pa. 2021) (mem. op.) (“Plaintiff . . . accepted an assignment to collect a debt owed by a Philadelphia machinery business on behalf of a new client, ostensibly a tool company in Florida. Plaintiff demanded payment of the outstanding bill, and a check for the full amount was quickly tendered. The check appeared on its face to have been issued by the Philadelphia business Plaintiff had been hired to pursue. The law firm deposited the check with its bank, Defendant Wells Fargo, and upon notice that the funds were available, authorized distribution to its purported client. Unbeknownst to Plaintiff, its ‘client’s’ in-

the bag.

Or at least that's usually how it happens. The Court of Appeals for the First District of Texas at Houston, however, shifted the loss to the bank that wired the money when it addressed a case of that sort.⁶⁶ The Texas Supreme Court subsequently reversed,⁶⁷ keeping the liability on the person most able to have prevented the theft.

A lawyer was contacted by a person previously unknown to him. The person sought the lawyer's help in a collection matter. Apparently eager for the business, the lawyer may have failed to engage in an extensive "know your client" undertaking. In any event, the "client" contacted the lawyer soon thereafter, told the lawyer that the collection matter had been settled, and the lawyer received a check purportedly representing the proceeds of the settlement.⁶⁸ The "client" simultaneously told the lawyer that the funds had to be wired immediately to Japan, and the lawyer arranged for the bank to do just that after depositing the check in his IOLTA (Interest on Lawyers Trusts Accounts) account.⁶⁹

We know how this ends. The check was fraudulent, but the money was wired before the check cleared and was thus in Japan, in the possession of unknown hands.⁷⁰ Normally, the lawyer would bear the loss.⁷¹ In this instance, however, the lawyer argued that the bank should bear the loss because of a form the lawyer had signed before the money was wired out.⁷²

The lawyer had been given a form required by the bank. The bank's standard form provided blanks to be completed with the name of the sender and the recipient, the amount to be transferred, and the relevant account numbers. The lawyer completed the form, signed it, and emailed it back to the bank. The bottom portion of the form had sections that needed to be filled in by bank employees before initiating the transfer. It contained the following warning to employees: "Before signing off, be sure you 'know your customer' and have verified the collected balance and documented any exception approvals."⁷³ In addition, the form had a field to be completed that was labeled "Collected Balance/Cash." The amount of \$497,643.89 was filled in and, next to the collected amount, a bank employee signed her name. In addition, an assistant branch manager signed the form, as was required by the form.⁷⁴

structions were to wire the money—almost \$200,000—not to Florida, but to a Nigerian bank. In fact, the check was forged. When the forgery was discovered, Wells Fargo debited Plaintiff in the amount of the wire.”).

66. *Cadence Bank v. Elizondo*, 606 S.W.3d 802, 806 (Tex. App.—Houston [1st Dist.] 2020, pet. granted).

67. *Cadence Bank, N.A. v. Elizondo*, 642 S.W.3d 530, 531 (Tex. 2022).

68. *Id.*

69. *Id.*

70. *Id.* at 532.

71. *Id.* at 533.

72. *Id.*

73. *Id.* at 531.

74. *Id.* at 532.

Two versions of the form had been produced in discovery.⁷⁵ One of the versions contained a handwritten note that the lawyer's account had a \$497,643.80 "Ava Bal" (available balance) and also read "verified @ 11:08 am." This section included the signature "S. Baker." The term "collected balance" was not defined in the form.⁷⁶

Because of this language on the form, the lawyer argued that the bank was obligated to wire out only funds that had been collected. The form, the lawyer contended, constituted an enforceable contract. Because the bank had not waited to be certain the check had cleared, the bank had violated its internal policies and the lawyer had relied upon the form.⁷⁷

The trial court and the court of appeals agreed.⁷⁸ The court of appeals had reasoned that, while it was true that the lawyer had breached the transfer warranties by depositing a fraudulent check, the wire transfer form had created a binding contract between the lawyer and the bank.⁷⁹ In that contract, the bank had committed to wire transfer only collected funds. While the bank had argued that the internal meaning of "collected funds" only referred to an end of day balance, the industry usage referred to funds that had already been collected, and because the bank's unusual internal definition had not been set forth on the form, the industry usage provided the definition of the term.⁸⁰

The Texas supreme court disagreed.

The supreme court reasoned that the applicable law is section 4.214(a) of the UCC.⁸¹ That section provides:

If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor . . . or otherwise to receive settlement for the item that is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account, or obtain refund from its customer . . . ⁸²

The supreme court noted that the attorney's deposit agreement with the bank echoed this law and stated, "[w]e may deduct funds from your account if an item . . . is returned to us unpaid, or if it was improperly paid, even if you have already used the funds."⁸³

This language is clear. While the Texas supreme court recognized that some courts have held that the UCC provisions might be varied by contract—although it specifically declined to determine whether in fact those UCC provisions could be varied by contract—here, no contract had been

75. *Id.*

76. *Id.* at 533.

77. *Cadence Bank v. Elizondo*, 606 S.W.3d 802, 812–13 (Tex. App.—Houston [1st Dist.] 2020, pet. granted).

78. *Id.* at 819–20.

79. *Id.* at 816 ("This evidence shows that the parties entered into a valid and enforceable agreement.")

80. *Id.* at 817.

81. *Cadence Bank*, 642 S.W.3d at 533.

82. TEX. BUS. & COM. CODE ANN. § 4.214(a).

83. *Cadence Bank*, 642 S.W.3d at 533.

formed by the mere inclusion of the term “Collected Balance” on a form that the attorney signed to initiate the wire transfer. The meaning of the term collected balance therefore did not matter.⁸⁴ The supreme court explained:

Even if the record conclusively supported Elizondo’s definition—which it does not—we would nonetheless hold that the transfer-request form was not ‘sufficiently definite to confirm that [Cadence] actually intended to be contractually bound’ by a promise to only transfer ‘collected’ funds.⁸⁵

Accordingly, the Texas supreme court reversed and remanded, with instructions to consider any outstanding issues not relating to the contract argument.⁸⁶

VI. CONSEQUENTIAL DAMAGES MUST BE FORESEEABLE AND PROVEN WITH REASONABLE CERTAINTY

Since the time of *Hadley v. Baxendale*,⁸⁷ the common law of contracts has been that consequential damages for breach of contract must be foreseeable. In 2021, the Texas Supreme Court recognized this long-standing rule and applied it to a case in which substantial consequential damages had been awarded.⁸⁸

The facts were relatively straightforward. The plaintiff had agreed to perform work on some of the defendant’s equipment. The defendant had agreed to pay for the work. The work was completed, but the defendant did not pay the bill, and instead argued that it was too high. The matter went to trial. The jury awarded direct damages—the amount of the unpaid bill—and over \$55,000,000.00 in compensatory damages. On appeal, the Court of Appeals for the Thirteenth District of Texas at Corpus Christi–Edinburg reduced the compensatory damage award to about \$12,000,000.00. The defendant subsequently appealed.

The basis for the compensatory damages was that, as a result of not having been paid on time, the plaintiff lost an opportunity to be sold to another entity for roughly \$42,000,000.00. When the plaintiff had begun experiencing desperate cash flow problems—indeed, these problems were so severe that payroll tax payments were missed—the offer had been withdrawn. Later, the company received other offers to be purchased for roughly \$10,000,000.00, but the company did not accept those low offers. On appeal, the reviewing court reduced the award to roughly \$12,000,000.00, believing that a decline in the plaintiff’s book value, rather than its allegedly lost opportunity to be acquired, was the appropriate measure of consequential damages.⁸⁹

84. *Id.* at 535.

85. *Id.*

86. *Id.*

87. 9 Exch. 341, 156 Eng. Rep. 145 (1854).

88. *Signature Indus. Servs., LLC v. Int’l Paper Co.*, 638 S.W.3d 179, 183 (Tex. 2022).

89. *Id.* at 184.

The Texas supreme court explained that Texas law “requires that consequential damages be both (1) foreseeable at the time of contracting, and (2) calculable with reasonable certainty.”⁹⁰ Upon further examination, the critical flaw with the plaintiff’s argument, namely that that it should be compensated for the lost opportunity to be acquired, was that its sale negotiations had been confidential and the defendant knew nothing about a possible sale of the plaintiff.⁹¹ For that reason, the supreme court concluded, the loss of that sale could not have been foreseeable by the defendant.⁹² Accordingly, even if the defendant’s failure to pay for the work were the cause of the sale collapsing, the collapse could not have been contemplated by the defendant and thus could not give rise to consequential damages.⁹³

The plaintiff also argued that the company’s collapse in “company value” was a basis for the consequential damages award.⁹⁴ It cited, however, no contract case that had upheld an award of consequential damages based on a decline in the plaintiff’s company value.⁹⁵ A few courts in Texas had considered the theory, but none had allowed a recovery based upon that argument, and the supreme court emphasized that it would not be the first to do so, further stressing that consequential damages must be foreseeable, and the deterioration of the company’s value could not have been foreseen.⁹⁶ Similarly, the supreme court refused to uphold a consequential damage award based upon the alleged lost “book value” of the company, because awards for consequential damages must be proven with “reasonable certainty,” which the plaintiff had failed to do.⁹⁷

The Texas Supreme Court also examined the compensatory damages and concluded that a portion of the plaintiff’s bills to the defendant had been unjustified. Consequently, the supreme court reduced the compensatory damages as well as the consequential damages, all in all leaving the plaintiff with a significantly reduced reward.⁹⁸

VII. CONCLUSION

The real action in the commercial law field in Texas this past year was in legislation; case law broke no new ground. Nevertheless, the two important cases decided by the Texas Supreme Court reaffirmed long-standing rules, helping to make business transactions more predictable.

90. *Id.* (citing *Phillips v. Carlton Energy Grp., LLC*, 475 S.W.3d 265, 279 (Tex. 2015); *Stuart v. Bayless*, 964 S.W.2d 920, 921 (Tex. 1998) (per curiam)).

91. *Id.* at 187.

92. *Id.*

93. *Id.*

94. *Id.* at 187–88.

95. *Id.* at 189.

96. *Id.*

97. *Id.* at 192.

98. *Id.* at 194–95.

