Banks and Banking - Bank May Finance the Involuntary Takeover of One of Its Borrowers and May, in Making Its Loan Decision, Rely on Confidential Information Received from the Takeover Target

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Recommended Citation
John C. Sullivan, Banks and Banking - Bank May Finance the Involuntary Takeover of One of Its Borrowers and May, in Making Its Loan Decision, Rely on Confidential Information Received from the Takeover Target, 25 Vill. L. Rev. 981 (1980).
Available at: https://digitalcommons.law.villanova.edu/vlr/vol25/iss6/7

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BANKS AND BANKING—Bank May Finance the Involuntary Takeover of One of its Borrowers and May, in Making its Loan Decision, Rely on Confidential Information Received from the Takeover Target.

Washington Steel Corp. v. TW Corp. (1979)

Defendant Chemical Bank (Chemical), having made a substantial loan to plaintiff Washington Steel Corporation (Washington Steel),¹ and having served as a registrar of Washington Steel's common stock,² became privy to confidential information concerning the corporation's financial affairs.³ This information included a study projecting Washington Steel's growth and earnings potential through 1982, as well as periodic financial statements.⁴

In January, 1979, Talley Industries, Inc. (Talley),⁵ which had long been a borrower from Chemical,⁶ sought financial backing from Chemical for a proposed acquisition of Washington Steel through a cash tender offer.⁷ A bank officer responsible for the Washington Steel account attended an intrabank meeting at which the propriety of financing Talley's acquisition of Washington Steel was discussed.⁸ His participation in the discussion was limited to statements that Chemical had a loan relationship with Washington Steel and that Washington Steel's response to the takeover proposal could not be predicted.⁹

Unwilling to acquiesce in the proposed takeover,¹⁰ Washington Steel sought to enjoin the tender offer,¹¹ alleging 1) that Talley had made in-
adequate disclosures and had engaged in deceptive practices, and 2) that Chemical had breached the fiduciary duty owed to Washington Steel through its misuse of confidential information. The district court ruled that Chemical had violated a fiduciary duty to its loan customer, Washington Steel, by participating in the takeover loan and restrained Chemical’s financing of the takeover attempt. The court refused, however, to enjoin the tender offer itself. Talley withdrew its tender offer while appeal was pending, thus making it unnecessary to seek to overturn the injunction.


13. 465 F. Supp. at 1101. Washington Steel also contended that a broker-dealer partnership had “misappropriated confidential and proprietary information.” Id. at 1102.

14. Id. at 1105. The district court opinion was written by Judge Simmons. Id. at 1101. The district court found that Chemical Bank was the “agent” of Washington Steel and owed a “fiduciary obligation to advance the best interests and welfare of the Plaintiff Washington Steel.” Id. at 1104. The court condemned Chemical’s “egregious and unethical” participation in the takeover loan and failure to disclose the “fact that it was operating in an adverse agency relationship and a dual agency relationship with an adverse party.” Id. at 1105.

15. 465 F. Supp. at 1105-06. In compliance with rule 65(c) of the Federal Rules of Civil Procedure, the district court had conditioned the issuance of the preliminary injunction on Washington Steel’s posting of a $2,000,000 bond. 602 F.2d at 598. The bond is a security set at the trial judge’s discretion representing an estimate of the anticipated losses which will be suffered by the party enjoined in the case of wrongful issuance. See FED. R. CIV. P. 65(c).

16. 465 F. Supp. at 1106. Although expressly granting preliminary injunctive relief for the bank’s breach of fiduciary duty, the district court denied injunctive relief for Talley’s alleged inadequate disclosures and deceptive practices surrounding the tender offer. See id. at 1105-06. Judge Simmons specifically stated that Talley would not be precluded from proceeding with its tender offer if it obtained alternate financing. Id. However, some financial analysts suggested that Talley was so deeply in debt that it would be unable to find another bank willing to take the lead in a similar financing agreement. Wall St. J., Feb. 20, 1979, at 4, col. 2.

17. 602 F.2d at 598. On March 9, 1979, after the district court had enjoined Chemical’s participation in the Talley loan, Washington Steel’s management endorsed a $40 per common
against Chemical's loan participation. Nevertheless, both Chemical and Talley appealed to the United States Court of Appeals for the Third Circuit asserting claims for damages resulting from the injunction against Chemical's participation in the tender offer. The Third Circuit reversed and remanded, holding that the injunction had been wrongfully issued since a bank may finance the involuntary takeover of one of its borrowers and may, in making its loan decision, rely on confidential information received from the takeover target. Washington Steel Corp. v. TW Corp., 602 F.2d 594 (3d Cir. 1979).

In recent years, growth-oriented corporations, recognizing that depressed stock prices have resulted in severe undervaluation of many corporations, have used cash tender offers to expand through acquisition, rather than through internal expansion. The cash tender offer is an acquisition technique through which a prospective purchaser of a corporation can circumvent resisting management by appealing directly to shareholders of the target corporation to sell their stock. Because few corporations have suffi-

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18. 602 F.2d at 598. Chemical alleged that it had been damaged in three ways as a result of the preliminary injunction. First, after the injunction, Talley had reduced its deposits with Chemical by more than $1 million which deprived Chemical of the use of these funds. Reply Brief of Defendant TW Corporation at 2, Washington Steel Corp. v. TW Corp., 602 F.2d 594 (3d Cir. 1979). Second, Chemical lost a 0.5% commitment fee on its $20 million loan from the date the injunction was entered. Id. Third, Chemical lost the interest payments, at a rate of 110% of the bank's prime rate, which it would have received on the Talley loan. Id. at 3.

Talley also claimed that it suffered damages as a result of the preliminary injunction, in attempting to renegotiate a credit agreement with another lending institution. Id. at 3-4. In addition, Talley made claims for commitment fees paid between the date of the loan agreement and the date the injunction was entered for a credit arrangement which was extinguished by the injunction. Id. at 4. Finally, Talley alleged damages flowing from its inability to proceed with the tender offer as a result of the injunction. Id. at 4-5.

19. The case was argued before Circuit Judges Gibbons and Hunter, and District Judge Meanor of the United States District Court for the District of New Jersey sitting by designation. Judge Gibbons wrote the opinion of the court.


During the past two decades the cash tender offer has become an increasingly popular and efficient mechanism of corporate expansion. Its chief advantages are speed and limited cost and risk. See Troubh, supra note 20, at 80-81.

22. See note 21 supra. Commentators have suggested that the cash tender offer is preferable to other acquisition techniques in three situations: 1) when acquisition is opposed; 2) when the
cient cash reserves to finance their tender offers, they have turned to commercial banks to obtain needed financing.23

Generally, the relationship between a bank and its customer is that of debtor and creditor—the bank's duty being merely to pay the amount deposited upon demand.24 Courts have recognized, however, that in certain bank-customer transactions which go beyond the typical deposit account situation, there exists a relationship of trust and confidence which justifies imposing a fiduciary duty upon the bank.25 Recently, questions have arisen concerning whether, in light of a bank's access to confidential information concerning its borrowers, a bank owes a fiduciary duty to a corporate borrower which precludes the bank from financing an involuntary takeover of that borrower.26 Even though the specific circumstances which give rise to

24. See, e.g., A. MICHE, MICHE ON BANKS AND BANKING, ch. 9, § 1 (1973); Annot., 70 A.L.R.3d 1344, 1347 (1976).
25. See, e.g., Milohnich v. First Nat'l Bank, 224 So. 2d 759, 760 (Fla. Dist. Ct. App. 1969) (bank has implied contractual duty not to disclose information concerning depositor's accounts to third parties); Richfield Bank & Trust Co. v. Sjogren, 309 Minn. 362, 369, 244 N.W.2d 648, 652 (1976) (bank's duty to disclose material information to a customer seeking a loan); Pigg v. Robertson, 549 S.W.2d 397 (Mo. Ct. App. 1977) (bank's duty not to use information acquired from customer in dealings antagonistic to the customer).

The basis for the application of fiduciary principles to the bank-customer relationship was explained by the Arizona Supreme Court in Stewart v. Phoenix Nat'l Bank, 49 Ariz. 34, 64 P.2d 101 (1937). The Stewart court noted that, in the past, most commercial transactions were for cash and that banks originally were merely places of security where a person could deposit his cash and valuables. Id. at 45, 64 P.2d at 106. However, in light of the highly complicated modern structure of credit, the court pointed out that

[1]It is almost inconceivable that any man should engage in financial transactions of any magnitude in the modern time without having recourse to some bank not only as a place of safety to keep his money, but as a place where he might secure loans to conduct his business. It is notorious that modern banks, before they make a loan of any extent, make a rigid investigation of the business of their customers, and even the purpose for which the loan is to be used, basing their action thereon.

Id.

Under the traditional rule, a fiduciary is prohibited from using knowledge acquired through a fiduciary relationship to subvert the principal's purpose in establishing the relationship. See Trice v. Comstock, 121 F. 620, 622 (8th Cir. 1903).


In addition, bank involvement in tender offer financing was the subject of recent congressional hearings. See Corporate Takeovers: Hearings on Regulation under Federal Banking and Securities Laws of Persons Involved in Corporate Takeovers Before the Senate Comm. on Banking, Housing and Urban Development, 94th Cong., 2d Sess. (1976) [hereinafter cited as Takeover Hearings]. The Senate Banking Committee hearings were prompted by an unsuccessful tender offer, similar to the offer in Washington Steel, by General Cable Corp. for the outstanding shares of Microdot, Inc. Id. at 1. The offer was to be financed by a loan from Irving Trust Co. which also had a loan agreement with Microdot through which Irving received con-
such a fiduciary duty have not been clearly defined,\textsuperscript{27} courts have traditionally considered whether a customer has placed his confidence in a bank and whether such confidence was invited and/or accepted.\textsuperscript{28}

Although finding that banks generally invite confidences,\textsuperscript{29} the New York Supreme Court, in \textit{M.L. Stewart} \& Co. \textit{v. Marcus},\textsuperscript{30} held that a corporation could not regard as a confidence its communication of information which it knew to be false.\textsuperscript{31} In \textit{Marcus}, the plaintiff corporation requested a loan to finance its purchase of real property,\textsuperscript{32} falsely informing the bank that it had already entered into a purchase agreement.\textsuperscript{33} Upon learning of the plaintiff's misrepresentation, the bank successfully negotiated and financed the purchase of the same property for another bank customer.\textsuperscript{34} Despite ruling that the misrepresentation precluded a finding of fiduciary duty, the \textit{Marcus} court recognized that the necessities of a competitive industrial system of business should be tempered by the "teachings of morality" so that banks cannot take advantage of their customers' confidences.\textsuperscript{35}

\textit{American Medicorp, Inc. \textit{v. Continental Illinois National Bank \& Trust Co.}}\textsuperscript{36} was the only case prior to \textit{Washington Steel} to examine fully the ques-
tion of whether a bank should be permitted to finance the involuntary takeover of one of its corporate borrowers.37 The district court in Continental Bank held that a bank should be free to extend a loan to finance the involuntary takeover of a corporate client, provided that the bank, in deciding to underwrite the takeover, does not rely upon confidential information furnished by that customer.38 In light of the fact that banks often deal with customers who have conflicting interests, the Continental Bank court reasoned that an absolute bar to bank participation in hostile takeovers of corporate customers would "tend to burden the free flow of bank financing

a loan to finance the involuntary takeover of a customer which has furnished confidential information to the bank is a per se breach of the fiduciary obligation owed by a bank to its customer. Id. at 7. Alternatively, American contended that Continental had used the confidential information in determining whether to make the loan to Humana, Inc. (Humana), the prospective purchaser. Id. Additionally, American alleged that Continental had disclosed the confidential information to Humana. Id.


In Harnischfeger, plaintiff sought a preliminary injunction to forestall a tender offer for plaintiff's common stock, alleging, inter alia, a breach of fiduciary duty by defendant Citibank. 474 F. Supp. at 1152. After examining the evidence, the Harnischfeger court concluded that there had been no breach of Citibank's "Chinese Wall," and thus, no breach of fiduciary duty had occurred. Id. at 1153-54. For a discussion of the operation of a "Chinese Wall," see notes 40-42 and accompanying text infra.

In Humana, a lawsuit arising out of the attempted takeover of American Medicorp, Inc., plaintiff alleged the improper use of confidential information by the bank which financed the tender offer. [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,286, at 92, 829. The Humana court agreed with the court's finding in American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co., that there had been no misuse of confidential information. Id. See notes 38-39 and accompanying text infra. Nevertheless, the Humana court expressed reservations about this type of bank activity, stating: "[S]ince banks play such a critical role in determining whether tender offers will go forward and as a result exert such significant influence in determining which management survives, it seems highly desirable that the potential for conflict should be avoided by the voluntary behavior of the bank itself." [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,286 at 92,829 (emphasis added).

38. 475 F. Supp. at 8. In denying plaintiff's motion for a preliminary injunction of the takeover loan, the court initially rejected plaintiff's contention that Continental Bank's participation in the takeover financing was a per se violation of the bank's duty to its customer. Id. The court based its rejection of this argument on the absence of case law "supporting a complete prohibition against lending money to a company seeking to take over one of the bank's customers which has provided it with 'non-public' information." Id. According to the court, the cases relied upon by the plaintiff did not require the court to enforce such a broad per se duty. Id.

Despite the perusal of the American Medicorp file by two bank officers working on the Humana, Inc. loan, and even though an informal meeting had taken place between officers working on the two accounts, the court found no evidence that the bank had actually relied upon confidential information in deciding to make the Humana, Inc. loan. Id. at 8-9. The court reasoned that such an examination would not be crucial to the bank's decision to make a loan. Id. Indeed, the bank would not be exercising good business judgment if it assumed that the assets of the acquired corporation would be used to repay a takeover loan, especially in light of the speculative nature of a takeover. Id. at 9.

Finally, the court rejected the plaintiff's allegation that Continental Bank had disclosed confidential information to third parties. Id. The court found insufficient evidence to support such an assertion. Id.
and the ability which a bank now has to deal with customers who have adverse interests to other customers.” 39

In order to prevent the unauthorized use of confidential information, some banks have erected within their loan departments a variant of the “Chinese Wall,” 40 the technique created by banks to prevent investment department misuse of inside information acquired from borrowers by the commercial loan department. 41 An intradepartmental “Chinese Wall” restricts the access of loan officers responsible for a tender offer loan to confidential information supplied to the loan department by the target corporation. 42

In Washington Steel, the Third Circuit, after deciding that the case was not rendered moot by Talley’s withdrawal of its tender offer, 43 considered whether a bank has a per se fiduciary obligation to refrain from financing the


In the aftermath of the expansive reading given to insider liability under SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1976), following the Commission’s ruling in In re Cady, Roberts & Co., 40 S.E.C. 907 (1961), multiservice banks faced a dilemma caused by the conflicting duties owed to corporate borrowers, trust beneficiaries, and the investing public. See Bruzda & Seidel, supra, at 375. Bruzda and Seidel observed:

The bank’s obligation to the commercial loan customer would require it to keep the information confidential, while its duty to the trust beneficiaries would require it to utilize the information in deciding whether to purchase or dispose of the stock for the trust accounts. Further, its responsibility to the investing public under rule 10b-5 would require the bank to either publicly disclose the inside information (which would defy its duty to the commercial loan customer) or refrain from trading in the commercial loan customer’s securities for its trust accounts (which would defy its obligation to the trust beneficiaries).

Id. The implementation of the “Chinese Wall” was advocated as a solution to the predicament. See id.

42. See generally Herzel & Rosenberg, supra note 40.

43. See 602 F.2d at 599; note 17 and accompanying text supra. Judge Gibbons concluded that this appeal was viable because the Third Circuit would be faced with the same issues on an appeal from the disposition of a claim to recover damages on the injunction bond. Id. at 598. The court supported its decision by citing prior cases in which, even though the primary claim had been settled before appellate review, the prospect of a suit on the bond prevented the lawsuit from becoming moot. Id. at 599, citing Liner v. Jafco, Inc., 375 U.S. 301, 305-06 (1964) (underlying labor dispute mooted but appeal allowed for union’s claim on injunction bond); Kelin v. Califano, 586 F.2d 250, 256 (3d Cir. 1978) (en banc) (medicaid funding dispute settled but appeal heard because of appellant’s intention to seek recoupment for past expenditures in compliance with injunctions); American Bible Soc’y v. Blount, 446 F.2d 588, 594-95 (3d Cir. 1971) (although amendment of regulation rendered enforcement action moot, appeal allowed because of likelihood same issue would be presented in a future suit on injunction bond).
involuntary takeover of its borrowers. Judge Gibbons noted that not only was a broad fiduciary duty unprecedented, but that it had been explicitly rejected in Continental Bank. Furthermore, the Third Circuit maintained that the adoption of a per se rule would dramatically affect the availability of financing for corporate acquisitions, an effect more properly initiated by legislation.

The Washington Steel court further found that Chemical had not, in fact, misused the confidential information. The court refused to presume misuse from the mere fact that the bank official supervising the Washington Steel account had attended a meeting at which the Talley loan was discussed. Testimony that discussion between bank officers working on the Washington Steel and Talley accounts had been prohibited and that all of the Washington Steel files had been secured to prevent their inspection by those responsible for the Talley loan persuaded the court that all necessary precautions had been taken.

Finally, the Third Circuit held that the bank would not have violated any fiduciary duty had it used the information obtained from Washington Steel in deciding whether to make the loan to Talley. The Washington Steel court further found that Chemical had not, in fact, misused the confidential information. The court refused to presume misuse from the mere fact that the bank official supervising the Washington Steel account had attended a meeting at which the Talley loan was discussed. Testimony that discussion between bank officers working on the Washington Steel and Talley accounts had been prohibited and that all of the Washington Steel files had been secured to prevent their inspection by those responsible for the Talley loan persuaded the court that all necessary precautions had been taken.

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Finally, the Third Circuit held that the bank would not have violated any fiduciary duty had it used the information obtained from Washington Steel in deciding whether to make the loan to Talley.

44. 602 F.2d at 599-601. The plaintiff contended that a bank, by obtaining confidential information from a loan customer, assumed an absolute obligation not to act adversely to the borrower's interests. Id. at 599. Although Washington Steel did not rely upon Chemical's service as registrar of the company's stock as inferring the per se fiduciary duty it advocated, the Third Circuit stated that it would have rejected such an argument. Id. at 599 n.2.

45. Id. at 599-600. Although the Marcus case was cited to support the plaintiff's position, the court felt that the Marcus weakened Washington Steel's argument to the extent that it was relevant at all. Id. at 600. The Third Circuit maintained that the plaintiff's proposed per se rule would "undermine" the business necessities recognized by the Marcus court. Id. For a discussion of the Marcus case, see notes 29-35 and accompanying text supra. Judge Gibbons similarly dismissed the other cases cited in support of the per se duty, characterizing them as attempts to "draw a fiduciary rabbit from a commercial loan agreement hat." 602 F.2d at 600.

46. 602 F.2d at 600. For a discussion of Continental Bank, see notes 36-39 and accompanying text supra.

47. 602 F.2d at 601, citing Note, supra note 36, at 835. The court expressed concern that if such a per se duty was imposed, a corporation could easily insulate itself from takeover by entering into loan transactions and supplying nonpublic information to the limited number of banks with sufficient assets to participate in tender offer financing. 602 F.2d at 601.

48. 602 F.2d at 601. Judge Gibbons stated that the legislature would be better able to "strike the appropriate balance between sound economics on the one hand, and expectations of loyalty on the other." Id. Furthermore, the court noted that a state common law fiduciary duty impacting on an area as vital to the national economy as banking would, in all probability, be preempted by federal regulation. Id.

49. Id. at 602. Although defendants Chemical and Talley asserted that the Pennsylvania Securities Commission had previously determined that no misuse had occurred, Judge Gibbons ruled that Chemical and Talley had forfeited the right to the benefits of collateral estoppel on appeal because of their failure to plead this affirmative defense in the district court. Id. at 603 n.4. See Fed. R. Civ. P. 8(e) (failure to plead an affirmative defense results in forfeiture).

50. 602 F.2d at 602. See text accompanying notes 8-9 supra.

51. 602 F.2d at 603. Washington Steel had argued that, in light of Talley's allegedly weak financial condition, Chemical would not have granted the loan without special knowledge of Washington Steel's financial situation. Id. at 602. However, Judge Gibbons found that Chemical had performed a "worst-case" analysis which had convinced the bank of Talley's ability to repay the loan. Id. But cf. note 16 supra (noting concern in the financial community over Talley's financial condition).

52. 602 F.2d at 603. The Third Circuit explicitly limited its holding to permitting the use of confidential information within the loan department. Id. Judge Gibbons recognized that the
Steel court found that, in the interest of sound banking practice, banks should be free to rely on confidential information supplied by one borrower in evaluating commercial credit transactions with other borrowers. According to the court, a commercial loan department has an overriding obligation to consider all information available to it in order to avoid taking "imprudent risks" with depositors' money. The Washington Steel court believed that restricting the bank's use of confidential information might unduly discourage the free flow of bank credit—"the largest part, by far, of the national money supply." In view of the generally accepted freedom of banks to deal among customers with adverse interests, it is submitted that the Third Circuit correctly rejected a per se rule against a bank's participation in the takeover of one of its customers. Arguably, the practical effect of the imposition of such a per se duty would be decreased competition in every industry. Fearing that small, expanding businesses may be potential takeover targets, a bank might be reluctant to finance small and new business enterprises if such loans would preclude the bank from making more profitable loans to acquiring corporations. Furthermore, by opening accounts with the relatively limited number of banks with sufficient assets to finance tender

transfer of confidential information obtained from the target corporation to the bank's investment department or to the acquiring corporation might violate the federal securities laws. Id. See note 41 supra.

53. 602 F.2d at 603.
54. Id. According to the Third Circuit, a bank might arguably be violating its duties to its depositors by ignoring relevant information it has on file from its borrowers. Id. For a critical analysis of this argument, see notes 73-74 and accompanying text infra.
55. 602 F.2d at 603. The court emphasized that the adverse impact on the free flow of funds which would be created by limiting the bank's use of information in its files was the fundamental reason for rejection of the per se rule advocated by Washington Steel. Id.
56. See Takeover Hearings, supra note 26, at 36-39 (statement of Gordon T. Wallis, Chairman of the Board, Irving Trust Co.). The Continental Bank court took this position in denying the plaintiff's motion for a preliminary injunction when it stated that a bar to bank participation in hostile takeover would "tend to burden the free flow of bank financing and the ability which a bank now has to deal with customers who may have adverse interests to other customers." 475 F. Supp. at 9 (emphasis added). For a discussion of Continental Bank, see notes 36-39 and accompanying text supra. See also Lutcher S.A. Celulose e Papel v. Inter-American Dev. Bank, 382 F.2d 454, 460 (D.C. Cir. 1967) (no duty exists, independent of contract, which would impair the bank's right to make loans to competitors of its customers). But cf. Humana, Inc. v. American Medicorp, Inc. [1977-1978 Transfer Binder] FED. SEC. L. REP (CCH) ¶ 96,286, at 92,829 (S.D.N.Y. 1978) (banks should voluntarily avoid the potential for conflict). For a discussion of Humana, see note 37 supra.
57. See 602 F.2d at 601.
58. See Takeover Hearings, supra note 26, at 39 (statement of Gordon T. Wallis, Chairman of the Board, Irving Trust Co.). Mr. Wallis further suggested that a bank should consider two questions when it deals with customers who have adverse interests: 1) whether the service requested by one customer requires recourse to confidential information supplied by the other; and 2) where the confidentiality of customer information is protected, whether the bank, as a matter of business judgment, wishes to finance the project. Id.
59. For a discussion of the characteristics of a likely takeover target, see E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 1-9 (1973).
offers, target management could preserve its control at the expense of shareholder profits. Such a sensitive economic matter is, as the court noted, more properly suited to legislative factfinding and policy determination than to judicial decree.

Nevertheless, in authorizing the loan department’s use of confidential information received from one customer in evaluating a loan to another borrower, the Third Circuit reached beyond the factual question before it to create an unprecedented rule of law. The court’s reasoning that a bank must be free to utilize all available information in order to conduct its loan transactions successfully deviates from the traditional rule that the recipient of confidential information may not use that information in a manner inconsistent with the confiding party’s purpose in disclosing it. The Washington Steel decision allows a bank to exploit its position as the recipient of confidential information by extending profitable loans to what might otherwise seem to be unsound credit risks. In permitting such a result, the Third Circuit appears to have disregarded the Marcus court’s admonition that banks should temper their business judgments with “moral considerations.” In emphasizing the “necessities of a competitive industrial system of business,” Judge Gibbons seemingly dismissed the Marcus court’s concern for the achievement of sound business ethics.

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60. See Takeover Hearings, supra note 26, at 37 (statement of Gordon T. Wallis, Chairman of the Board, Irving Trust Co.). Mr. Wallis pointed out that most corporations would not have enough cash available to finance tender offers by themselves. Id. He felt that it would be inefficient, if not impossible, for a corporation to raise the necessary capital for a takeover attempt through the marketing of securities. Id.

61. One commentator has recognized the capacity of the tender offer “to drive an economic wedge between target management and target securityholders.” Bromberg, Tender Offers: Safeguards and Restraints—An Interest Analysis, 21 CASE W. RES. L. REV. 613, 656 (1970). Target management, despite its fiduciary duties to the corporation and its shareholders, may attempt to thwart a tender offer which would be beneficial to those interests because of the fear of loss of employment or prestige. Id. Congress has also recognized the potential competing interests of target management and shareholders. 113 CONG. REC. 854 (1967) (statement of Senator Harrison Williams). Senator Williams, in introducing legislation to regulate tender offers, stated: “I have taken extreme care with this legislation [the Williams Act] to balance the scales equally to protect the legitimate interests of the corporation, management, and shareholders without unduly impeding cash takeover bids.” Id.

62. See notes 47-48 and accompanying text supra.

63. See 602 F.2d at 604; notes 52-55 and accompanying text supra.

64. 602 F.2d at 603.

65. See Trice v. Comstock, 121 F. 620, 622 (8th Cir. 1903). The Trice court stated that a fiduciary is prohibited from using knowledge acquired through a fiduciary relationship to subvert the principal’s purpose in establishing the relationship. Id.

66. It is suggested that a bank would be more likely to finance an otherwise marginal takeover if it had access to confidential information indicating the soundness of the venture. Chemical’s claims for lost profits due to the preliminary injunction demonstrate the profitability that tender offer financing holds for a banking institution. See note 18 supra. In making a takeover loan decision, banks also consider the possibility that a successful takeover will result in the transfer of millions of dollars of demand deposits to the financing bank. Schwartz & Kelly, Bank Financing of Corporate Acquisitions—The Cash Tender Offer, 88 BANKING L.J. 99, 101 n.3 (1971).

67. See 124 Misc. at 92, 207 N.Y.S. at 691; text accompanying note 35 supra.

68. Compare Washington Steel Corp. v. TW Corp., 602 F.2d at 600 (emphasizing the “necessities of a competitive industrial system of business”) with M.L. Stewart & Co. v. Mar-
Because Judge Gibbons believed that the adoption of a rule restricting a bank's use of confidential information would have consequences involving considerations of economic policy, he left that decision to the legislature. Such judicial restraint, however, appears to be unwarranted. Arguably, congressional inaction subsequent to a recent hearing on bank involvement in corporate takeovers was influenced by the suggestion of a representative of the banking industry that bankers fully expect that common law remedies are available to those damaged by a bank's abuse of confidences.

The arguments advanced by the Third Circuit to support its contrary conclusion that banks have no fiduciary duty to refrain from using confidential information appear to be less than convincing. Judge Gibbon's contention that a no use rule would force banks to make uninformed decisions ignores the fact that a bank financing a takeover would not normally have access to confidential information concerning the target. Only the fortuity that both the acquiring and target corporations borrow from the same bank makes the confidential information available. Further, the court's suggestion that the bank's duties to its depositors compel it to utilize "all available information" is also subject to question. Under traditional trust law, a fiduciary has no duty to violate the law to further the interests of its beneficiaries. In presuming that the use of confidential information is lawful for purposes of arguing that such use should be lawful, the court engages in circular reasoning. Finally, it is difficult to accept the Third Circuit's proposition that a no use rule would stem the free flow of bank credit. Since banks do not normally have access to confidential information, it is unclear why the inability to use such information, when available, would significantly impact tender offer financing. Furthermore, information concerning the financial well-being of the target corporation is of questionable relevance to the commercial lender since bankers, in making their loan decisions, tend to rely on the borrower's ability to repay the loan rather than on their anticipation that the target will be a source for loan repayment following the takeover.

It is submitted that a sounder legal basis for the Washington Steel decision would have been the adoption of the more conservative approach of the Continental Bank analysis which allowed bank participation in customer

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69. 602 F.2d at 601. See notes 47-48 and accompanying text supra.
70. See generally Takeover Hearings, supra note 26.
71. See id. at 99 (statement of Richard A. Debs, First Vice-President and Chief Administrative Officer, Federal Reserve Bank of New York).
72. 602 F.2d at 603. See note 54 and accompanying text supra.
73. See 2 A. Scott, TRUSTS § 166 (3d ed. 1967).
74. See 602 F.2d at 603; note 55 and accompanying text supra.
takeovers while recognizing fiduciary limitations on the use of confidential information.  Although fiduciary obligations have only been imposed on banks in limited circumstances, courts have recognized that a bank may not make unauthorized use of confidential information entrusted to it by a customer. In view of the fact that banks compel prospective borrowers to make substantial confidential disclosures in order to obtain loans necessary to conduct their businesses, fairness should require that banks be allowed to use this information solely for the purposes intended by the borrowers.

Although it might be argued that the Third Circuit's decision prevents spurious litigation by target management resisting a takeover, it is suggested that a more appropriate response would have been to recognize the existence of an intradepartmental "Chinese Wall" as prima facie evidence that the bank had not misused confidential information. In this way,

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78. See notes 24-28 and accompanying text supra.
79. See, e.g., Humana, Inc. v. American Medicorp, Inc. [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,286, at 92,829 (S.D.N.Y. 1978) ("a special relationship which may be designated fiduciary or confidential does exist between a prospective borrower and its bank which should preclude the bank from disseminating or using the information for improper purposes"); American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co., 475 F. Supp. at 8 (bank may finance a hostile takeover of one of its borrowers so long as it does not rely on confidential information supplied by the borrower). See also Takeover Hearings, supra note 26, at 99 (statement of Richard A. Debs, First Vice-President and Chief Administrative Officer, Federal Reserve Bank of New York) ("There is a special relationship between banks and their customers that is based on confidence and trust in the bank itself, and in the bank's commitment to safeguard the confidential [sic] affairs of its customers"); Herzel & Rosenberg, supra note 40, at 673-83 (banks should implement a "Chinese Wall" to avoid misusing confidential information).
82. For a discussion of the characteristics of a "Chinese Wall," see notes 40-42 and accompanying text supra.
borrowers' expectations of confidentiality would be protected without providing target management with additional defensive tactics with which to oppose tender offers.\textsuperscript{83}

In the instant case, Chemical had the opportunity to misuse confidential information, but it is apparent that no information about Washington Steel was disclosed other than the fact of its relationship with Chemical.\textsuperscript{84} The bank meeting attended by an officer responsible for the Washington Steel account apparently took place for the sole purpose of considering the potential conflict in serving both corporations, rather than to assess the merits of the Talley loan.\textsuperscript{85} Without this ability to review potential conflicts, banks would be caught in a legal "Catch-22"\textsuperscript{86} in which the very attempt to ascertain and avoid breaching their obligations would constitute, in itself, a breach of trust and confidence.

Nevertheless, despite the bank's stated limited purpose of simply assessing the conflict,\textsuperscript{87} its means were not particularly well-tailored to carry out this purpose.\textsuperscript{88} Even though a bank, in making its loan decision, will normally rely primarily on the borrower's financial status rather than the target's,\textsuperscript{89} the confidential information may be material in marginal tender offers where the acquiring corporation is financially weak and the target's assets may be used to repay the loan. Significantly, in Washington Steel, Talley's financial status was not considered particularly strong.\textsuperscript{90}

The Washington Steel decision established that, within the Third Circuit, bank financing of the involuntary takeover of a corporate customer does

\textsuperscript{83} It is submitted that this result is consistent with the congressional policy toward takeovers expressed through the enactment of the Williams Act. See 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1976). Federal regulation of cash tender offers, as proposed under an earlier bill, S. 2731, 89th Cong., 1st Sess. (1965), had a strong anti-takeover bias. See 111 CONG. REC. 25, 257 (1965) (remarks of Senator Williams) (characterizing tender offerors as "white collar pirates" who reduce "proud old companies" to corporate shells); Note, Cash Tender Offers, supra note 21, at 377, 381 n.28. When tender offer regulation was subsequently enacted, however, the Senate Committee provided a more evenhanded appraisal of the purpose of the Act:

"The Committee has taken extreme care to avoid tipping the balance of regulation in favor of management or in favor of the person making the takeover bid. The bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management an equal opportunity to present their case.


84. See 602 F.2d at 596; text accompanying notes 8-9 supra.

85. See text accompanying notes 8-9 supra.


87. See 602 F.2d at 596.

88. It seems probable that Chemical had no need for the officer in charge of the Washington Steel account to be present at the meeting to discuss the potential conflict of interest involved in making a takeover loan to Talley. Apparently, Chemical was already aware of the conflict since the bank knew who was in charge of the Washington Steel account.

89. See note 76 and accompanying text supra.

90. See note 16 supra.
not constitute a per se violation of any fiduciary duty owed to that customer. Consequently, any absolute prohibition against unfriendly takeover financing will have to come from the legislature. Since it is generally accepted that banks are not precluded from making loans to competitors of their customers, it is unlikely that this decision will effect a substantial change in bank lending practices.

The greatest impact of *Washington Steel* will, it is submitted, emanate from that portion of the opinion which permits banks to use confidential information received from one borrower in deciding whether to make loans to other borrowers. Arguably, small, expanding businesses which are likely takeover candidates will be particularly reluctant to provide the confidential disclosures necessary to arrange loans with a bank which engages in takeover financing out of fear that the confidential information may be used in a manner adverse to their corporate interests. Further, the bank's greater input in determining which tender offers go forward may well augur greater bank control over corporate expansion. Significantly, however, because a bank is particularly dependent upon its ability to maintain the confidence of its customers, the impact of the broad holding in *Washington Steel* may be mitigated by voluntary self-restraint on the part of banks. The appearance of impropriety resulting from a bank's use of confidential information in connection with takeover financing may engender a great deal of concern among corporate clients which are potential takeover targets, and banks will have to balance this concern against the economic benefit to be derived from using such information.

By refusing to impose fiduciary limitations on a bank's use of confidential information acquired from its customers, the Third Circuit has set a precedent against judicial interference with banking practices. In view of the lack of support in prior case law and in sound legal principles, it seems unlikely that the broad holding of *Washington Steel* will find widespread acceptance outside the Third Circuit.

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91. See 602 F.2d at 601.
92. See note 39 and accompanying text supra.
93. See 602 F.2d at 603.
94. See E. ARANOW & H. EINHORN, supra note 59, at 1-9.
95. Banks already play an important role in determining which tender offers will go forward since, without bank financing, few corporations would be able to raise the necessary capital for a takeover attempt. See note 60 supra. After *Washington Steel*, however, banks will be able to analyze not only the credit worthiness of the corporation seeking tender offer financing, but also the financial position of the target corporation on the basis of confidential information if the target is a client of the bank. See notes 89-90 and accompanying text supra.
96. See *Takeover Hearings*, supra note 26, at 99-100 (statement of Richard A. Debs, First Vice-President and Chief Administrative Officer, Federal Reserve Bank of New York).
97. See notes 47-48 & 69 and accompanying text supra.
98. See notes 63-68 and accompanying text supra.