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Bank Fiduciary Duty and Takeover: Washington Steel Corp. v. TW Corp.

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NOTE

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Chemical Bank (Chemical) agreed to participate in a loan to Talley Industries, Inc. (Talley) and TW Corporation[1] to be used to purchase the outstanding shares of Washington Steel Corporation (Washington). Talley's initial tender offer[2] to Washington was rejected, but the offer was subsequently renewed at a higher price.[3] Washington then sued to enjoin the tender offer, contending that Chemical had breached a fiduciary duty by using confidential information that had been obtained in the course of an earlier business relationship with Washington[4] in deciding whether to finance the tender offer. The trial court granted a preliminary injunction preventing Chemical from participating in the loan to Talley, holding that the bank, having received the confidential information from Washington,

1. TW Corporation is a wholly owned subsidiary of Talley Industries, Inc., organized solely for the purpose of acquiring Washington Steel.

2. The term "tender offer" as it applies to securities is not defined by federal legislation. It is generally understood as an offer to buy a substantial block of securities of a public company at a price above the current market value in an attempt to gain control of the company. *See generally* E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 1-34 (1977); 1 M. LIPTON & E. STEINBERGER, TAKEOVERS AND FREEZEOUTS 1-74 (1978); Schwartz, *Definition of a Tender Offer*, in CASH TENDER OFFERS 15 (R. Haft chrm. 1974); Einhorn & Blackburn, *The Developing Concept of "Tender Offer": An Analysis of the Judicial and Administrative Interpretations of the Term*, 23 N.Y.L. SCH. L. REV. 379 (1978); Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934*, 86 HARV. L. REV. 1250 (1973). For the definition of tender offer as used in the Pennsylvania Takeover Disclosure Law, see PA. STAT. ANN. tit. 70, § 73 (Purdon Supp. 1979-1980).

3. Talley also filed a Schedule 14D-1 Statement, which is required by the Securities Exchange Act of 1934, § 14(d), 15 U.S.C. § 78n(d) (1976). According to § 14(d), whenever a person intends to make a tender offer for any class of any equity security registered under § 12 of the Act, 15 U.S.C. § 78*l* (1976), that person must first file an information statement with the Securities and Exchange Commission if, after consummation of the transaction, that person will be the beneficial owner of more than 5% of such class. In addition to the 14D-1 Statement, Talley submitted a registration statement to the Pennsylvania Securities Commission. The statement was filed in accordance with the Pennsylvania Takeover Disclosure Law, which provides that, unless exempt, any offeror intending to make a takeover offer involving a target company or to acquire any equity securities of the target company pursuant to the offer must file such registration 20 days prior thereto. PA. STAT. ANN. tit. 70, § 74 (Purdon Supp. 1979-1980).

4. In 1974 Chemical had made a loan to Washington. In connection with the loan, Washington conveyed to Chemical nonpublic information that included quarterly financial statements, a year-end statement dated Dec. 28, 1978, for fiscal year ending Sept. 30, 1978, and cash flow and earnings projections for Washington through 1982. Not only had Chemical participated in a loan to Washington but it also had served as one of two registrars for its common stock. The trial court derived a duty from this latter relationship, but Washington did not assert that basis on appeal.

had breached a fiduciary duty by participating in the loan.[5] The bank appealed to the United States Court of Appeals for the Third Circuit. *Held, reversed and remanded*: A bank has no per se fiduciary duty to a corporate borrower arising from the receipt of confidential information from that borrower that would preclude the bank from participating in financing the takeover of the corporate borrower, and a bank violates no duty when it uses the confidential information in deciding whether to participate in the financing. *Washington Steel Corp. v. TW Corp.*, 602 F.2d 594 (3d Cir. 1979).

I. BANK FIDUCIARY DUTY TO CORPORATE BORROWERS

No state or federal statutory regulations restrict a bank from participating in a loan to one bank borrower that may result in the takeover of another bank borrower.[6] Accordingly, a legal challenge to the bank's participation depends upon the common law principles of agency and fiduciary duty.[7] Courts generally have not applied the law of agency to find a fiduciary duty in borrower and lender relationships, but instead have described the relationship as one of debtor and creditor.[8] When a bank loans

5. Washington Steel Corp. v. TW Corp., 465 F. Supp. 1100 (W.D. Pa.), *rev'd*, 602 F.2d 594 (3d Cir. 1979). The trial court determined that the bank, by acting as registrar and by receiving confidential information, was Washington's agent and thus had a duty not to act adversely to Washington's interests. 465 F. Supp. at 1104-05. The bank's participation in the loan was characterized as egregious and unethical conduct. *Id.* at 1105.

6. The National Bank Act, 12 U.S.C. §§ 21-215b (1976), and state banking regulations do not place any limitations on takeover loans. *See, e.g.*, CAL. FIN. CODE §§ 1220-1235 (West 1968); ILL. ANN. STAT. ch. 16 ½, § 132 (Smith-Hurd 1972); MASS. ANN. LAWS ch. 167, §§ 46-68 (Michie/Law. Co-op 1977 & Supp. 1980); N.Y. BANKING LAW §§ 103, 108 (McKinney 1971 & Supp. 1979-1980); PA. STAT. ANN. tit. 7, §§ 101-111 (Purdon 1967 & Supp. 1979-1980); TEX. REV. CIV. STAT. ANN. arts. 342-101 to -115 (Vernon 1973 & Supp. 1980). Bank loans to finance tender offers may have to comply with federal reserve regulations. *See* 12 C.F.R. §§ 221.1-.4(u) (1979) (security credit and margin requirements).

7. Generally, the nature of the agreement determines whether a principal and agent relationship exists. When money advanced to another is expressly labeled as money lent, no agency results. *See, e.g.*, Central Ga. Land & Lumber Co. v. Exchange Bank, 101 Ga. 345, 28 S.E. 863 (1897) (bank advancing money to cotton buyer not regarded as buyer's principal); Commercial Credit Co. v. L.A. Benson Co., 170 Md. 270, 184 A. 236 (1936) (a loan to voting machine manufacturer does not make lender liable as principal).

8. *See, e.g.*, *In re* Vickers, 557 F.2d 683, 688 (10th Cir. 1978) (relationship of bank and bank director who borrowed money one of debtor and creditor; no fiduciary duty existed); Graney Dev. Corp. v. Taksen, 92 Misc. 2d 764, 400 N.Y.S.2d 717, 720 (Sup. Ct.), *aff'd*, 66 A.D.2d 1008, 411 N.Y.S.2d 756 (1978) (borrower cannot maintain action against bank for breach of implied contract of confidentiality because no principal and agent relationship existed, only one of debtor and creditor); Ruddy v. Oregon Auto. Credit Corp., 179 Or. 688, 174 P.2d 603, 609 (1946) (auto dealer borrowing money from bank on blank auto title certificates in creditor and debtor relationship to bank, not principal and agent); Grace v. Moll, 285 Pa. 353, 132 A. 171, 171 (1926) (relationship one of borrower and lender, not one of confidential agent); Prater v. Fidelity Trust Co., 161 Tenn. 626, 34 S.W.2d 205, 207 (1930) (relationship of bank and borrower undertaking to pay outstanding mortgage not one of principal and agent). In addition courts have not found a fiduciary relationship between a bank and its depositor. *See, e.g.*, Klatt v. First State Bank, 206 Iowa 252, 220 N.W. 318, 320 (1928) (relationship of bank and depositor not confidential); Pritchard v. Myers, 174 Md. 66, 197 A. 620, 625 (1938) (relationship of bank and depositor one of debtor and creditor, not one of trust). *See generally* Annot., 70 A.L.R.3d 1344 (1976); 10 AM. JUR. 2d *Banks* § 339 (1963). For additional background on the issue of bank and customer relationships, see

money, it does not agree to act on behalf of the borrower and subject to the borrower's control; rather, the two parties act on their own behalf and for their own benefit.[9]

A fiduciary duty between a bank and its corporate borrower may exist, however, under special circumstances.[10] In *M.L. Stewart & Co. v. Marcus*,[11] a New York court, although finally rejecting a corporate borrower's claim,[12] recognized that a bank fiduciary duty may exist in some instances and rejected the narrow scope of debtor and creditor relationships, directing that the actual relation of the parties should be examined to determine whether there has been a breach of trust.[13] The court concluded that the test is "the reposing of confidence—in the sense of trust—and its abuse which must determine the result."[14] In addition, the court advocated the need to harmonize the necessities of a competitive industrial system of

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Hagedorn, *Fiduciary Aspects of the Bank Customer Relationship*, 34 MO. B.J. 406 (1978); Note, *Banks and Banking—Relationship of Depositor to Bank of Deposit*, 10 N.Y.U. L.Q. 366 (1933); Note, *Duties and Liabilities Arising From Bank-Depositor Relationship*, 25 ST. JOHN'S L. REV. 73 (1950).

9. RESTATEMENT (SECOND) OF AGENCY § 1(1) (1958).

10. *See, e.g.*, Brasher v. First Nat'l Bank, 232 Ala. 340, 168 So. 42, 46-47 (1936) (bank that holds insurance proceeds in trust for customer has fiduciary duty); Stewart v. Phoenix Nat'l Bank, 49 Ariz. 34, 64 P.2d 101, 106 (1937) (confidential relationship exists when bank customer of 23 years relies on bank officers for financial advice); Milohnich v. First Nat'l Bank, 224 So. 2d 759, 762 (Fla. Dist. Ct. App. 1969) (bank has obligation not to disclose information about depositor's account to third parties); Peterson v. Idaho First Nat'l Bank, 83 Idaho 578, 367 P.2d 284, 290 (1961) (bank has obligation not to reveal customer's account information to third persons unless authorized); First Nat'l Bank v. Brown, 181 N.W.2d 178, 182 (Iowa 1970) (bank president, who knows from borrower's questions that borrower trusts him, must disclose encumbrance of property being acquired by borrower); Richfield Bank & Trust Co. v. Sjogren, 309 Minn. 362, 244 N.W.2d 648, 652 (1976) (bank's special knowledge of depositor's fraudulent activities placed bank under duty to disclose prior to making loan to further fraud); Pigg v. Robertson, 549 S.W.2d 597, 601-02 (Mo. Ct. App. 1977) (when borrower seeks a loan to purchase property from bank officer and confides purpose of loan, bank officer has duty to disclose his interest in proposed deal); Morgan v. First Nat'l Bank, 58 N.M. 730, 276 P.2d 504, 508 (1954) (bank has duty to depositors not to charge account with a forged check because of relationship of confidence); M.L. Stewart & Co. v. Marcus, 124 Misc. 86, 207 N.Y.S. 685, 690-91 (Sup. Ct. 1924) (whether there is a trust relationship depends on actual relationship and whether confidence is shared); Burien Motors, Inc. v. Balch, 9 Wash. App. 573, 513 P.2d 582, 586 (1973) (independent business such as bank or realtor may have fiduciary duty when it assumes relationship of trust and confidence). *But see* Klein v. First Edina Nat'l Bank, 293 Minn. 418, 196 N.W.2d 619 (1972) (even 20 years as bank customer did not create fiduciary relationship).

11. 124 Misc. 86, 207 N.Y.S. 685 (Sup. Ct. 1924). In *M.L. Stewart* a plaintiff bank depositor and a defendant bank vice-president had simultaneously negotiated for the purchase of property. During a temporary lapse in negotiations, the defendant was erroneously informed by the plaintiff's treasurer-negotiator that the plaintiff had purchased the property. The defendant learned the amount of the alleged purchase price and agreed to the plaintiff's request for a loan to assist in financing the purchase. The defendant then renewed negotiations for the property and closed the purchase. Plaintiff sought an action to impose a trust on the realty and to secure a direct conveyance of the property on grounds that the defendant had induced the vendor to break his agreement to sell to the plaintiff and had breached a fiduciary duty arising from the interview in which the defendant agreed to extend a loan to the plaintiff.

12. The court decided that no fiduciary relationship had been created because the borrower had conveyed false information in applying for the loan. 207 N.Y.S. at 693.

13. *Id.* at 690.

14. *Id.*

business with the teachings of morality and to enforce the requirements of sound business ethics.[15]

Noting that the relationship between a bank and its depositor is usually one of debtor and creditor, the Arizona Supreme Court in *Stewart v. Phoenix National Bank*[16] emphasized that in some circumstances a relationship of trust may give rise to a fiduciary duty.[17] The plaintiff in *Stewart* had been a customer of the bank for twenty-three years, borrowing money on several occasions. During this period, the bank's officers and directors had also been his financial advisers. Although the action was dismissed on other grounds, the court stated that the bank's role as financial adviser had created a duty to disclose to the client all facts that might influence his actions.[18] Furthermore, the court emphasized that the complexity of credit and commerce during the 1930's had increased a bank customer's reliance on its bank for financial advice.[19] The court reasoned that this reliance established a confidential relationship between the bank and its customer and created a bank fiduciary duty.[20]

In 1977 the Missouri Court of Appeals in *Pigg v. Roberston*[21] held that when a bank knows or has reason to know that a customer is placing his trust and confidence in the bank, a confidential relationship may be found.[22] When applying for a loan, the plaintiff had disclosed to an auditor, who represented himself as a bank official, that the loan was to be used to purchase a farm. The auditor soon thereafter purchased the farm for himself. Stating that the disclosures were to be given the same protection as if made to a regular bank official, the court found evidence to support a finding of breach of a confidential relationship.[23]

The particular issue of a bank's fiduciary duty in financing takeovers of its customers was not addressed[24] until 1977 in *American Medicorp, Inc. v.*

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15. *Id.*

16. 49 Ariz. 34, 64 P.2d 101 (1937). The plaintiff bank customer sought damages for loss through fraud as a result of the foreclosure of a mortgage given by the plaintiff as security for indebtedness to the defendant bank. The plaintiff alleged that the bank had assured him it would not foreclose and that the mortgage was being taken simply as a matter of form to satisfy banking authorities. The plaintiff argued that he had a right to rely on the bank's representation because of a confidential relationship arising out of his 23 years as a bank customer and financial advisee of the bank's officers and directors.

17. 64 P.2d at 106.

18. *Id.*

19. *Id.*

20. *Id.* The court stressed that in view of modern business practices, when it is alleged that a bank has acted as the financial advisor of one of its customers for many years and that the customer has relied upon such advice, the allegation, if proved, is sufficient to establish a confidential relationship in regard to financial matters, and the bank is subject to the rules applicable to confidential relationships in general. *Id.*

21. 549 S.W.2d 597 (Mo. Ct. App. 1977).

22. *Id.* at 600.

23. *Id.* at 601-02.

24. Two other courts addressed the issue of a general bank fiduciary duty to corporate borrowers. In Lutcher S.A. Celulose e Papel v. Inter-American Dev. Bank, 382 F.2d 454 (D.C. Cir. 1967), the court held that a contract between a bank and borrower does not limit the right of the bank to loan to the borrower's competitors. No duty exists, independent of contract, that limits the right of the bank to make such loans. *Id.* at 460. In Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977), the

Continental Illinois National Bank & Trust Co.[25] In *American Medicorp* the corporate plaintiff had sued to enjoin the defendant bank from financing the acquisition of its stock through a tender offer made by another corporation. At the time of the other corporation's tender offer, the plaintiff was a customer of the bank, having received financial advice and other services. In addition, the plaintiff had supplied the bank with certain nonpublic financial information. Plaintiff alleged that under the circumstances the bank had a per se fiduciary duty that was breached when the bank made the loan to the aggressor corporation.[26] The plaintiff also contended that the bank breached its fiduciary duty when it used the confidential information in deciding whether to make the loan and when it furnished the information to the aggressor corporation.[27] The court denied the injunction, holding that the takeover loan was not a breach per se of the bank's fiduciary duty. A bank is not precluded under all circumstances from making a loan that facilitates the takeover of a customer.[28] Furthermore, an injunction would burden the free flow of bank financing and the ability a bank has to deal with customers who may have adverse interests to other customers.[29] In addition, the court found no evidence to support the allegations[30] involving the confidential information. The court

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court held that when a corporate merger broker has served previously as an investment banker for a corporation and confidence is placed in him based on that relationship, the corporation can rely on the preexisting and contemporaneous banker-client relationship for fair disclosure. 553 F.2d at 1043. Because he is in a quasi-fiduciary position with the corporation, the broker has an affirmative common law duty to disclose material facts relating to the proposed merger. *Id. See also* Microdot, Inc. v. Irving Trust Co., No. 01-23-76 (N.Y. Sup. Ct., filed Jan. 21, 1976) (suit concerning issue of bank financing of a takeover dropped when competing offer accepted).

25. No. 77 C 3865 (N.D. Ill. Dec. 30, 1977). The infrequent use of cash tender offers as a means of acquiring a substantial or controlling interest in publicly held companies may explain the lack of litigation in this area. *See* Hayes & Taussig, *Tactics of Cash Takeover Bids*, 45 HARV. BUS. REV., Mar.-Apr. 1967, at 135; Schwartz & Kelly, *Bank Financing of Corporate Acquisitions—The Cash Tender Offer*, 88 BANKING L.J. 99 (1971). For the most recent discussion of the legal issues involved in bank loans to finance tender offers, see Herzel & Rosenberg, *Loans to Finance Tender Offers: Borrower's Problems That May Affect the Bank*, 96 BANKING L.J. 581 (1979) [hereinafter cited as Herzel & Rosenberg, *Borrower's Problems*]; Herzel & Rosenberg, *Loans to Finance Tender Offers: The Bank's Legal Problems*, 96 BANKING L.J. 676 (1979) [hereinafter cited as Herzel & Rosenberg, *The Bank's Legal Problems*]. For a general discussion of tender offers and takeovers, see E. ARANOW, H. EINHORN & G. BERLSTEIN, note 2 *supra*; E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL (1973); A. FLEISCHER, TENDER OFFERS: DEFENSES, RESPONSES, AND PLANNING (1979); J. FLOM, M. LIPTON & E. STEINBERGER, TAKEOVERS AND TAKEOUTS—TENDER OFFERS AND GOING PRIVATE (1976); MERGERS AND ACQUISITIONS (J. McCord ed. 1969); Osborne, *Target Management and Tender Offers: Proposals for Structuring the Fiduciary Relationship*, 15 HARV. J. LEGIS. 761 (1978); *Corporate Takeovers—The Unfriendly Tender Offer and the Minority Stockholder Freezeout*, 32 BUS. LAW. 1297 (1977); *Tender Offer Developments*, 28 CASE W. RES. L. REV. 842 (1978); *Tender Offer Symposium* (pts. 1-2), 23 N.Y.L. SCH. L. REV. 375, 553 (1978).

26. No. 77 C 3865, slip op. at 3.

27. *Id.*

28. *Id.* at 7.

29. *Id.* at 12.

30. *Id.* at 8. In a companion case, Humana, Inc. v. American Medicorp, Inc., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,286, American Medicorp, Inc. sought a preliminary injunction to bar the aggressor corporation, Humana, Inc., from proceeding with its tender offer. American alleged misuse of confidential information because the bank

did imply, however, that if the bank had used the confidential information in deciding whether to make the takeover loan, such an act would be a misuse of the information and a breach of the bank's fiduciary duty.[31]

II. WASHINGTON STEEL CORP. V. TW CORP.

Against this background, the United States Court of Appeals for the Third Circuit decided *Washington Steel Corp. v. TW Corp.* The court considered two theories offered by Washington in support of the trial court's finding that the bank had a fiduciary duty and had breached it.[32] First, Washington contended that when it entrusted Chemical Bank with information, the bank impliedly assumed a per se fiduciary duty that was breached when the bank participated in financing the aggressor corporation's tender offer. Second, Washington contended that the bank breached a fiduciary duty arising from its receipt of the confidential information by using that information in deciding whether to finance the tender offer.

A. *Per Se Fiduciary Duty*

By entrusting the bank with nonpublic financial information, Washington claimed that it had a reasonable expectation that the bank would not take any action adverse to its interest; therefore, as a matter of law, the bank was precluded from financing the tender offer.[33] The court found this per se duty unprecedented[34] and refused to imply a duty whose sweep

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had used the information in deciding to make the takeover loan. The court, citing American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co., No. 77 C 3865 (N.D. Ill. Dec. 30, 1977), agreed with the Illinois court that American had not made a sufficient showing that the bank had used the information in deciding whether to make the loan and denied the preliminary injunction. In addition, the *Humana* court agreed with the Illinois court's holding that some kind of special duty on the part of the bank existed, concluding that a special relationship does exist between a borrower and its bank that should preclude the bank from disseminating or using confidential information obtained from the borrower for improper purposes. [1977-1978 Transfer Binder] FED. SEC. L. REP. at 92,829. The court emphasized that because a bank plays such a critical role in determining whether tender offers will be made and which management survives, the potential for conflict should be avoided by the voluntary behavior of the bank itself. *Id.*

31. "If it does not rely on the confidential information of its customers in its files, we believe that a bank is free to deal with any customer who comes to it." No. 77 C 3865, slip op. at 7. *See* Note, *Bank Financing of Involuntary Takeovers of Corporate Customers: A Breach of Fiduciary Duty?*, 53 NOTRE DAME LAW. 827, 835-37 (1978) (it is entirely consistent with the *Stewart* and *Robertson* cases to hold, as the *American Medicorp* court implied it would hold, that a bank may not use or rely upon confidential information in deciding whether to finance an involuntary takeover of that customer).

32. 602 F.2d at 599.

33. *Id.*

34. *Id.* at 600-01. The court cited American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co., No. 77 C 3865 (N.D. Ill. Dec. 30, 1977), and emphasized that "[i]ndeed the only case to have actually considered the legal issues raised by Washington has squarely rejected identical contentions." 602 F.2d at 600. Although arguably similar, the facts in *American Medicorp* represented a bank and borrower relationship that was closer than that of Washington and Chemical. In *American Medicorp* the bank had advised the plaintiff on financial matters, a close friendship between plaintiff's account existed, plaintiff had conveyed considerable amounts of confidential information to the bank, and plaintiff had made a proposal to invite a bank officer to stand for election to plaintiff's board. For an analysis of the relationship, see Note, *supra* note 31, at 832-33. The Third Circuit may have obscured

was as broad and whose restrictions were as severe as that urged.[35] Although the court distinguished *M.L. Stewart & Co. v. Marcus*[36] on its facts,[37] it followed *M.L. Stewart* to the extent of recognizing the need to consider and balance the competing demands of business necessity and moral obligation.[38] The court found, however, that a per se rule would undermine this economic necessity.[39] In addition, the court objected to a per se rule on policy grounds, reasoning that such a duty would discourage banks from dealing with a borrower's competitors or potential acquirers and thus diminish the availability of funding for capital ventures. Companies seeking to protect themselves from takeovers could disperse their loan business among the major banks and foreclose the banks from financing competitors.[40] Finally, the Third Circuit stated that establishing a per se rule is the province of the legislature,[41] and a common law rule would likely give way to the preemptive force of federal law.[42]

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or ignored some of the distinguishing elements in *American Medicorp* in relying on the policy basis of its decision.

35. 602 F.2d at 599. On appeal, plaintiff argued that a fiduciary duty existed based on express and implied contractual obligations, Brief for Appellee at 20, Washington Steel v. TW Corp., 602 F.2d 594 (3d Cir. 1979), or on the reasonable expectations of the parties. *Id.* at 21. Washington cited Brasher v. First Nat'l Bank, 232 Ala. 340, 168 So. 42, 47 (1936), for its definition of the duty based on contract as "the duty of requisite skill, fidelity, diligence, and a proper regard for the rights of others." In addition, Washington argued that the bank's duty was defined by the nature of Washington's expectation, and that Washington was justified in presuming that the bank would treat the confidential information and the corporate objectives embodied therein with the loyalty and good faith arising from its position of trust and confidence. Brief for Appellee at 26. Finally, Washington urged that the adversary nature of the bank's interests in its relationship with Washington and the aggressor corporation created an inevitable conflict of interest. *Id.* at 27. The inevitability of breach argued by Washington may have been what the court considered too broad and restrictive, particularly since it emphasized the pragmatic need to allow banks to deal with competitors.

36. 124 Misc. 86, 207 N.Y.S. 685 (Sup. Ct. 1924).

37. 602 F.2d at 600.

38. *Id.* The business necessities specified by the court are the freedom of banks to service competitors, the free flow of funds, and the necessity for banks to use all information at their disposal for loan decisions. *Id.* at 601, 603-04.

39. *Id.*

40. *Id.* at 601. The court's concerns may have been exaggerated. Dispersement of a corporation's loan business may be impractical. In fact, most tender offer defense strategists do not consider such a technique even though it has been discussed for some time. *See, e.g.*, E. ARANOW, H. EINHORN & G. BERLSTEIN, note 2 *supra*; A. FLEISCHER, note 25 *supra*; C. KANTER, TENDER OFFERS: MAKING AND MEETING THEM (1979). *But see* Herzel & Rosenberg, *The Bank's Legal Problems*, *supra* note 25, at 676-77; Wachtell, *Special Tender Offer Litigation Tactics*, 32 BUS. LAW. 1433 (1977). The problem is more pervasive in countries where the banking industry is more concentrated and fewer restrictions on branch banking exist. *See, e.g.*, F.W. Woolworth Co. v. Brascan, Ltd., No. 79 Civ. 1917 (S.D.N.Y., filed Apr. 12, 1979).

41. 602 F.2d at 601. The court noted current efforts in this regard. Congress, the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System are currently considering the issue. *See* N.Y. Times, June 11, 1979, at D1, col. 1. *See also* Proposed Treas. Reg. § 9.7(d), 42 Fed. Reg. 56,338 (1977), 43 Fed. Reg. 12,755 (1978), *reprinted in* Herzel & Colling, *The Chinese Wall and Conflict of Interest in Banks*, 34 BUS. LAW. 73, 100 nn.79-81 (1978). Refusing to decide the issue might have been more consistent with the court's position.

42. 602 F.2d at 601.

B. *Misuse of Confidential Information*

Noting that mere receipt of confidential information imposed no duty and that the trial court had made no express finding of misuse of information by the bank, the Third Circuit, nevertheless, considered Washington's second contention that the bank had used the confidential information in deciding whether to make the takeover loan and that such use constituted a breach of fiduciary duty.[43] The court rejected the contention[44] because no showing was made that the bank actually had used the information,[45] and the aggressor corporation's purportedly weak financial position did not raise a presumption of such use.[46] Assuming, however, that the bank had used the nonpublic information obtained from Washington in deciding whether to make the loan, the court found that no breach of fiduciary duty would have occurred.[47] The court emphasized that a bank does not violate any duty to its borrower when it uses information received from that borrower in deciding whether to make a loan to another borrower.[48] According to this decision, restricting the use of confidential information by a bank's commerical loan department is not the proper subject for court adjudication and is unwise banking policy. Furthermore, the court stated that prohibiting banks from using confidential information might compel them to enter loan transactions blindly, thus violating the banks' duties to their own depositors,[49] and might discourage loans to other companies expressing an interest in acquiring the stock of a bank customer.[50]

The court did not address, however, two questions related to the issue of bank financing of takeovers. First, the Third Circuit did not decide whether a bank actually may convey to an aggressor corporation information obtained from the target corporation.[51] Second, the court did not decide the question of disseminating information from the loan department to other bank departments, such as a trust department that recommends investments to its clients.[52] Although these issues seem clearly distinguish-

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43. *Id.* at 602. The court considered actual misuse of confidential information as a basis for the injunction, on the grounds that "a prevailing party can support a district court judgment on any ground, including ones overlooked or rejected by the trial court." *Id.*; *see* Dandridge v. Williams, 397 U.S. 471, 475 n.6 (1970); United States v. American Ry. Express Co., 265 U.S. 425, 435-36 (1924).

44. 602 F.2d at 602.

45. *Id.* at 602-03. Washington claimed that actual use occurred when the bank officer in charge of the Washington account said nothing at the meeting at which the takeover loan was discussed; the officer's silence arguably implied that the target was a wise investment. *Id.* at 602-03.

46. *Id.* at 602-03. Washington urged the court to presume use of the information, claiming that because of the aggressor's allegedly weak financial position, the bank would not have made the loan had it not known of Washington's alleged profit potential. *Id.*

47. *Id.* at 603.

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.* at 602.

52. *Id.* at 602-03. The court noted that such a dissemination of insider information might violate section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5. *Id.* For a discussion of the use of insider information by investment or trust departments, see Harfield, *Texas Gulf Suphur and Bank Internal Procedures Between the Trust and Commercial Depart-*

able from intradepartmental usage, the *Washington* decision represents a general erosion of confidentiality in bank and corporate borrower relationships. The decision leaves in doubt whether confidential loan information will be protected by the courts from trust and investment department uses and suggests that the banks must assume the burden of finding a means of protecting such confidential information.[53]

Furthermore, the policy basis of the decision does not consider the traditional and pragmatic role of trust in business relationships or the effect of diminishing that role.[54] For example, if a company is concerned about a possible takeover and, in particular, about an aggressor's using the target's assets to pay off the loan used to finance the takeover, the target company may hesitate to take a loan and disclose nonpublic financial information that can be used by a bank in deciding whether to finance the takeover.[55] Rather, to avoid such disclosures, corporations may not take the loan or they may seek to obtain their funds through sales of their own securities or from foreign lenders. By finding no bank fiduciary duty to corporate borrowers, the *Washington* court may have established barriers to the free flow of commercial activity that it sought to encourage.

Corporate takeovers are increasingly common, and their success requires fast, firm financing commitments.[56] Affirmance of the district court's decision enjoining the bank from participating in the takeover loan might have allowed corporations to disperse their loan transactions and

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ments, 86 BANKING L.J. 869 (1969); Herzel & Colling, note 41 *supra*; Huck, *The Fatal Lure of the 'Impermeable Chinese Wall'*, 94 BANKING L.J. 100 (1977); Hunsicker, *Conflicts of Interest, Economic Distortions and the Separation of Trust and Commercial Banking Functions*, 50 S. CAL. L. REV. 611 (1977); Jacobsohn, *Banks and Securities: The Regulatory Agencies Get Tougher*, 6 SEC. REG. L.J. 213 (1978); Lipton & Mazur, *The Chinese Wall Solution to the Conflict Problems of Securities Firms*, 50 N.Y.U. L. REV. 459 (1975); Méndez-Peñate, *The Bank "Chinese Wall": Resolving and Contending with Conflicts of Duties*, 93 BANKING L.J. 674 (1976); Schoenbaum, *Bank Securities Activities and the Need to Separate Trust Departments from Large Commercial Banks*, 10 U. MICH. J.L. REF. 1 (1976). For background on the role of the Securities Exchange Act of 1934 and rule 10b-5 in regulating disclosure and equality of information, see A. JACOBS, THE IMPACT OF RULE 10B-5 (Securities Law Series Vols. 5-5B, 1980); H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW (Securities Law Series Vols. 3-3B, 1979). *See also* Harnischfeger Corp. v. Paccar, Inc., 474 F. Supp. 1151 (E.D. Wis. 1979). In *Harnischfeger* the plaintiff target company sued to enjoin a tender offer. Although the court preliminarily enjoined the tender offer because the proposed takeover would be an antitrust violation, the court found that no breach of the "Chinese Wall" created by the bank to maintain confidentiality between bank departments had occurred. *Id.* at 1153-54.

53. *See* Herzel & Rosenberg, *The Bank's Legal Problems*, *supra* note 25, at 676-83; *Counsel's Corner: Takeover Financing—Maybe*, 97 BANKING L.J. 50-51 (1980) (the *Washington* opinion may encourage authors of institutional ethics codes for commercial loan departments to include explicit restrictions on what financial information concerning a target may be disclosed to a potential acquirer).

54. *See* R. BAUMHART, AN HONEST PROFIT: WHAT BUSINESSMEN SAY ABOUT ETHICS IN BUSINESS (1968); *Fiduciary Responsibilities Symposium*, 9 LOY. CHI. L.J. 525 (1978).

55. For a discussion of strategy in financing tender offers, see Herzel & Rosenberg, *Borrower's Problems*, *supra* note 25, at 582-90; Troubh, *Takeover Strategy: The Investment Banker's Role—Characteristics of Target Companies*, 32 BUS. LAW. 1301 (1977).

56. *See* Schwartz & Kelly, *Bank Financing of Corporate Acquisitions—The Cash Tender Offer*, 88 BANKING L.J. 99 (1971); *Breaking Faith? Takeover Fights Pose Ethical Questions for Banks, Brokers*, Wall St. J., Dec. 12, 1977, at 1, col. 6.

nonpublic information among major banks, thus providing a protective shield against aggressor corporations and restricting the freedom of banks to service competitors. Such a bank strategy is extremely impractical because of the large number of commercial banking institutions that are potential takeover lenders.[57] The Third Circuit's reversal, however, moved beyond *American Medicorp* and preserved the right of banks to finance the activities of aggressor corporations and to use confidential information obtained from target corporations in deciding whether to participate in that financing. Accordingly, corporations are no longer assured that their confidential financial information will not be used by banks in decisions involving takeovers by other corporations.

III. CONCLUSION

In *Washington Steel Corp. v. TW Corp.* the Court of Appeals for the Third Circuit held that a bank has no per se duty to refrain from loaning money to a corporation attempting to acquire one of the bank's other corporate customers that has provided the bank with confidential information. In addition, a bank may use such confidential information in deciding whether to finance the aggressor corporation's attempted acquisition. The court based its decision on policy reasons. A per se rule would discourage banks from participating in loans to a present borrower's competitors, thus diminishing the free flow of funds. A per se rule would also enable corporations to protect themselves from possible takeover by dispersing their loans among major banks. Moreover, restricting banks' use of confidential information might compel banks to enter loan transactions blindly, violating their duties to their depositors. Finally, a restriction on use of bank information is the province of the legislature.

In its decision, however, the court failed to consider the potentially detrimental effects of a loss of confidentiality in corporate borrower and bank relationships. Although the court did not address the related issues of disseminating confidential information to other bank departments or to aggressor corporations, the court makes clear that nonpublic financial information disclosed by a corporate borrower to banks' commercial loan departments may now be used by banks in decisions concerning other loans, including those to finance a takeover of a corporate borrower.

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57. *See* note 40 *supra*.