The Responsibilities of Banks in Financing Tender Offer Takeovers of Customers

Cash tender offers¹ frequently are employed as a means for the acquisition of firms that reject proposals for voluntary merger or consolidation. The offeror seeks to attain control of the target² by offering its shareholders a premium over market price for their stock. This method of acquisition often requires large amounts of capital to finance the offer, and in many instances acquiring firms turn to banks to capitalize the venture.³ Occasionally an offeror approaches a bank that is a creditor of the intended target, and the bank then faces a conceivable⁴ conflict between the interests of its present customer (the target) and its potential customer (the offeror).⁵

In recent cases confronting this situation,⁶ the targets' man-

¹ For general discussions of cash tender offers and trends in their use, see M. LIPTON & E. STEINBERGER, *TAKEOVERS AND FREEZEOUTS* (1978); Hayes & Taussig, *Tactics of Cash Takeover Bids*, 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).

² Throughout this comment, "target" is used to designate a firm that is the subject of a tender offer. A firm seeking to acquire the target by means of a tender offer is referred to as the "offeror."

³ See *Corporate Takeovers: Hearings Before the Senate Comm. on Banking, Housing & Urban Affairs*, 94th Cong., 2d Sess. 37-38 (1976) [hereinafter cited as *Corporate Takeovers*] (statement of Gordon T. Wallis, Chairman of the Board, Irving Trust Co.).

⁴ See Part I *infra*. It is now being debated whether the interests of a target are ever injured by a takeover bid. Compare Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) with Herzel, Schmidt & Davis, *Why Corporate Directors Have a Right to Resist Tender Offers*, 61 CHI. B. REC. 152 (1979) and Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979).

⁵ If the offeror has already established a relationship with the bank, the conflict will be between existing customers. See *Corporate Takeovers*, *supra* note 3, at 33-35. One could claim that the imposition of a duty on the bank to protect its customer from takeovers would create a conflict of duties in this situation. This would be inaccurate, however, because a bank owes no duty to make new loans to existing customers for tender offer financing or for any other purpose. The clash of interests may be sharper, but the analysis of possible duties to the customer target is unaffected.

⁶ *Washington Steel Corp. v. TW Corp.*, 602 F.2d 594 (3d Cir. 1979); *Humana, Inc. v. American Medicorp, Inc.* [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,286 (S.D.N.Y. 1978); *American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5 (N.D. Ill. 1977). A number of other cases presenting this situation were not litigated to a conclusion. See *Role of Banks Challenged in Unfriendly Takeovers*, N.Y. Times, June

agements have asserted that their firms' preexisting relationships with the banks imposed fiduciary obligations on those banks not to finance the tender offers. Specifically, the targets have claimed that the banks owe both a broad duty of loyalty to the interests of their customers and a duty to refrain from either disclosing or using confidential information about the targets for purposes other than those for which it originally was given.⁷

Fiduciary obligations are usefully imposed in a number of relationships.⁸ This comment concedes that the bank-customer relationship itself involves certain fiduciary responsibilities,⁹ and that it is improper for banks explicitly to disclose confidential information about their customers. The comment argues, however, that there is insufficient support for target firms' claims that these responsibilities prohibit banks from financing the takeover of a customer by tender offer. First, the interests of the customer, properly viewed, are probably not even injured by the banks' behavior. Second, even if an injury could be convincingly demonstrated, the principles that have justified the imposition of certain fiduciary obligations on banks in other contexts do not support the claimed obligation to refrain from financing takeovers.

I. CUSTOMER INJURY FROM BANK FINANCING OF TAKEOVERS

Courts that have examined the alleged duty of a bank to refrain from financing the takeover of a customer have been concerned primarily with the "legitimacy" of the duty claimed by the targets. They have ignored a more important question, however: do target firms have any legitimate interests in need of protection in this context? Absent injury, there is really no reason to enforce any obligation on the part of banks.¹⁰

11, 1979, § D, at 1, col. 1.

⁷ See *Washington Steel Corp. v. TW Corp.*, 602 F.2d 594, 599 (3d Cir. 1979); *American Mediacorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5, 7 (N.D. Ill. 1977). The two claimed duties are not identical. The former is broader and encompasses the latter; it would require a bank to refrain from injuring the interests of a customer in any way, thus paralleling the duty that prevents an attorney from representing two clients with competing interests.

⁸ For example, an attorney has a duty to refrain from disclosing the confidences of a client and to refrain from representing conflicting interests, ABA CODE OF PROFESSIONAL RESPONSIBILITY, EC 4-1 & EC 5-1 (1979), and a corporate director has a duty of loyalty to the interests of shareholders, see Marsh, *Are Directors Trustees?*, 22 BUS. LAW. 35 (1966) (tracing twentieth-century development of the duty).

⁹ See text and notes at notes 22-68 *infra*.

¹⁰ See Comment, 93 HARV. L. REV. 440, 450 (1979) (footnotes omitted):

On its face, a tender offer battle might seem to present the possibility of substantial injury to the target. A successful tender offer leaves the fate of the target in the hands of the offeror. Upper management is likely to be replaced, and the firm's remaining employees will work under new authority. The interests of the target's employees are not the relevant interests, however. The bank's relationship is with the corporation, not its officers (who are merely fiduciaries of the stockholders). Every duty owed by a bank to a corporate customer is a duty owed to the corporation as a legal entity; the only individual interests implicated are those derived through ownership of stock in the corporation.¹¹ Thus the proper interests to be examined in determining whether a tender offer will cause injury are those of the target's shareholders. A tender offer creates little chance of injury to those interests, however, as such an offer essentially presents the shareholders as a group with a "no loss" choice. They may either retain their shares if they regard the offer as unacceptable—an option that leaves them no worse off than if the offer had never been made—or tender their shares and receive the benefit of the premium over market price. If they sell their shares, any subsequent financial losses that may accrue as a result of the policies of the offeror will be borne by the offeror.

Despite this analysis, certain factors might yet be thought to create the danger of injury to shareholders, at least in certain situations. For example, a tender offer may violate the antifraud provisions of the securities laws,¹² or the antitrust statutes.¹³ Such an offer, it might be argued, could injure shareholders who make ill-advised decisions to tender or refrain from tendering,¹⁴ or who suffer a diminution in the value of their shares as a result of the offer¹⁵ or as a result of sanctions imposed following discovery of

[W]hile some fiduciary relationships operate under the strict prophylactic rule that the principal must consent to any use of property or confidential information entrusted to the trustee even absent harm to the principal, others do not. The cases which have found a violation of a fiduciary duty owed by a bank to a customer have invariably involved situations where the bank's use of confidential information was actually injurious or unfair to the customer.

¹¹ See, e.g., *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1 (1977). See also Comment, *supra* note 10, at 445-46.

¹² 15 U.S.C. § 78n(e) (1976). This provision is one part of the broader congressional scheme regulating tender offers. Williams Act, 15 U.S.C. §§ 78g, 78l-78n, 78s (1976).

¹³ Clayton Act § 7, 15 U.S.C. § 18 (1976).

¹⁴ Cf. *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975) ("The purpose of the Williams Act is to insure that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information . . .").

¹⁵ The diminution actually occurs as a result of the expense of defending against the

the violation. In addition, many tender offers seek only a portion of the target's outstanding shares, leaving some shareholders with only a minority interest in the acquired firm or facing the prospect of an unfavorable freezeout merger.¹⁶ On closer examination, however, the possibility of even these injuries does not provide a substantial justification for a prohibition of bank financings of tender offers that have customers as targets. Any injuries arising out of violations of the securities or antitrust statutes are properly redressed in actions against the parties responsible for the violations. Moreover, the possibility of being left in a minority position, or subject to an unfavorable freezeout merger, will be anticipated by the target's shareholders, who, as a group, will refrain from tendering their shares unless the premium they are offered is considered adequate compensation for such postoffer disadvantages.¹⁷

In short, no fiduciary obligation should be imposed on banks to prohibit them from financing the takeover of a customer because the interests of the customer (properly viewed as those of the shareholders of the customer) probably suffer no injury. In those circumstances where a tender offer might be thought to injure shareholders, the shareholders themselves are in the best position to evaluate the injury. They will, if so inclined, thwart the offer either by refusing to tender their shares or by taking legal action.

II. THE PROPRIETY OF A BANK'S DUTY NOT TO FINANCE TAKEOVERS OF CUSTOMERS

Even if, contrary to the thesis just advanced, the shareholders of a target (as opposed to its management) ultimately could show some injury directly resulting from a tender offer, the obligation to refrain from financing the takeover of a customer still should not be imposed. In fact, most previous judicial analyses have reached this conclusion.¹⁸ This is so because the rationale supporting the

offer. See Easterbrook & Fischel, *supra* note 4, at 1175 & n.39.

¹⁶ Shareholders of Pullman were confronted with this possibility when McDermott Inc. issued a tender offer for their stock. The offer was for a portion of the stock on a "first come first served" basis, to be followed by a freezeout merger. See *Wheelabrator and McDermott are Told to Extend Offers for Pullman to Oct. 17*, Wall St. J., Sept 22, 1980, at 9, col. 1.

¹⁷ In the Pullman tender offer, see note 16 *supra*, shareholders, sensing the risk of being left with shares of diminished value, declined to tender their shares to McDermott. Rather, they tendered to Wheelabrator-Frye, Inc., which was offering \$1.50 less per share, but more favorable freezeout terms.

¹⁸ Four courts have examined a bank's obligations to customers in the takeover context, and only one—overturned on appeal—has found a broad per se duty to protect what it perceived to be customer interests. See *Washington Steel Corp. v. TW Corp.*, 465 F. Supp.

imposition of fiduciary obligations on banks in other contexts cannot be applied to justify the imposition of the duty sought by the target firms in these cases.

Two reasons have been given by courts and commentators in declining to impose restraints on bank financing of hostile takeovers of customers: recognition of the detrimental effects that would result from imposition of the duty,¹⁹ and the lack of precedent for it.²⁰ Recognition of detrimental effects is an important element in analyzing the desirability of such a duty, but a complete analysis also requires consideration of reasons *supporting* imposition of the duty. Previous commentators have regarded the lack of precedent as conclusive proof that there is no legitimate basis for imposing the duty. The lack of precedent should not constitute such persuasive evidence, however, especially where, as here, the circumstances raising the question are rather novel.²¹ Furthermore, although it is true that courts have never imposed the precise duties sought by the target firms, banks do have certain fiduciary obligations to their customers. Most notably, courts have required banks to disclose material information to their customers in certain transactions, and have forbidden disclosure of confidential information about a customer to third parties.

Therefore, before banks can be deemed free of a duty to defer to customer interests in the takeover context, it must be shown

1100 (W.D. Pa.), *rev'd*, 602 F.2d 594 (3d Cir. 1979); *Humana, Inc. v. American Mediacorp, Inc.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,286 (S.D.N.Y. 1978); *American Mediacorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5 (N.D. Ill. 1977).

There seems to be somewhat stronger sentiment for imposing a duty not to use confidential information concerning the customer in evaluating takeover financings, *see id.* at 8 (dictum suggesting bank might be liable if target could prove use of confidential information by the bank), but the only court to face this question squarely has declined to do so. *Washington Steel Corp. v. TW Corp.*, 602 F.2d 594, 603-04 (3d Cir. 1979).

¹⁹ *See* *Washington Steel Corp. v. TW Corp.*, 602 F.2d 594, 601 (3d Cir. 1979); *American Mediacorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5, 9 (N.D. Ill. 1977); Comment, *supra* note 10, at 444-45.

²⁰ *See* *Washington Steel Corp. v. TW Corp.*, 602 F.2d 594, 601 (3d Cir. 1979); *American Mediacorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5, 8 (N.D. Ill. 1977); Comment, *supra* note 10, at 444.

²¹ *Cf. Note, Bank Financing of Involuntary Takeovers of Corporate Customers: A Breach of a Fiduciary Duty?*, 53 NOTRE DAME LAW. 827, 834 (1978) ("This issue has arisen only recently, and no case previous to [*American Mediacorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5 (N. D. Ill. 1977)] has ever reached the question presented here. Lack of cases on point should not inhibit a court from working with sound legal principles from the most analogous cases and filling in the interstices with its own legal reasoning." (footnote omitted)).

that the considerations compelling banks to recognize customer interests in some contexts do not justify creation of a duty to refrain from financing the takeover of a customer by a tender offer. The nature and foundations of the duties that have been imposed on banks are discussed below. The comment then shows that the justifications for these other duties compel no duty to refrain from financing takeovers.

A. The Nature of Bank Duties

1. *The Duty to Disclose Material Information.* A duty of disclosure is a duty to transmit information to a party if that party is likely to find such information useful in the course of the transaction.²² Normally, each party approaches a transaction with whatever information it has seen fit to gather: it need not disclose its information to, nor should it expect any information from, the other party.²³ To the extent that one party has superior information, it has a legitimate competitive advantage. In certain instances, however, including some bank-customer relationships, one party is not allowed this advantage: it has a duty to disclose information that the other party would find valuable.²⁴

A number of courts have analyzed a bank's duty to disclose material information. These cases usually arose when a customer took or guaranteed a loan from a bank and the bank failed to disclose information in its possession concerning the object of the customer's investment.²⁵ The customers claimed that they had fiduci-

²² This is known as "material information." It is commonly defined as information to which "a reasonable man would attach importance in determining his choice of action in the transaction in question." RESTATEMENT OF TORTS § 538(2)(a) (1938); *accord*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971).

²³ See RESTATEMENT OF CONTRACTS § 472 (1932); RESTATEMENT (SECOND) OF TORTS § 551 (1977). The propriety of nondisclosure is not universal, however, and there is a well-established trend toward requiring disclosure in many circumstances. See, e.g., Keeton, *Fraud—Concealment and Non-Disclosure*, 15 TEX. L. REV. 1, 31 (1936); sources cited note 37 *infra*. It should be noted that the propriety of refraining from disclosure is, in any case, limited by the prohibition of fraudulent nondisclosure. See, e.g., RESTATEMENT (SECOND) OF TORTS § 550 (1977).

²⁴ Williston has noted that "a positive duty to disclose material facts" arises "[w]here a fiduciary relationship exists between the parties, such as attorney and client, guardian and ward, trustee and *cestui que trust*, executor and legatee, principal and agent, partner and copartners, joint venturer and fellow joint venturers." 12 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1499 (3d ed. 1970) (footnotes omitted).

²⁵ Peoples Bank v. Figueroa, 559 F.2d 914 (3d Cir. 1977); Stewart v. Phoenix Nat'l Bank, 49 Ariz. 34, 64 P.2d 101 (1937); Manson State Bank v. Tripp, 248 N.W.2d 105 (Iowa 1976); First Nat'l Bank v. Brown, 181 N.W.2d 178 (Iowa 1970); Richfield Bank & Trust Co.

ary relationships with the banks that imposed a duty of disclosure on the banks. The first case to face this claim squarely²⁶ was *Earl Park State Bank v. Lowmon*.²⁷ The Indiana Appellate Court ruled that if a customer "had confidence in [the banker] and relied upon him to give him honest and disinterested advice looking to his best interest, it was the duty of [the banker] to act in good faith,"²⁸ including, in that case, the disclosure of information regarding the solvency of the business in which the customer was planning to invest.

The *Lowmon* court did not discuss its decision; it merely declared the existence of the duty to disclose. The first substantial discussion of the duty is found in *Stewart v. Phoenix National Bank*,²⁹ an opinion by the Arizona Supreme Court in 1937 that has formed the basis for most subsequent analyses of the issue. In *Stewart* the customer claimed that the bank had misrepresented its intention to foreclose on a mortgage—an act that the court likened to the failure to disclose material information.³⁰ Although the court noted that no confidential relationship arises out of the "relationship between a bank and a simple depositor,"³¹ it observed that in modern banking practice the relationship between a bank and a customer is rarely simple. The court noted the tendency of banks to investigate potential borrowers thoroughly, the tendency of investors to consult with and rely on banks before making investment decisions, and the frequent performance by banks of ser-

v. Sjogren, 309 Minn. 362, 244 N.W.2d 648 (1976); Klein v. First Edina Nat'l Bank, 293 Minn. 418, 196 N.W.2d 619 (1972); Sparks v. Union Trust Co., 256 N.C. 478, 124 S.E.2d 365 (1962). But cf. *Earl Park State Bank v. Lowmon*, 92 Ind. App. 25, 161 N.E. 675 (1928) (en banc) (customer was merely a depositor, not debtor, of bank; bank induced customer to make loan to firm that was indebted to bank without disclosing firm's insolvency); *Snow v. Merchants Nat'l Bank*, 309 Mass. 354, 35 N.E.2d 213 (1941) (bank failed to disclose that it had earned commission on transactions in securities conducted for customer).

²⁶ Claims that banks were required to disclose were disposed of in two early cases without dealing with a bank's duty of disclosure per se. In *People's Nat'l Bank v. Southern States Fin. Co.*, 192 N.C. 69, 133 S.E. 415 (1926), the court ruled that the bank was not required to disclose because "[a] national bank has no power" under its national charter to furnish information. *Id.* at 77, 133 S.E. at 419. In *Bank of Commerce & Trust Co. v. Dye*, 1 Tenn. App. 486 (1926), a duty of disclosure was imposed, but only because the bank was acting as an attorney.

²⁷ 92 Ind. App. 25, 161 N.E. 675 (1928) (en banc).

²⁸ *Id.* at 35, 161 N.E. at 679.

²⁹ 49 Ariz. 34, 64 P.2d 101 (1937).

³⁰ *Id.* at 44, 64 P.2d at 106 ("[A fiduciary] is under a duty to make a full and truthful disclosure of all material facts, . . . and . . . in such cases redress may be had for representations as to future conduct, and not merely as to past facts.").

³¹ *Id.*

vices viewed as confidential, concluding that "where it is alleged a bank has acted as the financial advisor of one of its depositors for many years, and that the latter has relied upon such advice, it is a sufficient allegation that a confidential relationship in regard to financial matters does exist."³²

The conditions that courts will require before imposing a duty of disclosure have been clarified in recent cases. The *Stewart* opinion could be read to imply that the only condition would be the customer's reliance on the bank to make disclosure, but subsequent cases have noted that the bank must have at least constructive knowledge of the customer's reliance. In *First National Bank v. Brown*,³³ the Iowa Supreme Court found a duty of disclosure, but not without noting that the banker "knew or should have known from [the customer's] questions and reactions that the latter trusted him implicitly."³⁴ The Minnesota Supreme Court, in *Klein v. First Edina National Bank*,³⁵ held that this condition is a necessary one. There, the court declined to impose the duty to disclose "unless special circumstances exist, such as where the bank knows or has reason to know that the customer is placing his trust and confidence in the bank and is relying on the bank so to counsel and inform him."³⁶

The cases thus demonstrate that the bank-customer relationship need not be an ordinary "arm's length" relationship: in certain cases, banks have a duty to disclose material information to their customers. Admittedly, the duty is limited to those instances in which the customer relies on the bank to disclose and the bank has reason to know of the customer's reliance. But even that limited duty is more than is required in a normal arm's length transaction.

2. *The Duty to Maintain Confidentiality of Customer Information.* In the context of a fiduciary relationship, the exchange of confidential information is protected by a duty to maintain confidentiality. The mere exchange of confidential information creates no such duty, however; if the exchange is not within a fiduciary relationship the receiver of the information is free to disclose, absent an explicit agreement to the contrary. Although there is some

³² *Id.* at 45-46, 64 P.2d at 106.

³³ 181 N.W.2d 178 (Iowa 1970).

³⁴ *Id.* at 182.

³⁵ 293 Minn. 418, 196 N.W.2d 619 (1972).

³⁶ *Id.* at 422, 196 N.W.2d at 623.

authority that the mere receipt of confidential information creates a duty of nondisclosure,³⁷ recent cases hold to the contrary. For example, in *Walton v. Morgan Stanley & Co.*,³⁸ an investment banker had received confidential information from a firm that one of its clients was considering acquiring in a friendly merger. Later, the banker used the information to induce another client to take over the firm by tender offer. Shareholders of the acquired firm then sued the banker claiming that use and disclosure of the confidential information for purposes other than those intended when the information was first given to the banker were breaches of its fiduciary duty. The Second Circuit rejected the plaintiffs' claim, holding that "the fact that the information was confidential did nothing, in and of itself, to change the relationship between [the investment bank] and [the acquired firm's] management."³⁹

A duty to maintain confidentiality of information, therefore, may only arise out of certain relationships in which information is exchanged. It has become well accepted that the bank-customer relationship supports a general duty to refrain from disclosing confidential information. While the duty had a somewhat confused beginning in England,⁴⁰ by 1923 the three justices who decided *Tournier v. National Provincial & Union Bank of England*⁴¹ could agree that "it was an implied term in a banker's contract with his customer that the banker shall not disclose the account, or transactions relating thereto, of his customers."⁴² *Tournier* was soon approved by an American court in *M.L. Stewart & Co. v. Marcus*,⁴³

³⁷ See 3 A. SCOTT, THE LAW OF TRUSTS § 505, at 2428 (1939). See also *Walton v. Morgan Stanley & Co.*, 623 F.2d 796, 801 (2d Cir. 1980) (Oakes, J., dissenting).

³⁸ 623 F.2d 796 (2d Cir. 1980).

³⁹ *Id.* at 799. See also *Chiarella v. United States*, 445 U.S. 222 (1980) (holding that use of nonpublic information in the purchase of securities is not fraudulent absent a fiduciary duty to disclose).

⁴⁰ The question was first addressed in *Tassell v. Cooper*, 9 C.B. 509, 137 Eng. Rep. 990 (C.P. 1850). Two of the three judges in that case suggested in dictum that a bank's disclosure did not support a cause of action. *Id.* at 533-35, 137 Eng. Rep. at 999-1000. Two later cases left the question to the jury. In the first case the court ruled that the jury's opinion that "it is the duty of a banker in no way to disclose his customer's account," was not against any law of which the court was aware. *Foster v. Bank of London*, 3 F. & F. 214, 217, 176 Eng. Rep. 96, 98 (Nisi Prius 1862). The court in the second case, however, sustained a verdict that a bank's disclosure was justified by the specific facts of the situation. *Hardy v. Veasey*, L.R. 3 Ex. 107, 111-13 (1868).

⁴¹ [1924] 1 K.B. 461 (C.A.).

⁴² *Id.* at 480 (opinion of Scrutton, L.J.).

⁴³ 124 Misc. 86, 92, 207 N.Y.S. 685, 691 (Sup. Ct. 1924) (rejecting duty on facts of case, but approving it in principle), *aff'd*, 220 A.D. 828, 228 N.Y.S. 856 (1927).

and is now accepted in most American courts without question.⁴⁴

Although generally accepted, the bank's duty in this context is not without exception. In *Tournier* itself, one justice noted that the disclosure of confidential information by a bank was permissible "where disclosure is under compulsion by law; . . . where there is a duty to the public to disclose; . . . where the interests of the bank require disclosure; . . . [and] where the disclosure is made by the express or implied consent of the customer."⁴⁵ While these exceptions have not been specifically adopted in American courts, the American doctrine of nondisclosure is also subject to qualification. In fact, the court in *M.L. Stewart & Co. v. Marcus* approved the disclosure in that case because the information was inaccurate and therefore not protected.⁴⁶ And in *United States v. Miller*,⁴⁷ the Supreme Court held that the defendant had no legitimate expectation of privacy in the records of his account kept by his bank; the information thus was validly obtained on a search warrant.

The precise nature of a bank's duty to maintain the confidentiality of customers' information is unclear because the exceptions to the duty have not been clearly defined. Nevertheless, the existence of some duty of confidentiality is further evidence that the bank-customer relationship can support certain fiduciary obligations. Whether the fiduciary nature of the bank-customer relationship encompasses a duty to refrain from financing takeovers of customers depends upon an examination of the principles justifying the duties that have been imposed.

3. *Justification of the Duties of Disclosure and Confidentiality: Equities and Costs.* The courts have failed to isolate the reasons for imposing the duties of disclosure and confidentiality on banks in certain bank-customer relationships. Indeed, they have not even defined the circumstances in which the duty of confidentiality is imposed. But the definition of the circumstances calling for imposition of the duty of disclosure indicates a rationalization of the duty that is consistent with factors that have shaped fiduciary obligations in other relationships. The duty of confidentiality,

⁴⁴ See, e.g., *Valley Bank v. Superior Court*, 15 Cal. 3d 652, 656-57, 542 P.2d 977, 979, 125 Cal. Rptr. 553, 555 (1975). See generally 1 T. PATON, PATON'S DIGEST 619 (4th ed. 1940); see also I. BAXTER, THE LAW OF BANKING 21-24 (2d ed. 1968) (discussing Canadian and British law).

⁴⁵ *Tournier v. National Provincial & Union Bank*, [1924] 1 K.B. 461, 473 (C.A.) (opinion of Banks, L.J.).

⁴⁶ 124 Misc. at 94, 207 N.Y.S. at 693.

⁴⁷ 425 U.S. 435 (1976).

as it has been applied in the bank-customer relationship, is also consistent with this explanation.

The justification for the duty of disclosure can be found in the interplay of two aspects of the bank-customer relationship: the expectations of the banking community, and the economic practicality of enforcing those expectations through the imposition of fiduciary obligations.

With regard to the first aspect, equitable considerations⁴⁸ justify enforcement of the mutually held expectations of transacting parties. When both parties to a transaction expect certain duties to inhere in the relationship, those expectations should not easily be defeated merely because they are not contractually specified. Indeed, the parties may have neglected contractual specification precisely because the expectations made such specification seem unnecessary.

The concept of equitable enforcement of expectations finds support in well-established principles, motivating, for example, the avoidance of contracts for mutual mistake of fact⁴⁹ and impossibility.⁵⁰ More importantly, equitable enforcement appears to underlie the imposition of fiduciary duties in a number of relationships. Such duties are enforced because certain relationships would be essentially meaningless if the duties were not in fact expected by the parties. Thus an agent cannot ignore its principal's interests consistently with its function of acting in behalf of the principal;⁵¹ an attorney cannot fulfill his responsibility to counsel and represent his client if his own interests "dilute his loyalty to his client";⁵² and a corporate director cannot properly fulfill his management function if he does not keep the interests of the corporation and its shareholders in mind. Furthermore, the concept of community expectations seems inherent in the traditional link between fiduciary duties and moral obligations. As one court has recognized, a court intervenes to impose fiduciary obligations "whenever [a] transac-

⁴⁸ See E. VINTER, *A TREATISE ON THE HISTORY AND LAW OF FIDUCIARY RELATIONSHIP AND RESULTING TRUSTS* 2 (3d ed. 1955) ("The doctrine of fiduciary relationship is a doctrine of equity . . .").

⁴⁹ See 13 S. WILLISTON, *supra* note 24, § 1559 (where parties have assumed the existence of a thing, the nonexistence of which makes performance impossible, it is "inequitable to charge the promisor").

⁵⁰ See 18 *id.* § 1931 ("The defense of impossibility [is] . . . essentially an equitable defense.").

⁵¹ RESTATEMENT (SECOND) OF AGENCY § 1 (1958).

⁵² ABA CODE OF PROFESSIONAL RESPONSIBILITY, EC 5-1 (1979).

tion is condemned by the wholesome moral sense, the *mores*, of the community."⁵³

Enforcement of the parties' (or the community's) expectations may, however, cause economic dislocations that make enforcement impracticable. If these impracticabilities cannot be overcome, the equity of enforcing expectations must bow to the costs incurred by enforcement. This has occurred in the development of the law of fiduciary obligations of corporate directors. Until the early twentieth century, the expected deference of corporate directors to corporate interests was held to imply that any transaction between a director and the corporation was void on its face.⁵⁴ The stringency of this standard has been eroded substantially, however. Courts first began to allow directors to transact with a corporation if the transaction was "approved by a disinterested majority of . . . directors and was not found to be unfair or fraudulent."⁵⁵ More recently, courts have abandoned even the requirement of approval by a disinterested majority.⁵⁶ The courts have failed to provide explicit reasons for these shifts, but language in several cases indicates that courts were operating with an awareness of the economic impracticability of the earlier rules.⁵⁷

The balance of equity and practicability of enforcing expectations of disclosure in the bank-customer relationship justifies the imposition of that duty. To recall, banks are required to disclose only when they know or should know that the customer is expecting them to disclose;⁵⁸ the facial equity of requiring disclosure under such circumstances is buttressed by the reasonableness of the customer's expectation in this regard. Banks normally have sophisticated methods of gathering and analyzing investment infor-

⁵³ *M.L. Stewart & Co. v. Marcus*, 124 Misc. 86, 91, 207 N.Y.S. 685, 691 (Sup. Ct. 1924), *aff'd*, 220 A.D. 828, 228 N.Y.S. 856 (1927).

⁵⁴ *Marsh*, *supra* note 8, at 36.

⁵⁵ *Id.* at 40.

⁵⁶ *Id.* at 41.

⁵⁷ *E.g.*, *Robotham v. Prudential Ins. Co. of Am.*, 64 N.J. Eq. 673, 709, 53 A. 842, 856 (1903) ("theoretical rules have to give way to the practical necessities of business"); *Genesee & Wyo. Ry. v. Retsof Mining Co.*, 15 Misc. 187, 195, 36 N.Y.S. 896, 901 (Sup. Ct. 1895) ("Indeed, it would be difficult to conduct the affairs of the multifarious corporations of the country, . . . if the element of good faith, instead of individual interests, were not established as the basis of intercorporate action."); *South Side Trust Co. v. Washington Tin Plate Co.*, 252 Pa. 237, 241, 97 A. 450, 451 (1916) ("The interests of corporations are sometimes so interwoven that it is desirable to have joint representatives in their respective managements, and at any rate it is not uncommon and not unlawful practice.") (quoting *Mercantile Library Hall Co. v. Pittsburgh Library Ass'n*, 173 Pa. 30, 41, 33 A. 744, 746 (1896)).

⁵⁸ See text and notes at notes 33-36 *supra*.

mation, and the disclosure of any information they acquire should contribute to the vitality of a customer's investment (if only by demonstrating that the customer should change its investment plans).⁵⁹ The bank's interest in the soundness of its customer's investment⁶⁰ would normally be expected to induce it to provide the information to the customer. The customer, in turn, aware of the bank's interest in his having complete knowledge concerning his investment, reasonably expects the bank to disclose any information it may have.

On the other hand, a duty to disclose information can result in at least two types of costs. Neither is realized in this context, however, and thus no costs can be said to offset the equity of enforcing expectations of disclosure.

The first of these potential costs is a suboptimal production of information. Because nondisclosure normally is profitable to the holder of information,⁶¹ a duty of disclosure reduces the incentive to invest in the production of information.⁶² Thus, if other incentives to produce information are insufficient, a duty of disclosure will result in a suboptimal production of information. In the banking context, however, self-interested concern over the vitality of the customer's investment will motivate the bank to produce a great deal of information even if it is required to disclose.

Not all information produced by a bank maintains its value upon disclosure. Information regarding the relative value of borrowed funds (for example, projected interest rates) typically would benefit the bank only if undisclosed. Disclosure of such information normally is not expected, however, and courts are unlikely to require its disclosure. Disclosure of information regarding the customer's investment is expected, however, and in certain circumstances that type of information does lose its value to the bank if disclosed. In fact, this was the situation in those cases in which customers have complained of nondisclosure. In the typical case,

⁵⁹ Banks need these resources to analyze the advisability of ventures for which they may advance funds. Courts have noted that customers are aware of banks' resources in this context. *See, e.g.,* *Stewart v. Phoenix Nat'l Bank*, 49 Ariz. 34, 44-45, 64 P.2d 101, 106 (1937); *First Nat'l Bank v. Brown*, 181 N.W.2d 178, 182 (Iowa 1970).

⁶⁰ *Cf. Stenberg v. Northwestern Nat'l Bank*, 307 Minn. 487, 488, 238 N.W.2d 218, 219 (1976) (per curiam) ("it would be ludicrous to assume that [banks] would deliberately make bad loans . . . because those loans would imperil the bank's own money").

⁶¹ *See Kronman, Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1, 15 (1978).

⁶² *Id.* at 13-14.

the bank was a creditor of the object of the customer's investment, and considered its current debtor a worse risk than the new customer. In effect, the bank sought to shift the risk to its new customer by retiring the loan to its old debtor out of the proceeds from the loan to the new customer.⁶³ The new customer undoubtedly would hesitate to invest in a venture if it knew the bank considered the investment a bad risk, and disclosure would thus be detrimental to the bank. Even here, however, a duty of disclosure will not result in a suboptimal production of information, for the bank has already produced the information.

The second way in which a duty of disclosure might be thought costly is that some parties will incur costs in contractually avoiding the duty. If banks feel unduly constrained by a duty of disclosure, they will seek to avoid the duty by agreeing with customers that they are free to withhold information. To the extent this occurs, the costs inherent in transacting these agreements⁶⁴ will be incurred. On the other hand, if the duty is not imposed by law, some customers will seek to impose it by agreement with banks. Therefore, legal imposition of the duty should be considered costly only to the extent that it is contractually avoided more frequently than it would be contractually imposed were it not legally imposed.⁶⁵

In fact, contractual avoidance of the duty is probably less frequent than contractual imposition. Banks will infrequently feel constrained by a duty of disclosure. Normally their interests are promoted by full disclosure⁶⁶ and they will seek to avoid the duty only when they have information they do not wish to disclose, a condition they would generally be aware of at the inception of a

⁶³ This classic case is exemplified by *Manson State Bank v. Tripp*, 248 N.W.2d 105 (Iowa 1976); *First Nat'l Bank v. Brown*, 181 N.W.2d 178 (Iowa 1970); and *Sparks v. Union Trust Co.*, 256 N.C. 478, 124 S.E.2d 365 (1962). *Cf.* *Peoples Bank v. Figueroa*, 559 F.2d 914 (3d Cir. 1977) (customer cosigned loan that consolidated debts to bank for third party that bank knew to be a bad risk); *Earl Park State Bank v. Lowmon*, 92 Ind. App. 25, 161 N.E. 675 (1928) (en banc) (at bank's urging, customer used deposits to invest in company that was debtor of bank); *Snow v. Merchant's Nat'l Bank*, 309 Mass. 354, 35 N.E.2d 213 (1941) (bank failed to disclose it was earning commissions on sales of customer's securities); *Richfield Bank & Trust Co. v. Sjogren*, 309 Minn. 362, 244 N.W.2d 648 (1976) (bank officer had substantial personal interest in object of customer's investment); *Klein v. First Edina Nat'l Bank*, 293 Minn. 418, 196 N.W.2d 619 (1972) (customer pledged securities on loan to third party that was already substantially indebted to bank).

⁶⁴ See R. POSNER, *ECONOMIC ANALYSIS OF LAW* 36 (2d ed. 1977).

⁶⁵ See *id.* ("efficiency is promoted by assigning the legal right to the party who would buy it . . . were it assigned initially to the other party").

⁶⁶ See text and note at note 60 *supra*.

transaction. Customers, on the other hand, will not be aware that a bank is failing to disclose fully, and therefore would seek contractual assurance of full disclosure in all transactions, if it were not legally required. Transactions—and thus net transaction costs—are therefore reduced by imposition of the duty.⁶⁷

In summary, the imposition of a duty of disclosure is less costly than failure to impose the duty and thus is consistent with the principle of equitable imposition of fiduciary obligations so long as there are no outweighing costs.

Although the indefiniteness of the duty of confidentiality makes harmonization of that duty with any theory difficult, the duty is, at least, not inconsistent with the explanation laid out above. There is a certain facial equity in requiring a banker to maintain the confidentiality of information it demands of a customer,⁶⁸ and the exceptions that have been allowed have occurred where failure to disclose would be costly to the bank or society at large.

B. Bank Duties in Contested Takeovers

Targets of takeover attempts have claimed that the fiduciary obligations of banks should extend to an obligation to refrain from financing the takeover of a customer, either because banks owe a broad-based duty of loyalty to their customers, or because use or disclosure of confidential information in evaluating the takeover attempt is a breach of the duty of confidentiality. Although there is some equity in imposing a duty not to finance takeovers, the costs of imposing such a duty outweigh those equities, except with regard to the duty not to disclose confidential information to third parties.

1. *Duty of Loyalty to Customer Interests.* A duty to refrain from financing takeovers is justifiable if its imposition would equitably enforce the expectations of the parties without inducing offsetting economic costs. An expectation that banks will not finance takeovers of their customers does appear to have developed, but

⁶⁷ If the cost of each transaction avoiding the duty were greater than the cost of each transaction imposing the duty, the aggregate cost of contractual avoidance could be greater than the aggregate cost of contractual imposition. There is, however, no reason to believe that the cost of one transaction is greater than that of the opposite transaction in this context.

⁶⁸ Compare the situation in *Walton v. Morgan Stanley & Co.*, 623 F.2d 796 (3d Cir. 1980). There, the confidential information was not demanded as a condition for any service sought by the disclosing party.

analysis of the effects of enforcing those expectations raises doubts about the desirability of their enforcement.

Although the opinion of the banking community is not unanimous, there appears to be widespread agreement that an ethical banker will avoid financing the takeover of a customer. Customers that have been the targets of takeover attempts financed by their banks have characterized the banks' behavior as "arrogance and indifference to ethics,"⁶⁹ and suggested that there is "a reasonable expectation that [the customer] can rely 'on the good faith of the bank not to deal adversely.'"⁷⁰ Although some bankers have denied that they should avoid financing the takeover of a customer,⁷¹ others have admitted that "a responsible bank will remain loyal to its present customers and certainly wishes to avoid choosing sides."⁷² Most banks apparently do attempt to avoid the practice.⁷³ Moreover, although bank regulators have been reluctant to say that banks have a legal duty to refrain from financing takeovers of customers, they tend to agree that the practice "offends the sense of ethics of most people."⁷⁴ Courts have refrained from enforcing the duty, but only one has expressly approved the practice.⁷⁵

Preliminary analysis of these expectations suggests that equitable considerations would support their enforcement by imposing

⁶⁹ *Corporate Takeovers*, *supra* note 3, at 5 (statement of Rudolph Eberstadt Jr., President of Microdot, Inc.).

⁷⁰ *Role of Banks Challenged in Unfriendly Takeovers*, *supra* note 6, at 6, col. 5 (quoting an official of Washington Steel Corp.).

⁷¹ *Corporate Takeovers*, *supra* note 3, at 39 (statement of Gordon T. Wallis, Chairman of the Board, Irving Trust Co.).

⁷² *Breaking Faith? Takeover Fights Pose an Ethical Question for Banks and Brokers*, Wall St. J., Dec. 12, 1977, at 27, col. 1 (quoting Philip Barksdale Jr., Executive Vice President of Irving Trust Co.).

⁷³ *Id.*, col. 2.

⁷⁴ *Id.*, col. 1 (quoting Robert Plotkin, Assistant Director, Federal Reserve Board, Division of Bank Supervision and Regulation). SEC Commissioner Phillip Loomis has suggested that "[i]t is more a matter of banking etiquette." *Id.*

⁷⁵ In *American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5, 8 (N.D. Ill. 1977), the court suggested that "[i]f 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." On the other hand, the district court in *Washington Steel Corp. v. TW Corp.*, 465 F. Supp. 1100, 1105 (W.D. Pa. 1979), held that the bank "had a duty not to act adversely to the interests of Plaintiff Washington Steel." On appeal, the Third Circuit reversed the district court's finding of a legal duty, but did not expressly approve bank financing of takeovers. *Washington Steel Corp. v. TW Corp.*, 602 F.2d 594 (3d Cir. 1979). In *Humana, Inc. v. American Medicorp, Inc.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,286 (S.D.N.Y. 1978), the court, while refusing to impose any legal duty, suggested that "the potential for conflict should be avoided by the voluntary behavior of the bank itself." *Id.* at 92,829.

on banks a duty to refrain from financing the takeover of a customer. When customers first transact with a bank, most probably expect the bank to refrain from financing any takeover attempts. The usual behavior of banks indicates that this expectation is justified. At the commencement of the bank-customer relationship banks presumably do not anticipate financing a takeover of their customer, and even if they do anticipate this possibility, they seem to be aware that their customers neither approve of nor expect this behavior. It would thus appear equitable to impose a duty that either is expected by both parties, or at least is known by the obligor to be expected by the beneficiary. Equity alone cannot justify the imposition of duties, however; the costs involved must also be considered. In this regard, requiring banks to refrain from financing the takeover of a customer would cause economic dislocations, and transactions avoiding the duty would, in the aggregate, be more costly than transactions imposing the duty.

The dislocative effects of imposing a duty to refrain from financing takeovers have been widely recognized. The Third Circuit, in *Washington Steel Corp. v. TW Corp.*,⁷⁶ observed that the duty "could wreak havoc with the availability of funding for capital ventures Companies seeking to insulate themselves from takeovers . . . could simply arrange for a series of loans from most major banks."⁷⁷ Another court noted that such a duty "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."⁷⁸ Furthermore, this effect has been said to discriminate in favor of large firms that may be in need of new management. As one bank regulator suggested in congressional hearings in 1976, "[i]t is not hard to imagine situations where the public interest would be better served by the acquisition of a major firm that [*sic*] by a continuation of a deteriorating situation," and "such firms are likely to be indebted to many banks, and a blanket

⁷⁶ 602 F.2d 594 (3d Cir. 1979).

⁷⁷ *Id.* at 601.

⁷⁸ *American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5, 9 (N.D. Ill. 1977). See also *Corporate Takeovers*, *supra* note 3, at 38 (statement of Gordon T. Wallis):

[I]f the mere fact that a company has a banking relationship with a particular bank were sufficient in itself to preclude the bank from financing a tender offer to the shareholders of that company, then companies could largely preclude their shareholders from ever receiving a tender offer by opening accounts at the relatively limited number of banks which ordinarily are looked to as a source for this type of financing.

prohibition of financing the acquisition of a customer could prevent the working out of a salvage operation that would be in the public interest."⁷⁹

These dislocative effects can be avoided if banks and customers are free to agree that the duty will not apply. When banks realize that the duty prevents them from financing ventures in which they are interested, they are likely to seek arrangements with customers allowing them to finance takeovers. Customers will be unenthusiastic about the arrangement and banks will have to pay for this concession by giving more favorable terms, but the price may well be worth the freedom to finance more ventures. The costs of requiring this transaction must therefore be understood and compared with the equity of allowing customers to benefit from imposition of the duty.

The cost of contractually *avoiding* a duty—as noted with respect to the duty of disclosure—must be compared with the cost of contractually *imposing* the duty. Imposition of a duty is disfavored because of transaction costs only when the duty would be avoided more frequently than imposed. The duty to refrain from financing the takeover of a customer, unlike the duty of disclosure, is costly in this respect.

Although a bank will have the opportunity to finance the takeover of only a few customers, at the outset it will have no idea which customers will later present such opportunities.⁸⁰ In order to maintain the availability of the financing opportunities that may arise, banks must seek agreements avoiding the duty with every customer. Similarly, if the duty is not imposed, banks will always have to resist contractual imposition of the duty.

Customers may, for similar reasons, seek contractual imposition of the duty in every transaction, and avoidance would be more frequent than imposition only if banks normally prevail. It seems that banks normally would prevail. Although banks will be reluctant to *bind* themselves to refrain from financing takeovers, the realization that customers will shun them if they overindulge in the practice limits banks' behavior in any event.⁸¹ Customers thus

⁷⁹ *Corporate Takeovers*, *supra* note 3, at 99 (statement of Richard A. Debs, First Vice President and Chief Administrative Officer, Federal Reserve Bank of New York).

⁸⁰ The situation is similar to that of customers seeking to impose a duty of disclosure in every transaction. See text and notes at notes 66-67 *supra*.

⁸¹ See *Corporate Takeovers*, *supra* note 3, at 103 (statement of Richard A. Debs):
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

can expect that even without contractual assurances banks will normally restrain themselves. With this assurance, it is likely that customers frequently would acquiesce in their banks' desires not to be bound.

Costly transactions thus would be more frequent if the duty not to finance tender offers were imposed. These costs cast doubt on the desirability of realizing the equities inherent in imposition of the duty, for, as noted above, the propriety of the duty rests in the balance of the costs and equities.

If a takeover by tender offer imposed substantial injury on the customer, the balancing of costs and equities might be difficult. But, as noted earlier, a takeover by tender offer causes slight, if any, damage to the interests of the customers. In light of this lack of significant damage, the costs of imposing a prohibition on financing takeovers of customers cannot be justified and a broad duty not to finance the takeovers of customers therefore should not be imposed.

2. *The Duty to Refrain from Using Confidential Information.* The use of confidential information to the benefit of the bank and the detriment of the customer has been condemned by a number of courts,⁸² including some considering bank financing of a takeover of a customer.⁸³ If there were a clear benefit to the bank, a clear detriment to the customer, and no social costs involved in prohibiting use, there is little doubt that such a result would be correct. In *Washington Steel*, however, the Third Circuit held that banks should be permitted to use confidential information in considering financing the takeover of a customer,⁸⁴ and this view is the

confidential affairs of its customers. If a bank does not maintain the highest standards of integrity in its dealings, that confidence and trust will be eroded, and the bank will suffer the consequences. A bank realizes this as it enters into areas of potential conflicts of interest, and wise bank management will make sure that the bank acts with utmost probity in undertaking transactions that may be questioned because of possible appearances of abusing its trust. And it will do so . . . in recognition of the future impact upon the bank if it should lose the confidence of its customers. This is, of course, not a legal safeguard, . . . but it should be recognized as an important constraint on the actions of banks in these circumstances.

⁸² See, e.g., *Pigg v. Robertson*, 549 S.W.2d 597 (Mo. Ct. App. 1977); *M.L. Stewart & Co. v. Marcus*, 124 Misc. 86, 207 N.Y.S. 685 (Sup. Ct. 1924), *aff'd*, 220 A.D. 828, 228 N.Y.S. 856 (1927).

⁸³ *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); *American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5, 8 (N.D. Ill. 1977). See also *Corporate Takeovers*, *supra* note 3, at 102 (statement of Richard A. Debs).

⁸⁴ *Washington Steel Corp. v. TW Corp.*, 602 F.2d 594 (3d Cir. 1979); see text and notes

more appropriate one.⁸⁵

In previous cases in which banks were restrained from using confidential information, that use clearly benefited the bank and disadvantaged the customer. But consideration of confidential information in financing the takeover of a customer is unlikely to have either effect. Although a bank may find some information about the customer-target useful, bankers generally consider information about the offeror a far more important factor in considering the offeror's request for financing.⁸⁶ Because information about the target is an unimportant factor, the use of a customer's information has little impact on the benefits the bank derives from financing and the losses (if any) the customer may suffer.

Some commentators have suggested that use of confidential information in considering financing a takeover injures the customer by disclosing the information to the offeror by implication. Customers have likened the practice to "bankrolling a blind poker player":⁸⁷ when the bank is willing to put up a substantial amount of cash on the basis of information to which the offeror does not have access, "it is a fair inference that the blind player [the offeror] has the benefit of whatever information a view of the cards would have provided him."⁸⁸ Customers have claimed they are injured by this indirect "disclosure."

The implicit-disclosure argument usually lacks merit. As a preliminary matter, the bank's behavior is an inappropriate basis for drawing inferences about the target. As noted, banks normally place little weight on information about the target, and thus a bank's decision to grant or withhold financing of an offer is usually no more than an expression of the bank's confidence in the offeror.

Even if a bank's behavior were a proper basis for drawing inferences about the customer, the inferences could not be construed as injurious disclosure. If the bank does finance, the offeror can infer merely that the bank has no confidential information indicat-

at notes 76-77 *supra*.

⁸⁵ The reasons given by the court in *Washington Steel* are not the proper ones, however. See Comment, *supra* note 10, at 449-51.

⁸⁶ See *Humana, Inc. v. American Mediacorp, Inc.* [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,286, at 92,829 (S.D.N.Y. 1978); *American Mediacorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.* 475 F. Supp. 5, 9 (N.D. Ill. 1977). See also *Corporate Takeovers*, *supra* note 3, at 35, 39 (statement of Gordon T. Wallis); Comment, *supra* note 10, at 448.

⁸⁷ *Role of Banks Challenged in Unfriendly Takeovers*, *supra* note 6, at 6, col. 5 (quoting an official of Woolworth Corp.).

⁸⁸ *Id.*

ing that the venture will be disastrous to the offeror. Such an indication cannot fairly be construed as a "disclosure" of information. Of course, the offeror could structure an offer that seemed inadvisable on the basis of publicly available information, in which case the bank's approval might indicate that the bank had favorable confidential information, but this tactic is unlikely. Few firms would rest a decision to undertake a speculative venture entirely on the bank's analysis of information to which the offeror did not have access, especially in light of the bank's relative indifference to any factor other than the offeror's ability to pay.

If the bank denies financing, the offeror could infer the existence of unfavorable information, but this "disclosure" would cause the target insignificant harm. The information conveyed about the target is too vague to be used by the offeror for any purpose but abandoning the venture, and abandonment only injures the customer to the extent that it loses any benefits it might have enjoyed as the target of a tender offer.⁸⁹ Such an injury is at most indirect and insignificant.

The absence of both direct and clear advantage to the bank and disadvantage to the customer thus tends to diminish the equity of prohibiting bank use of confidential information in financing the takeover of a customer. The costs of the duty, on the other hand, are significant. Although procedures to isolate information in one department of a bank from other departments have been approved as effective,⁹⁰ the takeover situation is fundamentally different, because the offeror's request for financing will be considered by the commercial loan department—the same department that possesses information about the target. It is unrealistic to expect a satisfactory result from the erection of "Chinese walls" in such a situation,⁹¹ so the only alternative means for enforcement of

⁸⁹ See text at note 10 *supra*. See also Easterbrook & Fischel, *supra* note 4.

⁹⁰ The SEC, see Sec. Exchange Act Rel. No. 8459 [1967-1969 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77,629 (Nov. 25, 1968); Brief for Securities Exchange Commission as Amicus Curiae, *Slade v. Shearson, Hammill & Co.*, 517 F.2d 398 (2d Cir. 1974), cited in Herzel & Colling, *The Chinese Wall and Conflict of Interest in Banks*, 34 BUS. LAW. 73, 81-82 (1978), the Comptroller of the Currency, see 12 C.F.R. § 9.7(d) (1979), and the Federal Reserve Board, see 43 Fed. Reg. 12,755 (1978), have each approved nondisclosure between bank departments as an enforceable protection against trading of securities on the basis of confidential information.

⁹¹ The difficulty of isolating information within a department was indicated in *American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5 (N.D. Ill. 1977), where several persons working on financing the takeover of American Medicorp had needed to look at its files on other occasions, and there had been informal conversations

the duty would seem to be a requirement that banks refrain altogether from financing takeovers of their customers—and this would impose an unacceptably high cost on the bank and society.⁹²

3. *The Duty to Refrain from Disclosing Confidential Information.* Banks have not denied that they have a duty to refrain from disclosing confidential information to third parties in takeover attempts. Although a duty not to use information is inappropriate because it could not be enforced without totally prohibiting bank financing of takeovers of customers, the duty not to disclose confidential information is proper because it can be enforced without encountering the costs associated with such a prohibition.

Given the general rule prohibiting disclosure of confidential information,⁹³ the inquiry boils down to whether there should be an exception in the context of takeover financing. There is no basis for an exception in this case. A prohibition on disclosure need not imply a total prohibition on financing, as banks should be able to isolate information from outsiders reasonably effectively. Although there are legitimate concerns about the enforceability of restraints on disclosures,⁹⁴ these concerns generally have not been found to be determinative when requiring isolation of information between departments *within* banks,⁹⁵ and there is no reason why they should be accorded greater weight when the information need only be kept from persons outside the bank.

CONCLUSION

Loyalty and preservation of confidentiality are legitimate elements of the bank-customer relationship, and recognition of these elements has motivated courts to impose certain restrictions on

between those working on the takeover and those working on American Medicorp's file, *id.* at 8-9. See Comment, *supra* note 10, at 450-51 (noting difficulty of proving effectiveness of an intradepartmental "Chinese wall"). Cf. Hunsicker, *Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions*, 50 So. CAL. L. REV. 611, 641-47 (1977) (expressing doubts about the effectiveness of interdepartmental "Chinese walls"). But see 68 CALIF. L. REV. 153, 162-64 (1980).

⁹² See text and notes at notes 76-81 *supra*. See also *Washington Steel Corp. v. TW Corp.*, 602 F.2d 594, 603 (3d Cir. 1979) ("[s]uch a rule might discourage banks from lending to any company which expresses an interest in purchasing shares of stock of another of the bank's customers").

⁹³ See text and notes at notes 37-47 *supra*.

⁹⁴ See, e.g., *Corporate Takeovers*, *supra* note 3, at 114-15, 117 (remarks of Sens. Proxmire & Morgan). But see *id.* at 117 (remarks of Richard A. Debs) (expressing faith in ability of judicial process to enforce nondisclosure rules).

⁹⁵ See note 90 *supra*.

banks. But a bank's duties to its true corporate customer—viewed properly as the aggregate of a debtor firm's stockholders rather than its management—do not justify a requirement that lending institutions refrain from financing takeover attempts. Although it is improper for a bank to disclose confidential information to its potential new customer, the offeror, it should nevertheless be allowed to employ such information in evaluating the venture.

Roger Patterson