

# Banks-Corporations: Consolidation and Merger-Bank May Use Confidential Information Obtained from Prior Contacts with Target Company to Evaluate Takeover Loan

Mark Holland

Follow this and additional works at: <http://scholarship.law.cornell.edu/clr>

 Part of the [Law Commons](#)

---

### Recommended Citation

Mark Holland, *Banks-Corporations: Consolidation and Merger-Bank May Use Confidential Information Obtained from Prior Contacts with Target Company to Evaluate Takeover Loan*, 65 Cornell L. Rev. 292 (1980)  
Available at: <http://scholarship.law.cornell.edu/clr/vol65/iss2/3>

This Article is brought to you for free and open access by the Journals at Scholarship@Cornell Law: A Digital Repository. It has been accepted for inclusion in Cornell Law Review by an authorized administrator of Scholarship@Cornell Law: A Digital Repository. For more information, please contact [jmp8@cornell.edu](mailto:jmp8@cornell.edu).

## RECENT DEVELOPMENT

### **Banks—Corporations: Consolidation and Merger—BANK MAY USE CONFIDENTIAL INFORMATION OBTAINED FROM PRIOR CONTACTS WITH TARGET COMPANY TO EVALUATE TAKEOVER LOAN**

*Washington Steel Corp. v. TW Corp.*,  
602 F.2d 594 (3d Cir. 1979)

Using cash tender offers, corporations have taken advantage of the depressed stock prices of the past few years to expand by acquisition rather than internal expansion.<sup>1</sup> Few corporations have sufficient ready cash to purchase a controlling interest in the target company; they often turn to commercial banks to obtain financing.<sup>2</sup> Banks are occasionally asked to finance the hostile takeover of another corporate customer.<sup>3</sup> The target customers, in attempts to stave off hostile takeovers, have argued that banks receiving confidential financial information in connection with a commercial loan agreement may not finance the hostile takeover of that customer. Alternatively, target customers argue that banks may not use the confidential information when deciding whether to finance the takeover.

In *Washington Steel Corp. v. TW Corp.*,<sup>4</sup> the Third Circuit Court of Appeals held that a commercial bank that had received confidential information from a corporate customer in connection with a loan agreement was not precluded from financing the hostile takeover of that customer.<sup>5</sup> Moreover, the court held that the bank's loan department would breach no duty in its active use of confidential financial information received from the target when evaluating a loan to the offeror.<sup>6</sup> This Note examines the conditions under which a bank may finance the hostile takeover of a corporate customer. Although no per se fiduciary duty should preclude a bank from financing the involuntary takeover of a corporate customer, a fiduciary duty or an implied contract right

---

<sup>1</sup> See Much, *Price Adequacy in Hostile Takeovers*, National L.J., Dec. 10, 1979, at 21.

<sup>2</sup> See Cole, *Role of Banks Challenged in Unfriendly Takeovers*, N.Y. Times, June 11, 1979, § D, at 1, col. 1; Note, *Bank Financing of Involuntary Takeovers of Corporate Customers: A Breach of Fiduciary Duty?*, 53 NOTRE DAME LAW. 827, 827 (1978).

<sup>3</sup> See Cole, *supra* note 2.

<sup>4</sup> 602 F.2d 594 (3d Cir. 1979).

<sup>5</sup> *Id.* at 601.

<sup>6</sup> *Id.* at 604.

should prevent the bank from using confidential information supplied by the target when deciding whether to finance an involuntary takeover.

## 1

## BACKGROUND

No state or federal statute prohibits a bank from financing the involuntary takeover of a corporate customer.<sup>7</sup> Targets have argued, however, that banks breach a common law fiduciary duty by financing hostile takeover attempts.

In the only case prior to *Washington* to consider the issues,<sup>8</sup> *American Medicorp, Inc. v. Continental Illinois National Bank and Trust Company of Chicago*,<sup>9</sup> the court held that a bank may make a loan to facilitate the takeover of a corporate customer if it does not rely on confidential information provided by the target in evaluating the loan.<sup>10</sup> The defendant bank had requested and received confidential financial information from Medicorp incident to a loan agreement. The following year, the defendant agreed to bankroll Humana, Inc. in its attempt to take over Medicorp. Medicorp sued to enjoin the loan contending that the loan constituted a breach of the bank's per se fiduciary obligation to Medicorp.<sup>11</sup> Alternatively, Medicorp argued that a breach of trust occurred when the bank relied on the confidential information in evaluating the loan to Humana.<sup>12</sup> The court found that the loan was not a per se violation of trust.<sup>13</sup> The court suggested, however, that had the bank relied on confidential information, a proposition unsupported by plaintiff's evidence, the bank would have breached a duty to Medicorp.<sup>14</sup>

---

<sup>7</sup> See generally Note, *supra* note 2, at 827.

<sup>8</sup> One earlier case involved the same issues, but the parties settled before trial. In 1976, Irving Trust Co. agreed to finance General Cable Corporation's hostile takeover of Microdot, Inc. At the time, Irving Trust had outstanding loan agreements with both General Cable and Microdot. The takeover was thwarted when Northwest Industries made a higher offer for Microdot's shares. See *Corporate Takeover: Hearings Before the Senate Comm. on Banking, Housing, and Urban Development*, 94th Cong., 2d Sess. 2-6 (1976) (testimony of Rudolph Eberhart, Jr., President, Microdot, Inc.) [hereinafter cited as *Corporate Takeovers*]; Cole, *supra* note 2.

<sup>9</sup> 475 F. Supp. 5 (N.D. Ill. 1977).

<sup>10</sup> *Id.* at 8.

<sup>11</sup> *Id.* at 7.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 8.

<sup>14</sup> *Id.*

## II

## WASHINGTON STEEL CORP. v. TW CORP.

In 1974, Chemical Bank participated in a credit agreement with two other banks to loan Washington Steel up to ten million dollars. Chemical also served as one of two registrars for Washington Steel's common stock. In connection with the credit agreement, Washington gave Chemical confidential information, including a May 1973 study projecting cash flow and earnings as well as periodic statements of Washington's financial affairs.<sup>15</sup> Chemical also served as the lead bank in loans to Talley Industries. In January 1979, Talley decided to acquire Washington and asked Chemical to help finance the takeover. After performing a credit analysis of Talley, Chemical assented.<sup>16</sup>

As part of its overall opposition to the offer, Washington's management sued Talley and Chemical.<sup>17</sup> Washington obtained a preliminary injunction upon a district court finding that Chemical had breached its fiduciary duty to Washington by agreeing to finance the tender offer.<sup>18</sup>

On appeal<sup>19</sup> the Third Circuit reversed, holding that the bank had not violated any common law fiduciary duty merely by agreeing to finance the takeover.<sup>20</sup> The court stated that such a per se fiduciary duty was objectionable because it would burden

---

<sup>15</sup> 602 F.2d at 596.

<sup>16</sup> *Id.*

<sup>17</sup> *Washington Steel Corp. v. TW Corp.*, 465 F. Supp. 1100 (W.D. Pa.), *rev'd*, 602 F.2d 594 (3d Cir. 1979).

<sup>18</sup> *Id.* at 1102-05. The court found that Chemical was an agent for both Washington and Talley, and breached its duty not to act adversely to Washington's interests. The court also held that Chemical had a duty to disclose all relevant facts so that Washington could decide whether it should allow a dual agency relationship to continue. The court concluded that "[t]he balance of hardship under the facts of this case, and in light of the egregious and unethical conduct of [Chemical], decidedly tips the balance . . . in favor of [Washington] and requires that we grant" the preliminary injunction. *Id.* at 1105. The district court apparently based its finding of an agency relationship on Chemical's role as one of two registrars for Washington's stock and on the receipt of confidential information in connection with the credit agreement. On appeal, Washington did not rely on Chemical's role as registrar to support its allegation of a per se fiduciary duty. 602 F.2d at 599.

<sup>19</sup> While the appeal was pending, Blount, Inc. offered \$40 per share for Washington Steel's stock and Talley withdrew its offer of \$37.50. The court of appeals decided the case was not moot, however, because Talley and Chemical could sue on the injunction bond and the court would eventually have to consider the same issues on appeal from the disposition of the bond claim. 602 F.2d at 598-99.

<sup>20</sup> *Id.* at 599-601.

the free flow of bank financing and diminish the funds available for financing corporate ventures.<sup>21</sup> On the basis of a cloudy district court record, Washington argued that, even absent a per se duty, Chemical had breached a fiduciary duty by using confidential information supplied by Washington in evaluating the loan to Talley. The court, however, refused to impose this duty, even if Chemical had used confidential information.<sup>22</sup> Such a rule, said the court, would force banks to enter blindly into loan agreements or restrict the free flow of bank financing by discouraging banks from lending money to potential raiders.<sup>23</sup> In effect, the court sanctioned the bank's use of confidential information received from one borrower in evaluating a loan to another borrower.<sup>24</sup>

### III

#### A BANK'S DUTY TO CORPORATE BORROWERS

##### A. *The Per Se Fiduciary Duty*

Precedent and public policy support the *Washington* court's holding that receipt of confidential information from a corporate borrower does not preclude a bank from financing the hostile takeover of that borrower. Absent a mutual understanding, no fiduciary duty should arise from a debtor-creditor relationship.<sup>25</sup>

---

<sup>21</sup> *Id.* at 601.

<sup>22</sup> *Id.* at 603.

<sup>23</sup> *Id.* at 601-04.

<sup>24</sup> *Id.* at 604.

<sup>25</sup> A fiduciary relation is said to exist whenever one person reposes trust and confidence in the integrity and fidelity of another. The very existence of such a relation precludes the party in whom the trust and confidence is reposed from profiting by or taking advantage of the relation at the expense of the other party. *See, e.g.*, *Twomey v. Mitchum, Jones & Templeton, Inc.*, 262 Cal. App. 2d 690, 712-17, 69 Cal. Rptr. 222, 238-40 (1968); *South v. Wishard*, 146 Cal. App. 2d 276, 284, 303 P.2d 805, 811 (1956). A fiduciary relation includes all legal relations, such as attorney and client, principal and agent, guardian and ward, and the like, and also cases where a fiduciary relation exists in fact: where confidence is reposed on one side and domination and influence result. *See, e.g.*, *Finn v. Monk*, 403 Ill. 167, 181, 85 N.E.2d 701, 708 (1949); *Clark v. Clark*, 398 Ill. 592, 600, 76 N.E.2d 446, 449 (1948).

In *Stenberg v. Northwestern Nat'l Bank of Rochester*, 307 Minn. 487, 488, 238 N.W.2d 218, 219 (1976), the court held that although the lending bank gave financial advice to the plaintiff-borrower, no fiduciary relationship arose to replace the normal commercial relationship between the parties because the plaintiff-borrower was an experienced businessman capable of independent judgment. Similarly, in *Umbaugh Pole Bldg. Co. v. Scott*, 58 Ohio St. 282, 390 N.E.2d 320 (1979), the court held that the relationship of debtor-creditor, without more, is not a fiduciary relationship. The court reasoned that

As the *Washington* court noted, one cannot "draw a fiduciary rabbit from a commercial loan agreement hat."<sup>26</sup> A debtor has no reasonable basis for the belief that receipt of confidential information by a creditor compels the creditor to act in the debtor's interest in all situations.<sup>27</sup>

A per se rule prohibiting banks from financing hostile takeovers of corporate customers would "wreak havoc with the availability of funding for capital ventures."<sup>28</sup> If banks were precluded from financing hostile takeovers of corporate customers, corporations could ensure against hostile takeovers by arranging loan agreements with the major banks, thereby drying up most sources of corporate funding.<sup>29</sup> Furthermore, potential takeover targets may encounter difficulties obtaining financing from commercial banks if such transactions would preclude the banks from making larger, more profitable loans to raiders.<sup>30</sup> The *Washington* court correctly recognized that such a result "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."<sup>31</sup>

where neither party had, or could have had, a reasonable expectation that the creditor would act solely or primarily on behalf of the debtor, the creditor's advice to the debtor did not transform a business relationship into a fiduciary relationship. The creditor and the debtor dealt with each other at arm's length in a commercial context where each party protected his own interests. The court noted, however, that a fiduciary relationship may be created out of an informal relationship if both parties understand that a special trust or confidence has been reposed. Thus, in *Stewart v. Phoenix Nat'l Bank*, 49 Ariz. 34, 44, 64 P.2d 101, 106 (1937), the court found that a fiduciary relationship had replaced the debtor-creditor relationship between a bank and a depositor because the bank had acted as the depositor's financial advisor for over 23 years and the depositor had relied on that advice.

<sup>26</sup> 602 F.2d at 600.

<sup>27</sup> See Herzel & Rosenberg, *Loans to Finance Tender Offers: The Bank's Legal Problems*, 96 BANK. L.J. 676, 680 (1979). Cf. *Snow v. Merchants Nat'l Bank of New Bedford*, 309 Mass. 354, 360-61, 35 N.E.2d 213, 216-17 (1941) (where bank derived profit from business of buying and selling securities, plaintiff-customer could not reasonably be of the opinion that investment advice rendered her was performed by bank acting in fiduciary rather than business relation).

<sup>28</sup> 602 F.2d at 601. See also *Corporate Takeovers*, *supra* note 8, at 38-39 (testimony of Gordon T. Wallis, Chairman of the Board, Irving Trust Co.); Note, *supra* note 2, at 835.

<sup>29</sup> 602 F.2d at 601; *Corporate Takeovers*, *supra* note 8, at 43 (statement of Gordon T. Wallis, Chairman of the Board, Irving Trust Co.).

<sup>30</sup> See *Corporate Takeovers*, *supra* note 8, at 43-44 (statement of Gordon T. Wallis, Chairman of the Board, Irving Trust Co.).

<sup>31</sup> 602 F.2d at 601 (quoting *American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5, 9 (N.D. Ill. 1977)). Such a result might also lead potential raiders to seek financing from foreign banks not subject to that restriction. See Herzel, *Banks, Mergers, and Conflicts of Interest*, N.Y. Times, Apr. 22, 1979, § 3 (Business & Finance), at 20.

### B. *The Use of Confidential Information*

In contrast, the portion of the *Washington* court's opinion dealing with the alleged duty not to use confidential information is more difficult to support. The court glossed over cogent arguments for finding an implied contractual obligation<sup>32</sup> or a fiduciary duty based on the debtor's reasonable reliance.<sup>33</sup> In counseling banks to use all available information to evaluate loan transactions, the court ignored the fact that the information's availability was fortuitous, and inexplicably exalted the interests of the bank's depositors over those of its debtors.<sup>34</sup>

The court couched its hesitation on two grounds. First, such a rule would "make unwise banking policy" by forcing banks to make uninformed decisions or alternatively by restricting the free flow of funds.<sup>35</sup> Second, even if the rule's effect was salutary, its creation was best left to Congress rather than to the states or the federal judiciary.<sup>36</sup>

The court's consideration of banking policy was shortsighted. Many banks analyze takeover loans on a "worst case" basis<sup>37</sup>—they focus solely on the borrower's ability to repay if the takeover is abortive. Even where the target's financial status is relevant—for example, if the target's stock or assets will serve as collateral for the loan<sup>38</sup>—the bank can derive most or all of the material information from the target's press releases, industry reports, and the target's disclosures pursuant to federal securities regulation. The modicum of information unavailable from these sources should be material only in the most marginal of tender offers—

---

<sup>32</sup> See note 44 and accompanying text *infra*.

<sup>33</sup> See note 43 and accompanying text *infra*.

<sup>34</sup> 602 F.2d at 603-04. Cf. *Corporate Takeovers*, *supra* note 8, at 118 (testimony of Richard A. Debs, First President and Chief Administrative Officer, Federal Reserve Bank of New York) (stockholder suit alleging that bank had information in files that acquisition of target was bad loan but failed to use it "would be thrown out of court").

<sup>35</sup> 602 F.2d at 603.

<sup>36</sup> *Id.* at 601, 603.

<sup>37</sup> Under the worst-case analysis, a bank's principal inquiry in evaluating a loan is whether the raider has the financial ability to support the transaction by itself: Would the raider be able to repay the loan in the worst possible situation, *e.g.*, where a raider is unable to either gain control of the target or sell those shares of the target it does acquire. The loan decision is based upon consideration of the raider's ability to repay the loan from its own cash flow, rather than from any assets it may acquire through the acquisition. See *Humana, Inc. v. American Medicorp, Inc.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,286, at 92,829 (S.D.N.Y. Jan. 5, 1978); *American Medicorp, Inc. v. Continental Illinois Nat'l Bank and Trust Co. of Chicago*, 475 F. Supp. 5, 9 (N.D. Ill. 1977).

<sup>38</sup> See Herzal, *supra* note 31.

offers that banks without access to the target's confidential information would refuse to finance. But by funding these marginal takeovers, the bank tacitly assures the offeror of the soundness of the acquisition<sup>39</sup>—the target's confidential information is effectively transmitted to third parties.

The court's authorization of the use of "all available information" begs the question.<sup>40</sup> Plaintiff in *Washington* sought to prevent the use of information obtained and obtainable only from the plaintiff.<sup>41</sup> The information was available only because of the bank's participation in a prior commercial transaction. Surely the court's opinion could not be extended to authorize the exchange of confidential information between banks that were not lucky enough to be privy to the records of particular takeover candidates.<sup>42</sup> A bank that is prevented from using confidential information is merely deprived of a fortuitous competitive advantage in the financial world.

<sup>39</sup> The situation has been analogized to that of the bank bankrolling a blind poker player.

[A] resourceful fellow [who does not know the financial condition of the target] asks his banker to sit in on the game. With his banker at the table looking at his cards, the blind man offers to bet \$425 million on his hand, but only if the banker will also bet \$700 million. When the bank pushes \$700 million in chips to the center of the table, it is fair inference that the blind player has the benefit of whatever information a view of the cards in his hand would have provided him in making his bet.

Cole, *supra* note 2.

<sup>40</sup> 602 F.2d at 603.

<sup>41</sup> Washington's ultimate goal was to defeat Talley's takeover attempt by preventing Chemical from financing the hostile takeover. The allegation of misuse could be characterized as simply another weapon in the target's armory of takeover defenses. See Herzog & Rosenberg, *supra* note 27, at 678; see, e.g., Harnischfeger Corp. v. Poccan, Inc., 474 F. Supp. 1151 (E.D. Wis. 1979); American Medicorp v. Continental Ill. Nat'l Bank & Trust Co., 475 F. Supp. 5 (N.D. Ill. 1977).

<sup>42</sup> Banks may not disclose confidential information about customers to third parties. See, e.g., Milohnich v. First Nat'l Bank of Miami Springs, 224 So. 2d 759, 760 (Fla. Dist. Ct. App. 1969) (bank under implied contractual duty not to disclose information about customers' accounts to third parties); Peterson v. Idaho First Nat'l Bank, 83 Idaho 578, 588, 367 P.2d 284, 290 (1961) (bank liable for breach of implied contract in disclosing information concerning customer's account); cf. Peoples Bank of V.I. v. Figueroa, 559 F.2d 914, 916-18 (3d Cir. 1977) (bank not liable for failure to reveal information about borrower to endorsers); Valley Bank of Nev. v. Superior Ct. of San Joaquin City, 15 Cal. 3d 652, 542 P.2d 977, 125 Cal. Rptr. 553 (1975) (before confidential customer information may be disclosed in civil discovery proceedings, bank must take reasonable steps to notify customer and afford customer reasonable opportunity to protect his interests). *But cf.* Graney Dev. Corp. v. Taksen, 92 Misc. 2d 764, 768, 400 N.Y.S.2d 717, 720 (Sup. Ct. Monroe Co.), *aff'd*, 66 A.D. 2d 1008, 411 N.Y.S.2d 756 (4th Dep't 1978) (bank not liable for breach of implied

The benefits of the unstaunched flow of information must be balanced against the target's legitimate interests in the confidentiality of the information. Courts should hold that the target's disclosure of confidential information creates a special relationship which precludes the bank from using the information for its own purposes and profit.<sup>43</sup> The prohibition against unauthorized use might also be seen as an implied term of the original agreement.<sup>44</sup>

The *Washington* court's reliance on congressional action in the field<sup>45</sup> is similarly misplaced. Although the court granted that the banking area was so vital to the national economy that it demanded the creation of uniform federal rules, the court declined to imply any fiduciary duty in the absence of federal legislation.<sup>46</sup> The congressional and executive action cited by the court<sup>47</sup> supports the court's characterization of the area as one in which federal regulation is appropriate; legislative *inaction* on the

---

contract for disclosing information about borrower which borrower would not normally expect to be kept confidential). According to Professor David F. Linowes, former chairman of the Federal Privacy Protection Study Commission, although most owners of small businesses assume their banking is private between them and their bankers, banks disclose information about their customers to any creditor who asks. This "erosion of that confidential relationship" between customers and their bankers often occurs without the customer's knowledge. A spokesman for the American Bankers Association responded that if a business owner lists his bank as a credit reference when applying for credit, he at least implicitly authorizes disclosure of his bank accounts. Commenting on Linowes' study, one banker stated that banks protect the legitimate privacy of their business customers even when not required by law, Molotsky, *Business-Loan Details Found To Be No Secret*, N.Y. Times, Nov. 1, 1979, § D (Business Day), at 12.

<sup>43</sup> See *Humana, Inc. v. American Medicorp, Inc.* [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96, 286, at 92, 289 ("a special relationship which may be designated fiduciary or confidential, does exist between a prospective borrower and its bank which should preclude the bank from disseminating or using the [confidential] information for improper purposes."); *Corporate Takeovers*, *supra* note 8, at 99 (testimony of Richard A. Debs, First Vice President and Chief Administrative Officer, Federal Reserve Bank of New York) ("There is a special relationship between banks and their customers that is based on confidence and trust in the bank itself, and in the bank's commitment to safeguard the confidential [sic] affairs of its customers."); *id.* at 49 (testimony of Gordon T. Wallis, Chairman of the Board, Irving Trust Co.).

<sup>44</sup> See *American Medicorp v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5, at 8 (N.D. Ill. 1977) (customary package of confidential documents are presented by prospective borrower to bank "with the understanding that they would be retained in a confidential posture within the bank, and also not released to outsiders."). See also Herzog & Rosenberg, *supra* note 27, at 676.

<sup>45</sup> 602 F.2d at 601. The court made this argument in its discussion of the per se fiduciary duty and then referred to it as a reason for not promulgating a rule restricting the use of confidential information.

<sup>46</sup> *Id.* at 603.

<sup>47</sup> *Id.* at 601. The regulations the court referred to involve the dissemination of confidential information between bank departments. See 43 Fed. Reg. 12,755 (1978); Fiduciary Powers of National Banks and Collective Investment Funds, 12 C.F.R. § 9.7(d) (1974).

very issue before the court, however, may reflect the congressional belief that the court system provided an adequate remedy for misuse of confidential information. The last time such legislation was considered,<sup>48</sup> banking industry representatives assured a Senate committee that confidential information was safeguarded in the context of hostile takeovers<sup>49</sup> and that the common law and the judicial process afforded sufficient protection against abuses.<sup>50</sup> State common law may well be inappropriate to deal with the problem;<sup>51</sup> at the least it provides a model<sup>52</sup> for the implication of a federal common law duty fit to serve until Congress enacts a responsive statute<sup>53</sup> or defers explicitly to the federal courts.

#### IV

##### A PROPOSAL

In the wake of *Washington*, potential targets may seek explicit contractual provisions to protect the information disclosed to their

<sup>48</sup> See *Corporate Takeovers*, *supra* note 8. No legislation resulted from the hearing.

<sup>49</sup> See *id.* at 33-35 (testimony of Gordon T. Wallis, Chairman of the Board, Irving Trust Co.).

<sup>50</sup> Richard A. Debs, First Vice President and Chief Administrative Officer, Federal Reserve Bank of New York, testified:

The judicial process is available to any party harmed by the action of a bank in improperly dealing with or otherwise misusing confidential information entrusted to it by the aggrieved party. There are no provisions in the banking laws that apply directly to abuses of this kind. But there are principles of the common law that could provide remedies for parties harmed by such abuses. The courts are particularly well equipped to deal with such cases, since they would presumably involve . . . critical findings of fact as to whether confidential information was indeed misused.

*Id.* at 99.

<sup>51</sup> 602 F.2d at 603.

<sup>52</sup> See *Pigg v. Robertson*, 549 S.W.2d 597, 600 (Mo. Ct. App. 1977) (although relationship between bank and borrower is one of debtor and creditor, the relation may give rise to a particular obligation such as an obligation not to misuse confidential information received from a customer); note 42 *supra*; *cf.* *Milchnich v. First Nat'l Bank of Miami Springs*, 224 So. 2d 759, 760 (Fla. Dist. Ct. App. 1969) (bank is under implied contractual duty not to disclose information about customer's accounts to third parties); *Peterson v. Idaho First Nat'l Bank*, 83 Idaho 578, 588, 367 P.2d 284, 290 (1961) (bank is liable for breach of implied contract for disclosing information concerning customer's account); *Valley Bank of Nevada v. Superior Ct. of San Joaquin Cty.*, 15 Cal. 2d 652, 542 P.2d 977, 125 Cal. Rptr. 553 (1975) (before confidential customer information may be disclosed in civil discovery proceedings, bank must take reasonable steps to notify customer and afford him reasonable opportunity to take legal action to protect his interests).

<sup>53</sup> See [1979] 528 SEC. REC. & L. REP. (BNA) A-18 (July 18, 1979) (Senate Committee on Banking, Housing, and Urban Affairs is soliciting suggestions for legislation to prevent misuse of confidential information in connection with tender offers).

banks.<sup>54</sup> In the present tight credit market, however, borrowers may lack the bargaining power to obtain these provisions.<sup>55</sup> Absent an express contractual provision, a federal court should imply a contractual provision forbidding the use of confidential information or find a fiduciary duty to the same effect.<sup>56</sup>

Targets may still face an insurmountable burden in showing that misuse occurred: the bank's use of confidential information is "peculiarly within the knowledge of the adversary."<sup>57</sup> Fairness and convenience argue that the bank should have the initial burden of showing that no abuse occurred.<sup>58</sup> Banks could satisfy this burden by demonstrating the safeguards they employed to prevent unauthorized access to confidential information. Banks can effectively prevent misuse of confidential information by designing "Chinese Walls"<sup>59</sup> to isolate lending officers from the target's

---

<sup>54</sup> See Herzel & Rosenberg, *supra* note 27, at 676 n.1 (bank's legal responsibilities regarding use of confidential information can be regulated by contract between bank and customer) and cases cited therein.

<sup>55</sup> Cf. *American Medicorp v. Continental Ill. Nat'l Bank & Trust Co.*, 475 F. Supp. 5, 8 (N.D. Ill. 1977) (corporation desiring loan must give confidential information to banks).

<sup>56</sup> See notes 43-44 and accompanying text *supra*.

<sup>57</sup> *United States v. New York, N.H. & H.R.R.*, 355 U.S. 253, 265 n.5 (1957) (ordinary rule, based upon fairness considerations, does not place upon litigant the burden of proving facts peculiarly within the knowledge of his opponent).

<sup>58</sup> Allocation of the burden should be based upon "experience as to what is convenient, fair, and good policy." Morgan, *Some Observations Concerning Presumptions*, 44 HARV. L. REV. 906, 910-11 (1931). Wigmore states that "in a limited class of cases . . . the burden of proving a fact is said to be put on the party who presumably has peculiar means of knowledge enabling him to prove its falsity if it is false." 9 J. WIGMORE, A TREATISE ON THE ANGLO-AMERICAN SYSTEM OF EVIDENCE IN TRIALS AT COMMON LAW § 2486 (3d ed. 1940). See *United States v. New York, N.H. & H.R.R.*, 355 U.S. 253, 256 n.5 (1957) ("The ordinary rule, based on considerations of fairness, does not place the burden upon a litigant of establishing facts peculiarly within the knowledge of his adversary."); *Browzin v. Catholic Univ. of America*, 527 F.2d 843, 849 (D.C. Cir. 1975) (ordinarily, a litigant does not have the burden of establishing facts peculiarly within the knowledge of the opposing party); *G.E.J. Corp. v. Uranium Aire, Inc.*, 311 F.2d 749, 751 (9th Cir. 1962) (generally, party must establish a fact which is essential to its claim or defense but burden of proving fact is put on party who presumably has means of knowledge enabling it to prove its falsity if it is false).

<sup>59</sup> A Chinese Wall is a body of rules and procedures designed to control the flow of information—usually between departments, such as the loan department and the trust department. It is not a physical barrier, although it may provide for physical separation. Hermon & Safander, *The Commercial Bank Trust Department and the "Wall,"* 19 B.C. IND. & COM. L. REV. 21, 31 (1972). The operative theory of a Chinese Wall is that denial of access to confidential information precludes its misuse. Lipton & Mazur, *The Chinese Wall Solution to the Conflict of Securities Firms*, 50 N.Y.U. L. REV. 459 (1975). See generally Herzel & Coling, *The Chinese Wall and Conflict of Interest in Banks*, 34 BUS. LAW. 73 (1978).

files and from other personnel who have dealt with the target.<sup>60</sup> Upon a showing that the bank has instituted and followed procedures to prevent the misuse of confidential information, the burden of proving misuse would shift to the target.

The reallocation of burdens would have at least two salutary effects. Banks would be encouraged to institute procedural safeguards as the least onerous means of fending off challenges to takeover loans. Targets, while still free employ the judicial process as a defensive tactic,<sup>61</sup> would have to present a stronger showing than mere access to the information in order to disrupt the potential takeover.

*Mark Holland*

---

<sup>60</sup> Since the isolation would occur within the commercial loan department, tender offer situations involve special problems not usually encountered when instituting Chinese Walls.

Unlike the situation with a trust department Chinese Wall, it probably is not possible to have a set of general procedures which would be continuously in place and applicable to all tender offer situations. A separate set of Chinese Wall rules would probably have to be designed quickly by the bank and its lawyers to fit each tender offer situation as it arises. Education programs for lending officers can be very helpful in assuring early recognition of tender offer problem situations and the quick development of a set of procedures that is best suited to the facts of the particular problem.

Herzel & Rosenberg, *supra* note 27, at 679.

The Wall is effective, however, if the final decisionmaker has been isolated from the confidential information. See Lipton & Mazur, *supra* note 59, at 467 n.19.

A simple way to accomplish this isolation is to obtain the assistance of a bank officer who has no prior connection with either customer and who will not be involved in making the loan. The lending officers making the loan should be careful to consider only publicly available information about the target company, and it is best to obtain such public information separately from public sources and not to use any items from the target company's credit files.

Herzel & Rosenberg, *supra* note 27 at 679.

<sup>61</sup> See note 41 *supra*.