COMMENTS

CORPORATIONS: CONFLICTING BANK DUTIES IN TENDER OFFER FINANCING

INTRODUCTION

In recent years, an increasing concern has been voiced by the government,[1] the judiciary,[2] and the public[3] over the potentially conflicting roles played by commercial banks with trust departments. The major groups to whom a bank owes duties are its shareholders, depositors, customers about whom the bank holds confidential information, customers for whom the bank acts as an agent, and beneficiaries of trusts for which the bank serves as trustee. These duties conflict when a bank finances a tender offer for the stock of one of its customers; the bank may be forced to breach one duty in order to fulfill another. Although several courts have shown little sympathy toward institutions which allow conflicts of this nature to arise, the great importance of banks to our economy suggests that another approach is needed.[4]

The purpose of this comment is to enumerate and analyze the conflicting roles of a commercial bank in a tender offer setting through an analysis of two recent cases, to demonstrate that no clear method of balancing these roles presently exists in the law, and to

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[1] Legislation regulating bank involvement in tender offer financing has recently been forwarded to Congress by the SEC. The SEC's proposal, if enacted, will mandate one of the conclusions proffered by this comment as to the appropriate conduct of a commercial bank which finances a tender offer for one of it customers. The proposal will prohibit

> [a]ny person that lends all or part of the consideration to be used in a tender offer . . . from conveying confidential information about their commercial customers to a person seeking to make a tender offer, under the legislation proposed by the SEC.

FED. SEC. L. REP. No. 847, Feb. 27, 1980 (CCH). *See* N.Y. Times, June 11, 1979, § D, col. 1. An indication of governmental concern about potential abuses by banking institutions are actions taken by both the Comptroller of the Currency and the Federal Reserve Board to alleviate misconduct resulting from inherently conflicting banking functions. *See* notes 136–38 *infra* and accompanying text.

[2] Several recent opinions dealing with alleged banking abuses in tender offer financing have evidenced a judicial concern for various interest groups affected. *See* American Medicorp, Inc. v. Continental Ill. Nat'l Bank, No. 77 C 3865 (N.D. Ill. Dec. 30, 1977); Washington Steel Corp. v. TW Corp., 465 F. Supp. 1100, 1101–02 (W.D. Pa.), *rev'd and remanded*, 602 F.2d 594 (3d Cir. 1979).

[3] There have been a number of newspaper articles reporting on the issues arising out of the recent wave of tender offers. *E.g.*, N.Y. Times, June 11, 1979, § D, at 1, col. 1; *id.* May 21, 1979, § D, at 1, col. 1.

[4] As noted in the one major case discussed in this comment, commercial bank financing plays a vital role in our economy today. It is this societal consideration which requires that courts find a viable method to protect banks from inordinate liability. Washington Steel Corp. v. TW Corp., 602 F.2d 594, 603 (3d Cir. 1979).

suggest several approaches which courts might employ to protect the interest groups involved without exposing banks to unreasonable liability. The areas of potential liability for banks are both considerable in size and diverse in nature, ranging from civil damages for a breach of confidentiality to criminal sanctions for violations of the federal securities laws. However, before examining the various problems created when a commercial bank finances a tender offer, the types of obligations arising out of the major banking functions will be examined.

DUTIES OF THE DEBTOR-CREDITOR RELATIONSHIP

When an entity, corporate or otherwise, places funds in a bank, it is considered a depositor.[5] "[T]he relation[ship] between a bank and [such a] depositor is that of debtor and creditor."[6] This traditional view gives rise to standard contractual duties,[7] requiring that a bank, through its directors and officers, protect the corpus of the deposit funds, while earning sufficient income to honor the terms embodied in the deposit agreement.[8] Although there is a reluctance among courts to view these contractual duties as creating a broad fiduciary relationship,[9] there is virtual unanimity among courts which hold that a bank's duty to honor these terms is of paramount importance.[10] By increasing the duty owed beyond that required in a

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[5] 5A MICHIE, BANKS AND BANKING § 3 at 18 (perm. ed. 1973).

[6] *Id.* § 1 at 1.

[7] *Id.* § 1 at 1–5, § 3 at 19. These duties obligate the bank to perform according to the terms of the deposit agreement, by releasing funds upon the depositor's demand and by honoring checks issued by the depositor against that account. *Id.*

[8] Meyer v. Idaho First Nat'l Bank, 96 Idaho 208, 209, 525 P.2d 990, 991 (1974).

> The relationship between a bank and the depositor is that of debtor and creditor. The funds deposited become the property of the bank and the bank's obligation to the depositor is to pay out an equal amount upon demand.

Id.

[9] 5A MICHIE, *supra* note 5, § 1 at 13. *See* Pigg v. Robertson, 549 S.W.2d 597, 600 (Mo. Ct. App. 1977). In *Pigg*, it was noted that between a depositor and his banker "the relation . . . is that of creditor-debtor, not a fiduciary relation," if there are no special circumstances which alter that status. *Id.*

The reluctance of most courts to impose broad fiduciary duties upon banks, results from the absence of provisions in deposit agreements, expressly or impliedly, providing for such. *See* Forbes v. First Camden Nat'l Bank & Trust Co., 21 N.J. Super. 133, 135, 90 A.2d 547, 548 (Law Div. 1952) (rights and liabilities determined by terms of contract, whether express or implied); Griffin v. Centreville Sav. Bank, 93 R.I. 47, 52–53, 171 A.2d 204, 206–07 (S. Ct. 1961) (rights and obligations controlled by contract between depositor and bank). *See generally* 5A MICHIE, *supra* note 5, § 1.

[10] *E.g.*, First Trust & Deposit Co. v. Potter, 155 Misc. Rep. 106, 278 N.Y.S. 847 (Sup. Ct. 1935). The court in *Potter* noted that:

standard contract relationship, courts protect the interests of depositors from risk of loss, due to improper bank action.

DUTIES TO CUSTOMERS BEYOND THE PURELY CONTRACTUAL DEBTOR-CREDITOR RELATIONSHIP

A bank is under duties towards its customers in addition to its paramount duty of protecting depositors' funds.[11] It is nearly universally recognized, that a bank is required to keep confidential any information concerning a customer's private affairs.[12] Courts have addressed this duty noting that, although the relationship may be one of debtor-creditor, the bank holds any information about that customer as his agent.[13] Such an agent has a fiduciary duty not to divulge information which his principal has entrusted under a condition, express or implied, that the information remain confidential.[14] In this

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> Having strict regard for the legal rights of its debtors, a bank's duty is primarily to its depositors, secondarily to its stockholders, and thirdly to the public, and it therefore should use reasonable effort to protect itself against possible loss.

Id. at 112, 278 N.Y.S. at 856.

It has been stated that "[c]ommercial banks are custodians of funds entrusted to their care, and they are charged with a high degree of legal and moral duty to maintain those funds intact." Bank of Commerce v. Seely, 23 Utah 2d 271, 273, 462 P.2d 154, 155 (1969). This strong public policy of protecting the interests of bank depositors has led some courts to imply that "[a] bank deals as a fiduciary with [the] funds of its depositors." Continental Bank & Trust Co. v. Taylor, 14 Utah 2d 370, 378, 384 P.2d 796, 801 (1963).

[11] For the purpose of these further duties, it is immaterial whether the bank is the debtor, as is the case in a deposit, or the creditor, as in a loan, of the relationship.

[12] *See, e.g.*, Zimmermann v. Wilson, 81 F.2d 847 (3d Cir. 1936); Milohnich v. First Nat'l Bank, 224 So. 2d 759 (Fla. Dist. Ct. App. 1969); Peterson v. Idaho First Nat'l Bank, 83 Idaho 578, 367 P.2d 284 (1961); Brex v. Smith, 104 N.J. Eq. 386, 146 A. 34 (Ch. 1929).

[13] Crawford v. West Side Bank, 100 N.Y. 50, 53, 2 N.E. 881, 881 (1885). In *Crawford*, the court addressed the duties of a bank arising out of a deposit agreement. The court held that

> [t]he relation existing between a bank and its depositor is, in a strict sense, that of debtor and creditor; but in discharging its obligation as a debtor, the bank must do so subject to the rules obtaining between principal and agent.

Id. See Peterson v. Idaho First Nat'l Bank, 83 Idaho 578, 367 P.2d 284 (1961). *See generally* 5A MICHIE, *supra* note 5, § 1.

[14] RESTATEMENT (SECOND) OF AGENCY § 395 (1957). Section 395 provides in part that:

> Unless otherwise agreed, an agent is subject to a duty to the principal not to use or to communicate information confidentially given him by the principal or acquired by him during the course of or on account of his agency or in violation of his duties as agent, in competition with or to the injury of the principal, on his own account or on behalf of another . . . .

Id. In considering this section as it applies to a bank which holds information about its customer, Comment b to section 395 provides guidance. It provides that

> [t]he rule stated in this Section applies not only to those communications which are stated to be confidential, but also to information which the agent should know his principal would not care to have revealed to others or used in competition with him.

Id. § 395, Comment b.

way the law assures a customer that his personal affairs will not be improperly revealed to third parties by a bank.[15]

When the bank is standing in a position of trust with the customer,[16] a further fiduciary obligation of disclosure arises. In determining if such a relationship exists, courts examine the true relationship between the parties,[17] beyond any debtor-creditor transaction.

See Peterson v. Idaho First Nat'l Bank, 83 Idaho 585, 587–88, 367, P.2d 284, 290 (1961) (confidentiality implied in all bank-customer relationships); Milohnich v. First Nat'l Bank, 224 So. 2d 759, 760–62 (Fla. Dist. Ct. App. 1969) (citing *Peterson* and other authorities for proposition that banks must retain customer information in confidence). Should the bank breach this duty, it will be liable to the customer for any damages which he suffers. Peterson v. Idaho First Nat'l Bank, 83 Idaho 585, 588, 367 P.2d 284, 290 (1961).

In a patent infringement case, Kinnear-Weed Corp. v. Humble Oil & Refining Co., 150 F. Supp. 143 (E.D. Tex. 1956), the court outlined the elements constituting a breach of a confidential relationship. The requisite elements are: possession of information not generally known, transmission of that information to an individual who agrees to retain it in confidence, improper disclosure by that individual to a third party, to the injury of the party originally transmitting the information. *Id.* at 159.

[15] When it is a branch of the government that is seeking such information through a valid court order or subpoena, the bank must disclose the information, and the bank customer has no cognizable right to prevent its release. United States v. Miller, 425 U.S. 435, 440–43 (1976). In *Miller*, the defendant asserted that the government's acquisition of his banking information from his bank violated his fourth amendment rights. *Id.* at 436–37. The Court rejected this argument, noting that when one communicates information to another, he runs the risk of that person conveying it to the government. *Id.* at 442–43. The Court further noted that this information had been communicated pursuant to a subpoena duces tecum, the formality of which protected the defendant from improper actions, *id.* at 444–46 and n.6, 7 & 8, without violating his fourth amendment rights. *Id.* at 444.

However, when the government acts without authority or legal process or when a private individual seeks the information, the customer has a right to have that information remain confidential. *E.g.*, Zimmermann v. Wilson, 81 F.2d 847 (3d Cir. 1936) (I.R.S. seeking information without justification); Milohnich v. First Nat'l Bank, 224 So. 2d 759 (Fla. Dist. Ct. App. 1969) (information given to third parties); Peterson v. Idaho First Nat'l Bank, 83 Idaho 578, 367 P.2d 284 (1961) (employer requesting information about employee's banking affairs); Brex v. Smith, 104 N.J. Eq. 386, 146 A. 34 (Ch. 1929) (county criminal prosecutor seeking information without legal process). *Contra*, Rush v. Maine Sav. Bank, 387 A.2d 1127 (Me. 1978) (court exonerated bank for releasing customer information concerning mortgage to I.R.S.—narrow language limited holding to facts of case).

[16] *See, e.g.*, Brasher v. First Nat'l Bank, 232 Ala. 340, 168 So. 42 (1936); Stewart v. Phoenix Nat'l Bank, 49 Ariz. 34, 64 P.2d 101 (1937); Pigg v. Robertson, 549 S.W.2d 597 (Mo. Ct. App. 1977).

In Klein v. First Edina Nat'l Bank, 293 Minn. 418, 421, 196 N.W.2d 619, 622 (1972), the court noted that:

> As a general rule, one party to a transaction has no duty to disclose material facts to the other. However, special circumstances may dictate otherwise. For example:
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> . . . .
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> (c) One who stands in a confidential or fiduciary relation to the other party to a transaction must disclose material facts.

Id. at 421, 196 N.W.2d at 622.

[17] M.L. Stewart & Co. v. Marcus, 124 Misc. Rep. 86, 90–91, 207 N.Y.S. 685, 690 (Sup. Ct. 1924), *aff'd*, 220 A.D. 828, 222 N.Y.S. 856 (App. Div. 1927). In *M.L. Stewart*, the court was

Should the court find that the bank has acted as an advisor to a customer, or has acted as his agent in various capacities, it will find a relationship of confidence and trust.[18] The bank will then be obligated to act solely in the best interests of the customer, within the scope of the relationship, and to make full disclosure of all material facts to that customer.[19]

It is apparent that when a bank acts for, or on behalf of, its customer in a position of trust, it becomes privy to information not otherwise available to it in a simple debtor-creditor relationship.[20] On holders of this information, courts have imposed a duty of confidentiality. An analysis of the case law in this area makes it apparent that this duty of confidentiality concerning data acquired in a fiduciary capacity applies with at least equal weight as the duty of confidentiality concerning customer accounts.[21]

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faced with an action requesting that a constructive trust be declared. The plaintiff contended that its banker had breached a confidential relationship which existed between them. In evaluating the nature of this relationship, the court held

> that it is not the nominal, but the actual, relation of the parties which must be examined in order to determine whether there has been a breach of trust . . . . [I]n [the] last analysis the test is the reposing of confidence—in the sense of trust—and its abuse, which must determine the result.

Id.

[18] Stewart v. Phoenix Nat'l Bank, 49 Ariz. 34, 45–46, 64 P.2d 101, 106 (1937). *See* Pigg v. Robertson, 549 S.W.2d 597, 601 (Mo. Ct. App. 1977). *But see* Klatt v. First State Bank, 206 Iowa 252, 256–57, 220 N.W. 318, 320 (1928) (bank advising customer not sufficient to raise fiduciary duties).

[19] RESTATEMENT (SECOND) OF AGENCY §§ 381, 387 (1957). Section 387 provides that "[u]nless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency." *Id.* § 387.

The Restatement recognizes that an agent must convey material information to his principal, noting that

> an agent is subject to a duty to use reasonable efforts to give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have and which can be communicated without violating a superior duty to a third person.

Id. § 381.

Cf. Black v. Shearson, Hammill & Co., 266 Cal. App.2d 362, 72 Cal. Rptr. 157 (Ct. App. 1968) (stockbroker liable for non-disclosure of material information); Burien Motors, Inc. v. Balch, 9 Wash. App. 573, 513 P.2d 582 (Ct. App. 1973) (real estate broker liable for nondisclosure when confidence reposed; analogizing to banker in dicta).

[20] *See* Pigg v. Robertson, 549 S.W.2d 597, 600–01 (Mo. Ct. App. 1977).

[21] The right of a customer to have the bank keep his affairs confidential is an express or implied contract right. Peterson v. Idaho First Nat'l Bank, 83 Idaho 578, 589, 367 P.2d 284, 290, 92 A.L.R.2d 891, 899 (1961). The *Peterson* court noted that:

> It is implicit in the contract of the bank with its customer or depositor that no information may be disclosed by the bank or its employees concerning the customer's or depositor's account, and that, unless authorized by law or by the customer or depositor, the bank must be held liable for breach of the implied contract.

Id.

DUTY TOWARD TRUST BENEFICIARIES

When serving as a trustee, banks owe various duties to the beneficiaries named in the trust instruments. Before elaborating upon those duties, however, the basis of the trust relationship will be examined. A trust is formed when a settlor transfers legal title in property to a trustee.[22] The trustee holds this property as a fiduciary for the sole benefit of the trust beneficiaries.[23] Upon the establishment of a trust, the trustee is compelled to follow the directives of the settlor as to both conduct, and the nature and quantum of benefits to be distributed.[24]

The duty of confidentiality with respect to a depositor customer's information arises from an implied contract term to hold such information as an agent. The duty of confidentiality, however, applies automatically when the bank agrees to take information from the customer, to achieve a specified objective. Such information would clearly fall within that information which the bank, as an agent, must hold confidentially. *See* note 14 *supra*.

[22] RESTATEMENT (SECOND) OF TRUSTS §§ 3(1), 3(2) (1959). The settlor may create the trust by will or by an inter vivos transfer. RESTATEMENT (SECOND) OF TRUSTS § 3, Comment a (1959). *See* Merchants Nat'l Bank v. Frazier, 329 Ill. App. 191, 201, 67 N.E.2d 611, 617 (1946) ("trustee has title to the trust fund").

Banks have been given the capacity to act as trustees by statutes. RESTATEMENT (SECOND) OF TRUSTS §§ 8, Comment i, 96, Comments e & f (1959). Most states have enabling legislation authorizing state banking institutions to act as trustees, *see, e.g.*, N.J. STAT. ANN. § 17:9A-28 (West 1963); while national banks are given this ability by federal statute wherever a state bank may be appointed a trustee. The Federal Reserve Act of 1913, as amended in 1918, 12 U.S.C. § 248 (1976). In light of these statutory provisions, "the capacity of a [bank] corporation to hold property in trust is the same as that of a natural person;" a bank may hold any property in trust, which it could legally hold as one of its own investments. RESTATEMENT (SECOND) OF TRUSTS §§ 96(1), 89(2) (1959).

[23] RESTATEMENT (SECOND) OF TRUSTS § 3(4) (1959). This trust creates "a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of" the beneficiary. *Id.* § 2. The beneficiary holds only an equitable interest in the trust property, which is managed and invested by the trustee, who holds legal title. Merchants Nat'l Bank v. Frazier, 329 Ill. App. 191, 200, 67 N.E.2d 611, 617 (1946). The court in *Frazier* discussed the trust relationship, noting that one authority had stated:

> "A trust, in the most enlarged sense used in English jurisprudence, may be defined to be an equitable right, title or interest in property, real or personal, distinct from the legal ownership thereof; in other words, the legal owner holds the direct and absolute dominion over the property, in view of the law; but the income, profits or benefits thereof in his hands belong wholly or in part to others."

Id. (quoting J. STORY, EQUITY JURISPRUDENCE (1849)).

[24] Colonial Trust Co. v. Brown, 105 Conn. 261, 284–85, 135 A. 555, 564 (1926). In *Colonial Trust*, the court quoted its earlier decision in Holmes v. Connecticut Trust & Safe Deposit Co., 92 Conn. 507, 103 A. 640 (1918), as stating the rule of law with respect to restrictions placed upon a trust by a settlor. The court noted that:

> "As a general rule, a testator has the right to impose such conditions as he pleases upon a beneficiary as conditions precedent to the vesting of an estate in him, or to the enjoyment of a trust estate by him as cestui que trust. He may not, however, impose one that is uncertain, unlawful, or opposed to public policy."

When the trust instrument is silent as to the trustee's duties, these duties "are determined by principles and rules which have been evolved by courts of equity."[25] Furthermore, all trustee functions must be discharged in accordance with a common law or statutory standard of care.[26]

These equitable principles require, *inter alia,* that the trustee, as a fiduciary, act "solely in the interest of the beneficiaries" while keeping them fully informed of all relevant facts.[27] Specifically, a trustee is under a duty to make the trust property productive, while preserving the corpus,[28] and to render a complete and timely accounting of all investments, transactions, and the status of the trust corpus.[29] Since a bank as a trustee must be completely loyal,[30] it must avoid

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Colonial Trust Co. v. Brown, 105 Conn. 261, 284–85, 135 A. 555, 564 (1926) (quoting Holmes v. Connecticut Trust & Safe Deposit Co., 92 Conn. 507, 514, 103 A. 640, 642 (1918)). *See* Branch v. White, 99 N.J. Super. 295, 306, 239 A.2d 665, (App. Div. 1968) (trustee's duties primarily depend upon trust instrument). *See also* Merchants Nat'l Bank v. Frazier, 329 Ill. App. 191, 200–01, 67 N.E.2d 611, 617 (1946).

There will be rare occasions when a settlor's restrictions may be ignored. However, these situations will only arise when there are major changes in the circumstances which existed at the time those restrictions were made, or when the restrictions are either against public policy or illegal. Colonial Trust Co. v. Brown, 105 Conn. 261, 284–85, 135 A. 555, 564 (1926). *Accord,* Petition of Wolcott, 95 N.H. 23, 27–28, 56 A.2d 641, 644 (1948).

[25] Branch v. White, 99 N.J. Super. 295, 306, 239 A.2d 665, 671 (App. Div. 1968). *See also* Homer v. Wullenweber, 89 Ohio App. 255, 258–59, 101 N.E.2d 229, 232 (1951).

[26] For a discussion of these statutory provisions, see notes 33–35 *infra* and accompanying text.

[27] Branch v. White, 99 N.J. Super. 295, 306–07, 239 A.2d 665, 671 (App. Div. 1968). *See generally* RESTATEMENT (SECOND) OF TRUSTS § 170 (1959).

[28] *In re* Hubbell, 302 N.Y. 246, 255, 97 N.E. 888, 892 (1951). Speaking for the court, Justice Fuld noted

> [t]hat trustees generally owe a duty to make the assets which they hold for the estate productive is plain. Indeed, the cases are at one in holding that fiduciaries, whether executors or trustees, are under a duty profitably to employ funds in their hands under penalty of personal liability for their neglect.

Id.

[29] RESTATEMENT (SECOND) OF TRUSTS §§ 172, 173 (1959). *See, e.g.,* Homer v. Wullenweber, 89 Ohio App. 255, 259, 101 N.E.2d 229, 232 (trustee must render accounting).

[30] City Bank Farmers Trust Co. v. Cannon, 291 N.Y. 125, 131, 51 N.E.2d 674, 675 (1943). The Court of Appeals noted that

> [t]he standard of loyalty in trust relations does not permit a trustee to create or to occupy a position in which he has interests to serve other than the interest of the trust estate. Undivided loyalty is the supreme test, unlimited and unconfined by the bounds of classified transactions.

Id.

See also Cohen v. First Camden Nat'l Bank & Trust Co., 51 N.J. 11, 18–19, 237 A.2d 257, 261 (1967) (trustee owes undivided loyalty to beneficiary).

any situations where it might be tempted to act for itself,[31] to the detriment of the beneficiaries.[32]

By the prevailing common law view, a trustee is obligated to discharge all of the above mentioned duties, with "such care and skill as a man of ordinary prudence . . . in dealing with his own property."[33] Traditionally, this standard has been applied more strictly to corporate trustees, such as banks, who hold themselves out as possessing greater capabilities in trustee functions; consequently, banks may be held liable for negligence in the discharge of their duties when an ordinary individual would not be.[34] A majority of jurisdictions have codified this common law standard of care.[35]

DUTY TO SHAREHOLDERS

In addition to duties arising from business transactions, a bank has obligations to its stockholders. It is well settled that the directors

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[31] RESTATEMENT (SECOND) OF TRUSTS § 170, Comments b,c,d,h,i,n (1959). In general, this precludes trust acquisitions by a trustee from itself, or the retention or acquisition of the trustee corporation's stock as a trust investment. *Id.* Thus, in the absence of authorization from the settlor or a court, the trustee is precluded from engaging in any transaction which might compromise its integrity. *Id.* § 170 & Comments. *See, e.g., In re* Lewis' Estate, 349 Pa. 455, 459, 37 A.2d 559, 561 (1944) (corporate trustee breached fiduciary duty when it purchased investments from its commercial department).

[32] Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928). In one of the most quoted passages regarding fiduciary duties, Chief Judge Cardozo held that:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.

Id.

[33] *In re* Schlemm, 11 N.J. Super. 286, 293, 78 A.2d 156, 159 (Hudson County Ct. 1951). *See* RESTATEMENT (SECOND) OF TRUSTS § 174 & Comment a (1959).

[34] RESTATEMENT (SECOND) OF TRUSTS § 174 (1959). *See, e.g., In re* Schlemm, 11 N.J. Super. 286, 293, 78 A.2d 156, 159 (Hudson County Ct. 1951).

[35] *E.g.*, N.J. STAT. ANN. § 3A:15-35 to -41 (West Cum. Supp. 1979-1980). The New Jersey statute is similar to that in effect in 33 states, while four others have similar but slightly modified statutes, and five jurisdictions apply this standard through case law. *Id.* § 3A:15-35, Comment.

The New Jersey statute provides in pertinent part:

> In investing and reinvesting money and property of a trust estate and in acquiring, retaining, selling, exchanging and managing investments, a fiduciary shall exercise care and judgment under the circumstances then prevailing, which persons of ordinary prudence and reasonable discretion exercise in the management of and dealing with the property and affairs of another, considering the probable income as well as the probable safety of capital. If the fiduciary has special skills or is named as the fiduciary on the basis of representations of special skills or expertise, he is under a duty to exercise those skills.

Id. § 3A:15-37.

and officers of a corporation are under a duty to act in the best interests of the corporate stockholders.[36] In analyzing this obligation in terms of bank directors, some courts have erroneously mixed the directors' strict duty to depositors with that duty owed to shareholders.[37] The better reasoned authorities, however, recognize that a bank director's duty to the shareholders is the same as that of any corporate director.[38] To properly discharge their duties toward the shareholders, corporate directors must focus upon the primary purpose of the corporation—the maximization of earnings available to the residual owners, the shareholders.[39]

In the course of business, a multitude of investment opportunities arise in a variety of contexts. Bank directors and officers, as is true in any corporation, are obligated to exercise diligence in evaluating the potential value and inherent risks of each investment,[40] since

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[36] "It has sometimes been said that directors are trustees. If this means that directors in the performance of their duties stand in a fiduciary relationship to the company, that statement is essentially correct." Litwin v. Allen, 25 N.Y.S.2d 667, 677 (Sup. Ct. 1940). *Cf.* W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 838 (rev. perm. ed. 1975) (directors and officers not strictly trustees, but of fiduciary character).

[37] *E.g.*, Litwin v. Allen, 25 N.Y.S.2d 667, 678 (Sup. Ct. 1940).

[38] FLETCHER, *supra* note 36, § 838. This implication may be drawn from section 838 which provides in part that

> the directors of a private corporation . . . are considered in equity as bearing a fiduciary relation to the corporation and its stockholders. . . . Moreover, these rules should be applied even more stringently to an officer and director of a bank who should be concerned with the welfare of depositors as well as that of customers and stockholders.

Id. (footnotes omitted).

What then is this fiduciary standard to which these directors, in positions of trust, must adhere? The fiduciary must act for the sole benefit of the other party, he must act in good faith, with morality, loyalty, honesty, unselfishness, and candor. *See generally id.* § 850. *See also* Litwin v. Allen, 25 N.Y.S.2d 667, 667 (Sup. Ct. 1940).

[39] Dodge v. Ford Motor Co., 204 Mich. 459, 497, 170 N.W. 668, 681 (1919) ("[t]he purpose of any organization under the law is earnings—profit").

There has been some debate in recent years over whether profit maximization is truly the purpose of all corporations. These discussions, however, usually involve questions regarding the propriety of charitable acts undertaken by the corporation. Such acts have generally been found permissible, but it has never been seriously contended that philanthropic acts have replaced profits as the primary purpose of corporations. An examination of this area is beyond the scope of this comment, and therefore will not be discussed further. *See* A.P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581 (1953). *See generally* Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964).

[40] FLETCHER, *supra* note 36, § 1019. Fletcher notes that:

> In making loans, the managing officers must, it is clearly evident, "exercise diligence in investigating as to the value of the securities and safety of the loan, and ordinary care and prudence in acting on the facts known to them." Furthermore, it

"[t]hose who have contributed to the formation of [the] banking capital by becoming shareholders . . . are entitled to protection against any . . . misapplication of the assets or funds of the institution."[41] Clearly, any failure on the part of an officer or director to seek out and utilize all pertinent information concerning a loan or investment constitutes negligence in the discharge of his duties, thus rendering him liable.[42]

Bank Conflicts in a Tender Offer Setting

In the course of business, a bank may pursue investment opportunities which will have adverse effects upon one or more of its customers. In such situations the bank must act scrupulously to avoid breaching pre-existing customer obligations.[43] A dilemma of this nature is presented when one customer requests debt financing to effectuate a cash tender offer for another customer of the bank.

Recently, two banks faced with requests of this nature concluded that a loan to the "raider" company would not constitute a breach of duty toward another customer who happened to be the "target" com-

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> is the duty of a member of the investment committee to "advise his associates of any and every thing known to him affecting the financial condition and situation of proposed borrowers. . . ."

Id. (footnotes omitted) (quoting New Haven Trust Co. v. Doherty, 75 Conn. 555, 562, 54 A. 209, 211 (1903); Toledo Sav. Bank v. Johnston, 94 Iowa 212, 221, 62 N.W. 748, 751 (1895)).

Of great importance is the fact that any information which an employee, agent, officer, or director of the bank acquires in the scope of his official duties, becomes a part of the knowledge of the bank for most legal purposes. *Id.* § 806.1. Fletcher feels that as a general rule, the knowledge of an agent is the knowledge of the bank. He notes that:

> It is a well-established rule that the knowledge of an agent of a bank, whether he be president, cashier, or other person, is knowledge of the bank which he represents in a transaction performed by him within the scope of his authority. . . . The size of the corporation does not affect the rule as to the imputability of knowledge on the part of a corporate officer to the corporation.

Id. (footnotes omitted).

[41] Gause v. Commonwealth Trust Co., 196 N.Y. 134, 154, 89 N.E. 476, 482 (1909). In *Gause*, the president and vice president had improperly committed the bank to certain agreements. The court noted that the law cannot permit banks to engage in foolhardy speculations, to the detriment of its shareholders, regardless of the motives or intentions of those responsible for the investment commitments. *Id.* at 154-55, 89 N.E. at 482-83.

[42] Fletcher, *supra* note 36, §§ 1011, 1019. In sections 1011 and 1019, Fletcher discusses the prevailing view that directors will be liable to the corporation for any loss caused by the negligent performance of their duties. *Id.* This view imposes liability for a lack of due care, but not for a valid business decision which proves unwise. Clearly directors are not required to be clairvoyant. They must, however, discharge their duties in good faith, by utilizing all of the skill and knowledge which they possess or should possess. *Id.*

[43] *See* notes 48–63 *infra* and accompanying text.

pany.[44] In response, the target companies instituted suits to enjoin the execution of these financing agreements,[45] alleging that the banks' actions constituted breaches of fiduciary duty,[46] warranting prospective relief.

The first of these actions, *American Medicorp, Inc. v. Continental Illinois National Bank & Trust Co.*,[47] was a case of first impression in the United States. Continental Illinois National Bank & Trust (Continental) had served as American Medicorp's (American) bank for approximately one year.[48] During their one-year relationship the defendant, Continental, amassed "a file of 'non-public' financial and other information"[49] concerning American's operations. While Continental possessed this information, Humana Inc., another of its customers, approached the defendant's commercial loan department to procure financing for an anticipated tender offer.[50] Although the defendant knew that this offer would be an attempt to acquire a controlling interest in American's common stock,[51] it approved the loan application.

[44] A tender offer is a form of corporate acquisition. In such an offer, one company (the "raider"), wishing to assume control of another (the "target"), approaches the shareholders of the target offering to purchase their stock. If a sufficient number of these shareholders transfer their interest in the target to the raider company, the tender offer results in the raider company acquiring a controlling interest in the target. *See generally* Fleischer & Mundheim, *Corporate Acquisition by Tender Offer*, 115 U. PA. L. REV. 317, 317 (1967). For a more detailed analysis of the tender offer, see A. BROMBERY SECURITIES LAW FRAUD, § 6.3 at 119–24 (1975).

[45] American Medicorp, Inc. v. Continental Ill. Nat'l Bank, No. 77 C 3865 at 1 (N.D. Ill. Dec. 30, 1977); Washington Steel Corp. v. TW Corp., 465 F. Supp. 1100, 1101–02 (W.D. Pa.), *rev'd and remanded*, 602 F.2d 594 (3d Cir. 1979).

[46] American Medicorp, Inc. v. Continental Ill. Nat'l Bank, No. 77 C 3865 at 3 (N.D. Ill. Dec. 30, 1977); Washington Steel Corp. v. TW Corp., 465 F. Supp. 1100, 1101–02 (W.D. Pa. 1979).

[47] No. 77 C 3865 (N.D. Ill. Dec. 30, 1977). In a related case in the southern district of New York, Humana, Inc. v. American Medicorp, Inc., [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,286 at 92,823 (S.D.N.Y. 1978), the defendant, American Medicorp, raised the same issues in a counter-claim against Continental National Bank as were being litigated in the northern district of Illinois. In disposing of this counterclaim, the district court in *Humana* cited the six day-old *American Medicorp* opinion as a proper statement of the law, and on that basis refused to grant an injunction against Continental's financing the offer. *Id.* at 92,829. As the *Humana* opinion does not differ from the *American Medicorp* rationale, it will not be discussed further in this comment.

[48] No. 77 C 3865, at 2. The court did not elaborate greatly upon the exact nature of the relationship between American and Continental. However, it did specify that Continental had loaned money to American during the recent past. *Id.* It appears from the court's opinion that the non-public information possessed by Continental was transmitted by American in order to acquire those loans. The court noted that items such as American's five-year projections were part of the package normally given to prospective financiers. *Id.* at 7.

[49] *Id.* at 2.

[50] *Id.*

[51] *Id.* Continental's officers were aware of their bank's ongoing relationship with American when they decided to finance the Humana takeover bid. *Id.* at 8. In fact, one of the officers

American brought suit in the United States District Court for the Northern District of Illinois requesting, *inter alia*, a preliminary injunction.[52] Although three alternative theories were asserted,[53] the district court denied issuance of the injunction stating that "the crux of this case" was that the plaintiff did not have " 'a reasonable likelihood of success on the merits.' "[54] The plaintiff's first theory was that Continental had committed "a *per se* breach of [its] fiduciary obligation"[55] towards American by assisting another customer in an attempt to seize control of the plaintiff. The court summarily rejected this contention noting that no cases or federal regulations[56] warranted such a sweeping view of a bank's duties. Holding explicitly to the contrary, the court noted "that a bank is not precluded under all circumstances from making a loan to facilitate" such a takeover.[57]

As a second rationale asserted for imposing the injunction, American alleged that Continental had breached a fiduciary duty toward the plaintiff by using confidential information about American in making its decision to finance Humana's take-over bid.[58] The court rejected this claim as unsubstantiated[59] in light of the evidence before it, but the court's language unequivocally indicated that use of

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working on the Humana loan had worked on a loan application from American one year earlier, while the other officer dealing with Humana's application reviewed American's credit file prior to approving Humana's loan. *Id.* The court noted, however, that there was no proof that either of these men had used this information in approving the Humana loan. *Id.* at 8–10.

[52] *Id.* at 1.

[53] *Id.* at 1–3.

[54] *Id.* at 6 (quoting Fox Valley Harvestore, Inc. v. A.O. Smith Harvestore Products, Inc., 545 F.2d 1096 (7th Cir. 1976) for prerequisites required before issuance of preliminary injunction).

[55] *Id.* at 3. Apparently, American felt that by giving confidential information to Continental, it entered into a fiduciary relationship. Furthermore, American asserted that this would impose a duty on Continental to act solely in its best interests. *Id.* There seems to be no support for this kind of broad duty. As discussed earlier, when a bank acquires information about a customer, it impliedly contracts to keep it confidential. However, possessing confidential information does not, without more, subject the bank to general agency duties. *See* notes 16–19 *supra* and accompanying text.

[56] *Id.* at 6–7.

[57] *Id.* at 7.

[58] *Id.* at 3. This assertion by American has a much more viable basis. Here, the information had been communicated for a specific purpose, *i.e.*, to procure a loan. Under that circumstance, the bank holds the information as an agent of the customer. Note 14 *supra* and accompanying text. Note that this is a very narrow agency, but within its scope, the bank must not act adversely to the customer. This duty of confidentiality means that the bank must not give information to another or employ it against the customer; it is unclear, however, whether the agent's use of the information for its own purposes, as in this case, would be a breach of duty. *See* notes 16–19 *supra* and accompanying text.

[59] *Id.* at 8.

this non-public information by Continental in its investment decision would have been an actionable breach of duty.[60]

The plaintiff's final theory, that Continental had communicated non-public information from its files to Humana,[61] was similarly rejected by the court.[62] It was implicit in the court's opinion, however, that had such disclosures occurred, the bank would have been liable for a breach of duty.[63] Having rejected the plaintiff's assertions, the court refused to issue an injunction.

Thus, while the court in *American Medicorp* attempted to protect bank customers by ensuring the confidentiality of their private affairs,[64] it refused to declare a *per se* violation[65] or to create a presumption that a breach had occurred, merely because there was an inherent potential for abuse.[66] Such rules, the court noted, "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."[67]

The second case in which a target company sought to enjoin its bank from financing a tender offer for its stock, *Washington Steel Corp. v. TW Corp.*,[68] is factually indistinguishable from *American*

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[60] *Id.* at 7. There is no other conclusion which can be drawn from the court's statement 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.*" *Id.* (emphasis added). This interpretation is supported by the fact that the court expended considerable effort to demonstrate that no such improper use of information had occurred. *Id.* at 7–13. Thus, the court denied the injunction, *id.* at 13, but concluded that a bank, holding information about a customer, could not use that information for its internal decision-making process.

[61] *Id.* at 3.

[62] The court found no evidence to support this allegation. *Id.* at 11–13.

[63] *Id.* at 12–13.

[64] *Id.* This conclusion may be gleaned from the court's recognition that the transmission of confidential information to third parties by the bank or its internal use of that material in deciding to finance the take-over of a customer, would constitute a cause of action, which if supported by sufficient evidence, would justify a preliminary injunction. *Id.* This holding is in accord with those authorities which mandate that a bank may not release customer information without customer authorization or a court order. This will be discussed at notes 125–28 *infra* and accompanying text.

[65] *Id.* at 11.

[66] *Id.* at 8–11.

[67] *Id.* at 12.

[68] 465 F. Supp. 1100 (W.D. Pa.), *rev'd and remanded*, 602 F.2d 594 (3d Cir. 1979). Both American and Washington Steel were major corporations who had various business relations with their banks. Both companies had acquired commercial loan financing in the recent past from these banks, at which time the target companies had been obliged to divulge non-public information to get their loan approved. *See generally* Washington Steel Corp. v. TW Corp., 602 F.2d 594 (3d Cir. 1979); American Medicorp, Inc. v. Continental Ill. Nat'l Bank, No. 77 C 3865 (N.D. Ill. Dec. 30, 1977).

Such information is clearly of the type which the bank acquires under an implied contractual obligation of confidentiality. *See* notes 11–21 *supra* and accompanying text.

Medicorp. In *Washington Steel*, defendants Talley Industries, Inc. and its parent company TW Corp. (Talley), sought financing from another defendant, Chemical Bank (Chemical), to launch a cash tender offer for a controlling interest in the common stock of the plaintiff, Washington Steel Corp. (Washington),[69] a customer of Chemical.

In an effort to forestall this tender offer, Washington instituted suit in the United States District Court for the Western District of Pennsylvania. Granting a preliminary injunction,[70] the district court held that Chemical had breached its common law fiduciary duty to Washington by agreeing to finance Talley's tender offer,[71] regardless of whether Chemical had employed confidential information gained from Washington in approving the loan. This breach was denominated as "egregious and unethical conduct"[72] by Chemical, an agent owing a duty to its principal, Washington. Thus, the court accepted the *per se* approach rejected two years earlier in *American Medicorp*.[73]

On appeal, the Court of Appeals for the Third Circuit reversed and remanded,[74] stating that a bank could not be precluded by a *per se* rule from financing the takeover of a customer, merely because it held confidential information concerning that customer.[75] The court noted that whatever expectations a bank's customer has regarding the confidentiality of information, "we cannot fairly imply a duty whose

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[69] 602 F.2d at 595–96.

[70] 465 F. Supp. at 1101–02. Only one of the four counts against all of the defendants alleged a breach of fiduciary duty by Chemical, which was the sole ground relied upon by the district court. *Id.* As the other claims made by Washington do not directly affect the subject of this comment, they will not be discussed further.

[71] *Id.* at 1104–05.

[72] 465 F. Supp. at 1105. The district court stated two grounds for holding that Chemical was Washington's agent. First, Chemical was the registrar for Washington's stock, *id.* at 1103, and second, Chemical had been "entrusted with comprehensive, confidential financial information" concerning Washington's affairs. *Id.* Based upon these findings, the court held that Chemical " 'was acting as agent for . . . Washington . . [sic] and . . . was charged with the responsibility of advancing the best welfare and corporate interests of . . . Washington.' " 602 F.2d at 598 (quoting 465 F. Supp. at 1104).

[73] The district court in *Washington Steel* did not mention *American Medicorp* or any other authority in its opinion. A possible reason for this conspicuous absence was that the court's holding appears totally unprecedented. Both the district court in *American Medicorp* and the Court of Appeals for the Third Circuit in *Washington Steel* concluded that no authority supported the *per se* approach asserted by the plaintiffs in those cases. *Washington Steel*, 602 F.2d at 601; *American Medicorp*, No. 77 C 3865 at 6–7. Both courts, in view of this lack of authority, looked to public policy and decided that such a *per se* approach would be unacceptable. *See Washington Steel*, 602 F.2d 594; *American Medicorp*, No. 77 C 3865.

[74] 602 F.2d 594.

[75] *Id.* at 599–601. *Accord*, American Medicorp, Inc., No. 77 C 3865, at 7.

sweep is as broad and whose restrictions are as severe as that urged by Washington."[76] The court espoused the need to " 'harmonize the *necessities of a competitive industrial system of business* with the teachings of morality' " as precluding any inflexible approach.[77]

The court of appeals in *Washington Steel* agreed with the district court in *American Medicorp* that a rigid *per se* approach to a bank's duty would be objectionable on public policy grounds.[78] Holding that "[t]o imply a common law fiduciary duty of banks not to deal with competitors of their borrowers, or even just potential acquirers to those borrowers, could wreak havoc with the availability of funding for capital ventures,"[79] the court concluded that an adoption of a *per se* approach would clearly be "archetypically within the domain of legislative judgment."[80]

Having rejected the grounds relied upon by the district court, the court of appeals turned to alternative theories not reached by the lower court.[81] The plaintiff alleged that Chemical had used confidential information concerning Washington's affairs in deciding to extend Tally funds to effectuate the takeover.[82] Although there was no specific finding of misuse by the lower court,[83] the court, on appeal, "reject[ed] for a more fundamental reason Washington's contention."[84] The court departed from the rationale of the *American Medicorp* court by holding that it did "not believe that a bank violates any duty it may owe to one of its borrowers when it uses information received from that borrower in deciding whether or not to make a loan to another prospective borrower."[85]

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[76] 602 F.2d at 599.

[77] *Id.* at 600 (court's emphasis) (quoting M.L. Stewart & Co. v. Marcus, 124 Misc. Rep. 86, 92, 207 N.Y.S. 685, 691 (Sup. Ct. 1924)).

[78] 602 F.2d at 601. It is difficult to determine the public policy upon which the court in *American Medicorp* relied. No. 77 C 3865 at 12. However, the *Washington Steel* court pointed to several possible public concerns which precluded the *per se* approach. 602 F.2d at 601, 603–04. There are other considerations which either the *American Medicorp* or *Washington Steel* courts could have relied upon to justify their rejection of any absolute approach. *See* notes 121–22 *infra* and accompanying text.

[79] 602 F.2d at 601.

[80] *Id.* The court stated that, "[a] legislature is best suited to consider the delicate financial issues at stake and strike the appropriate balance between sound economics on the one hand, and expectations of loyalty on the other." *Id.*

[81] *Id.* at 602.

[82] *Id.* at 601–02. This is the same allegation which the court in *American Medicorp* intimated would constitute a breach of fiduciary duty, thus rendering the bank liable. *See* notes 58–60 *supra* and accompanying text. Consider notes 110–17 *infra* and accompanying text.

[83] 602 F.2d at 602.

[84] *Id.* at 603.

[85] *Id.*

The court advanced three reasons for allowing a bank to use all information available to it in making loan decisions. First, to rule otherwise "might force banks to go blindly into loan transactions, arguably violating [their] duties to [their] own depositors."[86] Second, a bank might be discouraged from dealing with a company interested in acquiring any interest in another bank customer, thus impeding the free flow of a vitally important money supply. Third, such a restriction could only be properly imposed by legislative enactment.[87] In conclusion, the court noted that "[i]n making loans, unless it is to take imprudent risks with the funds on deposit with the bank, the commercial loan department must be free to make full use of the information available to it."[88]

The *Washington Steel* court, however, reserved opinion on two important issues not presented in that litigation. First, would Chemical have breached a duty toward Washington, if it had given non-public information to Talley?[89] Second, could Chemical's loan department have transferred information about either Washington or Talley to its Trust department, to aid the bank in its function as trustee?[90] The latter raises questions under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5.[91]

THE RESOLUTION OF CONFLICTS ARISING OUT OF TENDER OFFER FINANCING

The district court in *American Medicorp* and the court of appeals in *Washington Steel* attempted to protect jeopardized customer rights, while recognizing, as noted by Justice Holmes, that "[m]ost rights are qualified. . . . and in case of conflict between the claims of business on the one side and of third persons on the other lines have

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[86] *Id.*

[87] *Id. See* note 80 *supra*.

[88] *Id.* at 604. This conclusion is diametrically opposed to the *American Medicorp* court's conclusion that a commercial loan department can deal with customers having adverse interests only if it does not utilize any customer's non-public information against him. *See* note 60 *supra* and accompanying text.

[89] 602 F.2d at 602. The court in *American Medicorp* did address this issue. For the reasoning employed by the district court in holding that such a disclosure could not be made, see notes 61–63 *supra* and accompanying text.

[90] 602 F.2d at 603–04. Although the *American Medicorp* case did not involve this issue, since the bank had such a trust department, there was an inherent potential for abuse.

[91] *Id.* at 603. For a discussion of the potential violations of section 10(b) and rule 10b-5, see notes 130–54 *infra* and accompanying text. For the text of the statute and rule, see note 131 *infra*.

to be drawn that limit both."[92] In the tender offer setting a clear conflict between interests exists. The target company has an interest in keeping its affairs confidential;[93] the depositors[94] and shareholders[95] have an interest in the loan department using all data in its possession to make the most prudent investment decisions. Thus, the banks, faced with irreconcilable conflicts, must draw a line limiting these interests.

Concluding that a bank may not benefit one customer at the expense of another, the district court in *Washington Steel* held that financing the takeover of a bank customer constituted a *per se* violation of a bank's duty of loyalty to the target company. Although the court cited no supporting cases,[96] an understanding of the rationale behind such an approach may be gleaned from an earlier California Court of Appeals case involving an analogous situation.[97] In that case, *Black v. Shearson, Hammill & Co.*, a broker had served as a member of the board of directors for a corporation in whose stock he was dealing.[98] In his capacity as a director he became privy to certain confidential information[99] foreshadowing a diminution in the value of that corporation's stock. This turn of events presented the broker with two mutually exclusive duties—to keep this adverse information confidential,[100] and to advise his clients not to purchase

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[92] American Bank & Trust Co. v. Federal Bank, 256 U.S. 350, 358 (1921). In this case the Supreme Court was forced to balance the right of a holder of checks, in this case a bank, to present them for payment at any time, with a payee bank's need to retain only a small percentage of its deposit funds on hand. *Id.* at 357–58. The Court recognized that the customer's right to tender a check for payment was of great importance. It refused, however, to make this an unqualified right. *Id.* at 358. In looking at the business necessities which mandate that banks rely upon the average amount of funds demanded to project the cash reserves required, the Court concluded that there would be occasions when the banks could refuse to pay, for a time at least, the customer's drafts. *Id.* at 358–59.

[93] For a customer's right to have his affairs remain confidential, see notes 11–15 *supra* and accompanying text.

[94] For a discussion of the banks' duties toward depositors, to protect the corpus of the funds on deposit and earn sufficient interest, see notes 5–10 *supra* and accompanying text.

[95] For an analysis of the shareholders' rights to have the corporation make the maximum profit, through the use of all information in the bank's possession, see notes 39–42 *supra* and accompanying text.

[96] *See* Washington Steel Corp. v. TW Corp., 465 F. Supp. 1100 (W.D. Pa.), *rev'd and remanded*, 602 F.2d 594 (3d Cir. 1979).

[97] Black v. Shearson, Hammill & Co., 266 Cal. App. 2d 362, 72 Cal. Rptr. 157 (1968). This case is illuminating because the court examined two mutually exclusive duties owed by a stockbroker. Furthermore, the duties of that broker were similar to those owed by a banker extending tender offer financing—a fiduciary duty of loyalty and a duty of confidentiality.

[98] *Id.* at 363–64, 72 Cal. Rptr. at 158.

[99] *Id.* at 365–66, 72 Cal. Rptr. at 159.

[100] *Id.* at 367–68, 72 Cal. Rptr. at 161. In support of this proposition, the defendant asserted that he was under an absolute duty not to disclose inside corporate information until such time

this stock or to divest themselves of any shares they already held.[101] The broker weighed these obligations and decided that his duty of confidentiality must prevail; thus, to the detriment of his clients, he breached his fiduciary duty to inform them of all material information.[102] On the basis of this breach, both the director and his brokerage firm were held liable.[103]

The court rejected the defendant's balancing approach, stating that it had "been given no sufficient reason for permitting a person to avoid one fiduciary obligation by accepting another which conflicts with it."[104] Noting that this was a "classic problem encountered by one who serves two masters,"[105] the court held that the problem "should not be resolved by weighing the conflicting duties; it should be avoided in advance . . . or terminated when it appears."[106]

Fortunately, both the Court of Appeals for the Third Circuit in *Washington Steel* and the district court in *American Medicorp* rejected an unbending *per se* rule. They recognized that such a myopic view of a bank's duty would be unsound public policy;[107] "[b]ank credit is, after all, the largest part, by far, of the national money supply,"[108] and such a rule could inhibit that funding. Thus, both courts found it appropriate to " 'harmonize the *necessities of a competitive industrial system of business* with the teachings of morality.' "[109]

Although both opinions rejected the *per se* rationale and employed a balancing approach, they departed on a critical issue, ultimately giving precedence to opposite interests. In *American Medicorp*, the court indicated that the loan department has a duty not to use confidential information concerning the target company in de-

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as that information was made public. *Id.* As authority for this position, he directed the court's attention to New York Stock Exchange Educational Circular No. 162, which set forth this asserted duty in unequivocal terms. *Id.* at n.*.

[101] *Id.* at 367, 72 Cal. Rptr. at 160. This duty of a fiduciary to disclose all material facts is well established. *See* note 19 *supra*. The court here noted simply that "[i]ntentional failure to disclose a material fact is actionable fraud if there is a fiduciary relationship." Black v. Shearson, Hammill & Co., 266 Cal. App. 2d 362, 367, 72 Cal. Rptr. 157, 160 (1968).

[102] Black v. Shearson, Hammill & Co., 266 Cal. App. 362, 366–68, 72 Cal. Rptr. 157, 160–61 (1968).

[103] *Id.* at 369, 72 Cal. Rptr. at 162.

[104] *Id.* at 368, 72 Cal. Rptr. at 161.

[105] *Id.*

[106] *Id.*

[107] *Washington Steel*, 602 F.2d at 601; *American Medicorp*, No. 77 C 3865 at 12.

[108] 602 F.2d at 603.

[109] *Id.* at 600 (court's emphasis) (quoting M.L. Stewart & Co. v. Marcus, 124 Misc. 86, 92, 207 N.Y.S. 685, 691 (Sup. Ct. 1924)).

ciding to finance the takeover.[110] It is unclear whether the court derived this duty from an agency relationship or from a relationship of trust.[111] In any event, implicit in the court's holding was that the bank's duty not to use the information took priority over the bank's duty to its depositors or to the shareholders of the corporation.[112] It is difficult to understand how the court implied a duty to which it imputed greater importance than either the bank's duty toward depositors, which public policy considers of paramount importance,[113] or the clearly defined fiduciary duties owed to the bank's shareholders.[114] Perhaps this dicta by the court was the result of the cursory treatment given to this particular balancing of interests, since it was not the dispositive issue.[115]

Adopting a more pragmatic view of the interests to be balanced, the *Washington Steel* court recognized that precluding the bank from utilizing information in its files would force a breach of duty toward depositors.[116] The court noted that where the bank knows a loan "is preordained to failure, it should hardly be permitted, let alone required, to ignore the information, finance a foolhardy venture, and write off a bad loan."[117] In so holding, the *Washington Steel* court gave priority to depositors' rights, rather than to those of the target company.

The *Washington Steel* court refused to impose a fiduciary duty which would force the bank to act solely in the target customer's best interests[118] at the expense of its other duties. It is apparent from the court's opinion, which noted that Washington attempted "to draw a fiduciary rabbit from a commercial loan agreement hat,"[119] that a conceptual difficulty existed in finding an adequate foundation upon

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[110] No. 77 C 3865 at 7. *See* note 60 *supra*.

[111] For an example of some circumstances where an agency or trust relationship may be found to exist, between a bank and its customer, see notes 16–19 *supra* and accompanying text.

[112] Although the court did not make a statement to this effect, it must have made an evaluation of this nature in reaching its conclusion. Surely, the strong public policy of protecting depositors relied upon by the court in *Washington Steel* could not have been dismissed by the district court without consideration. *See Washington Steel*, 602 F.2d at 603–04.

[113] *See* notes 5–10 *supra* and accompanying text.

[114] *See* notes 36–42 *supra* and accompanying text.

[115] The court noted that the dispositive issue in *American Medicorp* was the lack of evidence to support any showing of misconduct by Continental. No. 77 C 3865 at 11–13. Thus, the court was not forced to address the substantive effect of such alleged misconduct.

[116] 602 F.2d at 603–04.

[117] *Id.* at 604.

[118] This is a reasonable conclusion, as there was no relationship from which these duties could be implied.

[119] *Id.* at 600.

which to impose such a sweeping duty on a bank. This language was not in derogation of the bank's duty to keep information concerning customers from third persons,[120] but was indicative of the fact that the bank has no apparent duty to avoid using this information for its own internal functions.[121]

This laudable holding would be justified upon the alternative ground that the interests of the bank's shareholders warranted the use of the information in the loan process.[122] Giving priority to the duty owed to the shareholders, over the alleged duty owed to a target customer, would have been consistent with the decision in *Washington Steel.*[123] Either reasoning similar to that employed by the *Washington Steel* court,[124] or the alternative justification based on shareholders' rights should have been employed by the *American Medicorp* court to allow the use of all data held by the bank in the internal decision making process.

A conceptually distinct question is the extent of a bank's duty to avoid communicating confidential information about a target company to a raider. Of the two cases only *American Medicorp* addressed this issue but there is ample supporting authority for its holding that had this type of transmission to the raider company occurred, the bank would have breached its duty of confidentiality to the target.[125] A court's analysis of such an alleged breach should be identical regardless of the relationship between the bank and target company.[126]

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[120] For a discussion of a bank's duty to keep its customers' affairs confidential, see notes 11-15 *supra* and accompanying text.

[121] The duty of an agent not to misuse information communicated by his principal is well established, *see* note 14 *supra*. However, the court of appeals did not find that an agency relationship existed.

[122] For a discussion of a bank's duties toward its shareholders, see notes 36–42 *supra* and accompanying text. These duties require that the bank consider all relevant information in the investment process. Note 42 *supra* and accompanying text. This, of course, does not require the bank to do anything illegal. However, when the bank has information that it may properly consider, the shareholders are entitled to the potential benefits attendant to its use. A bank's obligation to its shareholders is therefore rather clearly defined, while the bank's duty to a customer, not to finance ventures which may have adverse effects on that customer, is not.

[123] Such a conclusion is a logical inference from the *Washington Steel* opinion. Had the court addressed this argument, it surely would have given priority to the shareholder's interest. This conclusion is bolstered by the court's avoidance of any language which could be interpreted as a tacit recognition of an agency relationship. *See generally* Washington Steel Corp. v. TW Corp., 602 F.2d 594 (3d Cir. 1979).

[124] 602 F.2d at 603.

[125] *See* American Medicorp, No. 77 C 3865 at 7–9; notes 18–37 *supra* and accompanying text.

[126] As noted earlier, courts almost universally recognize an implied term in the banker-customer relationship which requires the bank to keep all customers' affairs confidential. *See* notes 12–15 *supra* and accompanying text.

Addressing this issue, the court in *American Medicorp* correctly avoided any balancing of interests in reaching its conclusion. Such a result is conceptually sound, as the interests of neither depositors nor shareholders would be promoted by such a flagrant breach of a target company's right of privacy.[127] The court in *American Medicorp* tacitly recognized the prevailing view that, absent customer authorization or a court order, this information must be held in confidence.[128] When no countervailing interest is present, as in *American Medicorp*, such a conclusion is the only one possible. If the court of appeals in *Washington Steel* had expressed an opinion on this issue, it probably would have followed the view of the court in *American Medicorp*.[129]

The foregoing analysis represents a legally sound method which comports with public policy and which permits commercial banks to resolve conflicting duties owed their target and raider customers, depositors, and shareholders. An additional area of inherent conflict which could subject a bank to liability, however, is subsumed within the tender offer setting as it existed in the *Washington Steel* and *American Medicorp* cases. Since both banks in these cases had trust departments, it may be questioned whether they should have, or could have, utilized the non-public information concerning the companies involved, or the impending tender offer, in their role as trustees. It has been observed that access to this type of "inside" information was one of the primary reasons that banks were originally selected for the trustee function.[130] Yet as the *Washington Steel* court noted, any use of material non-public information today might

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[127] *See* notes 12–15 *supra* and accompanying text. It would neither increase the security of the deposit funds nor increase the profitability of the bank, to transmit confidential information about the target to the raider company.

[128] *See* note 15 *supra* and accompanying text.

[129] 602 F.2d at 602. The court reserved judgment on this question, as it was not properly presented for resolution on appeal. *Id.*

[130] E. HERMAN, CONFLICTS OF INTEREST: COMMERCIAL BANK TRUST DEPARTMENTS 75 (1975). Herman noted that:

> Before the rise of the "insider" problem and the liabilities associated with the possession and use of privileged information, it was established practice for banks to use the personnel and knowledge available from all the activities in which the bank was engaged in the interest of the institution as a whole. One of the original arguments for association of trust and commercial banking functions, in fact, was "better investment facilities and a stronger group of directors, and the valuable information and help which can be obtained from other departments of a bank."

Id. (quoting J. REMINGTON, "TRUST BUSINESS OF TOMORROW," TRUST COMPANIES 677 (Dec. 1938)).

arguably violate section 10(b) and rule 10b-5 of the Securities Exchange Act of 1934.[131]

A bank which serves as a trustee is held to a high standard of care and loyalty.[132] These duties require the bank to utilize all available information to ensure that its investments of trust funds are prudent. By federal regulation,[133] it is the duty of the board of directors of each bank to ensure that these duties are properly discharged. Yet these duties do not compel a trustee to violate the law in order to make the trust productive.[134] On the contrary, if an act is illegal, as the use of non-public information may be, the trustee is obligated to act accordingly.[135] Thus, banks must determine whether their use of non-public information as trustee would violate the securities law.

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[131] 602 F.2d at 603. The *Washington Steel* court noted that such actions might violate section 10(b) which is codified at 15 U.S.C. § 78j. Section 78j provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j (1976). Pursuant to this statute, the S.E.C. has promulgated rule 10b-5, which states that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1979).

[132] *See* notes 25–35 *supra* and accompanying text.

[133] 12 C.F.R. § 9.7(a)(1) (1979). This regulation promulgated by the Comptroller of the Currency provides in pertinent part that

> [t]he board of directors is responsible for the proper exercise of fiduciary powers by the bank. All matters pertinent thereto, including the determination of policies, the investment and disposition of property held in a fiduciary capacity, and the direction and review of the actions of all officers, employees, and committees utilized by the bank in the exercise of its fiduciary powers, are the responsibility of the board.

Id.

[134] RESTATEMENT (SECOND) OF TRUSTS § 166 (1959). *See also In re* Cady, Roberts & Co., 40 S.E.C. 907, 916 (1961).

[135] RESTATEMENT (SECOND) OF TRUSTS § 166, Comment a (1959).

Recently, this determination has become even more critical both for national and federal reserve banks, as a result of a regulation promulgated by the Comptroller of the Currency[136] and a policy statement released by the Federal Reserve Board.[137] In all transactions executed for trust accounts, banks are now expressly required to comply with the federal securities law, particularly to avoid "us[ing] material inside information."[138]

In determining whether a bank may properly use non-public information in trading for trust accounts, a two-tiered analysis is appropriate. The threshold question is whether banks are within the ambit of section 10(b) and rule 10b-5. The second question is whether the type of information held by trustee banks is "material inside information" which may not be traded upon prior to public disclosure.[139]

In the landmark decision *In re Cady, Roberts & Co.*,[140] the Securities and Exchange Commission set broad parameters indicating the entities which are subject to the restrictions of section 10(b) and rule 10b-5. The Commission noted that although corporate insiders

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[136] 12 C.F.R. § 9.7(d) (1979). Recognizing that banks may have access to information which, if used, could violate the securities law, the Comptroller of the Currency amended its regulation in 1978 to require that national banks comply with all federal laws in the discharge of their trust duties. This new section provides that:

> The trust department may utilize personnel and facilities of other departments of the bank, and other departments of the bank may utilize personnel and facilities of the trust department only to the extent not prohibited by law. Every national bank exercising fiduciary powers shall adopt written policies and procedures to ensure that the Federal securities laws are complied with in connection with any decision or recommendation to purchase or sell any security. Such policies and procedures, in particular, shall ensure the national bank trust departments shall not use material inside information in connection with any decision or recommendation to purchase or sell any security.

Id.

[137] 43 Fed. Reg. 12,755–56 (1978). Pursuant to its statutory authority "[t]o exercise general supervision over [the] Federal reserve banks," 12 U.S.C. § 248(j) (1976), the Board of Governors of the Federal Reserve System issued a policy statement in 1978. This statement evidenced a concern about the use of inside information by bank trust departments. Although the Board requires only a written set of policies and procedures to be followed by each bank, more stringent measures were suggested as means of restricting a trust department's use of this information. 43 Fed. Reg. 12,756 (1978). The Board felt that each bank must have the ability to implement measures suited to its needs. The Board made clear, however, that banks would be carefully monitored to ensure that whatever methods are adopted are effective in keeping bank activities from violating federal securities laws. *Id.*

[138] 12 C.F.R. § 9.7(d) (1979). *See* 43 Fed. Reg. 12,756 (1978). *See also* notes 136–37 *supra*.

[139] Under section 10(b) and rule 10b-5, only trading on "material" information can create liability. Therefore if non-public information is not important, there will be no 10b-5 action. *See* note 131 *supra*.

[140] 40 S.E.C. 907 (1961).

such as directors, officers, and controlling shareholders were traditionally obligated not to trade on non-public inside information,[141] "[t]hese three groups . . . do not exhaust the classes of persons upon whom there is such an obligation."[142] The purview of section 10(b), and therefore rule 10b-5, was held to encompass any person with "a relationship giving access . . . to information intended to be available only for a corporate purpose,"[143] when the use of that information would be inherently unfair to those dealing without it. Furthermore, the Commission noted that this prohibition applied regardless of whether the transaction was executed for the trader's own account or on behalf of another.[144]

The inference to be drawn from *Cady, Roberts* is that banks would violate section 10(b) and rule 10b-5 if they utilized material non-public information in trust account trading, since banks possess the information through the type of customer relationship specified in that case.[145] *Cady, Roberts* implies that rule 10b-5 applies regardless of whether the individual trading is acting for himself or as a fiduciary.[146]

Some commentators have argued that *Cady, Roberts* is not determinative of the parameters of section 10(b) and rule 10b-5, and that banks should be exempted from those provisions.[147] A persuasive reason for rejecting this argument is that Congress explicitly exempted banks from portions of the securities acts of 1933 and 1934, but not from section 10(b).[148] As one court noted, Congress, cogni-

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[141] *Id.* at 911.

[142] *Id.* at 912.

[143] *Id.*

[144] *Id.*

[145] *Id. Compare In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961), *with* Washington Steel Corp. v. TW Corp., 602 F.2d 594 (3d Cir. 1979) *and* American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co., No. 77 C 3865 (N.D. Ill. Dec. 30, 1977).

[146] 40 S.E.C. at 916.

[147] Bruzda & Seidel, *Bank Trust Departments And The 10b-5 Dilemma*, 21 VILL. L. REV. 367, 379 (1976) (citing Schuyler, *From* Sulpher *to Surcharge?—Corporate Trustee Exposure Under SEC Rule 10b-5*, 67 NW. U.L. REV. 42, 50–52 (1972)).

[148] Lehigh Valley Trust Co. v. Central Nat'l Bank, 409 F.2d 989, 992–93 (5th Cir. 1969). In *Lehigh Valley*, the defendant bank sold a participation interest in a loan to the plaintiff, Lehigh Valley Trust Co. *Id.* at 990. When making this sale, the defendant failed to disclose certain information to the plaintiff. *Id.* at 990–91. In its action based upon section 10(b) and rule 10b-5, the plaintiff claimed to have been defrauded. *Id.* at 990. Holding section 10(b) applicable to banks, the court noted:

> the Act makes no general exception for transactions between financial institutions, and no case has been found which reads such an exception into the statutory framework. Moreover, the fact that Congress exempted from the registration requirements of the Securities Act of 1933 the securities of any "banking institu-

zant that special considerations were involved in regulating banking institutions, nevertheless failed to exempt any group from section 10(b). Therefore, that provision was intended to apply to any entity trading securities.[149]

If banks trading on non-public information are subject to section 10(b) and rule 10b-5, to be liable for a violation that information must be "material." To determine materiality, " '[t]he basic test . . . is whether a reasonable man would attach importance . . . [to the information] in determining his choice of action in the transaction in question.' "[150] Applying this test, there is no doubt that information concerning an impending tender offer is material.[151] Indeed, in a recent criminal prosecution for violation of section 10(b) and rule 10b-5, the defendant stipulated that knowledge of anticipated tender offers was material information within the meaning of the securities law.[152]

> tion . . ." indicates that Congress was aware of the peculiar problems and strengths of banks resulting from their regulation by state and federal banking statutes. That Congress made no express general exemption for banks under the fraud provisions of either the Securities Act of 1933 or the Securities Exchange Act of 1934 indicates that Congress did not intend any such exemption.

Id. at 992–93. *Cf.* Bailey v. Meister Brau, Inc., 535 F.2d 982, 993 (7th Cir. 1976) (bank as trustee held to violate 10b-5 by not making appropriate disclosures to minority shareholders); Peoples Bank v. Williams, 449 F. Supp. 254, 260 (W.D. Va. 1978) (banks are "any person" within meaning of section 10(b) and rule 10b-5).

In Carrol v. First National Bank, 413 F.2d 353 (7th Cir. 1969), the court noted that banks came within the purview of 10b-5. *Id.* at 358. The court stated that

> the Bank argues that it is not "any person" within the purview of Section 10(b) and Rule 10b-5. However, those provisions are intended to be construed flexibly to effectuate the remedial purposes of the securities legislation . . . . Here the Bank, through its officers and directors, is alleged to have knowingly participated in a fraudulent scheme to manipulate the market. In such circumstances, it would distort the purpose of the statute and the rule to exclude the Bank from their applicability to "any person."

Id.

[149] Lehigh Valley Trust Co. v. Central Nat'l Bank, 409 F.2d 989, 992–93 (5th Cir. 1969).

[150] SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) (emphasis deleted) (quoting List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir. 1965)). In *Texas Gulf Sulfur*, the Second Circuit reiterated this test of "material" within the meaning of section 10(b) and rule 10b-5 enunciated in an earlier case. *Id.*

[151] Since the raider company offers the shareholders of the target a price above the prevailing market price, there is an obvious advantage in knowing of a tender offer before it is publicly announced. When an individual has such information, he must either disclose it to the investing public, or, if disabled from disclosing it in order to protect a corporate confidence, or if he refuses to disclose, he must abstain from trading in or recommending the securities concerned while that information remains undisclosed. *Id.* at 848.

[152] United States v. Chiarella, 588 F.2d 1358, 1364 n.5 (2d Cir. 1979), *rev'd*, 99 S. Ct. xxx (1980). Chiarella worked in a Wall Street printing house, where he became privy to non-public information concerning anticipated tender offers. *Id.* at 1362–63. When he was prosecuted for violation of section 10(b) and rule 10b-5, he stipulated to the fact that this type of non-public

Thus, the use by banks of material inside information concerning tender offers, in their trustee function will likely constitute a violation of the securities law if traded upon prior to public disclosure.[153] This may subject banks to liability under both federal law and banking administrative regulations.[154] Recognizing this potential liability, banks should heed the measures advanced by the Comptroller and the Board to avoid such infractions.

The focal point of the precautionary measures suggested by these regulatory bodies,[155] and the solution proffered most often by commentators,[156] is the so-called Chinese Wall (the Wall). The Wall consists of policies and procedures intended to forestall the flow of information, especially confidential information, between the bank's commercial loan and trust departments. The measures suggested to effectuate the imposition of a Wall range from the circulation, by management, of policy statements prohibiting the transmission of information between departments,[157] to the autonomous operation of the departments.[158]

The Securities Exchange Commission has indicated,[159] and some commentators have asserted, that the Wall is a viable solution to the commercial loan—trust department dilemma. Others, however, have cogently opined that this is an impracticable approach to the problem,[160] since ultimately either the board of directors or the chief operating officers of a bank must approve all major loans and all major trust decisions. Therefore, even if a totally effective Wall is instituted

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information was material. *Id.* at 1364 n.5. In light of the fact that his liberty was at stake, had there been any question as to whether this information was material, Chiarella would certainly have contested the point.

[153] SEC v. Texas Gulf Sulfur Co., 401 F.2d 833, 848 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969); *In re* Cady, Roberts & Co., 40 S.E.C. at 911.

[154] *See* notes 136–37 *supra* and accompanying text.

[155] 43 Fed. Reg. 12,756 (1978); 43 Fed. Reg. 6,759 (1978) (press release announcing 12 C.F.R. § 9.7(d)).

[156] *E.g.*, Bruzda & Seidel, *Bank Trust Departments and the 10b-5 Dilemma*, 21 VILL. L. REV. 367 (1975-1976); Herzel & Colling, *The Chinese Wall and Conflict of Interest in Banks*, 34 BUS. LAW. 73 (1978); Hunsicker, *Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions*, 50 S. CAL. L. REV. 611 (1977); Lipton & Mazur, *The Chinese Wall Solution to the Conflict Problems of Securities Firms*, 50 N.Y.U. L. REV. 459 (1975).

[157] Herzel & Colling, *supra* note 156, at 88.

[158] *Id.* at 91.

[159] *Id.* at 80–84. These authors believe, as do others, that the S.E.C. indicated its approval of a Wall approach to this problem in an *amicus curiae* brief submitted in Slade v. Shearson, Hamill & Co., Inc., 517 F.2d 398 (2d Cir. 1974). *See also* Bruzda & Seidel, *supra* note 156, at 386–89.

[160] *E.g.*, Herman, *supra* note 130, at 76–87.

between departments, before major commitments are made those giving final approval will have access to inside information from both areas.[161] It is unrealistic to imagine that officers and directors, individuals of vast business experience, will ignore potentially vital information which they receive in one capacity when making decisions in another.

Two alternatives thus present themselves; the first, which is unlikely, is to exempt banks from section 10(b) and rule 10b-5, as some commentators have urged. The second, and more reasonable, is the implementation of an approach more prophylactic than the Wall. One such preventive measure would be to bifurcate boards of directors, so that the loan and trust responsibilities, and their corresponding liabilities, are allocated to separate portions of the board. Such a change, if adopted, would allow an effective barrier to be maintained throughout the decision making process. Unless the problem of top management access to all departmental information is resolved, it will be the legislatures' obligation to prescribe a solution. It has been noted that legislation requiring banks to divest their trust departments would create enormous economic costs,[162] but in order to prevent the improper use of inside information by banks, such a solution may nonetheless be forthcoming.[163]

CONCLUSION

A commercial bank should be able to finance a tender offer for the stock of one of its customers without risk of a *per se* violation. Furthermore, as the Court of Appeals for the Third Circuit in

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[161] *Id.* at 82. Herman notes that

> the board and the chief executive officers of the bank have a responsibility to both the commercial *and* trust departments, and maintaining an effective wall between them would require a dichotomy of mind that may be difficult or impossible to attain.

Id. (footnote omitted) (emphasis in original). In the footnote to this passage Herman wrote that when

> [s]peaking at a panel discussion dealing with bank-related insider problems, Mr. Phillip Loomis, then General Counsel of the SEC, stated:
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> "I was talking about this point to a banker—and it wasn't too small a bank. He said that he was often consulted by both the trust department and the commercial department, and that what he learned in one capacity he had to 'forget' in the other, which struck me as something of a mental feat!"

Id. at 153 n.34.

[162] Bruzda & Seidel, *supra* note 156, at 382–83.

[163] In *Washington Steel*, the Court of Appeals for the Third Circuit noted that Congress has already begun inquiries into this area, evidencing a concern about the potential abuses inherent in the tender offer setting. 602 F.2d at 601.

Washington Steel, concluded in making its decision to finance such an offer, the bank should utilize any and all information in its files. This is a sound result which enables banks to make prudent investment decisions. By using all information, banks are able to properly discharge their duties to depositors and shareholders, without impeding their ability to finance business ventures. If banks communicate confidential information about one customer to another, however, such a transmission would abrogate a customer's right to have his affairs remain confidential. Similarly, the loan department should not transmit material non-public information to the trust department for use in securities transactions.

At the present time, the cases seem to indicate that banks are subject to the strictures of section 10(b) and rule 10b-5. Banks must therefore ensure that material non-public information is not improperly used when making trust investments. There are serious questions about the efficacy of the Chinese Wall, and unless banks take the initiative to adopt more effective measures to avoid any securities violations, the legislature may enact drastic measures. A viable solution may be the bifurcation of bank boards into commercial loan department directors and trust department directors.

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