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# BANK FINANCING OF INVOLUNTARY TAKEOVERS OF CORPORATE CUSTOMERS: A BREACH OF A FIDUCIARY DUTY?

## I. Introduction

In a period of depressed stock prices, moderate interest rates, and high construction costs, the cash tender offer is a swift and inexpensive way to finance corporate expansion. This combination of factors is in large part responsible for the recent rash of takeovers.<sup>1</sup> With the increasing use and acceptance<sup>2</sup> of the cash tender offer, a commercial bank, being a major source of cash tender offer financing, may well face the question whether it would breach any fiduciary obligation to a corporate customer by financing an involuntary takeover of that customer.<sup>3</sup>

In the course of considering that question, this note will review the nature of the fiduciary duty a bank owes to its corporate customer. The recent decision in *American Medicorp, Inc. v. Continental Illinois National Bank and Trust Company of Chicago*,<sup>4</sup> the only case to squarely face the issue, will therefore be examined in detail. On the basis of the foregoing, the note will then suggest institutional precautions that a commercial bank might take to prevent the problem, and will conclude with a discussion of the repercussions arising from involuntary tender offer financing.

## II. The Nature of a Bank's Fiduciary Duty to Its Corporate Customer

At this writing, there are no state<sup>5</sup> or federal<sup>6</sup> statutes prohibiting a bank from financing an unfriendly takeover of a customer. In the absence of statutory regulation, the common law rules of fiduciary obligation are necessarily the initial focus in a determination of the present state of the law concerning this issue.<sup>7</sup>

1 Eisen, *Humana Found Medicorp's Achilles Heel*, Philadelphia Evening Bulletin, Feb. 13, 1978, at 1, col. 1.

2 Taussig & Hays, *Are Cash Take-Over Bids Unethical?*, FIN. ANAL. JOUR. (Jan./Feb. 1967).

3 Research has located no articles on point. The following articles, however, are useful in understanding some of the issues raised in corporate acquisitions through tender offers: *Financing and Other Aspects of Cash Tender Offers—A Panel*, 32 BUS. LAW. 1415 (1977); Hayes & Taussig, *Tactics of Case Takeover Bids*, 45 HARV. BUS. REV. 135 (1967); Schumltz & Kelly, *Cash Takeover Bids—Defense Tactics*, 23 BUS. LAW. 115 (1967); Schwartz & Kelly, *Bank Financing of Corporate Acquisitions—The Cash Tender Offer*, 88 BANK L. JOUR. 99 (1971); Taussig & Hays, *Are Cash Take-Over Bids Unethical?*, FIN. ANAL. JOUR. (Jan./Feb. 1967); Wander, *Special Problems of Acquisition Disclosure*, 7 INST. SEC. REG. 157 (1976).

4 No. 77 C 3865 (N.D. Ill. Dec. 30, 1977).

5 The states are silent on this issue. See, e.g., CAL. FIN. CODE ch. 10 §§ 1220-35 (West 1968); ILL. ANN. STAT. ch. 16½ § 132 (Smith-Hurd 1972); MASS. ANN. LAWS ch. 167 § 46 et seq. (Law Co-op 1977); N. Y. BANK. LAW (McKinney 1971); OHIO REV. CODE ANN. ch. 1107 (Page 1968).

6 National Banking Act, 12 U.S.C. §§ 21-215 (1970).

7 The state common law also governs a case involving a national bank. *Blaney v. Florida National Bank*, 357 F.2d 27, 30 (5th Cir. 1966). In this case the court stated that the law of fiduciary capacity was "a matter of state concern."

The Senate Committee on Banking, Housing and Urban Development conducted hearings in 1976 dealing, in part, with the propriety of a bank's financing a takeover of a corporate

The relationship between a bank and its depositor or customer has traditionally been viewed by the courts to be one of debtor-creditor. The duty of a bank to a customer is merely to pay the sum deposited upon a proper demand by the customer.<sup>8</sup> This relationship, courts have observed, does not ordinarily impose upon a bank a fiduciary duty to its customer.<sup>9</sup>

The courts, however, have long recognized an exception to this general rule. In certain bank-customer relationships which go beyond the typical bank-depositor relation, the courts will recognize a relationship of trust and confidence imposing a fiduciary duty upon the bank. The Arizona Supreme Court has explained the development of this exception in the following manner:

It may have been that generations ago, when most commercial transactions were for cash, or at least consisted of personal obligations between vendor and purchaser, and the highly complicated modern structure of credit and corporate securities did not exist, that banks, which were originally merely places of security where a man might deposit his cash and valuables, did not, as such, hold any greater confidential relations with their clients than those between any other two businessmen. But times have changed. It is almost inconceivable that any man should engage in financial transactions of any magnitude in the modern time without having recourse to some bank not only as a place of safety to keep his money, but as a place where he might secure loans to conduct his business. It is notorious that modern banks, before they make a loan of any extent, make a rigid investigation of the business of the customer. . . . It is equally notorious that in many, if not most, cases an investor will consult his bank before committing himself, believing that *he has the right to rely upon the advice of its officers as being given in good faith*. . . . [If] a confidential relationship in regard to financial matters does exist, . . . *the bank is subject to the rules applying to confidential relations in general*.<sup>10</sup>

Two cases illustrate the courts' application of the rules of fiduciary duty in the bank-customer context.

A half-century ago, a case before a New York Supreme Court produced a thoughtful discussion of a bank's fiduciary duty to a corporate customer. In

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customer. The chief administrative officer of the 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. . . . However, there are limits to what the examiners can do—or should do—in such situations. Since the Federal banking laws do not deal with such cases, the bank cannot be cited in a violation of law. This is not unlike other situations where banks may have breached their civil obligations—under the law of contracts, for example—but where they have not violated any provisions of the banking laws that impose specific penalties or sanctions upon them. Nor can an examiner—because of the very nature of the bank examination process—cause a bank to reverse its action or to compensate a party harmed by its action. Thus, in this respect, the proper legal remedy for the aggrieved party lies in the judicial process.

*Corporate Takeovers: Hearings Before the Senate Comm. on Banking, Housing and Urban Development*, 94th Cong., 2d Sess. 99, 100 (1976).

<sup>8</sup> *Stewart v. Phoenix Nat. Bank*, 64 P.2d 101 (Ariz. 1972); *M.L. Stewart & Co. v. Marcus*, 124 Misc. 86, 207 N.Y.S. 685 (1924); 10 Am. Jur. 2d, *Banks* § 339 (1963); *Annot.*, 70 A.L.R.3d 1344 § 2 (1976).

<sup>9</sup> *Id.*

<sup>10</sup> *Stewart v. Phoenix Nat. Bank*, 64 P.2d 101, 106 (Ariz. 1972) (emphasis added).

*M. L. Stewart & Co. v. Marcus*,<sup>11</sup> the corporate plaintiff Stewart brought an action against Marcus, the vice president of the Bank of the United States, to enforce a trust upon, and to direct the conveyance of, certain real property in favor of Stewart. The controversy arose out of the competition between Stewart and Russek Co., both customers of the Bank of the United States, to acquire a parcel of commercial property. Russek, subsequent to making an offer on the land, instructed Marcus to negotiate for the purchase. A few days later, Stewart, unmindful of Russek's attempt to purchase the same land, made the seller a higher offer. The seller was interested and suggested that the parties meet to draw up an agreement. The seller informed Marcus that he had favorable negotiations pending and would only consider an offer from Marcus if the negotiations broke down. Stewart's treasurer met Marcus casually on the street two weeks later and misinformed Marcus that Stewart had purchased the property, concluded the necessary financing with other banks, and now needed further financing. Marcus agreed that the bank would lend Stewart up to its legal limit, stating, "[Y]ou can depend upon us for all the law will permit us to give you."<sup>12</sup> In further discussions that day at Marcus' office at the bank, the treasurer asked, "'Now we can absolutely depend upon you for a loan, Mr. Marcus?' . . . [Marcus answered:] 'You can depend on us for anything you want.'"<sup>13</sup> Upon the treasurer's departure, Marcus contacted the owner and made an offer based upon the treasurer's confidential disclosures. This offer was accepted by the seller.

Stewart's theory of liability maintained that the undisputed facts were sufficient to establish such a relation between the bank's vice president and its customer Stewart as to subject Marcus to the application of the principle governing fiduciaries. Stewart thus petitioned the court to impress a constructive trust upon the property acquired by Marcus in violation of his fiduciary duty.

The court granted Marcus' demurrer, stating that the "determinative consideration" was the treasurer's misrepresentations to Marcus that Stewart had completed the purchase and concluded the necessary financial arrangements with other bankers. Since Stewart's claim was predicated upon the communication of valuable information in confidence, the court inferred that the misrepresentation could not be regarded "as a confidence at all."<sup>14</sup>

The opinion, however, is valuable for its discussion of the considerations involved in analyzing a situation in which a bank is accused of having breached its trust with a corporate customer. The opinion sets forth three propositions which are useful for courts facing the issue today: the "actual," not nominal, relationship between the bank and corporate customer must be controlling; the courts should provide "adequate relief" to an aggrieved customer; and the courts should attempt to construct a remedy within the ambit of "sound business ethics."

*The Actual Relation.* The court, acknowledging that the case presented

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11 124 Misc. 86, 207 N.Y.S. 685 (1924).

12 *Id.* at 88, 207 N.Y.S. at 687.

13 *Id.*

14 *Id.* at 94, 207 N.Y.S. at 693.

"questions altogether novel, both in fact and principle,"<sup>15</sup> prefaced its opinion by stating that it would not let the strict classifications of the law of fiduciary relationships control: ". . . [I]t 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."<sup>16</sup> The court thus quickly rejected Marcus' contention that under well-known authorities the relation involved in this case was one merely of debtor and creditor.

*Judicial Remedies.* Although the misrepresentations prevented the court from holding that Marcus had breached his fiduciary duty to Stewart since no confidences had been communicated, the court in a dictum stated that this situation was one in which "the courts, whether of law or equity would afford some form of adequate relief."<sup>17</sup> Adequate relief for the breach of a fiduciary duty in such a case would include an injunction against the purchase,<sup>18</sup> a constructive trust for the benefit of the plaintiff,<sup>19</sup> and where appropriate, damages.<sup>20</sup>

*Ethics.* The court also demonstrated a sensitivity to the ethical considerations involved:

[T]he courts endeavor, wherever it can be done without too radical a departure from recognized legal rules, to harmonize the necessities of a competitive industrial system of business with the teachings of morality. It is not easy to reconcile the doctrine of caveat emptor, or, indeed, the very notion of a 'good bargain,' with the sense of universal justice exemplified in the Golden Rule. But courts of justice are making a gradual advance toward enforcing the requirements of what, in default of a more precise designation, we may perhaps term sound business ethics.<sup>21</sup>

Despite this court's sensitivity, however, the idea of holding banks to a standard of "sound business ethics" in the financing of customer takeovers has not gained widespread support.<sup>22</sup>

15 *Id.* at 95, 207 N.Y.S. at 694.

16 *Id.* at 90, 207 N.Y.S. at 690. The court's conception of its role in deciding cases of fiduciaries can be seen in its citation of the much-quoted language of Lord Chelmsford in *Tate v. Williamson*:

The jurisdiction exercised by courts of equity over the dealings of persons standing in certain fiduciary positions has always been regarded as one of a most salutary description. The principles applicable to the more familiar relations of this character have been long settled by many well-known decisions, but the courts have always been careful not to fetter this useful jurisdiction by defining the exact limits of its exercise. Whether two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one, and the influence which naturally grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exercised to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relation existed.

*Id.* at 90, 207 N.Y.S. at 689.

17 *Id.* at 93, 207 N.Y.S. at 692.

18 *American Medicorp, Inc. v. Continental Illinois National Bank and Trust Company of Chicago*, No. 77 C 3865 (N.D. Ill. Dec. 30, 1977) [hereinafter cited as *American*].

19 This is the remedy sought in *Stewart*.

20 *Peterson v. Idaho First National Bank*, 83 Idaho 578, 367 P.2d 284 (1961); *Pigg v. Robertson*, 549 S.W.2d 597 (Mo. Ct. App. 1977).

21 124 Misc. 92, 207 N.Y.S. at 691.

22 When asked about the legality of a bank's financing of a customer's takeover, the assistant director of the Federal Reserve Bank's division of bank supervision and regulation

The controversy in *Stewart*, while not exactly apposite to the issue presented in this note, provides a workable outline for courts in determining whether a bank breaches its trust with a customer by financing the customer's involuntary takeover. A court should mold the rules of fiduciary duty to fit a relationship not within the strict classical definitions.<sup>23</sup> The bank-financed takeover should not fall outside the scope of the rules applying to confidential relations in appropriate cases merely because the issue has not heretofore been squarely presented to a court. Secondly, a court in attempting to "afford some form of adequate relief"<sup>24</sup> must acknowledge and accept the necessity of utilizing the potent judicial remedy of the injunction. Customers that are targets of an acquiring company may be without any adequate remedy if the tender offer is not prevented. Finally, a court must be willing to perform an appropriate role in the enforcement of "sound business ethics."<sup>25</sup>

Recently, a Missouri court of appeals relied heavily upon *Stewart* in deciding a case involving a somewhat similar situation. In *Pigg v. Robertson*,<sup>26</sup> the plaintiff brought an action against a bank auditor<sup>27</sup> for damages for breach of a confidential and fiduciary relationship and alternatively for declaration of a constructive trust. The plaintiff, a customer of the bank for over ten years, attempted to borrow funds to purchase farmland which the defendant was also interested in purchasing. The plaintiff briefly discussed his plan with the defendant in the bank president's office, but was informed by the defendant that no decision could be made on the loan agreement until after consultation with the president. A half hour after this conversation, the defendant contacted his attorney and instructed him to draft a purchase and sale agreement which was executed later that day. The defendant shortly thereafter sold the land for double his purchase price.

The court held that the evidence was sufficient to show a fiduciary relationship based on the plaintiff's ten-year association with the bank during which he borrowed money over a dozen times. The plaintiff had a right to rely on the defendant and to expect that his disclosures to the defendant would be kept in confidence and not used against his interest. "Given the existence of a confidential relation, there was evidence from which the jury could have found a breach by [the defendant] of obligations resulting from such relation."<sup>28</sup>

*Robertson* clearly holds that when a fiduciary relationship exists, a bank or its employees cannot misuse a customer's confidential disclosures given in reliance that the bank would not use these disclosures against the customer and in the expectation that the bank would keep these disclosures confidential.

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answered, "It offends the sense of ethics of most people, but I don't think there's any banking law that it violates." Likewise, an SEC Commissioner stated it is more "a matter of etiquette." Green, *Breaking Faith? Takeover Fights Pose An Ethical Question For Banks and Brokers*, Wall St. J., Dec. 12, 1977, at 1, col. 6 [hereinafter cited as *Breaking Faith?*].

23 See, e.g., *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1043 (7th Cir. 1977).

24 124 Misc. at 92, 207 N.Y.S. at 692.

25 See note 22 *supra*.

26 549 S.W.2d 597, 601 (Mo. Ct. App. 1977).

27 The case is unusual in that the defendant bank auditor, while performing the audit, gave financial advice to bank customers in the president's absence. The court held him to be in the same position as a bank officer in his relations with the bank's customers.

28 549 S.W.2d at 601.

The discussion of the *Stewart* and *Robertson* cases is a necessary introduction to the rules of fiduciary duty in the banker-corporate customer relation. While *Stewart* and *Robertson* dealt with issues far less sophisticated than the issue presented in this note, namely, whether a bank violates its fiduciary duty to a customer when it finances that customer's involuntary takeover, the principles they set forth are sound and useful in considering a bank's duty in the takeover context.<sup>29</sup> Unfortunately, the sole case dealing with the precise question in this note, *American*, did not discuss the nature of the bank's fiduciary obligation.

### III. The *American* Controversy

In *American Medicorp, Inc. v. Continental Illinois National Bank and Trust Co. of Chicago*,<sup>30</sup> the corporate plaintiff American brought an action to enjoin Continental from lending money to Humana, Inc. Humana, a competitor of American, planned to use the loan proceeds to finance the acquisition of American through a tender offer.

In April 1976, Continental solicited and obtained a portion of American's banking business. A \$12.3 million loan was arranged by Continental, and a second loan agreement for \$11.4 million was under preparation. Continental created an ongoing banking relationship with American, stressing it was a "relationship-oriented" bank and giving American financial advice on the structuring of a \$200 million capital expansion program. American's chairman developed a close personal relationship with Continental's senior officer dealing with the American account.<sup>31</sup> American was considering inviting this officer to stand for election as a director of American.<sup>32</sup>

As the relationship developed, Continental asked for and received extensive confidential information from American, including a five-year projection of earnings which American considered so confidential that only four of its top officers and one other lender had seen it.<sup>33</sup> Continental had total access to American's financial and business information, and was never denied any requested information.<sup>34</sup>

Two Continental officers who worked on the Humana tender offer loan had access to American's credit file, consisting of more than two hundred pages and including a detailed thirteen-page credit summary.<sup>35</sup> Two loan officers working on the Humana loan and two working on the American account discussed the planned tender offer loan at an informal meeting.<sup>36</sup>

29 A similar case arose in 1975 when Irving Trust Company made a loan arrangement with General Cable Corp., to acquire Microdot, Inc., an Irving customer. Microdot sued Irving for breach of its fiduciary duty. The litigation was dropped, however, when Microdot accepted a competing offer from Northwest Industries, Inc. *Breaking Faith?* at 1, col. 6.

30 No. 77 C 3865 (N.D. Ill. Dec. 30, 1977).

31 Hearing Transcript at 48, *American Medicorp, Inc. v. Continental Illinois National Bank and Trust Company of Chicago*, 77 C 3865 (N.D. Ill. Dec. 30, 1977) [hereinafter cited as *Hearing Tr.*].

32 *Id.*

33 *Id.* at 67-68, 84-87.

34 *Id.* at 81.

35 *American* at 8.

36 *Id.*

American's theory of liability maintained that the facts demonstrated the existence of a fiduciary relationship. American contended that making the loan to Humana, enabling Humana to acquire American, was *per se* a breach of Continental's fiduciary obligation which should be enjoined. Alternatively, American contended that a breach of trust occurred when "Continental itself used some of the 'non-public' information in determining whether or not to make the loan."<sup>37</sup>

The court held that Continental's loan to Humana was "not *per se* a violation of trust,"<sup>38</sup> and that the evidence was insufficient to show that Continental "used confidential information received from plaintiff in deciding to loan to Humana."<sup>39</sup>

### A. *The Fiduciary Relationship*

Although the court did not directly address the issue, it appears that the court recognized the existence of some type of fiduciary relation.<sup>40</sup> The court's discussion of the use of confidential information implicitly assumed the existence of a fiduciary duty on the part of Continental neither to disclose nor to misuse this information. Moreover, on the basis of the *Stewart* and *Robertson* cases, it is clear that more was involved than a simple debtor-creditor relationship. The facts demonstrated that during Continental's eighteen-month association with American, a relationship of trust and confidence arose.

### B. *Violation Per Se*

The court summarily rejected American's argument that the loan was a violation of fiduciary duty *per se*, holding: "[A] bank is not precluded under all circumstances from making a loan to facilitate the attempted takeover of a customer. If it does not rely on the *confidential information* of its customers in its files, we believe that a bank is free to deal with any customer who comes to it."<sup>41</sup> This holding, however, is somewhat obfuscated by the court's later summarization of its holdings: "The fact that some of defendant's officers who were responsible for the Humana loan obtained, saw, touched, and to some extent used and interchanged *information* from the defendant's files on plaintiff, in our opinion, is not a *per se* violation of trust."<sup>42</sup>

The apparent contradiction is reconcilable by the court's use of the word "confidential" in the former statement of the holding. This explanation would allow a bank to use *any* information so long as it does not rely on *confidential information*, and it appears to be the interpretation the court intended.

The holding was supported on two bases. The court first noted that "plaintiff has cited no cases supporting a complete prohibition against lending money

<sup>37</sup> *Id.* at 3.

<sup>38</sup> *Id.* at 11.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at 3. The court implies that the banker-customer relationship in this case was not "a true fiduciary relationship."

<sup>41</sup> *Id.* at 7 (emphasis added).

<sup>42</sup> *Id.* at 11 (emphasis added).



to a company seeking to take over one of the bank's customers which has provided it with 'non-public' information."<sup>43</sup> This argument, however, carries little weight. This issue has arisen only recently, and no case previous to this one has ever reached the question presented here. Lack of cases on point should not inhibit a court from working with sound legal principles from the most analogous cases and filling in the interstices with its own legal reasoning.<sup>44</sup>

The court's second basis was its rejection of the cases relied on by American, *Trice v. Comestock*,<sup>45</sup> and *Tyler v. Sanborn*.<sup>46</sup> The court noted that these cases involved the breach of a fiduciary obligation, but felt that applying their holdings would force the court to "go too far" on the facts of this case.<sup>47</sup> Without discussing these cases further or attempting to expand upon its statement that these cases would require the court to "go too far" in this instance, the court supported its rejection of *Trice* and *Tyler* by citing the lack of a statutory banking regulation prohibiting the type of tender offer loan at issue in *American*.<sup>48</sup> While the rejection of *Trice* and *Tyler* may have been justified, the lack of statutory regulation cannot be deemed to be approval by Congress<sup>49</sup> or the state legislatures. It is perhaps more persuasive to argue that the state legislatures deem the common law doctrines of fiduciary duty to be sufficiently flexible to handle this situation, or that they are not even aware of the problem.

Neither the lack of case authority on point nor the absence of statutory regulation is a particularly illuminating reason for the court's holding that Continental's loan to Humana was not a *per se* violation of its fiduciary obligation. Since the court was reasoning by negative implication in rejecting *Trice* and *Tyler*, an examination of these cases is necessary in order to understand what the court attempted to imply in rejecting them.

In *Trice*, a case somewhat similar to *Stewart* and *Robertson*, the plaintiff brought an action against the defendant to construct a trust for the plaintiff's benefit. The plaintiffs hired the defendant banker to represent them in a land purchase. The defendant purchased the land for himself, later selling it at a higher price.

The court held for the plaintiffs. Its reasoning comported with generally accepted principles of fiduciary duty:

For reasons of public policy, founded in a profound knowledge of human intellect and of the motives that inspire the actions of men, the law peremptorily forbids every one who, in a fiduciary relation, has acquired information concerning or interest in the business or property of his correlate from using that knowledge or interest to prevent the latter from accomplishing the purpose of the relation.<sup>50</sup>

Both the plaintiff and the court in *American* appear to have misapplied

<sup>43</sup> *Id.* at 6.

<sup>44</sup> The court, unfortunately, cites no authority in the opinion except a case listing the elements necessary for an injunction.

<sup>45</sup> 121 F. 620 (8th Cir. 1903).

<sup>46</sup> 128 Ill. 136, 21 N.E. 193 (1889).

<sup>47</sup> *American* at 6.

<sup>48</sup> *Id.* at 6-7.

<sup>49</sup> This is especially true in view of note 7 *supra*.

<sup>50</sup> 121 F. 620, 622.

the *Trice* case, although for different reasons. *American* cited the case as support for its theory that the Continental loan was a *per se* violation of trust. *Trice*, however, does not support this contention; the opinion speaks of "using" information acquired in a fiduciary relation. Such language does not conflict with the court's holding in *American* that a bank does not breach its trust "[i]f it does not rely on the confidential information of its customers in its files."<sup>51</sup> Instead of summarily rejecting *Trice*, the court in *American* could have cited the case as support.

The rejection of *Tyler*, on the other hand, was justified. In *Tyler*, the plaintiff, executor of a decedent's estate, hired the defendant to act as his agent in the sale of estate property. The defendant purchased the land in a deal involving a straw man. Upon learning that the defendant purchased the estate property, the plaintiff sued. Relying on the principles of agency law, the court stated:

The doctrine is familiar, and has been often recognized by this court, that an agent cannot, either directly or indirectly, have an interest in the sale of property of his principal, which is within the scope of his agency, without the consent of his principal, freely given, after full knowledge of every matter known to the agent which might affect the principal.<sup>52</sup>

The case is clearly inapposite to *American*; Continental was never hired by *American* to act as its agent. The law of agency, moreover, in many respects goes beyond the appropriate bounds of the principles of fiduciary obligation as applicable to the banker-customer relationship in *American*.

The negative implication intended by the court through its rejection of *Trice* and *Tyler* is difficult to pinpoint with certainty. *Trice* is actually supportive of the court's position. Since *Tyler* is not analogous to the case, the best that can be said of the rejection of *Tyler*, then, is that the court did not see the law of agency as helpful or appropriate in deciding the issue in *American*.

The court's most persuasive reason for not holding the loan a *per se* violation is its brief mention that the public interest would be disserved. Although the court's reference to public policy considerations comes at the end of the opinion, it is perhaps the one consideration upon which the holding turns. To issue an injunction in this controversy would, the court believed, "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>53</sup>

This statement assumes the customer is not without judicial recourse; the law will provide a remedy for a bank's misuse of confidential information. The law will not, however, hinder the free workings of the market place. Provided no confidential information enters the determination whether a tender offer loan should be made, a customer stands in no different legal relation with its bank in this context than it does with other banks.<sup>54</sup> According to this position, a customer is no more entitled to protection from unfriendly tender offers than

<sup>51</sup> *American* at 7.

<sup>52</sup> 128 Ill. 136, 142, 21 N.E. 193, 194 (citations omitted).

<sup>53</sup> *American* at 12.

<sup>54</sup> This statement, of course, does not deal with the ethical issues involved.

it is in other business contexts. A customer, for example, is not entitled to petition a court to enjoin its bank from lending money to other customers to be used for corporate purposes adverse to its own.

### C. *Violation for Misuse of Confidential Information*

The court's holding on American's alternative theory of liability ("that Continental itself used some of the non-public information in determining whether or not to make the loan")<sup>55</sup> has been peripherally mentioned in the discussion of the court's *per se* holding above. To repeat, a bank's fiduciary duty to its corporate customers is not breached "if it does not rely on the confidential information of its customers in its files."<sup>56</sup> A bank will not violate its obligation because its loan officers "obtained, saw, touched, and to some extent used and interchanged information"<sup>57</sup> of a "non-public" nature. The court found American's evidence insufficient to prove that Continental "used confidential information received from [American] in deciding upon the loan to Humana."<sup>58</sup> Before reviewing the correctness of this holding in light of the *Stewart* and *Robertson* doctrines, it is necessary to examine the court's interpretation of the term "non-public," confidential information.

The court did not deem it necessary to formulate a precise, workable definition of "non-public," confidential information since American did not prove that Continental improperly used or disseminated *any* of the materials American had furnished.<sup>59</sup> Nevertheless, the court indicated that defining the proper ambit of legally confidential information would be difficult, especially when the customer involved has given "[t]he same information to other banks from which it desires a loan, to its accountants, its tax-preparers, and, to some extent to its suppliers of credit and its stockholders and the public."<sup>60</sup>

This difficulty, however, is exaggerated by the court. Obviously, information disseminated to the public and filed with the Securities and Exchange Commission could not be deemed "non-public," confidential information. As a correlative, information not disseminated to the public and not reported to governmental agencies would be considered legally confidential. That other banks, accountants, and tax-preparers are privy to confidential information is irrelevant in a determination of confidentiality; they, too, are subject to a fiduciary obligation of confidentiality, since the information is, in the court's own words, "presented with the understanding that [it] would be retained in a confidential posture . . . and also not released to outsiders."<sup>61</sup>

Despite the court's difficulty with defining confidential information, the court clearly indicated that it would hold that a bank breaches a fiduciary duty to its customer if information given in trust and confidence were misused. The court's position in this respect is sound, and it comports with the principles set

55 *American* at 11.

56 *Id.* at 7.

57 *Id.* at 11. See text accompanying notes 41-42 *supra*.

58 *Id.* at 8-9, 11.

59 *Id.* at 8.

60 *Id.* at 7-8.

61 *Id.* at 7.

forth in *Stewart* and *Robertson*, two decisions indicative of the common law's treatment of a bank's breach of its fiduciary obligation. *Stewart*, it will be recalled, quoted the famous words of Lord Chelmsford:

Whenever two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one . . . and this confidence is abused . . . to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relation existed.<sup>62</sup>

Likewise in *Robertson*, the court held that the bank customer had a right to expect that his disclosures would be protected, and that it was a breach of the confidential relation for the bank auditor to use the customer's disclosure for his own gain at the expense of the customer.<sup>63</sup> It is entirely consistent with the *Stewart* and *Robertson* cases to hold, as the *American* court implied it would hold, that a bank may not use or rely upon confidential information in deciding whether to finance an involuntary takeover of that customer.

#### IV. Institutional Safeguards

A bank deciding to finance an unfriendly tender offer of a customer necessarily runs a great risk of legal action. A bank will escape liability for breach of its fiduciary obligation to its customer only when it does not use or rely on confidential information. To prevent litigation, therefore, a bank should take precautions to insure that the appearance of impropriety does not arise.

It is suggested that the appearance of impropriety might be negated by institutional procedures and safeguards prohibiting loan officers and other bank personnel working on the tender offer loan from obtaining access to the files of the target company. In addition, contacts with bank personnel responsible for the target company's account should be avoided. Bank policy must forbid the discussion of the target company's financial and business situation with anyone involved with the takeover financing.

In *American*, loan officers working on the Humana loan had access to, and read materials from, American's file.<sup>64</sup> An informal meeting to discuss the tender offer took place between two loan officers preparing the Humana loan and two loan officers responsible for the American account.<sup>65</sup> The *American* court held that American failed to show that the confidential information obtained from the files or the informal meeting was used in deciding to make the Humana loan.<sup>66</sup> Institutional safeguards and accurate record keeping, however, might have prevented the unfavorable implications that arose out of the use of the file and the informal meeting.

<sup>62</sup> 124 Misc. at 90, 207 N.Y.S. at 689.

<sup>63</sup> 549 S.W.2d at 601.

<sup>64</sup> *American* at 8.

<sup>65</sup> *Id.* at 8-9.

<sup>66</sup> *Id.* at 9.

## V. "Sound Business Ethics"

A bank contemplating the financing of a customer's takeover must consider the ethical implications as well as the legal ramifications. While a bank might not "harmonize the necessities of a competitive system of business with the teachings of morality"<sup>67</sup> as the *Stewart* court espoused, it should look beyond the "dollars and cents" involved. In addition to costly litigation, unfriendly takeover financing may bring a bank unwanted press coverage and governmental investigation. Moreover, such practices may understandably cause concern among other customers who are potential takeover candidates.

The Humana loan, for example, brought Continental an unfavorable front-page article in *The Wall Street Journal*, entitled, *Breaking Faith? Takeover Fights Pose Ethical Questions for Banks, Brokers*.<sup>68</sup> A loan agreement to General Cable Corp., by Irving Trust to acquire Microdot, Inc., an Irving Trust customer, generated litigation,<sup>69</sup> Senate Banking Committee hearings,<sup>70</sup> and an investigation by the SEC.<sup>71</sup> The loan also proved to be an embarrassing situation for four of Irving's directors who were also directors of General Cable and for one of Irving's executive vice presidents, who fifteen months earlier, at an Irving sponsored symposium on tender offers, told banking and investment professionals: "[A] responsible bank will remain loyal to its present customer and certainly wishes to avoid choosing sides."<sup>72</sup>

A bank involved in this type of tender offer financing causes concern among other customers, perhaps outweighing the financial rewards of the loans. A rare comment on tender offer loans appearing in a legal periodical states:

A bank's willingness to finance a cash tender offer may be inhibited by the prospect that its name will be publicly involved in the controversy. . . . Such publicity is unwelcome to most bankers, particularly because of its impact on other customers, some of whom may themselves be potential takeover candidates. Bank customers may be less willing to discuss their internal problems with the bank if they feel that it looks favorably on potential "raiders."<sup>73</sup>

Some banks, as a matter of policy, refuse to engage in financing unfriendly takeovers of customers.<sup>74</sup> A few officers of Continental questioned the unprecedented Humana loan, deeming it unjust to American and inappropriate.<sup>75</sup>

Each bank must decide for itself if the financial reward of a loan is a suffi-

67 124 Misc. at 92, 207 N.Y.S. at 689.

68 Dec. 12, 1977, at 1, col. 1.

69 See note 29 *supra*.

70 *Corporate Takeovers: Hearings Before the Senate Comm. on Banking, Housing and Urban Development*, 94th Cong., 2d Sess. (1976).

71 *Breaking Faith?* at 20, col. 2.

72 *Id.*

73 Schwartz & Kelly, *Bank Financing of Corporate Acquisitions—The Cash Tender Offer*, 88 BANK. L. JOUR. 99, 109-10 (1971).

74 The plaintiff in *American* contended that Manufacturers Hanover Trust Company, when invited to participate in the Humana loan, "declined because American was its customer." Brief for Appellant at 24, *American Medicorp, Inc. v. Continental Illinois National Bank and Trust Company of Chicago*, No. 77 C 3865 (N.D. Ill. Dec. 30, 1977).

75 Hearing Tr. at 48-49, 89-90.

cient inducement to become involved in a contested tender offer. According to members of the securities industry, an unfriendly tender offer is the ultimate corporate battle, complete with warlike terms: "raider," "target" and "bloodbath." In fact, the American-Humana battle has become known among security analysts as the "Philadelphia Bloodbath."<sup>76</sup> In light of these adverse consequences, it is difficult to understand how the monetary gain from an unfriendly tender offer loan could ever outweigh the costs.

## VI. Conclusion

Courts have traditionally viewed the relationship between a bank and its customer as merely one of debtor-creditor, imposing no special fiduciary duty upon the bank. An exception has been recognized, however, in certain bank-customer relationships where the customer has placed trust and confidence in the bank. This exception has given rise to the principle that when a fiduciary relationship exists, a bank or its employees cannot misuse a customer's confidential disclosures given in reliance that the bank would not use these disclosures against the customer and in the expectation that the bank would keep these disclosures confidential.

*American Medicorp, Inc. v. Continental Illinois National Bank and Trust Company of Chicago*,<sup>77</sup> the sole case addressing the issue whether a bank violates its fiduciary duty to its corporate customer when it finances an involuntary takeover of that customer, held that such financing is not *per se* a breach of trust. The *American* court stated, however, that misuse of the customer's information in determining whether to make the takeover loan would be a breach of the bank's fiduciary duty to its customer, entitling the customer to an injunction prohibiting the bank from making the loan. Although the court cited no authority for this principle, this note has shown that this principle comports with generally accepted rules of fiduciary obligation.

This note has suggested institutional safeguards a bank may use to protect against the appearance of impropriety when it engages in unfriendly tender offer financing of a customer. While these safeguards may legally protect a bank in such financing, a bank should give consideration to more than the legal implications of its action. Past instances have shown that takeover financing of a customer may lead to litigation, government investigation, and adverse publicity, and may cause concern among other customers which are prime takeover candidates. Beyond these considerations, a bank must decide whether unfriendly tender offer financing violates its sense of sound business ethics. In short, a bank must decide whether involuntary takeover financing is the type of activity with which it wishes the bank's name and reputation to be associated.

*Daniel M. Snow*

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<sup>76</sup> Eisen, *Tale of a Whale and a Shark: How Medicorp Was Swallowed by Humana*, Philadelphia Sunday Bulletin, Feb. 12, 1978, § 7 (Business Today), at 1. American Medicorp is based in Bala Cynwyd, Pennsylvania, an adjacent suburb of Philadelphia.

<sup>77</sup> No. 77 C 3865 (N.D. Ill. Dec. 30, 1977).