Conflicts of Interest: The Chinese Wall and Bank Financing of Hostile Tender Offers

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CONFLICTS OF INTEREST: THE CHINESE WALL
AND BANK FINANCING OF HOSTILE TENDER OFFERS

A commercial bank may have a conflict of interest problem when a
corporate customer asks the bank to finance a hostile cash tender offer for
the stock of another customer.1 This conflict arises if the bank has re-
ceived material, inside information from the target customer.2 In order to
abate conflicts of interest, banks often establish a procedure popularly
called a "Chinese Wall."3 The purpose of the Chinese Wall is to assure
that the confidential information received by the bank personnel from the
target company is not transferred to the offeror or to the bank personnel
responsible for the offeror's account.4 In Washington Steel Corp. v. TW
Corp.,5 the Third Circuit considered the effects of a Chinese Wall on a
bank's alleged liability to a customer because the bank agreed to finance a
hostile tender offer for the stock of that customer.6 The Third Circuit
decided whether a bank owes the target customer a per se fiduciary duty
to refrain from financing the tender offer.7 The Washington Steel court
also addressed an alternative claim that a bank is liable for the misuse of
confidential information received from the target if the bank uses the in-
formation to decide whether to finance the tender offer.8

In 1974, Washington Steel furnished Chemical Bank with ten-year
cash flow and earnings projections9 in connection with a credit agreement

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1 See Securities and Exchange Commission Legislative Proposals on Tender Offers,
Beneficial Ownership, Issuer Repurchases, 542 SEC. REG. & L. REP. (BNA) 5 (Special Sup-
plement Feb. 27, 1980) [hereinafter cited as SEC Legislative Proposals].
2 See id.
3 See Slade v. Shearson, Hammill & Co., 517 F.2d 398, 402 (2d Cir. 1974); Herzel &
Colling, The Chinese Wall and Conflict of Interest in Banks, 34 Bus. LAW. 73, 74, 75 n.2
(1978) [hereinafter cited as Herzel]. Investment banking departments of securities firms and
banks are major users of Chinese Wall procedures. The wall prevents material, inside infor-
mation concerning a customer from flowing to the securities firm's sales department or to
the bank's trust department. See generally Slade v. Shearson, Hammill & Co., 517 F.2d 398
(2d Cir. 1974); Lipton & Mazur, The Chinese Wall Solution to the Conflict Problems of
Securities Firms, 50 N.Y.U.L. REv. 459 (1975); Herzel, supra.
4 See Washington Steel Corp. v. TW Corp., 602 F.2d 594, 603 (3d Cir. 1979); Harnisch-
5 602 F.2d 594 (3d Cir. 1979).
6 See id. at 601-04.
7 See text accompanying notes 19-24 infra.
8 See text accompanying notes 25-32 infra. In addition to alleging that the bank used
the confidential information in deciding whether to finance the tender offer, a target cus-
tomer may claim that the bank misused the information by disclosing the information to the
tender offeror. See text accompanying notes 48-56 & 62-65 infra.
9 Washington Steel alleged that the cash flow and earnings projections were the confi-
dential information it gave to Chemical. 602 F.2d at 596. What information given to a bank

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with Chemical for an amount up to $2,250,000. Chemical also was a major lender of Talley Industries, the parent company of TW Corporation. Talley asked Chemical on January 13, 1979, to finance Talley's possible acquisition of Washington Steel. Two days later, members of the Chemical Banking Department discussed the possibility of financing the proposed acquisition. Although Chemical's senior officer present knew about the outstanding loan to Washington Steel, he decided that Chemical should finance the acquisition so long as Talley was creditworthy.

Subsequently, Washington Steel rejected two different merger proposals by Talley and sent a letter to its stockholders urging rejection of Talley's tender offer. On February 5, 1979, Washington Steel initiated suit in federal court to enjoin the tender offer. Washington Steel alleged that Chemical violated its fiduciary duty to Washington Steel by misusing confidential information obtained from Washington Steel in deciding to finance Talley's tender offer. The district court issued a preliminary in-
junction against Chemical’s financing the tender offer, ruling that Chemical breached a common law fiduciary duty owed to Washington Steel arising upon receipt of Washington Steel’s confidential information.\(^15\)

The Third Circuit, on appeal, reversed the district court’s preliminary injunction against Chemical.\(^16\) Washington Steel urged two possible grounds to support its claim that Chemical violated a common law fiduciary duty owed to Washington Steel. Washington Steel maintained that Chemical violated a fiduciary duty by misusing Washington Steel’s confidential information.\(^17\) Alternatively, Washington Steel maintained that, by receiving the confidential information, Chemical implicitly assumed a per se fiduciary duty not to aid another company’s efforts to subvert Washington Steel’s interests.\(^18\)

The Third Circuit rejected Washington Steel’s per se fiduciary duty claim because of important policies.\(^19\) The court reasoned that prohibiting a bank from financing a hostile tender offer would curtail the availability

\(^{15}\) Washington Steel Corp. v. TW Corp., 465 F. Supp. 1100, 1105-06 (W.D. Pa. 1979). The district court reasoned that Chemical was Washington Steel’s agent because Chemical was the transfer agent for Washington Steel and because Chemical received confidential information from Washington Steel. As Washington Steel’s agent, the district court held that Chemical had a fiduciary duty not to act adversely to Washington Steel’s interests. Id. at 1104-05. The district court, however, did not enjoin the tender offer. Id. at 1106.

\(^{16}\) 602 F.2d at 604. While the appeal was pending, Talley withdrew its tender offer after WS-B, Inc., a wholly-owned subsidiary of Blount, Inc., offered $40 per share for Washington Steel’s common stock. Id. at 598. Since Talley withdrew the tender offer, Washington Steel argued that Chemical’s appeal was moot. Id. The circuit court held that the appeal was not moot since Chemical might have been able to recover damages under the $2,000,000 injunction bond posted by Washington Steel. Chemical must show that the preliminary injunction was wrongfully ordered in order to recover under the bond. Id. at 598-99.

\(^{17}\) Id. at 599; see text accompanying notes 25-32 infra.

\(^{18}\) 602 F.2d at 599; see text accompanying notes 19-24 infra.

\(^{19}\) 602 F.2d at 601. Washington Steel cited M.L. Stewart & Co. v. Marcus, 124 Misc. 86, 207 N.Y.S. 685 (Sup. Ct. 1924), as support for its per se rule. In M.L. Stewart two companies bidding on property were customers of the same bank. The plaintiff, Stewart, falsely informed the defendant, Marcus, the vice-president of the bank, that the plaintiff had won the bid and asked for assurances of a loan. The defendant agreed, but subsequently learned that the plaintiff had not won the bid. The defendant then submitted a successful bid for the property on behalf of the second company. Id. at 88, 207 N.Y.S. at 687. Stewart sued, alleging that the request for the loan created a fiduciary duty in the bank which the bank breached when the defendant placed the successful bid for the other company. The New York court rejected the plaintiff’s contentions. Id. at 94, 207 N.Y.S. at 693. Although noting that courts occasionally will impose a fiduciary duty, the New York court stated that courts should try “to “harmonize the necessities of a competitive industrial system of business with the teachings of morality.” Id. at 92, 207 N.Y.S. at 691. The New York court determined that since the plaintiff lied to the defendant about the bid, no fiduciary duty existed. Id. at 94, 207 N.Y.S. at 693.

The Washington Steel court correctly noted that M.L. Stewart does not support Washington Steel’s per se rule of fiduciary duty. 602 F.2d at 599-600. The M.L. Stewart court sought to harmonize the necessities of competitive business. See 124 Misc. at 92, 207 N.Y.S. at 691. A per se rule, however, would undermine the economic necessities discussed by the M.L. Stewart court. See 602 F.2d at 600; text accompanying notes 20-21 & 33-35 infra.
of funding for capital ventures. The court suggested that, if a per se duty existed, a company could insulate itself from possible takeovers by simply arranging a series of loans from most major banks and supplying the banks with confidential information. The Washington Steel court also reasoned that the legislature is the most appropriate forum to balance the financial issues involved with a bank customer's expectation of loyalty. Recognizing the need for uniform rules in banking, the court feared that federal law would preempt any implicit state common law rule of a per se duty.

Ruling on Washington Steel's alternative theory that Chemical misused confidential information supplied to Chemical by Washington Steel, the Third Circuit held that the evidence did not establish that Chemical used the confidential information in deciding to make the loan to Tal-

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20. 602 F.2d at 601; accord, American Medicorp, Inc. v. Continental Ill. Nat'l Bank & Trust Co., 475 F. Supp. 5, 9 (N.D. Ill. 1977). In American Medicorp, Continental Bank agreed to finance Humana, Inc.'s hostile tender offer for American Medicorp's common stock. Id. at 7. American Medicorp sought to enjoin the tender offer, alleging that the bank had a per se fiduciary duty not to finance the tender offer. Id. The court rejected the claim and reasoned that a per se rule would burden the free flow of bank financing. Id. at 9.

21. Only one other court has considered the legal issues raised by Washington Steel. Ten days before the Third Circuit decided Washington Steel, a district court in the Eastern District for Wisconsin rejected a per se rule of fiduciary duty identical to the one raised by Washington Steel. Harnischfeger Corp. v. Paccar, Inc., 474 F. Supp. 1151, 1153-54 (E.D. Wis. 1979). The Wisconsin District Court rejected the district court's opinion in Washington Steel and accepted the American Medicorp rationale. Id. The Harnischfeger court neither found any evidence of a breach of the bank's Chinese Wall erected within its loan department nor that the bank had a per se fiduciary duty to the target company. Id.


23. 602 F.2d at 601.

24. No federal banking laws currently prohibit a bank from financing a hostile tender offer directed at a customer. See Cole, Role of Banks Challenged in Unfriendly Takeovers, N.Y. TIMES, June 11, 1979, at D1, col. 1, D6, col. 3 (statement by Federal Reserve Chairman William E. Miller) [hereinafter cited as Unfriendly Takeovers].

25. 602 F.2d at 601. The Washington Steel court did not suggest that a court could imply a state common law rule of a per se duty. See id. At least three state securities commissions, including Pennsylvania, the home state of Washington Steel, have ruled that a bank neither breaches a fiduciary duty nor violates a state securities law by financing a hostile tender offer for the stock of one of its customers. See Washington Steel Corp. v. TW Corp., 602 F.2d at 597 (Pennsylvania); Bank Did Not Violate Wisconsin Law in Financing Client's Hostile Takeover, 519 SEC. RES. & L. REP. (BNA) A-21, 22 (Sept. 12, 1979) (involving Paccar, Inc.'s attempt to acquire Harnischfeger Corp.); Unfriendly Takeovers, supra note 23, at D6, col. 3 (South Carolina, involving Brascan Ltd. of Canada's takeover attempt of F.W. Woolworth).

The SEC has proposed legislation which would preempt state tender offer laws except for those relating to tender offers for truly "local" companies. See SEC Legislative Proposals, supra note 1, at 23, 29. The SEC does not intend the proposed legislation to preempt state laws concerning fiduciary duties of corporate officers, directors, or controlling shareholders owed to the company's shareholders. Id. at 29.
Chemical constructed a Chinese Wall around Washington Steel's files and the personnel who worked on the Washington Steel account. Chemical prohibited the personnel on the Talley account from talking with anyone working on the Washington Steel account and from looking at any Washington Steel file. The officer responsible for the Washington Steel account personally secured all of the target company's files and thereby prevented any possible use of those files by the Chemical personnel working on the Talley loan. In addition, the court noted that Chemical decided to finance the tender offer on the basis of Talley's financial standing and Chemical's long-term familiarity with Talley.

The Washington Steel court further reasoned that even if a bank uses the target's confidential information in deciding to finance the tender offer, the bank would not violate any duty owed to the target. The court justified this view by claiming that the prohibition of the use of confidential information could force a bank to make a loan blindly. By making a blind loan, the court suggested that the bank would violate a duty owed to its depositors. Alternatively, a no-use rule might discourage banks from lending money to finance tender offers. The court believed that the adverse implication of a no-use rule would restrict the free flow of funds and, thus, have the same effect as a per se rule of fiduciary duty.

The Washington Steel court correctly rejected a per se fiduciary duty prohibiting a bank from lending money to finance a hostile tender offer directed at a customer. As the court stated, companies seeking to insulate themselves from takeovers could arrange a series of loans from most major banks, thereby foreclosing banks as financial sources for potential tender offerors. A bank customer is entitled to no more protection from a hostile tender offer than it is in other business contexts. Since a bank customer cannot petition a court to enjoin the bank from lending money to a competitor, a court should not enjoin the financing of a hostile tender offer.

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55 602 F.2d at 602-03; see note 48 infra.
56 See 602 F.2d at 603.
57 Id. at 602. Chemical performed a worst-case analysis of Talley's ability to repay the loan. This analysis convinced Chemical of Talley's ability to cover its debt service. Id. The Washington Steel court noted that the silence of the Chemical officer in charge of the Washington Steel account at Chemical's initial meeting to discuss the Talley loan was not an implicit recommendation of the loan by that officer. The officer could have done nothing more than remain silent after informing the participants at the meeting about Chemical's loan to Washington Steel. Id. at 602-03; see note 11 supra.
58 602 F.2d at 603-04.
59 Id. at 603.
60 Id.
61 Id.
62 Id.; see text accompanying notes 19-21 supra.
63 602 F.2d at 601.
for the customer's stock. Furthermore, although a target company has standing under the federal tender offer laws to seek an injunction of a tender offer, the policy behind these laws suggests that enjoining bank financing of a tender offer, based on a per se fiduciary duty, would be improper. The policy behind the federal tender offer laws is full disclosure. Those laws are not designed to favor one party in a tender offer battle. A court would thus frustrate this balancing policy by enjoining bank financing of a tender offer.

The *Washington Steel* court's reasoning in its dictum allowing a bank to use the target's confidential information, however, is questionable. A bank that does not use the confidential information in making a decision to finance a hostile tender offer is no more "blind" than any other bank without the benefit of the confidential information. Since evidence suggests that banks do not use confidential information in making their loan decisions, a no-use rule would not restrict the free flow of funds as the Third Circuit suggested. Additionally, although no per se fiduciary duty should exist between a bank and its customers, a bank should not avail itself of confidential information to the detriment of the supplier of that information. A bank customer properly expects that the bank will not

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58 See id.
59 See, e.g., Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 946-47 (2d Cir. 1969); Wellman v. Dickinson, 475 F. Supp. 783, 816-17 (S.D.N.Y. 1979); Aranow, Einhorn, & Berlstein, *Standing to Sue to Challenge Violations of the Williams Act, 32 Bus. Law. 1755, 1763 (1977).* Although a target company can seek injunctive relief under the federal tender offer laws, neither a tender offeror nor a target has standing to bring an action for damages. *See Piper v. Chris-Craft Indus., 430 U.S. 1, 42 (1977) (tender offeror); Wellman v. Dickinson, 475 F. Supp. at 816 (target company).*
62 See SEC Legislative Proposals, supra note 1, at 9. An injunction of a bank's financing of a tender offer would give the management of the target an unfair advantage. *Id.*
66 See Pigg v. Robertson, 549 S.W.2d 597, 601-02 (Mo. Ct. App. 1977); M.L. Stewart & Co. v. Marcus, 124 Misc. 86, 90, 207 N.Y.S. 685, 689 (Sup. Ct. 1924); *Bank Confidentiality,*
use the confidential information to its own advantage.\textsuperscript{45} This justifiable expectation has led courts to hold banks to a fiduciary standard of conduct when the bank has accepted a customer's trust and confidence by receiving confidential information.\textsuperscript{46} Such a restricted fiduciary duty does disadvantage the bank to some degree. A court, however, must weigh the inconvenience caused by the imposition of a limited fiduciary duty against the legitimate expectations of the customer.\textsuperscript{47}

An issue which \textit{Washington Steel} did not address is whether a bank or the offeror violates federal securities laws if the bank conveys the confidential information to the offeror.\textsuperscript{48} The resolution of this issue probably depends on whether the offeror decides to proceed with the tender offer after it receives the confidential information about the target. If the offeror continues with the offer and does not disclose the information publicly, the stockholders of the target probably could sue the bank and the offeror for damages under sections 10(b) and 14(e) of the Securities Exchange Act of 1934 ('34 Act)\textsuperscript{49} and under Rule 10b-5.\textsuperscript{50} The bank would

\textsuperscript{45} See M.L. Stewart & Co. v. Marcus, 124 Misc. 86, 90, 207 N.Y.S. 685, 689 (Sup. Ct. 1924); \textit{Bank Confidentiality, supra} note 40, at 160; \textit{Bank Financing, supra} note 34, at 836-37. See also ABA Code of Professional Responsibility, DR 4-101(B)(2), (3) (1979) (lawyer cannot use client's confidences or secrets to disadvantage of client or for advantage of lawyer or third person).

\textsuperscript{46} See, e.g., Trice v. Comestock, 121 F. 620, 622-23 (8th Cir. 1903); Pigg v. Robertson, 549 S.W.2d 597, 601 (Mo. Ct. App. 1977); \textit{Bank Confidentiality, supra} note 40, at 155; \textit{Bank Financing, supra} note 34, at 827-32.

\textsuperscript{47} For a more thorough discussion of the nature of a bank's fiduciary duty to a corporate customer, see \textit{Bank Financing, supra} note 34, at 827-32, 836-37.

\textsuperscript{48} See Senate Hearings, supra note 21, at 26 (statement of Gordon T. Wallis). If the bank has the burden of proving nonuse and if proof of a Chinese Wall does not satisfy that burden, a bank probably could not meet its burden of proof. Consequently, placing a burden of proof on the bank could lead to a per se prohibition against the financing. See text accompanying notes 19-24 & 33-39 supra.

\textsuperscript{49} Since \textit{Washington Steel} did not allege that Chemical had relayed any confidences to Tulley, the \textit{Washington Steel} court determined that it had no occasion to decide whether a court could enjoin a bank from financing a hostile tender offer when the bank actually provided the offeror with confidential information obtained from and concerning the target. 602 F.2d at 602, 604. The court noted, however, that if the bank had supplied such confidential information to the offeror, the bank might have violated § 10(b) of the '34 Act, 15 U.S.C. § 78j(b) (1976), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1979). 602 F.2d at 603-04.

\textsuperscript{50} 15 U.S.C. §§ 78j(b), 78n(e) (1976). Section 14(e) forbids any person to misstate or omit a material fact, or engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with a tender offer. Id. § 78n(e).
be liable as a tipper,\(^5\) and the offeror would be liable as a tippee.\(^6\) Liability, however, is doubtful if the offeror elects to withhold the tender offer after receiving the confidential information.\(^5\) Section 10(b) and Rule 10b-5 require that the alleged disclosure was in connection with the purchase or sale of any security.\(^6\) A prerequisite for liability under section 14(e) is that the disclosure was in connection with a tender offer.\(^5\) Since the offeror elected not to make the tender offer, the tip by the bank was not in connection with a purchase, a sale, or a tender offer.\(^6\)

Another problem involving the federal securities laws and bank financing of tender offers is the disclosure requirement of section 13(d) of the '34 Act.\(^5\) Under section 13(d), a tender offeror must disclose to the SEC and the offerees the source of funds used in making the tender offer.\(^5\) The section excepts disclosure if a commercial bank provides the funds in the ordinary course of business.\(^5\) Congress included this exception to prevent the target company from pressuring the bank to withhold


\(^6\) "Tipping" is the selective disclosure of material, inside information that has not been disseminated publicly. See SEC Legislative Proposals, supra note 1, at 6 n.8. See also Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 230-31, 241 (2d Cir. 1974) (non-trading tipper and trading tippees liable under § 10(b) and Rule 10b-5); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 852-53 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969) (insider-tippee liable under § 10b and Rule 10b-5).

\(^5\) A bank's disclosure of confidential information to the tender offeror presents a situation similar to Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974). In Shapiro, Merrill Lynch was the managing underwriter of a debenture offering by Douglas Aircraft Company. Douglas had given Merrill Lynch certain material, adverse inside information regarding Douglas's earnings. Before this confidential information became public, Merrill Lynch disclosed the information to some of its customers. These customers proceeded to sell their holdings in Douglas. Id. at 231-32. The Shapiro court held that both Merrill Lynch and its customers were liable under § 10(b) of the '34 Act and Rule 10b-5 as "tipper" and "tippees" respectively. Id. at 231, 241. The only major difference in the situation of bank disclosure would be that the tender offeror-tippee bought the target's stock after receiving non-public information about the target.

See SEC Legislative Proposals, supra note 1, at 6. If the offeror does not proceed with the tender offer, the SEC possibly can maintain an injunctive action against the bank. Id. Rule 10b-5 proscribes conduct which not only operates but also would operate as a fraud or deceit upon investors, 17 C.F.R. § 240.10b-5 (1979). See SEC v. Lum's, Inc., 365 F. Supp. 1046, 1058 (S.D.N.Y. 1973) (tipping works unfairness in market even if tippee takes no direct action on information conveyed).


\(^5\) See SEC Legislative Proposals, supra note 1, at 6. See also Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754-75 (1975) (plaintiff must be actual purchaser or seller to have standing under Rule 10b-5); Brascan, Ltd. v. Edper Equities Ltd., 477 F. Supp. 773, 789 (S.D.N.Y. 1979) (liability under § 14(e) occurs only if tender offer existed).

\(^6\) 15 U.S.C. § 78m(d) (Supp. II 1978). Section 13(d) lists what an offeror must include in his tender offer statement filed with the SEC. Id.; see note 62 infra.


\(^5\) Id.
financing for the tender offer. This exception, however, discourages disclosure of any conflict of interest the bank may have and arguably is inconsistent with the full disclosure policy of the federal securities laws.

The SEC recently recommended amendments to sections 13(d) and 14(d) of the '34 Act due to these twin problems. Under the proposed section 14(d) amendment, a bank could not disclose to the offeror any material, non-public information concerning the target without the target's consent. Consequently, the bank would violate the securities laws irrespective of the offeror's decision to proceed with the tender offer. The amended section 13(d) would require the offeror to disclose the name of the financing bank unless, after reasonable inquiry, the offeror does not have reason to know that any prior or present commercial relationship exists between the bank and the target. The SEC believes that this pro-

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10 See SEC Legislative Proposals, supra note 1, at 9.
11 See id.
12 15 U.S.C. §§ 78m(d), 78n(d) (1976 & Supp. II 1978). Section 14(d) currently prohibits any person from making a tender offer which would result in his owning more than five percent of a class of securities registered under § 12 of the '34 Act, id. § 78(l), unless he has filed a statement with the SEC. The person also must furnish each offeree with the statement, and the statement must contain the information required under § 13(d) of the '34 Act, id. § 78m(d). Section 14(d) also imposes certain substantive restrictions on the terms of an offer, with respect to such matters as right of withdrawal, extensions, and variations of the offer. Id. § 78n(d).
13 See SEC Legislative Proposals, supra note 1, at 10, 20-22. The SEC submitted these proposals pursuant to a request by Senators Proxmire, Sarbanes, and Williams. Id. at 2-4. The SEC recognized that an absolute ban on bank financing of a tender offer, if the bank has received confidential information, would upset the balance of the federal tender offer laws not to favor one side of a tender offer battle. Id. at 5; see text accompanying notes 36-39 supra.
14 See SEC Legislative Proposals, supra note 1, at 10, 22, 27.
15 The proposed § 14(d) probably would not attach liability to the tender offeror if the bank discloses the confidential information to the offeror. See id. at 11 n.34. The SEC believes, however, that the prohibition against disclosure by the bank would preclude the offeror from ever receiving the information. Id.
16 A “prior commercial relationship” would exist provided the relationship between the bank and the target satisfies two conditions. The target must have had a business relationship with the bank within two years before the offeror first approached the bank concerning the financing of the tender offer. Second, the relationship may have provided the bank with access to material, non-public information concerning the target. Id. at 10.
17 Id. at 10, 21, 25. In addition to the recommended amendment to § 13(d), the SEC considered two alternative amendments to § 13(d). The first alternative would allow the offeror to withhold the bank's identity only if the bank is not in possession of any material, non-public information obtained from the target company. Id. at 9. The SEC rejected this alternative because once the offeror learns that the bank possesses material, non-public information, the offeror might draw inferences from the bank's loan decision about the financial status of the target company. Id. The second alternative would delete entirely the current disclosure exception applicable to banks. Id. at 10. The SEC rejected this deletion because it would permit the target to use its influence to dissuade the bank from financing the tender offer. Id. The SEC chose the submitted proposal because any inferences which a bidder could draw from the mere existence of a commercial relationship would be highly speculative. Id. See also text accompanying notes 57-61 supra.
Proposal is necessary in order to make section 13(d) consistent with the full disclosure policy of the federal securities laws. The SEC, however, is opposed to any specific legislation concerning bank use of confidential information about the target in deciding to finance a tender offer. Instead, the SEC asked Congress to give the SEC additional rulemaking authority to govern bank use of confidential information.

These legislative proposals do not appear to place any additional burdens on banks and tender offerors. The proposed anti-fraud amendment to section 14(d) apparently does no more than codify a recognized common law duty not to disclose one customer's confidential information to another customer. If a bank were to disclose confidential information to the offeror, the target or the SEC also may have an impossible task proving that the disclosure occurred. Additionally, while the proposed disclosure requirement of section 13(d) will provide the target's stockholders with more information, this amendment will not furnish any real aid to the target company. Once a bank has decided to finance the tender offer, the bank probably realizes that the target will take its business elsewhere if the tender offer is not successful. Since the bank has accepted the possible loss of the target as a customer, the target will have little leverage by which to pressure the bank to withhold the financing.

Based on the Washington Steel decision and the SEC legislative proposals, a bank does not have a per se fiduciary duty prohibiting it from financing a hostile takeover of one of its customers. The bank must realize, however, that it must respect the confidential nature of any information which the bank received from the target. If the bank discloses the target's confidential information to the offeror, the bank faces possible liability under the federal securities laws. Although the Washington

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[8] See SEC Legislative Proposals, supra note 1, at 9; text accompanying notes 57-61 supra.
[9] See SEC Legislative Proposals, supra note 1, 11-12. Since the issue of bank use of confidential information only recently has become the subject of controversy, the SEC fears that any legislation at this time may not provide the flexibility needed to respond adequately to the issue. Id. at 11.
[10] Id. at 12, 13. The SEC recommended that Congress add a new subsection to § 14 of the '34 Act. Under the proposed addition, Congress would give the SEC rulemaking authority to define acts and practices which are fraudulent, deceptive, or manipulative involving the planning, financing, or otherwise participating in, or rendering advice in connection with any tender offer. The SEC also would have authority to prescribe means reasonably designed to prevent such acts and practices. Id.
Steel decision suggests otherwise, a bank owes the target a fiduciary duty to refrain from using the target's confidential information in deciding whether to finance the tender offer. When asked to finance a hostile takeover of a customer, a bank should construct a Chinese Wall within its loan department as a defense against possible allegations by the target that the bank misused the target's confidential information. The bank should design this Chinese Wall to prevent the tender offeror and the bank personnel involved in the loan to the offeror from gleaning any confidential information about the target.

THOMAS McN. MILLHISER

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77 See text accompanying notes 28-32 supra.
78 See text accompanying notes 40-47 supra.
79 One possible Chinese Wall procedure which a bank could implement is the procedure which Chemical used in Washington Steel. See text accompanying notes 25-26 supra. Another possible procedure is the one which Irving Trust Company uses. See Senate Hearings, supra note 21, at 47-48 (Irving Trust Co. Policies and Procedures Regarding Confidential Information in Connection with Tender Offer Loans). In processing requests for tender offer financing, Irving Trust bypasses normal loan approval processes. Immediately upon receiving the request, the officer who received the request will notify only the head of the division to whom he reports. The division head will then notify, if available, his group executive, the head of the Loan Administration Division, the president, and the chairman of the board. This group of people are the only individuals in Irving Trust who determine whether to grant the loan. Members of the group cannot discuss the tender offer with anyone else inside or outside the bank, except those directly involved with the tender offer or the loan. The group members make sure that no bank employee misuses any confidential information relating to the tender offer, the offeror, or the target. In addition, the group members see that no person conveys confidential information to any officer or employee in Irving Trust's personal Trust Division or to anyone who has any responsibility for the investments of the bank's own funds or customers' funds. Id. Interestingly, Irving Trust's procedure not only constructs a Chinese Wall within the loan department but also constructs a Chinese Wall around the loan department to prevent confidential information from flowing to the trust department. Id. See also note 3 supra.