A New Interpretation of the Contemporaneous Ownership Requirement in Shareholder Derivative Suits: In re Bank of New York Derivative Litigation and the Elimination of the Continuing Wrong Doctrine

Terence L. Robinson Jr.
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I. INTRODUCTION

In today’s fierce business world some corporate directors feel the need to try anything possible to gain an edge, even if it means engaging in illegal business practices. Reports highlighting corporate corruption and greed frequent the news. Politicians around the nation are lining up to support harsher penalties for corporate abusers. The recent scandals involving Enron, WorldCom, and the Bank of New York are a few of the more publicized examples of corporate corruption. The increase in the number of shareholder derivative suits is another sign of growing corporate corruption. While shareholder derivative suits are a common means through which shareholders enforce their rights, cunning investors may also abuse these suits to make a quick profit. For this reason it is important to protect the rights of shareholders to bring derivative actions while preventing cunning litigants from abusing such actions for personal profit.


These competing interests have caused a split between the Second and Fifth Circuit courts of appeal concerning the scope and interpretation of Federal Rule of Civil Procedure 23.1. Rule 23.1 provides, in part, that any shareholder who brings a derivative suit must have owned shares in the corporation at the time the transaction complained of occurred. The Fifth Circuit has allowed an exception to this general rule—known as the “continuing wrong” doctrine. Under the continuing wrong doctrine, a shareholder may bring a derivative suit


8. FED. R. CIV. P. 23.1. Rule 23.1 provides the following:
   In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff’s share or membership thereafter devolved on the plaintiff by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff’s failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

9. Id. Rule 23.1 provides that for a shareholder to establish federal derivative standing, the shareholder must allege that he or she “was a shareholder or member at the time of the transaction of which the plaintiff complains.” This provision is known as the contemporaneous ownership requirement.

10. See Bateson, 414 F.2d at 130–31. Although the continuing wrong doctrine has been addressed, discussed, and sparingly used in other courts, no circuit has openly adopted the doctrine to the extent that the Fifth Circuit has. See generally Noland v. Barton, 741 F.2d 315, 318 (10th Cir. 1984) (holding that the trial court correctly held that even if the continuing wrong doctrine exists, it would not apply to the facts of the case); Ensign Corp., S.A. v. Interlogic Trace, Inc., No. 90 Civ. 3497 (LBS), 1990 WL 213085, at *2 (S.D.N.Y. Dec. 19, 1990) (discussing the continuing wrong doctrine as used by other courts); Pullman-Peabody Co. v. Joy Mfg. Co., 662 F. Supp. 32, 35–36 (D. Conn. 1986) (refusing to use the continuing wrong doctrine, despite the fact that other courts have used the doctrine to grant standing to plaintiffs in shareholder derivative suits); In re Penn Cent. Transp. Co., 341 F. Supp. 845, 846 (E.D. Pa. 1972) (granting standing to a plaintiff who did not own shares in the corporation at the time that the wrongful transaction was entered into because the transaction was a continuing wrong). Therefore, this Note will focus on the diverging interpretations of Rule 23.1 adopted by the Second and Fifth Circuits.
if the injurious effects of the alleged wrongful transaction continued while the shareholder owned shares in the corporation, even if the actions upon which the shareholder’s claim is based arose before his acquisition of shares in the corporation.11

Recently, the Second Circuit openly refused to accept the continuing wrong doctrine in *In re Bank of New York Derivative Litigation* (hereinafter *Bank of N.Y. II*).12 In its decision, the court decided to offer its own interpretation of Rule 23.1 rather than apply the continuing wrong doctrine. The court held that the contemporaneous ownership requirement of Rule 23.1 is not satisfied if the shareholder has not “owned stock in the corporation throughout the course of the activities that constitute the primary basis of the complaint.”13 The court clarified what constitutes the primary basis of a complaint by stating that the “plaintiff must have owned stock in the corporation before the core of the allegedly wrongful conduct transpired.”14 By establishing its “core of the conduct doctrine,” the Second Circuit correctly rejected the continuing wrong doctrine by stringently interpreting Rule 23.1 in a manner that (1) prevents shareholders from using the derivative suit to forum shop, (2) prevents shareholders from using the derivative suit to litigate “purchased grievances,” and (3) allows both courts and litigants to reach equitable results in shareholder derivative suits.

This Note examines the differences between the Second and Fifth Circuits’ approaches when applying the contemporaneous ownership requirement. Part II begins with a brief background of shareholder derivative suits and concludes with a discussion of their modern development, focusing on Rule 23.1. Part III explains the factual and procedural background of *Bank of N.Y. II*, presents a brief synopsis of the majority opinion written by Judge José A. Cabranes,15 and contrasts the holding of the opinion with the modern day continuing wrong doctrine. Part IV examines the effects of the *Bank of N.Y. II* holding, focusing on its divergence from the continuing wrong doctrine and the future of the core of the conduct doctrine. Part V contains a brief conclusion. Ultimately, this Note argues that *Bank of N.Y. II* correctly eliminated the continuing wrong doctrine because the doctrine weakened the contemporaneous ownership requirement of Rule 23.1 to the point that it

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13. *Id.* at 298.
14. *Id.*
15. *See id.* at 293.
did not effectively protect against litigation of purchased grievances, litigation by uninjured and uninterested shareholders, and manufactured federal diversity jurisdiction.

II. BACKGROUND

A. The Origin of the Shareholder Derivative Suit

The shareholder derivative suit originated in England’s nineteenth-century courts of equity.\(^\text{16}\) As the Industrial Revolution spread across England and altered its economic landscape, individuals established corporations with greater frequency.\(^\text{17}\) The primary reason developers used the corporate structure during the Industrial Revolution was that it allowed them to secure funding for large ventures while minimizing their individual liability. As the number of individuals who owned corporate shares increased, friction and conflict strained the relationship between shareholders and corporate directors.\(^\text{18}\) Gradually, these conflicts induced the courts of equity to recognize that shareholders needed a way to protect the corporation from wrongdoing committed against it when, for various reasons, the corporate directors failed to do so.\(^\text{19}\) Thus, a new species of legal action, the shareholder derivative suit, was born. The concept behind the shareholder derivative suit was new in that it allowed one or more shareholders of a corporation to initiate a lawsuit on behalf of the corporation.\(^\text{20}\) Consequently, shareholders acquired the ability to enforce a corporate right or remedy a wrong against the corporation when the corporate directors failed to do so.\(^\text{21}\)

By 1855, the United States Supreme Court recognized the shareholder derivative suit.\(^\text{22}\) As the shareholder derivative suit developed in the United States, it became apparent that the ability of shareholders to protect the corporation from harm was prone to two potential shareholder abuses.\(^\text{23}\) First, shareholders could forum shop by

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\(^{17}\) See id.

\(^{18}\) See id.

\(^{19}\) See id. at 99–103.

\(^{20}\) See id. at 99–101.

\(^{21}\) See 19 \textit{AM. JUR. 2D} Corporations § 2250 (2003).

\(^{22}\) See generally \textit{Dodge v. Woolsey}, 59 U.S. 331 (1855); Kim, \textit{supra} note 16, at 99.

\(^{23}\) See Kim, \textit{supra} note 16, at 99–100. In her discussion of the development of the shareholder derivative suit, Kim explains:
transferring their corporate shares to out-of-state residents, thus allowing a new shareholder to litigate a preexisting derivative claim in federal court through manufactured federal diversity jurisdiction.\textsuperscript{24} Second, clever investors could realize corporate stock gains by purchasing shares in corporations for the sole purpose of litigating an existing shareholder derivative claim.\textsuperscript{25}

The Supreme Court, prompted by these potential abuses of the shareholder derivative suit, established certain requirements that a shareholder must meet before bringing a derivative suit in federal court.\textsuperscript{26} The requirements established by the Supreme Court were later codified in the Equity Rules\textsuperscript{27} and became part of the original Federal Rules of Civil Procedure.\textsuperscript{28} Although the federal standing requirements

Under the basic corporate law paradigm, shareholders, as owners of the corporation, elect directors to manage the corporation on the shareholders’ behalf and to make decisions affecting the corporation, including the decision to initiate litigation. Shareholders who use unconstrained derivative proceedings to usurp the management authority of directors violate these basic principles of corporate governance.

\textsuperscript{24} See 7C CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 1828 (2d ed. 1986).

\textsuperscript{25} See id. The primary response to these problems was the creation of the contemporaneous ownership requirement:

The requirement of an allegation of contemporaneous ownership originally was viewed as a means of discouraging the collusive practice of transferring stock to a nonresident for the purpose of manufacturing federal diversity jurisdiction in order to litigate a pre-existing claim owned by the corporation in federal court. More recently, however, the provision has been described as a general principle of equity aimed at preventing the federal courts from being used to litigate purchased grievances.

\textsuperscript{26} See generally Hawes v. City of Oakland, 104 U.S. 450, 461 (1881) (creating the contemporaneous ownership requirement for standing in a shareholder derivative suit).

\textsuperscript{27} See Kim, supra note 16, at 100.

\textsuperscript{28} FED. R. CIV. P. 23(b) (1937) (repealed 1966). Although the original Rule 23(b) varies from the modern Rule 23.1, both rules are substantially similar. Original Rule 23(b) provided:

In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort.

\textsuperscript{Id.} For the text of modern Rule 23.1, see supra note 8.
for shareholder derivative suits have been slightly altered from their original form, the contemporaneous ownership requirement contained in the original Rule 23(b) has been preserved and is currently articulated in Federal Rule of Civil Procedure 23.1—Derivative Actions by Shareholders.29

B. The Modern Development of Rule 23.1

Rule 23.1 provides, in part, that a party bringing a derivative suit in federal court “shall be] a shareholder or member at the time of the transaction of which the plaintiff complains.”30 This requirement was included in the original Rule 23(b) and was carried over into the modern Rule 23.1 to eliminate forum shopping and/or the litigation of purchased grievances.31 This “contemporaneous ownership” requirement is essential in maintaining the viability of the shareholder derivative suit.32

However, because Rule 23.1 does not specifically define “transaction,” confusion has arisen as to what constitutes a “transaction” for purposes of Rule 23.1. Based on a plain reading of Rule 23.1, it appears that a transaction is an event or series of events that create a legal right on behalf of the corporation.33 Nevertheless, Rule 23.1 fails to adequately define the boundaries of the events that constitute a wrongful transaction. This inadequate definition has created a situation in which courts have come to different conclusions about whether a shareholder who brings a derivative suit has to: (1) own shares in the corporation throughout the entire series of events that constitute the wrongful

29. See supra note 8. Modern Rule 23.1 and original Rule 23(b) contain equivalent language with reference to the contemporaneous ownership requirement.
30. FED. R. CIV. P. 23.1.
31. See 7C WRIGHT ET AL., supra note 24, § 1828. Rule 23.1 derives from the decision in Hawes, 104 U.S. at 461. In Hawes, the Supreme Court held that an allegation that complainant was a shareholder at the time of the transactions of which he complains, or that his shares have devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction in a case of which it could otherwise have no cognizance, should be in the bill, which should be verified by affidavit.
32. Id.
33. FED. R. CIV. P. 23.1.
transaction; \(^3^4\) own shares in the corporation during a portion of the series of events; or (3) own shares in the corporation at a point in time when the effects of the wrongful transaction continue, \(^3^5\) despite the fact that the underlying series of events that constitute the transaction were completed prior to the shareholder’s ownership. \(^3^6\)

Despite the differing interpretations of Rule 23.1, federal courts have generally rejected the notion that the entire series of events that constitutes the wrongful conduct is a single transaction. \(^3^7\) However, based on the equitable history of the shareholder derivative suit, the Fifth Circuit has broadly interpreted the meaning of a Rule 23.1 transaction. The Fifth Circuit has held that a shareholder may bring a derivative suit for injuries suffered by the corporation prior to the shareholder’s purchase of shares in the corporation, \(^3^8\) thus interpreting the contemporaneous ownership requirement against the backdrop of the equitable doctrine of continuing wrong. \(^3^9\) Under the continuing wrong doctrine, shareholders obtain federal derivative standing when they acquire shares in the corporation after the Rule 23.1 transaction has occurred if they meet two conditions. First, the effects of the wrongful

\(^{34}\) See, e.g., Weinhaus v. Gale, 237 F.2d 197, 199–200 (7th Cir. 1956).

\(^{35}\) See, e.g., Bank of N.Y. II, 320 F.3d 291, 298–99 (2d Cir. 2003) (discussing the continuing wrong doctrine).

\(^{36}\) See, e.g., Bateson v. Magna Oil Corp., 414 F.2d 128, 130 (5th Cir. 1969).

\(^{37}\) See, e.g., Weinhaus, 237 F.2d at 199–200 (rejecting the continuing wrong doctrine); Pullman-Peabody Co. v. Joy Mfg. Co., 662 F. Supp. 32, 35–36 (D. Conn. 1986) (refusing to apply the continuing wrong doctrine); 7C WRIGHT ET AL., supra note 24, § 1828. Wright, Miller, and Kane note the general attitude of federal courts toward the continuing wrong doctrine as follows:

The federal courts generally have rejected the contention that the entire series of events constitutes a single transaction—the so-called “continuing wrong” notion—entitling plaintiff to bring suit for injuries suffered by the corporation subsequent to plaintiff’s acquisition of stock. Rather, plaintiff has been barred from complaining about events of this character on the theory that they assume their wrongful character as of the time of the initial event, which antedated plaintiff’s gaining shareholder status.

Id. (footnote omitted).

\(^{38}\) The Fifth Circuit held that a shareholder who had owned stock in the corporation when the alleged wrongdoing occurred, then sold his stock in the corporation, and then reacquired stock in the corporation in order to file a derivative suit had standing to bring a shareholder derivative suit in federal court because

one who buys stock in the corporation cannot maintain a stockholders’ derivative suit if the wrongs complained of were completed before his acquisition of stock. However, where the complaint charge[s] continuing wrongs, occurring at the time plaintiff owned stock, the complaint should not be dismissed on defendant’s contention that the claims actually arose prior to the time plaintiff acquired his stock.

Bateson, 414 F.2d at 130 (citation omitted).

\(^{39}\) See id.
conduct must span the shareholder’s ownership of shares in the corporation. \(^{40}\) Second, the shareholder must have been injured by the effects of the wrongful conduct. \(^{41}\) On the other hand, in the years prior to the *Bank of N.Y. II* decision, the trend among courts within the Second Circuit was to not apply the continuing wrong doctrine when considering whether a shareholder derivative plaintiff had standing. \(^{42}\) While the Fifth Circuit maintains the validity of the continuing wrong doctrine, \(^{43}\) the Second Circuit’s complete rejection of the doctrine culminated in *Bank of N.Y. II*. \(^{44}\)

### III. In re Bank of New York Derivative Litigation

#### A. The Facts

Before the commencement of litigation, the Bank of New York (BONY) was a financial institution owned by the Bank of New York Company, Inc. (the Company), one of the largest bank holding companies in the United States. \(^{45}\) BONY operated as the principal subsidiary of the Company \(^{46}\) and engaged in widespread financial ventures throughout the United States and in many foreign nations.

As the political atmosphere in Russia began to change during the late 1980s, BONY became aware of opportunities to expand its business into the Russian banking industry. \(^{47}\) In 1990, BONY started planning its Russian expansion, and in 1992 it reorganized its European Division to create an Eastern European Division that would oversee and facilitate its expansion into the Russian market. \(^{48}\) BONY aggressively pursued this

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40. *See id.*
42. *See Seth Aronson et al., Recent Developments in Shareholder Derivative Actions*, 1386 PRAC. L. INST./CORP. 73, 82 (2003). While support within the Second Circuit prior to *Bank of N.Y. II* appears to be sparse at best, several courts recognized and discussed the doctrine. See *Hoover v. Allen*, 180 F. Supp. 263, 267 (S.D.N.Y. 1960) (holding that the wrongs complained of were continuing in nature).
43. *See Bateson*, 414 F.2d at 130.
45. *Id.* at 294.
46. *Id.*
47. *Id.*
48. *Id.*
expansion into the Russian banking industry despite governmental and market warnings that the Russian banking industry was rife with organized crime and substantial corruption.\textsuperscript{49}

Several of the officers within BONY’s newly formed Eastern European Division created a scheme called “Prokutki,” or “spinning around,” designed to conceal the illegal movement of certain assets, primarily U.S. dollars, out of Russia.\textsuperscript{50} The illegally removed funds were then laundered through multiple offshore accounts as the Eastern European Division officers behind the scheme took a percentage of the total value of the assets as their commission.\textsuperscript{51} The Eastern European Division officers managing the Prokutki scheme maintained the secrecy of their operations and communications through an encryption code.\textsuperscript{52} In addition, the scheme was marketed to other Russian banks.\textsuperscript{53}

The Prokutki scheme was established in 1992, became fully operational that year, and continued to be used throughout the mid-1990s.\textsuperscript{54} The scheme was eventually discovered by BONY’s competitors. In 1998, the Republic Bank of New York detected unusual volumes of BONY transfers to Russian accounts. As a result, it filed a Suspicious Activity Report with the Treasury Department.\textsuperscript{55} This Suspicious Activity Report prompted an FBI investigation that led to the indictment of several BONY employees, two of whom pled guilty to illegal conduct that occurred as recently as 1999.\textsuperscript{56} In addition, the FBI investigation and subsequent CIA investigations uncovered links between BONY’s Prokutki scheme and an alleged Russian organized crime leader reportedly involved in activities such as arms trafficking, extortion, and organized prostitution.\textsuperscript{57}

On August 19, 1999, news of BONY’s Prokutki scheme became public when the \textit{New York Times} reported that through March 1999, $4.2 billion, much of which was connected to Russian organized crime, had

\begin{itemize}
\item \textsuperscript{49} Bank of N.Y. I, 173 F. Supp. 2d 193, 195 (S.D.N.Y. 2001), \textit{aff’d}, 320 F.3d 291 (2d Cir. 2003).
\item \textsuperscript{50} \textit{Id}.
\item \textsuperscript{51} \textit{Id}.
\item \textsuperscript{52} \textit{Id}.
\item \textsuperscript{53} Bank of N.Y. I, 173 F. Supp. 2d at 195.
\item \textsuperscript{54} Bank of N.Y. II, 320 F.3d at 294.
\item \textsuperscript{55} \textit{Id}.
\item \textsuperscript{56} \textit{Id}.
\end{itemize}
been laundered in BONY accounts. In response to the publicity that the Prokutki scheme received in the media and the continued FBI investigation, BONY formed an Anti-Money Laundering Oversight Committee in September 1999. The oversight committee examined what was considered “unusual activity,” but due to the limited power of the oversight committee, most of the Russian banking ventures conducted by the Eastern European Division continued.

B. Procedural History

Mildred and Edward Kaliski purchased shares in BONY on July 21, 1998. They filed a shareholder derivative suit on behalf of BONY and the Company on September 23, 1999, in the United States District Court for the Southern District of New York. The derivative action named as defendants various officers and directors of both BONY and the Company. The named defendants included the directors and officers directly responsible for the Prokutki scheme (the Officers). In their complaint, the Kaliskis claimed that the Officers breached their fiduciary duties to BONY and the Company by “fail[ing] to fully inform

58. Id. (“Money laundering is a legal catch phrase that refers to the criminal practice of taking ill-gotten gains and moving them through a sequence of bank accounts so they ultimately look like legitimate profits from legal businesses.”).
59. Bank of N.Y. II, 320 F.3d at 294 (quoting Am. Compl., Sept. 1, 2000, ¶ 171). The true direction and breadth of the investigation conducted by the Anti-Money Laundering Oversight Committee created by BONY is unclear. The plaintiffs in this case alleged that the oversight committee did little to stop or remedy the wrongful behavior that BONY’s Eastern European Division committed. See id.
60. Id.
61. Id. at 294–95.
62. Id.
63. For convenience, the BONY and Company directors involved in the Prokutki scheme and the ill-advised entry into the Russian banking industry will be referred to as the Officers. This should not be understood to include all the directors or officers of either BONY or the Company.
64. The Kaliskis claimed, in particular, that the various officers and directors of BONY and the Company who were named defendants breached their fiduciary duties by “fail[ing] to implement and enforce an adequate compliance system or to adequately oversee the development of the business in derogation of their duties to implement compliance controls.” Bank of N.Y. II, 320 F.3d at 295 (quoting Am. Compl., Sept. 1, 2000, ¶ 193). In addition, the Kaliskis claimed that the directors of BONY and the Company “‘ignored multiple, specific warnings issued by governmental, regulatory, and private security sources that the Russian banking system was being infiltrated by organized crime—a fact recognized by other banks in the United States, which began to scale down their Russian operations.’” Id. (quoting Am. Compl., Sept. 1, 2000, ¶ 171). To support their claims, the Kaliskis introduced newspaper articles, magazine articles, Russian banking reports, and governmental reports from 1991 to 1994 that warned of money laundering and corruption in the Russian banking system. Id.
themselves [about the Russian banking industry] to the extent reasonably appropriate under the circumstances."\textsuperscript{65}

Although the Kaliskis acknowledged in their complaint that the majority of the wrongful conduct associated with the Prokutki scheme occurred between 1992 and 1996, they claimed that a significant amount of the illegal conduct continued into the late 1990s.\textsuperscript{66} The Kaliskis claimed, for example, that after 1996 the Officers made numerous telephone calls and conducted meetings concerning the structure of their Prokutki scheme, the percentages of each individual’s commission, and the general movement of the laundered Russian assets.\textsuperscript{67} Furthermore, the Kaliskis claimed that, beyond 1996, the Officers made numerous computer entries that reflected their individual shares in the offshore companies through which they routed the Russian assets and that the Officers maintained a continuous relationship with the Russian banks that they solicited to become part of the Prokutki scheme.\textsuperscript{68} Finally, through discovery, the Kaliskis obtained BONY reports and wire transfers indicating that the Officers’ relationships with the Russian banks using the Prokutki scheme continued into 2000 and that the Officers may have continued transferring money out of Russia through the Prokutki scheme after the Kaliskis purchased their BONY shares in 1998.\textsuperscript{69} Ultimately, the Kaliskis’ standing depended on their claim that even though the Prokutki scheme was created and put in place between 1992 and 1996, it continued in use until 2000, during which time the Officers regularly met and communicated for the purpose of maintaining the profitability of the scheme.

On August 31, 2001, the Officers filed a motion to dismiss the Kaliskis’ complaint pursuant to Federal Rule of Civil Procedure 12(c).\textsuperscript{70}

\textsuperscript{65} Id. (alterations in original) (quoting Am. Compl., Sept. 1, 2000, ¶ 193).
\textsuperscript{66} Id.
\textsuperscript{67} Id.
\textsuperscript{68} Id.
\textsuperscript{69} Id.
\textsuperscript{70} Id. at 296. Federal Rule of Civil Procedure 12(c), Motion for Judgment on the Pleadings, provides the following:

\begin{quote}
After the pleadings are closed, but within such time as not to delay the trial, any party may move for judgment on the pleadings. If, on a motion for judgment on the pleadings, matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.
\end{quote}

\textit{FED. R. CIV. P. 12(c)}.
They claimed that the Kaliskis lacked standing to bring a shareholder derivative suit on behalf of BONY and the Company because they did not meet the contemporaneous ownership requirement of Rule 23.1.71 Specifically, the Officers argued that the alleged wrongful transaction—BONY’s ill-advised entry into the Russian banking industry and their creation and implementation of the Prokutki scheme—occurred before the Kaliskis purchased their BONY shares in 1998. The Kaliskis responded by arguing that they did have standing to bring a shareholder derivative action because even though they bought their BONY shares after the illegal conduct of the Officers began, the illegal conduct continued after they bought their BONY shares and into 2000.72 The trial court granted the Officers’ motion to dismiss on the grounds that the Kaliskis did not own BONY shares when the illegal conduct occurred.73 The Kaliskis appealed to the Second Circuit Court of Appeals.74

C. The Holding of the Second Circuit Court of Appeals

On February 12, 2003, the Second Circuit affirmed the judgment of the district court.75 The court held, *inter alia*, that the Kaliskis did not have standing to bring a shareholder derivative suit against the Officers on behalf of BONY and the Company because they did not meet the contemporaneous ownership requirement of Rule 23.1.76 The court held that for the Kaliskis to satisfy the contemporaneous ownership requirement of Rule 23.1, they must have owned shares in the Company “throughout the course of the activities that constitute the primary basis of the complaint.”77 The Second Circuit also held that the Prokutki scheme concluded in 1996 when the majority of the wrongful conduct associated with the scheme was complete.78

71. *Bank of N.Y. II*, 320 F.3d at 296; see also *Fed. R. Civ. P.* 23.1 (requiring that the plaintiff be a shareholder “at the time of the transaction of which the plaintiff complains”).
72. Id.
73. *Bank of N.Y. I*, 173 F. Supp. 2d 193, 198, 200–01 (S.D.N.Y. 2001), aff’d, 320 F.3d 291 (2d Cir. 2003). The district court recognized that some courts have held that the continuing wrong doctrine is a valid exception to the contemporaneous ownership rule, yet the district court refused to use the exception because “it is unclear whether the doctrine is the law of this Circuit.” Id. at 198. The district court granted the Officers’ motion to dismiss because the Kaliskis did not own stock during the course of the transaction. *See id.* at 201.
74. *Bank of N.Y. II*, 320 F.3d at 297.
75. Id. at 301.
76. Id.
77. Id. at 298–99.
78. Id. at 299.
Although there were lingering effects, continued communications, and new transactions relating to the Prokutki scheme from 1996 to 2000, the court ultimately concluded that the transaction described in the complaint only included BONY’s expansion into the Russian banking industry from 1992 to 1996. Because the Kaliskis did not purchase their shares in the Company until 1998, the court held that they failed to meet the contemporaneous ownership requirement of Rule 23.1.

In reaching its decision, the court recognized the conflict between the contemporaneous ownership requirement and the continuing wrong doctrine. On the one hand, the Second Circuit recognized that generally “[w]hen a series of wrongful transactions is alleged and some of them transpired before plaintiff became a shareholder but others took place subsequent to that date, the shareholder’s action may be maintained only on the basis of the later events.” Yet, on the other hand, the court acknowledged the existence of the continuing wrong doctrine and its use in the Fifth Circuit. Ultimately, the court stated that even if it adopted the continuing wrong doctrine, the Kaliskis would not have standing because they did not provide sufficient evidence to support their claim that BONY’s wrongful conduct continued after they purchased their shares in the corporation.

Having recognized the conflict between the contemporaneous ownership requirement and the continuing wrong doctrine, the Second Circuit split from the Fifth Circuit by declining to adopt “the expansive definition of the term “transaction” that is inherent in the continuing wrong doctrine.” The Second Circuit stated that, for purposes of Rule 23.1, a transaction does not include illegal conduct that began prior to and continued after a shareholder’s purchase of corporate stock. The court then redefined transaction for purposes of Rule 23.1 by stating that

79. Id.
80. Id. at 298–99.
81. Id. at 297 (alteration in original) (quoting 7C WRIGHT ET AL., supra note 24, § 1828).
82. Although the Second Circuit would ultimately refuse to accept the continuing wrong doctrine, it did acknowledge its use in other circuits:
Some courts have held that an entire series of events constitutes a single transaction entitling a plaintiff to bring suit for injuries suffered by the corporation subsequent to the plaintiff’s acquisition of stock as long as the same series of events continued after the plaintiffs acquired their shares. This interpretation of the term “transaction” is known as the continuing wrong doctrine.

Bank of N.Y. II, 320 F.3d at 298 (citations omitted).
83. Id.
84. Id. (citing 7C WRIGHT ET AL., supra note 24, § 1828).
the contemporaneous ownership requirement is met when a shareholder “own[s] stock in the corporation throughout the course of the activities that constitute the primary basis of the complaint.”85

While the Second Circuit clearly refused to accept the broad interpretation of transaction inherent in the continuing wrong doctrine, the court did not fully define the limits of its new interpretation of the contemporaneous ownership requirement. The court briefly cited a district court holding that “the continuing wrong doctrine is less an exception to the contemporaneous ownership rule than an expansive definition of what constitutes a ‘transaction’ as that term is used in Rule 23.1.”86 The court did, however, clearly reject the notion that the shareholder must own stock in the company during the entire course of all relevant events.87 In an apparent attempt to avoid a brightline rule that would inhibit future courts from employing equitable principles to achieve a correct result, the Second Circuit held that when applying its new interpretation of the contemporaneous ownership requirement, courts should approach the issue as a “fact-specific question to be determined on a case-by-case basis.”88 The court explained that if a trial court determines that “a single, ongoing transaction is involved, the plaintiff must have acquired stock in the company before all of the core conduct occurred in order to bring suit.”89 On the other hand, the court explained that if the trial court determines that “the allegedly wrongful conduct consists of a series of separate transactions, a plaintiff may assert

85. Id.
86. Id. (quoting Ensign Corp. v. Interlogic Trace, Inc., No. 90 Civ. 3497 (LBS), 1990 WL 213085, at *3 (S.D.N.Y. Dec. 19, 1990)).
87. The Second Circuit made sure to clarify that its new interpretation of the contemporaneous ownership requirement did not require stock ownership during the course of all relevant events.

As an initial matter, we decline to adopt the expansive definition of the term “transaction” that is inherent in the continuing wrong doctrine. Instead, we hold that, in order to invoke derivative standing pursuant to Federal Rule of Civil Procedure 23.1 and New York Business Corporation Law § 626(b), a plaintiff must have owned stock in the corporation throughout the course of the activities that constitute the primary basis of the complaint. This is not to say that a plaintiff must have owned stock in the company during the entire course of all relevant events. It does mean, however, that a proper plaintiff must have acquired his or her stock in the corporation before the core of the allegedly wrongful conduct transpired.

88. Id. at 298 n.4.
89. Id.
standing over those transactions for which the core conduct occurred after the plaintiff acquired stock in the company. 90

IV. ANALYSIS

The Second Circuit’s decision in Bank of N.Y. II raises several questions. While it is apparent from the court’s opinion that the Second Circuit officially rejects the continuing wrong doctrine, 91 it is unclear what effect its new “core of the conduct” doctrine will ultimately have on the contemporaneous ownership requirement. Does the core of the conduct doctrine establish a new method of applying the contemporaneous ownership requirement that is genuinely different from the continuing wrong doctrine? What effect will the core of the conduct doctrine have on shareholder derivative suits and how will it be applied? Ultimately, the Second Circuit’s core of the conduct doctrine establishes a new method of applying the contemporaneous ownership requirement that is genuinely different from the continuing wrong doctrine and more fully accomplishes the purposes of Rule 23.1.

A. The Divergence of the Core of the Conduct Doctrine from the Continuing Wrong Doctrine

In Bank of N.Y. II, the Second Circuit recognized the historical existence of the continuing wrong doctrine but openly refused to adopt it. 92 In theory, its ruling eliminated the common law continuing wrong doctrine by requiring that a shareholder “own[] stock in the corporation throughout the course of the activities that constitute the primary basis of the complaint.” 93 But what does this mean? In determining what constitutes “the primary basis of the complaint,” 94 the court focused on whether the shareholder owned stock in the corporation when the “core” of the wrongful conduct occurred. 95 Therefore, while the Second Circuit did adopt a new interpretation of the contemporaneous ownership requirement 96 by expressly excluding the continuing wrong doctrine

90. Id. at 298 n.4.
91. Id. at 298; see also supra Part III.C.
92. See Bank of N.Y. II, 330 F.3d at 298.
93. Id.
94. Id.
95. Id.
96. Id.
from its new view of contemporaneous ownership, it remains unclear what its core of the conduct doctrine really is. Could it be interpreted as broadly as the continuing wrong doctrine? In order to better understand the core of the conduct doctrine it is helpful to examine its divergence from the continuing wrong doctrine.

1. The continuing wrong doctrine

The equitable origins of the shareholder derivative suit have led courts to create the continuing wrong doctrine as a means of balancing the strict standing requirements of Rule 23.1 with the desire to grant relief to shareholders when corporate directors fail to protect the legal rights of the corporation. This struggle has caused some courts to excessively erode the Rule 23.1 protections inherent in the contemporaneous ownership requirement by creating the continuing wrong doctrine. The clearest definition and use of this doctrine is found in Bateson v. Magna Oil Corp. In Bateson, the shareholder filed a derivative suit on behalf of Magna Oil against the corporation’s directors for alleged acts of fraud, mismanagement, conspiracy, and breach of fiduciary duty. The plaintiff, a long-time shareholder in Magna Oil, acquired stock in the corporation in 1956. Despite the fact that the plaintiff claimed he knew of the directors’ improprieties, and in fact planned to bring a shareholder derivative suit on behalf of the corporation, he inadvertently sold all of his stock in the corporation on May 5, 1967. On July 21, 1967, the plaintiff reacquired one hundred shares of stock in the corporation and shortly thereafter filed a derivative suit on behalf of the corporation.

Specifically, the Bateson plaintiff alleged that the directors engaged in five wrongful transactions. First, the plaintiff alleged that Howell, one of the directors, caused the corporation “to advance him money on open account and promissory note.” Second, the plaintiff claimed that Howell caused the corporation to purchase an airplane that was

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97. Id. (citing 7C WRIGHT ET AL., supra note 24, § 1828).
98. See Kim, supra note 16, at 99.
100. See id. at 129.
101. See id.
102. See id. at 129–31.
103. See id. at 129.
104. Id.
The plaintiff’s failure to maintain ownership of shares of stock in Magna Oil from 1956 until the suit’s filing forced the Fifth Circuit to face the question of how to apply the contemporaneous ownership requirement of Rule 23.1. Although the court does not give dates for the five wrongful transactions alleged by the plaintiff, it appears from the court’s discussion that all of the wrongful transactions alleged by the plaintiff were completed prior to plaintiff’s reacquisition of shares in Magna Oil. Nevertheless, the Fifth Circuit concluded that the wrongful transactions were continuing when plaintiff reacquired shares in the corporation.

As announced in Bateson, the Fifth Circuit’s view of the term “transaction” in Rule 23.1 is broad enough to include the latent effects of completed transactions, purchases, and agreements. The advancement of money, the purchase of an airplane, the agreement to pay a set salary, and the mortgaging of property to pay a personal debt were transactions that were entered into and completed prior to the plaintiff’s acquisition of stock in July 1967. Nevertheless, for the Fifth Circuit the fact that the plaintiff owned stock when funds were still available, an airplane was still used, salaries were paid, and interest was incurred was sufficient to hold that the plaintiff was a shareholder in the corporation at the time of the wrongful transactions.

Therefore, the continuing wrong doctrine provides that the contemporaneous ownership requirement is met if the plaintiff is injured by a transaction or wrong that “spans the plaintiff’s ownership” of shares in the corporation, “if new elements in a pattern of wrongful conduct occur after” the plaintiff acquires shares in the corporation, or if the

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105. Id.
106. Id.
107. Id.
108. Id.
109. See id. at 128, 131.
110. Id. at 130.
111. See id. at 130–31.
direct effects of the wrongful transaction continue unremedied when the plaintiff acquires shares in the corporation.\footnote{112}{See id. at 130–31 (quoting Bert S. Prunty, Jr., Business Associations, 35 N.Y.U. L. REV. 1467, 1468–69 (1960)); 19 A.M.JUR.2D Corporations § 2331 (2003); Aronson et al., supra note 42, at 82.}

This doctrine clearly loosens the standing restrictions imposed on shareholder derivative plaintiffs by Rule 23.1. Until a wrong is corrected or remedied, one may reasonably argue that the wrong is continuing\footnote{113}{See 19 A.M.JUR.2D Corporations § 2332 (2003).} because the transaction’s effects, both public and private, continue to injure and damage the corporation, even though the underlying actions and events that produced the wrongful transaction may have been completed long ago. Therefore, a court that applied the continuing wrong doctrine could reasonably grant federal derivative standing to any plaintiff who puts in issue an alleged wrongful transaction that has not been corrected or remedied when the suit is filed, even if the plaintiff purchased shares in the corporation long after the underlying actions and events that produced the wrongful transaction occurred.\footnote{114}{See id.}

2. The core of the conduct doctrine

It is clear from the Second Circuit’s language that their creation of the core of the conduct doctrine was impacted by their desire to formally diverge from the excessive manner in which the continuing wrong doctrine erodes the protections of the contemporaneous ownership requirement.\footnote{115}{See Bank of N.Y. II, 320 F.3d 291, 298–99 (2d Cir. 2003).} The core of the conduct doctrine establishes a more stringent interpretation of the contemporaneous ownership requirement than the Fifth Circuit’s continuing wrong doctrine by requiring shareholder derivative plaintiffs to acquire shares in the corporation before the core of the alleged wrongful transaction occurred.\footnote{116}{See id. at 298.} What may be questioned, however, is whether the Second Circuit’s core of the conduct doctrine leaves any room for results similar to those reached through the use of the continuing wrong doctrine. This question arises from the Second Circuit’s limited definition of the “core” of a wrongful transaction and the fact that this creates room for some judicial interpretation, but ultimately there are several reasons why the core of the conduct doctrine will not produce results similar to those of the continuing wrong doctrine.

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\begin{itemize}
  \item 112 See id. at 130–31 (quoting Bert S. Prunty, Jr., Business Associations, 35 N.Y.U. L. REV. 1467, 1468–69 (1960)); 19 A.M.JUR.2D Corporations § 2331 (2003); Aronson et al., supra note 42, at 82.
  \item 113 See 19 A.M.JUR.2D Corporations § 2332 (2003).
  \item 114 See id.
  \item 115 See Bank of N.Y. II, 320 F.3d 291, 298–99 (2d Cir. 2003).
  \item 116 See id. at 298.
\end{itemize}
The Second Circuit clearly stated that its view of the contemporaneous ownership requirement does not include the continuing wrong doctrine.117 The court refused “to adopt the expansive definition of the term ‘transaction’ that is inherent in the continuing wrong doctrine.”118 This expansive definition of a transaction includes the unremedied injurious effects of an otherwise completed transaction, such as the illegitimate use of an airplane purchased by a corporation prior to the plaintiff’s acquisition of shares in that corporation.119 Therefore, by rejecting the broad interpretation of transaction inherent in the continuing wrong doctrine, the court showed that the core of a wrongful transaction consists of more than the injurious effects of an unremedied wrongful transaction.

It may be argued, however, that despite the Second Circuit’s open rejection of the continuing wrong doctrine, the net effect of Bank of N.Y. II was to replace one broad doctrine of the contemporaneous ownership requirement with another. After all, the core of the conduct doctrine rests upon a determination of what events constitute the “core” of a wrongful transaction. The court’s limited definition of what constitutes the “core” of a wrongful transaction allows for the possibility that judicial interpretation of the core of the conduct doctrine could produce results similar to those under the continuing wrong doctrine. Despite this inherent weakness in the court’s opinion, its discussion of the core of the conduct doctrine strongly supports the conclusion that the core of a wrongful transaction must include some portion of the creation, organization, or implementation of the wrongful transaction, not just the injurious effects of an unremedied wrongful transaction.120

The court separates wrongful transactions into two classes: continuous transactions and discrete transactions.121 Whether a wrongful transaction is continuous or discrete “is a fact-specific question to be

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117. Id.
118. Id.
119. See Bateson v. Magna Oil Corp., 414 F.2d 128, 129–31 (5th Cir. 1969) (holding that the alleged wrongdoings, including the improper use of a airplane purchased by the corporation prior to the plaintiffs acquisition of shares in the corporation, were continuing at the time plaintiff acquired shares in the corporation); supra Part IV.A.1.
120. See generally Bank of N.Y. II, 320 F.3d at 298 n.4 (discussing two forms of transactions and what constitutes the core of each).
121. Id.
decided on a case-by-case basis.” 122 The court held that if a continuous transaction—“a single, ongoing transaction” 123—is involved, “the plaintiff must have acquired stock in the company before all of the core conduct occurred in order to bring suit.” 124 On the other hand, the court held that if discrete transactions—“wrongful conduct [that] consists of a series of separate transactions” 125—are involved, the “plaintiff may assert standing over those transactions for which the core conduct occurred after the plaintiff acquired stock in the company.” 126 Whether the transaction is discrete or continuous, valid derivative standing would require that the plaintiff acquire shares in the company before all of the core conduct for each distinct transaction occurred.

For this reason, the Second Circuit denied standing to the Kaliskis. 127 Even though they acquired BONY shares prior to the total shut down of the Prokutki scheme (a continuous transaction), 128 they did not acquire their shares prior to the creation, organization, or implementation of the scheme. Therefore, even though the Second Circuit does explain what events constitute the “core conduct” of a transaction, it is likely from their holding in Bank of N.Y. II that, in the court’s view, the “core conduct” of a wrongful transaction includes the creation, organization, or implementation of the transaction. Future courts should take this approach when determining what constitutes the “core conduct” of a wrongful transaction in order to follow the Second Circuit’s clear intent to create a more stringent interpretation of the contemporaneous ownership requirement than currently found in the continuing wrong doctrine. As a consequence, the holding in Bank of N.Y. II eliminates the continuing wrong doctrine in the Second Circuit.

122. Id. (“Whether the conduct at issue in a given complaint amounts to a continuous transaction or a series of discrete transactions is a fact-specific question to be decided on a case-by-case basis.”).
123. Id.
124. Id.
125. Id.
126. Id.
127. Id. at 297–99.
128. Although the court does not expressly state that the Prokutki scheme was a continuous transaction, it is apparent from their language that it was. Had the scheme been considered a discrete transaction by the court the Kaliskis’ claim would have been allowed on those portions of the Prokutki scheme that occurred after they acquired BONY stock.
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B. The Continuing Wrong Doctrine Versus the Core of the Conduct Doctrine

Because the core of the conduct doctrine articulated by the Second Circuit in *Bank of N.Y. II* eliminates the continuing wrong doctrine, it is now necessary to determine whether that decision was correct and how Rule 23.1 will now operate within the Second Circuit.

Rule 23.1 protects against potential abuses of the shareholder derivative suit by (1) “prevent[ing] potential derivative plaintiffs from ‘buying a lawsuit’ by purchasing stock,”129 (2) “insur[ing] that derivative actions are brought by shareholders who have actually suffered injury and have an interest in the outcome of the case,”130 and (3) preventing shareholders from manufacturing federal diversity jurisdiction by transferring their stock to an out-of-state resident.131 Despite the equitable foundation of the continuing wrong doctrine, the doctrine weakens these three protections, while the core of the conduct doctrine132 found in *Bank of N.Y. II* strengthens them. The center of the core of the conduct doctrine rests upon the court’s definition of what constitutes the “core” of a transaction. The Second Circuit stated that its view of what constitutes the core of a wrongful transaction is not so broad as to include all relevant events, but as suggested above, likely includes the creation, organization, or implementation of the transaction.133 The simple fact pattern that follows demonstrates that the Second Circuit correctly rejected the continuing wrong doctrine because the doctrine makes it more probable that the shareholder derivative suit will be used as a vehicle to litigate purchased grievances, will be used by uninjured shareholders, and will be used to manufacture federal diversity jurisdiction.

Suppose the director of a large corporation causes the corporation to enter into a transaction that violates state law. Initially, the wrongful transaction causes substantial damage to the corporation and its shareholders. After the transaction is completed, the director uses his influence to ensure that damages from the transaction are not remedied,

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130. Id. (quoting Ensign, 1990 WL 213085, at *2).
131. 7C WRIGHT ET AL., *supra* note 24, § 1828.
132. See *supra* Part II.B.
133. *Bank of N.Y. II*, 320 F.3d at 298 n.4.
thereby causing further nominal losses to the corporation and its shareholders on a monthly basis. Although the damaging effects of the harmful transaction are not yet widely known, a private investor learns of the wrongful transaction through a friend who owns shares in the corporation and resides in the state where the corporation is incorporated. The friend sells his shares to the investor at above fair market value, after which the investor files a shareholder derivative suit in federal court based on diversity jurisdiction. The investor argues that his stock ownership meets the contemporaneous ownership requirement of Rule 23.1 because the injurious effects of the wrongful transaction remained unremedied when he purchased his shares in the corporation, thus satisfying the continuing wrong doctrine.

Although this fact pattern may be simple, it demonstrates the flaws of the continuing wrong doctrine. Under the continuing wrong doctrine, derivative standing exists if the shareholder acquires shares before the injurious effects of the wrongful transaction are remedied.\textsuperscript{134} Even though the transaction was essentially completed before the investor acquired shares in the corporation, its injurious effects continued at the time the investor acquired his shares, thus meeting the requirements of the continuing wrong doctrine.\textsuperscript{135} Therefore, applying the continuing wrong doctrine would undermine all three of the shareholder derivative suit protections contained in Rule 23.1\textsuperscript{136} by granting standing to a plaintiff who is litigating a purchased grievance, is not a shareholder that was truly harmed by the wrongful transaction, and has manufactured federal diversity jurisdiction.

While such a situation could reasonably happen if courts apply the continuing wrong doctrine, the Second Circuit’s core of the conduct doctrine would prevent such a situation. Under the core of the conduct doctrine, the investor would be denied standing upon the court’s finding that the core of the transaction—the wrongful transaction that the director caused the company to enter into—was completed prior to the investor’s acquisition of shares in the corporation.\textsuperscript{137}

This fact pattern highlights the fatal flaw of the continuing wrong doctrine. The continuing wrong doctrine undermines the contemporaneous ownership requirement by defining the term

\textsuperscript{134} See Bateson v. Magna Oil Corp., 414 F.2d 128, 130–31 (5th Cir. 1969) (holding that the injurious effects of an unremedied wrongful transaction are continuing wrongs); supra Part IV.A.1.

\textsuperscript{135} See supra note 132.

\textsuperscript{136} See supra text accompanying notes 129–31.

\textsuperscript{137} See Bank of N.Y. II, 320 F.3d at 298–99 (describing the core of the conduct test).
“transaction” so broadly that it strips the requirement of any power. Under the continuing wrong doctrine, shareholders can more easily litigate purchased grievances because plaintiffs can show, with relatively little effort, that the effects of the wrongful transaction have gone unremedied. Likewise, the ease with which shareholders can satisfy the continuing wrong doctrine makes it nearly impossible to “insure that derivative actions are brought by shareholders who have actually suffered injury and have an interest in the outcome of the case.”

Finally, shareholders are not effectively barred from manufacturing federal diversity jurisdiction because the continuing wrong doctrine allows the transfer of corporate shares to a new shareholder who may then initiate the litigation so long as the underlying transaction is not remedied and the effects of the transaction continue.

The Second Circuit’s holding in Bank of N.Y. II is superior to the continuing wrong doctrine because it is more closely aligned with the contemporaneous ownership requirement, thus safeguarding the protections of Rule 23.1 while still allowing plaintiffs to receive equitable results for actual injuries. Bank of N.Y. II does not require that the shareholder own shares in the corporation during the entire course of events that constitutes the wrongful transaction. Rather, the Second Circuit requires that the shareholder have owned shares in the corporation before the core of the wrongful conduct transpired. This requirement prevents shareholders from litigating purchased grievances because it ensures that they actually suffered from the wrongful transaction and have a stake in the outcome of the case. In addition, the Second Circuit’s core of the conduct doctrine prevents forum shopping by making it nearly impossible for a shareholder to transfer her corporate shares to an out-of-state resident without violating the contemporaneous ownership test.

Finally, the core of the conduct doctrine still allows the court to achieve equitable results. This doctrine clearly sets a higher standard than the continuing wrong doctrine, but it does not establish a bright-line rule. It is unclear where the core of the conduct doctrine lies on the spectrum between continuous injurious effects and all relevant events because the court also held that the doctrine’s application is fact

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139. See Bank of N.Y. II, 320 F.3d at 298.
140. See id.
141. See supra Part III.C.
specific. As a result, judges will still be able to achieve equitable results when deciding what constitutes the core of a wrongful transaction. They will not be able to extend derivative standing as far as the continuing wrong doctrine allowed, but it appears that the Second Circuit’s limited definition of the core of a transaction gives judges a little wiggle room for equitable considerations. Shareholder derivative plaintiffs will be able to appeal to a judge’s discretion by arguing that those portions of the transaction that preceded their purchase of shares in the corporation did not constitute the core of the wrongful transaction unless augmented by the portions of the transaction that followed their purchase of corporate shares. Therefore, judges will theoretically be able to reach equitable results by broadly determining what constitutes the core of the transaction when equity lies on the side of the shareholder.

V. CONCLUSION

In Bank of N.Y. II, the Second Circuit correctly eliminated the continuing wrong doctrine some courts had read into Rule 23.1 in shareholder derivative suits. The continuing wrong doctrine allowed shareholders to meet the contemporaneous ownership requirement of Rule 23.1 even though they may have acquired corporate shares after the underlying transactions were completed but not yet remedied. This broad exception weakened the contemporaneous ownership requirement of Rule 23.1 to the point that it did not effectively protect against litigation of purchased grievances, litigation by uninjured and uninterested shareholders, and manufactured federal diversity jurisdiction.

The Second Circuit rejected the continuing wrong doctrine and provided a new interpretation of the contemporaneous ownership requirement, the core of the conduct doctrine. This new doctrine maintains the viability of the contemporaneous ownership requirement by requiring shareholders who bring derivative suits to have owned shares in the corporation throughout the course of the activities (defined as owning shares before the core of the wrongful acts occurred) that constitute the primary basis of the complaint. The core of the conduct

142. See Bank of N.Y. II, 320 F.3d at 298 n.4.
143. Id. at 298.
144. See generally Bateson v. Magna Oil Corp., 414 F.2d 128, 129–31 (5th Cir. 1969) (granting shareholder derivative standing to a shareholder who acquired shares in the corporation after the underlying transactions were completed but not yet remedied).
145. Bank of N.Y. II, 320 F.3d at 298.
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document also promotes equitable results by not requiring the shareholder to own shares in the corporation during the period when all relevant events occurred. This leaves the door open for equitable interpretations of what constitutes the core of the transaction, thus preserving the equitable nature of the shareholder derivative suit. Ultimately, the Second Circuit’s core of the conduct doctrine is superior to the continuing wrong doctrine because it maintains the protections that Rule 23.1 was designed to provide while still allowing judges to distribute justice.

Terence L. Robinson Jr.