COMMENT

Maintaining Standing in a Shareholder Derivative Action

Sarah Wells[*]

TABLE OF CONTENTS

* Articles Editor, U.C. Davis Law Review; J.D. Candidate, U.C. Davis School of Law, 2005; B.S. Business Administration, University of the Pacific, 2002. Many thanks to our faculty, staff, and fellow editors — it has been a privilege to learn from you. Above all, I am grateful to my family and friends for their love and patience, which I tested frequently throughout this process. Finally, I want to thank my editors at the U.C. Davis Law Review, including Wendy Tauriainen, Rebecca Jackson, and Lila Hayatdavoudi, whose capable advice and hard work brought this piece to publication.

INTRODUCTION

When the Enron scandal broke in October of 2001, millions of shareholders lost billions of dollars.[1] The company itself was left in financial ruin, ultimately filing the second largest bankruptcy petition in United States history.[2] The highly publicized corporate misconduct of WorldCom, Tyco, and Global Crossing placed those companies, and their stockholders, in similar positions.[3] With no corporate leaders left to initiate civil action, these formerly thriving corporations now struggle to survive in the aftermath of their directors' illegal actions.[4] Though less sensational cases are much more frequent in the business world, these

---

[1] Edward Iwata, *Panel: FERC dropped ball on Enron*, USA TODAY, Nov. 11, 2002, *available at* http://www.usatoday.com/money/industries/energy/2002-11-12-ferc-criticism_x.htm (last visited Oct. 5, 2003); *Explaining the Enron Bankruptcy*, CNN.com, *at* http://www.cnn.com/2002/US/01/12/enron.qanda.focus/ (last visited Oct. 3, 2004) [hereinafter CNN.com, *Explaining Enron*].

[2] CNN.com, *Explaining Enron; MCI Exits Largest Corporate Bankruptcy*, ISP-LISTs, *at* http://isp-lists.isp-planet.com/isp-dsl/0404/msg00130.html (last visited Oct. 3, 2004) [hereinafter ISP-LISTs, *MCI Bankruptcy*].

[3] *See* Stephan C. Friedman, *Corporate Crooks Stole 10G From Your 401(k)*, THE NEW YORK POST, Aug. 21, 2003, *available at* http://www.lexis.com/research/retrieve/frames?_m=d193ea5caf6e6d8f70a9c43cec3e9470&csvc=fr&cform=free&_fmtstr=CITE&docnum=1&_startdoc=1&wchp=dGLbVlz-zSkAA&_md5=1c35e3013f85754577a0cbf3da4983cc.

[4] *See id.*

corporations are stunning examples of the devastating effects of mismanagement and the need for a special form of redress when the corporate leaders are at fault.[5]

When a corporation does not prosecute a cause of action itself, corporate shareholders may assert a claim on the entity's behalf.[6] These claims —— usually initiated against a director, officer, or third party —— are termed "derivative lawsuits."[7] They are not direct class actions for stockholders' individual injuries.[8] Instead, derivative lawsuits concern only the wrongs to the corporation, which are not always easy to differentiate from those of a shareholder.[9] The key is tracing the primary impact of the injury.[10] If the wrong affected the stockholders only through the resulting drop in share price, then the claim belongs to the corporation.[11] The corporation is the real victim of mismanagement, through the depletion of corporate accounts or reputation.[12] Under these circumstances, individual shareholders may recover indirectly in a derivative suit through a damage award, by virtue of their part-ownership in the corporation.[13] The acting-plaintiff, however, can recover no more than his or her legal fees for initiating the suit, if the suit is successful.[14]

This Comment takes special note of the ownership timing requirement and the chronological problems involved in publicly traded, highly desirable stock. Prospective plaintiffs lack standing to sue under Federal Rule of Civil Procedure 23.1 unless they are owners of stock during the

---

[5] *See generally* sources cited *supra* notes 1-3 (noting billions of dollars lost by shareholders and corporations as result of mismanagement and fraud).

[6] DEBORAH A. DEMOTT, SHAREHOLDER DERIVATIVE ACTIONS LAW AND PRACTICE § 1:01 (2002); FLETCHER CYC CORP § 5939 (perm ed. 1995) [hereinafter FLETCHER]; WILLIAM S. LERACH, CLASS AND DERIVATIVE ACTIONS UNDER THE FEDERAL SECURITIES LAWS 77 (1980); STANLEY NEMSER, NEW TRENDS IN SECURITIES LITIGATION 15-16 (1977) (Stuart D. Wechsler, chairman 1997); MICHAEL A. SCHAEFTLER, THE LIABILITIES OF OFFICE: INDEMNIFICATION AND INSURANCE OF CORPORATE OFFICERS AND DIRECTORS 15 (1976); Robert C. Heim et al., *Class and Derivative Litigation: Defendants' Strategy in Defending Derivative Suits, in Current Developments and Their Impact on U.S. Companies, Insurers, and Lawyers* *1 (A.L.I.-A.B.A. Course of Study Materials 1996).

[7] DEMOTT, *supra* note 6, § 1:01; FLETCHER, *supra* note 6, § 5943; LERACH, *supra* note 6, at 77; NEMSER, *supra* note 6, at 15-16; SCHAEFTLER, *supra* note 6, at 15; Heim et al., *supra* note 6, at *1.

[8] DEMOTT, *supra* note 6, §1:01.

[9] *Id.* § 2:03.

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] SCHAEFTLER, *supra* note 6, at 15-16.

[14] *Id.*

alleged wrongdoing.[15] Because of this ownership requirement, Rule 23.1 and the many state statutes that mirror its wording are commonly referred to as the contemporaneous ownership rule in most cases interpreting the issue of shareholder standing.[16] While courts almost always enforce this rule,[17] there are certain exceptions to the requirement. The most notable is the continuing wrong doctrine.[18] This doctrine allows standing if plaintiffs can show that the previous misconduct and its negative effects continued after the acquisition of the stock.[19]

Circuits are split on the use and application of the continuing wrong doctrine.[20] In February 2003, the conflict resurfaced, after a thirty-six year absence, in the Second Circuit case *In re Bank of New York Derivative Litigation*.[21] The circuit court relied solely on the contemporaneous ownership requirement, overlooking the unfair outcomes potentially created by the requirement.[22] In contrast, this Comment proposes greater judicial acceptance of the continuing wrong doctrine to reduce unfair or unpredictable decisions and make corporate recovery easier to obtain.

This Comment discusses the history behind Rule 23.1 and its state counterparts, as well as the evolution of its various versions. Part I describes the history of derivative suits and the standing issues. Part II examines the present state of the law and its shortcomings within the current legal climate. Part III presents the policy concerns of the judiciary and legal scholars, and also debates the arguments favoring both legal standards. Finally, this Comment advocates greater use of the continuing wrong doctrine. A framework similar to the American Law Institute's Model Statute is outlined in Part IV as a wholly feasible solution to the circuit conflict. Ultimately, this Comment explains the

---

[15] *Id.*; DEMOTT, *supra* note 6, § 2:02; FLETCHER, *supra* note 6, § 5972; NEMSER, *supra* note 6, at 17; John L. Reed et al., *Directors' and Officers' Liability for Y2K: A Corporate Governance Bear and a Securities Litigation Bull?*, *20 (A.L.I.-A.B.A. Course of Study Materials 1999); Lawrence A. Larose, *Suing in the Right of the Corporation: A Commentary and Proposal for Legislative Reform*, 19 U. MICH. J.L. REFORM 499, 528-29 (1986).

[16] FLETCHER, *supra* note 6, § 5981; *see In re* Bank of New York Derivative Litigation, 320 F.3d 291 (2d Cir. 2003) [hereinafter *In re BONY*]; Bateson v. Magna Oil Corp., 414 F.2d 128 (5th Cir. 1969); Gallup v. Caldwell, 120 F.2d 90 (3d Cir. 1941); Rinn v. Asbestos Mfg. Co., 101 F.2d 344 (7th Cir. 1938).

[17] FLETCHER, *supra* note 6, § 5981.

[18] *Id.*; Anne Charles Haberle et al., 19 AM. JUR. 2D. *Corporations* § 2332 (1985).

[19] FLETCHER, *supra* note 6, § 5982; LERACH, *supra* note 6, at 82; Heim et al., *supra* note 6, at *4; Larose, *supra* note 15, at 532.

[20] *Compare Gallup*, 120 F.2d at 90 (employing contemporaneous ownership rule), *and Rinn*, 101 F.2d 344 (same), *with Bateson*, 414 F.2d at 128 (using continuing wrong doctrine).

[21] *In re Bank of New York*, 320 F.3d 291 (2d Cir. 2003).

[22] *See In re BONY*, 320 F.3d at 298; Larose, *supra* note 15, at 529-30.

myriad reasons to support the use of the continuing wrong doctrine. Such a change would preserve the ideals of justice and fairness which are of great import to courts when evaluating the continuing wrong doctrine.

I. BACKGROUND

Derivative suits have undergone some changes since they became part of American law in the 1800s.[23] Throughout the metamorphosis, courts have remained anxious about potential abuse in the derivative process. The creation of complex ownership requirements demonstrates the courts' anxiety.[24] Recent scholarly evaluations of the judiciary's policy-based approach, however, have called for a more straightforward method to establish standing.[25] In fact, three states enacted their own derivative requirements, completely ignoring the contemporaneous ownership rule.[26] Both a change in the Federal Rules and in the corporate climate are responsible for this new interpretation of derivative suit requirements. Understanding the legal history of derivative lawsuits is imperative to understanding the current conflicts.

A. The Historic Evolution of Derivative Suits

The modern form of derivative litigation developed in the United States during the mid-nineteenth century.[27] Early court cases noted that such suits could result in possible jurisdictional preferences and abuse by minority shareholders trying to usurp the directors' decision-making role.[28] With this in mind, the United States Supreme Court established requirements that shareholder plaintiffs must satisfy in order to proceed

---

[23] FLETCHER, *supra* note 6, § 5940.

[24] *See In re BONY*, 320 F.3d at 297 (noting purpose of contemporaneous ownership rule is to prevent purchased grievances); Ensign Corp., S.A. v. Interlogic Trace Inc., 1990 U.S. Dist. LEXIS 17147, at *7 (S.D.N.Y. 1990) (explaining that policy behind contemporaneous ownership is to prevent purchased suit and ensure suit is brought by shareholder with interest in outcome).

[25] *See generally Ensign*, 1990 U.S Dist. LEXIS 17147, at *9 (recognizing American Law Institute's suggested replacement).

[26] *See* sources and discussion *infra* notes 61-62.

[27] FLETCHER, *supra* note 6, § 5940; *see* Dodge v. Woolsey, 18 How. 331, 331 (1855) (holding that bank directors were properly joined in equity suit for breach of fiduciary duty).

[28] DEMOTT, *supra* note 6, § 1:03; FLETCHER, *supra* note 6, § 5940; *see* Hawes v. Oakland, 104 U.S. 450, 450 (1881) (establishing requirement that plaintiffs must show fraud or breach of trust and that will of majority must govern corporate actions); Larose, *supra* note 15, at 499-500.

derivatively in federal courts.[29] The rules were codified in 1938 in Rule 23 of the Federal Rules of Civil Procedure, which treated derivative actions as a part of the class action suits they resemble.[30] In 1966, Congress substantially revised the rules, and Rule 23.1 was added to treat derivative suits separately,[31] with the distinctive aspects of derivative suits in mind.[32]

Rule 23.1 now requires a verified complaint containing four allegations.[33] First, the plaintiff must have been "a shareholder or member at the time of the transaction of which the plaintiff complains or the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law."[34] Second, the complaint must state that the action is not collusive to help confer jurisdiction.[35] Third, the Rule requires that the plaintiff previously demanded specific action from the directors.[36] Finally, the plaintiff must fairly and adequately represent similarly situated stockholders.[37]

---

[29] DEMOTT, *supra* note 6, § 1:03; FLETCHER, *supra* note 6, § 5940; *see Hawes*, 104 U.S. at 450; Larose, *supra* note 15, at 499-500.

[30] David B. Levendusky, Annotation, *Requirement of Rule 23.1 of Federal Rules of Civil Procedure that Plaintiff in Shareholder Derivative Action "Fairly and Adequately Represent" Shareholders' Interests in Enforcing Corporation's Rights*, 15 A.L.R. FED. 954, *2 (2003).

[31] *Id.*; FLETCHER, *supra* note 6, § 5940; *see* FED. R. CIV. P. 23.1.

[32] FED. R. CIV. P. 23.1 advisory committee's notes (1966 ed.)

[33] FED. R. CIV. P. 23.1. Full text:

> In a derivative action brought by one or more shareholders or members to enforce a right of 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 plaintiff was a shareholder or member at the time of 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 in a court of the United States which it would otherwise not 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 of for not making the effort. The derivative action may not be maintained if it appears that plaintiff does not fairly and adequately represent the interests of the shareholder 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 a manner as the court directs.

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] *Id.*

B. Court Concerns about Professional Plaintiffs' Role in Derivative Actions

The wording and interpretation of Rule 23.1 are precisely aimed at guaranteeing that derivative suits are brought to protect a corporation's interests, not those of the shareholders.[38] This is especially true of the ownership period requirements, which seek to identify plaintiffs who will best represent the injured corporation.[39] Of foremost concern is the prevention of purchased lawsuits by professional plaintiffs.[40] These so-called professional plaintiffs look for injured companies, as reflected in depressed stock prices, and purchase stock so that they may act as plaintiff in a derivative suit.[41] They hope to reap a windfall in these purchased suits if the corporate fund is successfully replenished by a damage award.[42] The professional plaintiffs' involvement in the case may extend no further than allowing a lawyer to file abusive suits in their name, in exchange for bounty payments and bonuses.[43] Courts' general practice of awarding generous attorney's fees lures devious lawyers to recruit plaintiffs and to file complaints.[44]

Similarly, courts are concerned with thwarting potential strike suits to blackmail the corporation.[45] Officers may repurchase plaintiffs' shares at an exorbitant price or agree to large settlement payments in exchange for discontinuing the suit.[46] A frivolous suit is an expensive nuisance, and a meritorious suit can be quite dangerous to a director.[47] Often, the mere threat of such a suit is enough to trigger the desired offer.[48] A director hoping to hide his or her indiscretions or merely dispose of annoying,

---

[38] FLETCHER, *supra* note 6, § 5940; SCHAEFTLER, *supra* note 6, at 16-17 (1976).

[39] *See* DEMOTT, *supra* note 6, § 1:01 (stating purpose of derivative litigation is to recover for corporation); FLETCHER, *supra* note 6, §§ 5939, 5941.10 (stating purpose of derivative suit is to right wrongs and shareholder is merely representative).

[40] *See In re BONY*, 320 F.3d 291 (2d Cir. 2002); Ensign Corp., S.A. v. Interlogic Trace Inc., 1990 U.S. Dist. LEXIS 17147, at *7 (S.D.N.Y. 1990); DEMOTT, *supra* note 6, § 4:03; SCHAEFTLER, *supra* note 6, at 15; Nicholas E. Chimicles, *The Future of Litigation Under the Private Securities Litigation Reform Act, in Securities Litigation: Planning and Strategies for the '90s and Beyond* *8 (A.L.I.-A.B.A. Course of Study Materials 1996); Larose, *supra* note 15, at 529-32.

[41] Bateson v. Magna Oil Corp., 414 F.2d 128, 131 (5th Cir. 1969); *Ensign Corp.*, 1990 U.S. Dist. LEXIS 17147, at *7; Larose, *supra* note 15, at 529-30.

[42] *Bateson*, 414 F.2d at 131; *Ensign Corp.*, 1990 U.S. Dist. LEXIS 17147, at *7; Larose, *supra* note 15, at 529-30.

[43] Chimicles, *supra* note 40, at *8; *see* DEMOTT, *supra* note 6, § 1:03.

[44] DEMOTT, *supra* note 6, § 1:03; SCHAEFTLER, *supra* note 6, at 16.

[45] SCHAEFTLER, *supra* note 6, at 16-17; Heim et al., *supra* note 6, at *3.

[46] *Id.*

[47] SCHAEFTLER, *supra* note 6, at 16.

[48] *Id.*

expensive litigation often agrees to a settlement that is not in the corporation's best interest.[49] With so much money at stake, courts worry that the injured corporation and its original stockholders may face even greater injury if the corporation makes a large settlement offer, whether or not the suit was meritorious.[50]

Concomitant with these types of suits is the courts' fear that a litigious plaintiff may not adequately represent the corporation.[51] The lead plaintiff is merely a voluntary substitute for the corporation, and the court's decision is final, regardless of the plaintiff's intentions.[52] When the purpose of a suit is to recover for financial injuries officers inflicted upon the corporation, the plaintiff must act to maximize damages with a minimum of legal costs.[53] In addition, the judgment affects the plaintiff's fellow shareholders' recovery in the form of increased stock price and corporate value.[54] A potential plaintiff looking for the financial windfall attendant with purchase and strike suits likely will not operate with these interests in mind.[55] The plaintiff may accept a stock repurchase or small settlement offer including attorney's fees, without fully compensating the corporation.[56]

C. *Shift Toward Continuing Wrong Doctrine*

States differ in their treatment of derivative suits. Thirty-three states have developed their own statutory provisions addressing derivative suits and thirty-two have incorporated these statutes into their rules of civil procedure, which tend to be more precise.[57] Of those states that have enacted their own versions of Rule 23.1's ownership requirements,

---

[49] *Id.* at 16-17 (citing *Manufacturers Mutual Fire Insurance v. Hopson*, 176 Misc. 220 (N.Y Sup. Ct. 1940), where plaintiffs exploited nuisance value of suit to force settlement of seven times stock's actual market value).

[50] Ensign Corp., S.A. v. Interlogic Trace Inc., 1990 U.S. Dist. LEXIS 17147, at *7 (S.D.N.Y. 1990); Larose, *supra* note 15, at 529-30.

[51] *Ensign Corp.*, 1990 U.S. Dist. LEXIS at *7. *See generally* Bateson v. Magna Oil Corp., 414 F.2d 128, 131 (5th Cir. 1969) (holding that long-standing shareholder who sold stock "allegedly inadvertently" but purchased back before filing suit was sufficiently concerned with management to have adequate interest in case for purposes of standing).

[52] DEMOTT, *supra* note 6, § 1:03; FLETCHER, *supra* note 6, § 5941.10.

[53] *See* DEMOTT, *supra* note 6, §§ 1:01, 1:03, 2:02 (establishing that purpose of suit is to recover damages and that attorney fees may be recovered from this award); SCHAEFTLER, *supra* note 6, at 16 (noting recoverable cost of legal fees).

[54] *See* Larose, *supra* note 15, at 514 (discussing shareholder stake in litigation).

[55] *See* DEMOTT, *supra* note 6, § 4:03; SCHAEFTLER, *supra* note 6, at 15; Chimicles, *supra* note 40, at *8; Heim et al., *supra* note 6, at *3.

[56] *Id.*

[57] FLETCHER, *supra* note 6, § 4.02.

fourteen have statutes that closely parallel it, and all but three of the states' civil procedure rules follow the federal rule verbatim.[58] Two states, Maryland and Oregon, have neither rule nor statute governing derivative suits, though case law does allow such shareholder actions.[59] Despite the similar language of all these guidelines, states have interpreted the ownership requirement differently.[60] California and Pennsylvania provide specific exceptions to the contemporaneous ownership rule, Rhode Island does not require contemporaneous ownership at all, and Minnesota is completely silent on the issue.[61] These four states have attempted to both expand the number of plaintiffs eligible for standing and prevent the misuse that courts fear when a derivative suit is filed.[62]

Conscious of the sometimes negative effects of the contemporaneous ownership rule, California, Pennsylvania, and Ohio have explicitly or implicitly adopted the continuing wrong doctrine.[63] The Fifth Circuit

---

[58] *Id.* The states whose statutes mirror Federal Rule 23.1 are Alaska, California, Georgia, Kentucky, Maine, Michigan, Nebraska, Nevada, New York, North Carolina, Oklahoma, South Carolina, Tennessee, and Wisconsin. Connecticut, North Carolina, and Rhode Island are the exceptions to this mirroring trend.

[59] *Id.*

[60] DEMOTT, *supra* note 6, §§ 4:02, 4:03 (discussing Rhode Island's and Minnesota's statutes); FLETCHER, *supra* note 6, § 5981 (noting California and Pennsylvania statutes and additional precautions); Larose, *supra* note 15, at 529 (noting California's and Pennsylvania's statutes).

[61] *Id.*

[62] *Id.*

[63] Larose, *supra* note 15, at 531 n.104 (listing CAL. CORP. CODE § 800 (West 1977 & Supp. 1985), OHIO CIV. R. 23.1 (West 1970 & Supp. 1985), and WIS. STAT. ANN. § 180.403 (West 1957 & Supp. 1985) as adopting continuing wrong doctrine). California has specifically authorized the use of the continuing wrong doctrine. Its corporations statute states, in relevant part, that:

> [T]he plaintiff [must] allege that [plaintiff] . . . was a shareholder . . . at the time of transaction *or any part thereof* which plaintiff complains or that plaintiff's shares . . . thereafter devolved upon plaintiff by operation of law from a holder who was a holder at time of transaction *or any part complained thereof*; provided that any shareholder who does not meet these requirements may nevertheless be allowed in the discretion of the court to maintain the action [. . .] (should there be another "." At the end of the sentence so it would be ". . . ."?

CAL. CORP. CODE § 800(b)(1) (West 1977 & Supp. 1985) (emphasis added). Neither the Ohio nor Wisconsin statute are blatant endorsements of the doctrine as alleged. However, the continuing wrong doctrine is not without some additional state support. DEMOTT, *supra* note 6, § 4:03. Minnesota has no ownership requirement and Pennsylvania has an exception to the contemporaneous ownership rule that is even less strenuous than the California statute. *Id.* Pennsylvania's statute states, in relevant part, that "[a]ny shareholder . . . who, except for [ownership] provisions of subsection (a) would be entitled to maintain the action or proceeding and who does not meet such requirements may,

Court of Appeals has also shown support for the doctrine.[64] The courts in these jurisdictions allow plaintiffs standing to sue if they can show that the misconduct continued to occur after they purchased their shares.[65] In keeping with the contemporaneous ownership rule's purpose, these jurisdictions only apply the doctrine in cases where potential plaintiffs were unaware of the wrongdoing before acquiring shares.[66] However, the dangers of purchased litigation and the other hazards of derivatives suits are still quite strong, and the continuing wrong doctrine is applied sparingly, even in these supportive jurisdictions.[67]

II. STATE OF CURRENT LAW

The circuit split over the contemporaneous ownership rule remained dormant after the Fifth Circuit's ruling in 1969, favoring the continuing wrong doctrine.[68] In 2003, the Second Circuit revived this debate in *In re Bank of New York Derivative Litigation*.[69] Though the court chose to adopt the contemporaneous ownership rule, the lack of any recent court decisions forced it to rely on cases decided before the implementation of Federal Rule 23.1 in an effort to support its findings.[70] With this decision came a new discussion of the standing issue and the various ways the court may protect a corporation's recovery.[71]

---

nevertheless in the discretion of the court, be allowed to maintain the action or proceeding . . . ." PA. STAT. ANN. tit. 15 § 1782 (Purdon 1987).

[64] *See* Bateson v. Magna Oil Corp., 414 F.2d 128 (5th Cir. 1969).

[65] FLETCHER, *supra* note 6, § 5982; 2-14A MOORE'S MANUAL — FEDERAL PRACTICES AND PROCEDURE § 14A.102 (2004) [hereinafter MOORE'S MANUAL]; Larose, *supra* note 15, at 531-32.

[66] *In re BONY*, 320 F.3d 291, 298 (2d Cir. 2002); *Bateson*, 414 F.2d at 131; MOORE'S MANUAL, *supra* note 65, § 14A.102.

[67] Ensign Corp., S.A. v. Interlogic Trace Inc., 1990 U.S. Dist. LEXIS 17147, at *8 (S.D.N.Y. 1990).

[68] *Bateson*, 414 F.2d at 128.

[69] *In re BONY*, 320 F.3d at 299.

[70] *See* Gallup v. Caldwell, 120 F.2d 90, 94 (3d Cir. 1941) (relying on Rule 23 for derivative suit requirements); Rinn v. Asbestos Mfg. Co., 101 F.2d 344, 344-45 (7th Cir. 1938) (using requirements prior to 1966 revision).

[71] *See Ensign Corp.*, 1990 U.S. Dist. LEXIS 17147, at *8 (noting American Law Institute's desire to "streamline" standing decisions).

A. Re-emergence of the Standing Issue and Contemporaneous Ownership Rule

In *In re Bank of New York*, the Second Circuit Court dismissed a shareholder derivative suit for lack of standing under the contemporaneous ownership rule.[72] The court explicitly refused to accept the continuing wrong doctrine.[73] The case, decided in February 2003, was a derivative action filed against officers and directors of the Bank of New York.[74] The plaintiff-shareholders alleged that directors committed systematic wrongs during the bank's expansion into the Russian banking industry.[75] The core of these transactions took place in the early- to mid-1990's, though the executives hid their misconduct throughout the end of the decade.[76]

The plaintiffs, Edward and Mildred Kaliski, sought redress for the effects of a money-laundering scheme called "Prokutki" ("spinning around" in Russian).[77] Three top-ranking employees devised the scheme in 1992 and continued the activity throughout the decade.[78] The Kaliskis did not purchase their stock until July 21, 1998, after much of the illegal activity had occurred.[79] Several Bank of New York employees, however, pled guilty to federal crimes committed as late as 2000.[80] Though the Republic Bank of New York filed a Suspicious Activities Report with the Treasury Department one month after the Kaliskis' purchase, no real news concerning the Bank of New York's illegal activities was public at that time.[81] More than one year after the Kaliskis' purchase, *The New York Times* reported the first indication of trouble in a front-page article entitled "Activity at Bank Raises Suspicions of Russia Mob Tie."[82]

---

[72] *2nd Circuit: Plaintiffs Didn't Hold Shares During Core Period*, 1-9 MEALEY'S EMERGING SEC. LITIG. 14 (Mar. 2003) [hereinafter MEALEY'S]; *see In re BONY*, 320 F.3d at 291.

[73] *In re BONY*, 320 F.3d at 299 (stating "[W]e decline the Kaliskis' invitation to adopt [continuing wrong doctrine] for the purposes of Federal Rule of Civil Procedure 23.1 . . . . Instead, we hold that, in order to assert standing under the contemporaneous ownership rule, a plaintiff must have owned stock in the corporation throughout the course of the activities that constitute the primary basis of the complaint.").

[74] *Id.* at 293.

[75] *Id.*

[76] *Id.*

[77] *Id.* at 294.

[78] *Id.*; *see* MEALEY'S, *supra* note 72, at 14.

[79] *In re BONY*, 320 F.3d at 294.

[80] MEALEY'S, *supra* note 72, at 14.

[81] *In re BONY*, 320 F.3d at 299.

[82] *Id.*; Raymond Bonner & Timothy O'Brien, *Activity at Bank Raises Suspicions of Russia Mob Tie*, N. Y. TIMES, Aug. 19, 1999, at A1.

Based on these facts, the Southern District Court of New York held the continuing wrong doctrine inapplicable.[83] It found that the acts complained of during the Kaliskis' tenure of ownership were effects of prior wrongdoing or separate instances altogether.[84] The court believed the Kaliskis purchased stock with the sole intention of suing based on multiple reports on the corruption and illegal activities in Russian banking.[85] These reports, however, contained nothing specific regarding the Bank of New York.[86]

The Second Circuit court upheld the dismissal by the district court.[87] It required the plaintiffs to own stock during the primary basis of the complained wrongs to have standing under Rule 23.1.[88] Because the Kaliskis purchased their stock well after all or most of the illegal transactions occurred, they lacked standing under the rule.[89] The court did not consider the continuing wrong doctrine because it found no continuous misconduct during plaintiffs' ownership and reiterated the district court's rationale.[90] Neither court considered the possible injustice the contemporaneous ownership requirement created or the changing corporate climate.[91]

1. Reliance on Out-Dated Case Law to Support Contemporaneous Ownership Rule

The Second Circuit supported its ruling with case law from the Third and Seventh Circuits decided over six decades earlier.[92] The most recent decision came in a 1941 case from the Third Circuit, *Gallup v. Caldwell*.[93] Bella Gallup, a shareholder of Indian Territory Illuminating Oil Co., filed an action to recover damages for the defendant director's alleged

---

[83] *In re BONY*, 320 F.3d at 299.

[84] *Id.*

[85] *Id.* at 296-97; *In re* Bank of New York Derivative Litig. (Kaliski v. Bacot, 173 F. Supp. 2d 193, 199 (S.D.N.Y. 2001)].

[86] *In re BONY*, 173 F. Supp. 2d at 199.

[87] *In re BONY*, 320 F.3d at 299.

[88] *Id.*

[89] *Id.*

[90] *Id.* at 296.

[91] *See generally id.* at 291 (dismissing continuing wrong doctrine based on older court rationale); *In re BONY*, 173 F. Supp. 2d at 199 (dismissing plaintiffs' arguments in favor of out-dated courts' ruling).

[92] *See* Gallup v. Caldwell, 120 F.2d 90 (3d Cir. 1941); Rinn v. Asbestos Mfg. Co., 101 F.2d 344 (7th Cir. 1938).

[93] *Gallup*, 120 F.2d at 90.

corporate waste.[94] While plaintiff averred that she was a stockholder during some of the wrongdoing, the stock certificates were all held in her daughter's name.[95]

Under New Jersey state law, Gallup's assertions and documentations sufficiently satisfied equitable ownership requirements, though she was not the shareholder of record.[96] The wrongdoing began in 1930, however, and she did not purchase the shares until April of 1937.[97] Following the earlier promulgations of the federal law governing derivative suits, Rule 23(b), the Third Circuit concluded that the plaintiff could complain only of acts that occurred after she purchased shares in the company.[98] The court never discussed the continuing wrong doctrine.[99]

Three years prior to *Gallup*, the Seventh Circuit handed down a similar decision in favor of the contemporaneous ownership rule, in *Rinn v. Asbestos Mfg. Co.*[100] Like the Third Circuit, the Seventh Circuit also decided this case under the former incarnation of the federal rule, when it was still included with class actions in subsection b of Rule 23.[101] Although the case was primarily an appeal of the lower court's ruling that found no fraud or mismanagement, it indirectly touched upon the issue of standing.[102] In dicta, the court chastised the plaintiffs, noting that the events took place long before the plaintiffs' stock purchase.[103] Prior to *In re Bony*, *Rinn* and *Gallup* were the most recent judgments of any circuit in favor of the contemporaneous ownership rule.[104]

---

[94] *Id.* at 91-92.

[95] *Id.* at 93.

[96] *Id.* at 94.

[97] *Id.*

[98] *Id.* at 95.

[99] *See generally id.* (indicating no judicial attention concerning policy or rationale behind decision nor any adherence to doctrine).

[100] 101 F.2d 344 (7th Cir. 1938). Plaintiffs in this case were four individual shareholders owning just 240 shares of a total issue of over 300,000. *Id.* They alleged that directors of the Asbestos Company diverted funds to themselves, though the company apparently incurred no great harm and was still a viable, going-concern at the time of suit. *Id.*

[101] *Id.* at 345.

[102] *Id.* at 347.

[103] *Id.*

[104] *See In re* BONY, 320 F.3d 291, 298 (2d Cir. 2002).

2. Reliance on Lower Court Decisions to Support the Contemporaneous Ownership Rule

In addition to relying on six-decade old cases from other circuits, the Second Circuit Court, in *In re BONY*, used a more recent district court case to justify its rationale.[105] The Southern District of New York decided *Ensign Corp., S.A. v. Interlogic Trace, Inc.* in 1990 under the current rule, Rule 23.1.[106] The plaintiff, Ensign Corp., was a Panamarian corporation that owned stock in a New York corporation, Interlogic Trace Inc.[107] Ensign alleged that Interlogic's directors used corporate assets to purchase stock in a related corporation in an effort to retain personal control of it.[108] Ensign purchased its stock after the first contested stock transaction, but prior to the second transaction.[109] Ensign tried to invoke the continuing wrong doctrine to establish standing for both transactions, but the district court declined this application.[110]

The court called the continuing wrong doctrine nothing more than an expansive definition of the word "transaction" under Rule 23.1.[111] It cited the familiar policy concerns in its rationale: the prevention of purchased litigation and ensuring that injured parties bring the suit.[112] The court noted that other courts invoke the continuing wrong doctrine sparingly, if at all.[113] The court decided that any negative effects of the first transaction were complete on the day the transaction was complete and, accordingly, denied standing as to the first count.[114] Despite the Second Circuit's decision, however, some courts, and an increasing number of scholars, support the continuing wrong doctrine.[115]

---

[105] *See generally id.* (noting existence of little persuasive authority and reliance on cases in district).

[106] Ensign Corp., S.A. v. Interlogic Trace Inc., 1990 U.S. Dist. LEXIS 17147, *1-4 (S.D.N.Y. 1990).

[107] *Id.*

[108] *Id.*

[109] *Id.* at *5.

[110] *Id.* at *5-8.

[111] *Id.*

[112] *Id.* at *7.

[113] *Id.* at *8.

[114] *Id.* at *11.

[115] *See generally* Bateson v. Magna Oil Corp., 414 F.2d 128 (5th Cir. 1969); Chimicles, *supra* note 40, at *8; Heim, *supra* note 6, at *3; Reed, *supra* note 15, at *20 (illustrating variety of American Bar Association and American Legal Institute publications supporting or indicting virtues of continuing wrong doctrine in current legal environment).

B. Circuit Support for Continuing Wrong Doctrine

The Fifth Circuit is the only circuit court explicitly supporting the continuing wrong doctrine.[116] It did so in the 1969 decision, *Bateson v. Magna Oil Corp.*[117] In *Bateson*, a decade-long shareholder inadvertently sold all of his several hundred shares on May 5, 1967.[118] He repurchased one hundred shares over two months later, on July 21, 1967, and promptly filed a suit, alleging that he had always planned to sue.[119] The lower court dismissed the claim for failing to meet the contemporaneous ownership requirement.[120] The Fifth Circuit, however, reversed the decision and remanded the case.[121] According to the circuit court, standing could be maintained if the wrong was continuing, meaning it spanned the plaintiff's ownership or if new events occurred after acquisition of the stock.[122] The court then moved on to the somewhat difficult task of defining the continuing wrong doctrine.

1. Defining a Continuing Wrong

In *Bateson*, the court relied on an earlier Fifth Circuit case to determine the definition of a continuing wrong.[123] It characterized a continuing wrong as a wrong that is incomplete or has not terminated prior to plaintiff's acquisition of stock.[124] The court believed that denying standing for purchases made after published reports of wrong doing

---

[116] *See In re BONY*, 320 F.3d 291, 298 (2d Cir. 2002).

[117] *Bateson*, 414 F.2d at 128.

[118] *Id.* at 129.

[119] *Id.*

[120] *Id.* at 129, 131.

[121] *Id.*

[122] *Id.* at 130 (quoting Prunty, *Business Associations*, 35 N.Y.U. L. REV. 1468 (1960) that wrong is continuing if it "'spans the plaintiff's ownership or if new elements in a pattern of wrongful conduct occur after acquisition.'").

[123] Palmer v. Morris, 316 F.2d 649 (5th Cir. 1963). In *Palmer*, the Fifth Circuit reversed the district court's dismissal of a derivative suit and remanded the case back to the lower court for hearing. *Id.* at 651. The lower court had dismissed the case for insufficient pleading and failure to meet the ownership requirements of Rule 23(b). *Id.* at 649-50. The suit stemmed from a transaction made prior to plaintiff's stock purchase. *Id.* at 650. However, the plaintiff complained only of the exorbitant fees for rents and unnecessary services still being paid pursuant to the earlier agreement. *Id.* Because the charges were not against the initial transaction, but rather the current payments, the courts could not dismiss the charges as transactions that had completely occurred and been terminated prior to plaintiff's stock purchase. *Id.* This was a tacit endorsement of the continuing wrong doctrine, made even before the revised Federal Rules offered increased protection against strike suits and inadequate representation. *See generally id.* (using Rule 23(b) and allowing standing for continuing malfeasance of defendants).

[124] *Bateson*, 414 F.2d at 130 (citing *Palmer*, 316 F.2d at 650).

would sufficiently prevent strike suits.[125] It held that the plaintiff's long-standing relationship with the corporation was unique enough to allow him to proceed in spite of potential abuses.[126]

It is difficult to discern what exactly constitutes a continuing wrong in the cases and legal texts that appear receptive to the doctrine.[127] The controversy involves the determination of whether a wrong is continuing or consummated.[128] Plaintiffs can never have standing for a purchase made after the consummation of the wrong because courts assume they had full knowledge and lack injury.[129] Courts consider a wrong continuing based on the timing of the transaction, not on when its effects are felt.[130] The difficulty faced by the courts is that, in a sense, every wrongful transaction is continuing until it is righted. Nevertheless, invoking the continuing wrong doctrine in every case would circumvent the carefully constructed contemporaneous ownership requirement.[131]

2. Inconsistencies in Court Definitions

Courts are somewhat inconsistent in their determinations of continuing wrongs.[132] For example, high loan payments on a land purchase made before plaintiff obtained stock are not continuing wrongs.[133] Equally high rental prices stemming from transactions made before stock purchase, however, are deemed continuing for purposes of standing.[134] Although there is some distinction between a rental and a purchase contract, the effects on the corporation are not so different as to distinguish plaintiff shareholders.[135] There is no bright-line rule for making the continuing wrong determination, which may make

---

[125] *Id.* at 131.

[126] *Id.*

[127] Haberle et al., *supra* note 18, § 2332.

[128] *Id.*

[129] *Id.*

[130] *Id.* (citing Schreiber v. Bryan, 396 A.2d 512 (Del. Ch. 1978)); FLETCHER, *supra* note 6, § 5982 (same).

[131] Haberle et al., *supra* note 18, § 2332 (citing Bowman v. Alaska Airlines, Inc., 14 F.D.R. 70 (D. Alaska 1952) and Henis et al. v. Compania Agricola de Guatemala, et al., 210 F.2d 950 (D. Del. 1954)).

[132] *See generally id.* (illustrating courts' difficulty drawing "the line" between continuing wrongs and purchased suits).

[133] *Id.* (comparing *Goldie v. Yaker*, 432 P.2d 841 (N.M. 1967) with *Palmer v. Morris*, 316 F.2d 649 (5th Cir. 1963)).

[134] *Id.*

[135] *See generally id.* (discussing similar form but differing function in continuing wrong definitions).

acceptance of the doctrine more difficult. Nevertheless, the distinction is the decisive factor in whether many wronged plaintiffs may seek redress for their company.[136] In a time when many shareholders are just becoming aware of the long-standing deceptive and illegal practices of their corporate advisors, determining which shareholders have been "wronged" and are, therefore, appropriate lead plaintiffs is a necessary step to ensuring that justice is served.[137] Using the continuing wrong doctrine in lieu of the outmoded contemporaneous ownership doctrine is the only way to do this.

III. ARGUMENTS SUPPORTING CONTINUING WRONG DOCTRINE

If care is not taken in its application, the continuing wrong doctrine can create significant problems. This possibility has always worried the courts.[138] Increasingly, however, legal scholars have written in defense of the continuing wrong doctrine.[139] Among the growing list of supporters are the American Law Institute and the American Legal Institute.[140] Such prominent support lends much credence to the doctrine.

A. Continuing Wrong Doctrine Satisfies the Statutory Mandates of Rule 23.1

Despite the scholastic support, courts could not apply the continuing wrong doctrine if it did not fit within the Constitutional requirements for court jurisdiction.[141] Rule 23.1 requires only that a shareholder owned the stock when corporate officers committed the wrongdoing.[142] It makes no mention of the contemporaneous ownership rule in its wording.[143] One could easily interpret the requirement to include ownership during the continuing wrongs, as opposed to the date they commenced.[144] The ownership requirement, in fact, is based on the equitable principle

---

[136] *See* FLETCHER, *supra* note 6, § 5982 (describing differing outcomes with each determination); Haberle et al., *supra* note 18, § 2332 (examining difficulty making distinction between two similar situations with different outcomes).

[137] Larose, *supra* note 15, at 530 (stating that contemporaneous ownership rule is "over-broad" and excludes two classes of plaintiffs capable of presenting meritorious claims).

[138] *See id.*

[139] *See generally* Chimicles, *supra* note 40, at *8; Heim, *supra* note 6, at *3; Reed, *supra* note 15, at *20 (illustrating variety of American Bar Association and American Legal Institute publications supporting or indicting virtues of continuing wrong doctrine in current legal environment).

[140] *Id.*

[141] *See generally* U.S. CONST. art. III, § 2, cl. 1 (stating jurisdiction of courts).

[142] FED. R. CIV. P. 23.1.

[143] *Id.*

[144] *Id.*

prohibiting standing if the plaintiff acquired shares from a participant in the wrongdoing.[145] The continuing wrong doctrine does not violate that principle.[146]

In addition, Rule 23.1 itself contains no language indicating a cut-off period for completion or termination of a wrong.[147] It would seem, then, that where transactions are continuing, anyone who owns stock during these transactions meets the requirement.[148] In fact, courts could easily reconcile the continuing wrong doctrine with the contemporaneous ownership requirement.[149] In such cases, the plaintiff would be a shareholder during the commission of the wrong, although the wrong began before the plaintiff purchased stock.[150] This interpretation would not interfere with the other requirements of the Rule, including adequate representation.[151] In addition to satisfying the statutory requirements of the Rule, the continuing wrong doctrine also satisfies the courts' legal and policy concerns.

B. *Fairness and Shareholder Compensation Are Only Satisfied Through Use of the Continuing Wrong Doctrine*

The issues of fairness and shareholder compensation are of foremost importance to courts.[152] Continuing wrongs, no matter how well concealed, hurt stock purchasers throughout the life of the stock.[153] Often, shareholders do not discover some of the most destructive fraud until well after the transaction is consummated.[154] Much of the off-the-books accounting and officer mismanagement occur years before independent auditors or shareholders are able to uncover the crime.[155]

---

[145] MOORE'S MANUAL, *supra* note 65, § 14A.102.

[146] *See generally* FED. R. CIV. P. 23.1; *id.*

[147] MOORE'S MANUAL *supra* note 65, § 14A.102; *see also supra* note 33 (containing actual text of rule).

[148] FED. R. CIV. P. 23.1; Bateson v. Magna Oil Corp., 414 F.2d 128, 130 (5th Cir. 1969).

[149] 5-23.1 MOORE'S FEDERAL PRACTICE — CIVIL § 23.1.07 (3d ed. 1977).

[150] *Id.*

[151] FED. R. CIV. P. 23.1; *Bateson*, 414 F.2d at 130.

[152] *See* discussion *infra* Part IV.A-B.

[153] *See generally* RICHARD A. BREALEY, AN INTRODUCTION TO RISK AND RETURN FROM COMMON STOCKS 67-78 (1983) (computing required return, dividend payment, and forecasted year-end stock price as methods for valuation as well as ability to resell stock).

[154] *See generally In re BONY*, 320 F.3d 291, 291 (2d Cir. 2002) (finding that injury and publication were not visible until years after core wrong-doing); sources cited *supra* notes 1-2.

[155] *See generally* sources cited *supra* notes 1-2. As an illustration, the plaintiffs in *In re BONY* purchased their stock some time after the main portion of the activities occurred, though before newspapers published the serious allegations. *Id.* at 294-95. Years had

1. All Shareholders Incur Losses and Have Adequate Incentive to Represent the Corporation

Directors' indiscretion may, in fact, injure short-term shareholders more than shareholders with longer tenures of ownership.[156] People purchasing stock at the tail-end of the wrongdoing, but before the acts have become public, may be purchasing at an inflated stock price.[157] Long-term owners most likely purchased stock at a much lower, pre-growth price.[158] When the scandal breaks and the stock price inevitably

---

elapsed between the "mid-1990's," when the directors began the money laundering scheme, and the filing of the Suspicious Activity Report by the Republic Bank of New York in August of 1998. *Id.* at 294. These stockholders lacked standing under the contemporaneous ownership rule, but their suit did not represent any of the potential abuses that call for the application of that rule. *See id.* at 298-99 (discussing purpose of contemporaneous ownership doctrine and denying Kaliskis standing because they purchased stock six years after scheme began but year before news broke). They lacked knowledge of the scheme and, thus, had not purchased the suit. *See generally id.* Moreover, BONY's directors' actions had sufficiently injured company owners to ensure fair representation of their fellow shareholders. *Id.* It is illogical to remain stubbornly faithful to the rule when it hinders, rather than promotes, justice in such situations. *See generally* Larose, *supra* note 15, at 531-32 (noting courts' adherence to contemporaneous ownership rule despite underlying deficiencies and problems).

[156] *See generally* CHARLES D. ELLIS, INVESTMENT POLICY 23, 31 (2d ed. 1993) (discussing higher rate of return and price growth on long-term holdings as incentive to invest stocks for greater periods of time). Daily stock price fluctuations generally yield some gain on investment. *Id.* at 32. This average one-day investment has the potential to yield returns somewhere between a profit of 405.5 percent and a loss of 372.5 percent. *Id.* However, using the same math, a ten-year holding increases the consistency of returns "significantly." *Id.* at 34. A twenty-year period is even more consistent; there are no losses, just gains. *Id.* Couple these consistent and stable gains with the low price at which most stocks are initially offered and long-term investors reap much higher returns than an investor purchasing at or near the zenith of the stock's price. Thus, a late-coming purchaser or a short-term stockholder potentially loses much more on the investment than a long-term holder, creating more incentive to sue. *See generally id.*

[157] BREALEY, *supra* note 153, at 53-61 (discussing efficient market theory, its forms, and its implications); GARY P. BRINSON & ROGER G. IBBOTSON, INVESTMENT MARKETS: GAINING THE PERFORMANCE ADVANTAGE 46-48 (1987) (discussing efficient market theory and effects of information of stock price); *see* discussion *infra* note 155 (illustrating dramatic drop of pre-disclosure Enron share price after news of fraud was made public).

Market theory asserts that current stock prices reflect whatever information is knowable about the future. BRINSON & IBBOTSON, *supra*, at 46. Though not disproved as a theory, markets do not always behave as theory predicts. *Id.* at 48. Often stock price only reflects *past* information. BREALEY, *supra* note 153, at 53. No one believes that all relevant information is known or even knowable. *Id.* Fiduciary breaches, especially those criminal in nature, may simply be impossible to discover despite the investor's diligence. *See generally id.* Cover-ups and reporting fraud necessarily imply that some information will not be public and markets cannot be completely efficient. *Cf. id.* (inferring that because market does not reflect complete knowledge of company, directors' actions may not be known at time of purchase).

[158] *See supra* note 157 and accompanying text.

drops, late-comer purchasers almost certainly incur greater monetary losses.[159] These stockowners have just as much, if not more, incentive to zealously pursue the corporation's claims.[160] Courts should not prevent them from bringing such a suit simply because the directors thought up a brilliant scheme and cover-up, nor should nefarious directors be rewarded for their cunning. The inability of shareholders to obtain necessary information in a timely manner is evidenced by the Enron scandal, where public detection of off-balance sheet transaction was impossible and resulting losses were quite large.[161]

2. Market Information Is Imperfect and Late-Coming Plaintiffs May Purchase Without Knowledge of Wrongdoing

The contemporaneous ownership rule assumes, sometimes incorrectly, that the market is completely efficient.[162] Stock purchasers are not necessarily aware of every corporate injury, nor are such injuries always immediately reflected in a decreased stock price.[163] Those with access to this information are often insiders who use it to manipulate stock prices to hide their mismanagement or to reap further financial gains for themselves.[164]

Though using this information to manipulate price is undeniably criminal, it is an acknowledged danger of having a market for stocks.[165]

---

[159] Brenda Sapino Jefferies, *Houston Lawyer Wants to Move ENRON Case to* Texas, THE RECORDER, Dec. 13, 2001, *available at* http://www.enronerisa.com/news/news121301.html (last visited Jan. 13, 2004); *see also* CNN, *Enron: Countdown to Chapter 11*, *available at* http://www.cnn.com/interactive/us/0201/enron.timeline/content.html (last visited Jan. 14, 2004) (reporting that stock plummeted from $40 in mid-October to twenty-six cents at end of November); *cf.* ELLIS, *supra* note 156, at 23, 31 (discussing greater potential for loss of short-term shareholder).

For example, Enron executives began overstating income in 1997. Jefferies, *supra*. The massive cover-up orchestrated by a slew of executives and accountants prevented public awareness of this fraud until mid-October 2001. *Id.*; CNN, *supra*. The shock sent stock prices plummeting, falling ninety-nine percent from the beginning of 2001. Jefferies, *supra*. Effectively, investors purchasing at stock highs incurred a substantial loss while those investing at lower, pre-inflated prices lost considerably less of their investment. *Id.*

[160] Ensign Corp., S.A. v. Interlogic Trace Inc., 1990 U.S. Dist. LEXIS 17147, at *7 (S.D.N.Y. 1990).

[161] *See generally* sources cited *supra* notes 1-2, 159 (describing various illegal transactions made by Enron officers).

[162] Larose, *supra* note 15, at 529.

[163] *Id.*

[164] *Id.*

[165] *Cf. supra* note 157 and accompanying text (discussing efficient market theory and unavailability of complete market information).

The market is inherently speculative.[166] It is comprised of buyers and sellers who believe they know the true value of the company.[167] Each willingly gambles on the accuracy of his or her own information, knowing another market actor might have better data.[168] The real winners are stockholders who sell their shares early while the price is still high.[169] The losers, by inference, are those who made the opposite bet.[170] In fact, they lose twice. They own an injured company with diminished stock value and corporate assets, and courts may deny them standing because the injury occurred before their good-faith purchase.[171]

3. Plaintiff Recovery Through Increased Stock Price and Reimbursement of Legal Fees Gives Any Plaintiff Incentive to Effectively Litigate

Any injured shareholder, regardless of the date of his or her stock purchase, has the incentive to effectively litigate a suit.[172] It is a chance to recoup some of their losses as well as punish the directors at whose hands they have suffered a loss.[173] Because the cost of litigation is awarded as part of the damages, they would incur no additional losses.[174] In fact, late-purchasers may have actually incurred a greater monetary loss if they invested when the stock was at an artificially high price.[175] Thus, these purchasers may feel especially duped by the concealment and may be motivated to litigate even more fervently, particularly if they

---

[166] *See generally* ELLIS, *supra* note 156, at 11 (noting that beating market involves discovering and exploiting others' mistakes).

[167] *Cf. supra* note 157 and accompanying text (discussing efficient market theory and unavailability of complete market information). *See generally id.* at 5-11 (discussing investor attempts to gain and effectively use market information to make profit).

[168] ELLIS, *supra* note 156, at 11; *cf. supra* note 157 and accompanying text (discussing efficient market theory and unavailability of complete market information).

[169] ELLIS, *supra* note 156, at 11-16. Investors attempt to "beat the market" and outmaneuver other investors. *Id.* Market timing purports to move stocks within the market to become fully invested during rising markets and out of a market with rising prices. *Id.* at 11-12. Investors select stock to exploit the difference between a stock's low market price and the higher true value of a stock, or vice versa. *Id.* at 15.

[170] *Id.*

[171] *See In re BONY*, 320 F.3d 291, 298-99 (2d Cir. 2003) (discussing contemporaneous ownership doctrine and denying Kaliskis standing though they conceivably lost money on stock purchase).

[172] Chimicles, *supra* note 40, at *10.

[173] *Id.*

[174] *Id.*

[175] *See generally id.* (inferring that shareholders incur no monetary losses in derivative suits and that those who have lost most will be adequate representatives of injured company)

will incur no court costs.[176]

While courts seem especially concerned with late-buyers' motivations, even scrupulous shareholders may be seduced into court by an unethical lawyer.[177] The promise of compensation for their company, and possibly themselves, through an increased stock price is enough to lure anyone into court.[178] Though no suit guarantees recovery, most suits settle before they reach trial.[179] Despite the possible reward, the chance that a plaintiff might lose at trial after incurring hefty attorney's fees deters spurious lawsuits.[180]

Even assuming that the suit was purchased, the plaintiff shareholder then becomes an owner in the corporation and, thus, has a stake in the suit.[181] Although some professional plaintiffs receive a form of compensation from their position as a class representative, such compensation comes from a settlement or damage award that wrongdoers may never pay.[182] When corrupt directors and officers have already been caught and are anticipating or defending against criminal charges, there likely is little money available for recovery.[183] Any money recovered on the company's behalf often raises the stock price by just pennies.[184] The recovery ultimately belongs to the corporation, and any plaintiff who makes the decision to bring a derivative suit is aware of this, regardless of their motivation.[185]

---

[176] *See generally id.* (indicating that plaintiff-shareholders often do not incur monetary losses in derivative suits and that those who have lost comparatively more money will be adequate representatives of injured company).

[177] *Id.*

[178] *Id.*

[179] DEMOTT, *supra* note 6, § 1:01.

[180] Chimicles, *supra* note 40, at *10.

[181] *See* DEMOTT, *supra* note 6, § 1:01; FLETCHER *supra* note 6, § 5943; LERACH, *supra* note 6, at 77; NEMSER, *supra* note 6, at 15-16; SCHAEFTLER, *supra* note 6, at 15; Heim et al., *supra* note 6, at *1.

[182] *See generally id.* at *8 (noting that attorney's fees are paid based on reasonable estimates, if successful).

[183] *See* Anthony J. Sebok, Can Tort Litigation Against Enron Work?: The Problems and Possibilities in Suing a Bankrupt Company, FindLaw's Writ, *available at* http://writ.news.findlaw.com/sebok/20020225.html (last visited Jan. 13, 2004) (noting that any recovery will first go to creditors of bankrupt corporation and that "no matter how wealthy the directors may be" there will not be enough to help company or shareholders through stock value).

[184] Larose, *supra* note 15, at 514.

[185] *See generally* DEMOTT, *supra* note 6, § 1:01 (stating definition and nature of "derivative suit," the recovery of which belongs to corporation); FLETCHER, *supra* note 6, § 5943 (defining derivative suit); LERACH, *supra* note 6, at 77 (defining derivative suit); NEMSER, *supra* note 6, at 15-16 (discussing nature and purpose of derivative actions); SCHAEFTLER, *supra* note 6, at 15 (discussing nature and purpose of derivative actions); Heim

Courts attempt to avoid spurious litigation at all costs.[186] Yet, courts encourage the redress of a wrong, so shareholders' incentive should not be an issue.[187] The trial is expensive and time-consuming, but the outcome is desirable for all involved: deterrence, punishment, and compensation for injury.[188] Even if late-comers purchase the stock at a low price reflecting the wrong, it is nonetheless purchased in anticipation of a raised price.[189]

Quite possibly, the plaintiff in a purchased suit has an even greater incentive to achieve the best outcome.[190] He or she constantly operates with an eye toward eventual maximization of profit.[191] Regardless of who is allowed to bring the suit, the stockholder who sold at the depressed stock price will never recover.[192] Likewise, the buyer of the

---

et al., *supra* note 6, at *1 (describing nature of suit and purpose of recovery).

[186] Courts have remained staunch supporters of the contemporaneous ownership requirements, despite changes in state and federal statutes, to avoid frivolous lawsuits. *See* DEMOTT, *supra* note 6, § 4:03; SCHAEFTLER, *supra* note 6, at 15-17; Chimicles, *supra* note 39, at *8; Heim et al., *supra* note 6, at *3; Larose, *supra* note 15, at 529-32.

[187] *See generally* Chimicles, *supra* note 40, at *8 (noting benefits of derivative litigation and ways to avoid pitfalls of frivolous suits).

[188] Haberle et al., *supra* note 18, § 2332.

[189] *See generally* ELLIS, *supra* note 156, at 15 (stating that investors select stock to exploit difference between stock's low market price and higher true value).

[190] *Id.*

[191] *Id.* There is some concern about the legitimacy and adequacy of settlements, especially in cases of potential strike suits. *Id.* However, Rule 23.1 requires that discontinuances and settlements must be approved by the court to prevent abuse of strike or purchased lawsuits. *Id.* Courts are given wide discretion in determining the fairness and adequacy of the proposed settlement, approving offers with no substantial corporate benefit if the shareholders will be benefited in the long-term. *Id.* Judges are the most disinterested participants in the process and are best equipped to determine the best interest of all involved. *Id.* If judicial process is working efficiently, there should be no problem with a plaintiff not effectively pursuing a suit. FLETCHER, *supra* note 6, § 6020. Likewise, there is no reason to exclude the continuing wrong doctrine from general use. *Id.* Further, it would appear that settlement or final adjudication of one derivative suit does not preclude the existence of another suit as a matter of res judicata. *Id.* § 5981.4. Judgment operates as res judicata only to similarly situated unnamed parties adequately represented by the suit. *Id.* This holdover from the classification with class action suits implies that, if not adequately represented by a recent purchaser, long-term shareholders would not be prevented from initiating further proceedings. *See id.* Allowing both long- and short-term stockholders to have standing and pursue claims would be expensive for both parties and the government. Regardless, an additional suit may be necessary to recompense the corporation and ensure that all injured parties are heard. *See id.* It would also avoid some of the injustice and inequality that result from refusing standing to injured parties based on duration of ownership. FLETCHER, *supra* note 6, § 5981.4; *see* Levendusky, *supra* note 30, at *2-3.

[192] *See also* DEMOTT, *supra* note 6, § 1:01 (confining recovery in derivative suit to corporation only); FLETCHER, *supra* note 6, § 5943 (indicating recovery belongs to corporation); LERACH, *supra* note 6, at 77 (stating that recovery is to reimburse corporate

depressed stock will always reap the windfall, assuming payment is possible, regardless of who is lead plaintiff.[193]

C. *Inconsistency Within Contemporaneous Ownership Rule and Rule 23.1*

There is some inconsistency within the wording of Rule 23.1.[194] Because the Rule governing derivative suits was originally codified with class action guidelines, Congress remained concerned over adequacy of representation.[195] In order to determine adequacy and week out litigious plaintiffs, the Rule requires that the plaintiff be representative of all shareholders.[196] The Rule's drafters, however, did not match the strict ownership requirements with equally strict guidelines for adequate shareholder representation.[197]

The inconsistency in the rigidity of the ownership and representation requirements defeats one of the main rationales behind the contemporaneous ownership doctrine: ensuring adequate representation and personal interest in continuing zealous litigation.[198] It also does nothing to alleviate the threat of purchased or strike suits.[199] For instance, there are no comparable requirements for the number of shares a plaintiff must own to demonstrate the desire and ability to bring suit for the corporation.[200] Plaintiffs are not precluded from representing the corporation merely because of minority status.[201] In fact, proceedings

---

losses); NEMSER, *supra* note 6, at 15-16 (noting that suit is brought on corporation's behalf); SCHAEFTLER, *supra* note 6, at 15 (confining recovery in derivative suit to corporation only); Heim et al., *supra* note 6, at *1 (noting that suit is brought on corporation's behalf).

Only a corporation recovers in a derivative suit. SCHAEFTLER, *supra* note 6, at 15. The damages award is returned to the corporation as reimbursement for losses from injury. *Id.* Any gains outside the corporation will be in the form of increased value of the company and will be reflected in, possibly minute, increases in stock price. *Id.* These are available only to current stockholders. *See id.* at 15-16 (noting "proportional" recovery of stockholders as owners of interest in company). Further, derivative suits may only be brought by a current stockholder. *See* FED. R. CIV. P. 23.1. This means that any financial incentive to sue, including bounties and court costs, are confined to those left holding the injured stock. *See id.* (stating derivative action must be "brought by one or more shareholders").

[193] *Id.*

[194] Larose, *supra* note 15, at 529.

[195] DEMOTT, *supra* note 6, § 4:04; FLETCHER, *supra* note 6, § 5981.41.

[196] Heim et al., *supra* note 6, at *4-5.

[197] *See generally* FED. R. CIV. P. 23.1 (requiring only "fair and adequate representation" with no definitive guidelines).

[198] Larose, *supra* note 15, at 529.

[199] *Id.*

[200] *See* FED. R. CIV. P. 23.1.

[201] *See generally id.* (stating no requirement for standing other than ownership during

are usually brought by a minority shareholder who cannot force directors to sue in the corporation's own name.[202] It is contradictory to attribute greater litigation incentive to a stockholder with a few, long-held shares than a person with more shares who happened to purchase them at a later time.[203]

D. Acknowledged Problems of Continuing Wrong Doctrine

Of course, the continuing wrong doctrine is not perfect. Courts must resolve the inconsistency in their definition of continuing activities.[204] Without a bright-line rule, there cannot be consistent judicial decision-making and predictable outcomes.[205]

The current circuit split is no less confusing. A major issue courts continue to grapple with is the potential for strike suits and purchased litigation.[206] Plaintiffs could purchase shares at a lowered price, reflecting the true value of the corporation, and still have standing to sue

---

offending transactions and "fair and adequate representation").

[202] FLETCHER, *supra* note 6, § 5941.10.

[203] Certain incongruity is evident in the wording of the rule itself. *See* FED. RULE 23.1. Plaintiffs must allege ownership at time of transaction or "that his share or membership thereafter devolved upon him by operation of law." *Id.* Coupling this clause with the contemporaneous ownership requirement grants the fortunate devisee of an inheritance standing but denies a bona fide purchaser that same right. *Compare id., with* DEMOTT, *supra* note 6, § 2:02 (contrasting requirements of Rule 23.1 with contemporaneous ownership rule). This frustrates part of the contemporaneous ownership rule's purpose. *See generally* DEMOTT, *supra* note 6, § 2:02. A purchaser incurs a great loss when the wrongdoing is made public, no matter when the purchase is made. *Cf.* BRINSON & IBBOTSON, *supra* note 157, at 46 (asserting that efficient market theory means that current stock prices reflect whatever information is knowable). The real windfall is to the person who lost no money on the stock purchase and had no expectation prior to the devisor's death. *Id.* This person can still maintain a suit, recover court costs, and even earn a possible fee as lead plaintiff with no expenditure on his part. *See* FED. R. CIV. P. 23.1.

For example, in *Bateson*, the court granted standing to a person who accidentally sold his shares prior to litigation and repurchased them with the intention to initiate a suit. Bateson v. Magna Oil Corp., 414 F.2d 128, 129 (5th Cir. 1969). This was a blatant example of purchased litigation, but the Fifth Circuit recognized the unfairness of denying standing and used the continuing wrong doctrine as a means to pursue justice. *Id.* at 130-31. This holding recognized the crux of the standing issue: current owners, no matter when their stock was purchased, have the greatest interest in pursuing — and prevailing in — any litigation. Larose, *supra* note 15, at 514. Unfortunately, many shareholders have lost so much, emotionally and financially, that they are simply unwilling to pursue their suits. Haberle et al., *supra* note 18, § 2332. Directors should pay for their wrongs, and restricting willing and able plaintiffs undermines this principle. *Id.*

[204] DEMOTT, *supra* note 6, § 1:01; FLETCHER *supra* note 6, § 5943; LERACH, *supra* note 6, at 77; NEMSER, *supra* note 6, at 15-16; SCHAEFTLER, *supra* note 6, at 15; Heim et al., *supra* note 6, at 1.

[205] *See* sources cited *supra* note 204.

[206] Larose, *supra* note 15, at 532-33.

if the wrongs were, indeed, continuing.[207] There is a way to alleviate some of this risk, however. Courts should adopt the dicta in *Ensign*, which prohibited standing where the representative plaintiff has knowledge of the wrong-doing.[208]

IV. PROPOSED SOLUTION

While neither circuit's interpretation of Rule 23.1's ownership requirements is perfect, the continuing wrong doctrine is preferable. This Comment proposes two ways courts and Congress could implement this doctrine. The American Law Institute drafted a model statute that could solve the problems with frivolous and litigious suits discussed in Part III. The judiciary could also adopt the more expansive view of the Fifth Circuit in *Bateson* when interpreting Federal Rule 23.1.

A. ALI Proposed Statute and Additional Recommendations

While some problems do exist with the continuing wrong doctrine, they are easily corrected.[209] The doctrine remains highly desirable in light of its greater emphasis on fairness and justice to all aggrieved parties.[210] The California and Pennsylvania legislatures acknowledge this emphasis in their relevant statutes, as has the Fifth Circuit in the *Bateson* decision.[211]

With the ideals of fairness and justice in mind, the American Law Institute developed Model Rule 23.1.[212] Section 7.02 of this model rule deals specifically with a plaintiff's standing to maintain a derivative action.[213] The most notable revision is section 7.02 (a)(1).[214] This

---

[207] *Id.*

[208] Ensign Corp., S.A. v. Interlogic Trace Inc., 1990 U.S. Dist. LEXIS 17147, at *2-4 (S.D.N.Y. 1990).

[209] *See supra* Part III.D and discussion.

[210] *See supra* Part III.A-B.

[211] *See* CAL. CORP. CODE § 800 (West 2004); Bateson v. Magna Oil Corp., 414 F.2d 128 (5th Cir. 1969).

[212] PRINCIPLES OF CORPORATE GOVERNANCE, § 7.02 (1992); *see Ensign Corp.*, 1990 U.S. Dist. LEXIS 17147, at *9 n.4 (referencing PRINCIPLES OF CORPORATE GOVERNANCE, Discussion Draft No. 1, 1985, § 7.02(a)(1), noted in Federal Practice § 1828 n.21).

[213] PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 212, at § 7.02.
Full text:

> (a) A holder [§ 1.22] of an equity security [§1.20] has standing to commence and maintain a derivative action if the holder:
>
> (1) Acquired the equity either (A) before the material facts relating to the alleged

provision grants standing to anyone holding a security prior to public disclosure or private communication of material facts relating to the alleged wrong.[215] Thus, the section is an implicit endorsement of the continuing wrong doctrine.[216]

Ultimately, the purpose of the contemporaneous ownership rule is to prevent frivolous lawsuits.[217] Courts can easily accomplish this without resorting to the sweeping disqualifications of the contemporaneous ownership rule.[218] Ensuring that potential plaintiffs' purchases are made before any material information of the corporate wrongs is knowable is a key factor in the fight against spurious suits.[219] Establishing the date of disclosure as the relevant date for eligibility is much easier than trying to parse out which events were "wrongs" and which were merely "after

---

wrong were publicly disclosed or were known by, or specifically communicated to, the holder, or (B) by devolution of law, directly or indirectly, from a prior holder who acquired the security as described in the preceding clause (A);

(2) Continues to hold the equity security until the time of judgment, unless failure to do so is the result of corporate action in which the holder did not acquiesce, and either (A) the derivative action was commenced prior to the corporate action terminating the holder's status, or (B) the court finds that the holder is better able to represent the interests of the shareholder than any other holder who has brought a suit;

(3) Has complied with the demand requirement of § 7.03 (Exhaustion of Intracorporate Remedies: The Demand Rule) or was excused by its terms; and

(4) Is able to represent fairly and adequately the interests of the shareholders

(b) On a timely motion a holder of an equity security should be permitted to intervene in a derivative action, unless the court finds that the interest to be represented by the intervenor has already been fairly and adequately represented or that the intervenor is unable to represent fairly and adequately the interests of the shareholders.

(c) A director [§ 1.13] of a corporation has standing to commence and maintain a derivative action unless the court finds that the director is unable to represent fairly and adequately the interests of the shareholders.

[214] *Id.*, § 7.02 (a)(1).

[215] *Id.*

[216] *Id.* at cmt. a.

[217] SCHAEFTLER, *supra* note 6, at 16-17; Chimicles, *supra* note 40, at *8; Heim et al., *supra* note 6, at *3; *see In re BONY*, 320 F.3d 291, 291 (2d Cir. 2003); *Ensign Corp.*, 1990 U.S. Dist. LEXIS 17147 at *7; DEMOTT, *supra* note 6, §§ 1:03, 4:03.

[218] *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 212, § 7.02 cmt. c.

[219] CAL CORP. CODE § 800 (West 2004); PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 212, § 7.02.

effects."[220]

Lawmakers and judges could also supplement the ALI's model statute with additional provisions to guarantee that each stockholder is fairly and adequately represented by an attentive plaintiff.[221] One such measure would be to impose a requirement on the percentage of shares one must own to assume the role of lead plaintiff.[222] Another check on litigious plaintiffs would be to require potential plaintiffs to demonstrate that they have incurred actual financial harm as a result of the corporate wrong.[223] This would prove that they had purchased stock without knowledge, evidenced by a plummeting price, and had sufficient incentive to zealously litigate the claim.[224] Absent such measures, courts cannot ascertain the sincerity of claims without needlessly excluding large numbers of injured late-coming shareholders.[225]

To eliminate professional plaintiffs, legislatures can also require potential plaintiffs to disclose other recent involvement in derivative suits.[226] To that end, drafters could implement limits on the number of times individuals may serve in a representative capacity during a designated time period.[227] State legislatures and Congress should further remove any financial incentive to act as lead plaintiff by granting only reasonable costs at the courts' sole discretion and a pro rata share of any recovery.[228] Similarly, limiting attorney fees would deter unscrupulous

---

[220] *See* Haberle et al., *supra* note 18, § 2332. *See generally* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 212, § 7.02 cmts. a, c (stating trend toward using date of disclosure and difficulty determining continuing wrong "cut-off").

[221] *See generally* Chimicles, *supra* note 40, at *8-17 (discussing various suggestions proposed in Dec. 6, 1995 issue of Fed. Sec. L. Rep. in response to Private Securities Litigation Reform Act of 1995).

[222] Most strike suits and professional plaintiffs own only a nominal amount of shares of distressed companies in anticipation of a suit. Chimicles, *supra* note 40, at *8. Requiring a showing of a substantial or at least mildly significant amount of stock in a corporation would help "weed out" those with litigious motivations or lacking incentive. *See id.* Should one such shareholder not pursue the corporation's action, the California, Pennsylvania, and ALI statutes would allow less representative plaintiffs standing as required to ensure justice and corporate compensation. *See* DEMOTT, *supra* note 6, § 1:03; Chimicles, *supra* note 40, at *8.

[223] Chimicles, *supra* note 40, at *8.

[224] *See generally* DEMOTT, *supra* note 6, §§ 1:03, 4:03 (noting problems with inadequate representation, quick settlements, and purchased suit concerns); SCHAEFTLER, *supra* note 6, at 16-17 (discussing similar problems); Chimicles, *supra* note 40, at *8 (stating same concerns); Heim et al., *supra* note 6, at *3 (discussing similar concerns and proposing some solutions).

[225] *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 212, § 7.02 cmt. c.

[226] Chimicles, *supra* note 40, at *8-9.

[227] *Id.* at *8-9.

[228] *Id.* at *9.

lawyers from effectively bribing stock owners with a portion of fee award to participate in litigation.[229]

Imposing a type of personal liability on a lead plaintiff would also deter professional plaintiffs.[230] Plaintiffs may still bring suits at their discretion, but they would face a reciprocal suit if their cause of action proves frivolous.[231] Though legislators must revise corporations law accordingly, adopting a practice similar to the tort action of "malicious use of process" would likely reduce non-meritorious suits.[232] This policy also serves the ultimate end of redressing corporate wrongs and fiscal plundering, this time at the hands of a shareholder.[233]

As of yet, the United States Supreme Court has refused to rule in favor of either interpretation of the ownership requirements of Rule 23.1.[234] However, the American Law Institute's recommended statute surely carries some weight as an amalgamation of current legal trends and legal expertise.[235] The judiciary has some flexibility in rule interpretation and can look to the rationale of the Fifth Circuit in *Bateson* when deciding future cases.

B. Judicial Role in Solution

In the absence of Congressional revisions of Rule 23.1, the courts must play a strong role in establishing the continuing wrong doctrine. The Fifth Circuit demonstrated that the doctrine is a viable interpretation of Rule 23.1.[236] In fact, the view of many courts that the continuing wrong doctrine is merely an expansive definition of what constitutes a "transaction" is less at odds with Rule 23.1 than they allege in their opinions.[237] An "expansive definition" does not conflict with the Rule's

---

[229] The current "lodestar" approach multiplies the lawyers' time by a judicially determined "reasonable hourly fee." *Id.* at *10. Despite the court's intervention in hourly wage determinations, attorney fees can still constitute up to thirty-five percent of the settlement awarded to the class. *Id.* Giving the court flexibility, as opposed to a set percentage of fees and costs, can lower the final amount of fees awarded and protect much of the corporation's compensation. *See id.*

[230] SCHAEFTLER, *supra* note 6, at 18.

[231] *Id.*

[232] *Id.*

[233] *See generally id.* at 16-19 (noting harms of strike and purchased lawsuits and ways to eliminate them).

[234] *See generally id.* (relying only on circuit and district courts for decision).

[235] *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 212, § 7.02 cmt. c.

[236] Bateson v. Magna Oil Corp., 414 F.2d 128, 128 (5th Cir. 1969).

[237] *In re* BONY, 320 F.3d 291, 291 (2d Cir. 2003) (citing Ensign Corp., S.A. v. Interlogic Trace Inc., 1990 U.S. Dist. LEXIS 17147, *8 (S.D.N.Y. 1990)).

purpose — it is a logical extension of the words' meaning.[238]

Also in the doctrine's favor is the absence of significant case law supporting the contemporaneous ownership rule.[239] The circuit cases cited in *In re BONY*, were decided nearly half a century earlier, long before the Federal Rule of Civil Procedure revisions in 1966.[240] Only three circuits are bound by these cases, and even those decisions should be reevaluated in light of new statutes and the shifting corporate world.[241]

In addition to determining whether a continuing wrong exists, the court must also exercise its power over plaintiffs. The court must determine whether plaintiffs fairly and adequately represent the corporation and other shareholders.[242] It is also the court's job to monitor settlements and keep the best interests of the corporation in mind.[243] Neither approach can truly eradicate all devious plaintiffs. The potential for greed is too high, whether the stock has been held for years or just months.[244] An attentive judge can weed-out a frivolous suit and make sure all plaintiff decisions are in the corporation's best interest.

The circuit courts currently decide standing issues in derivative cases using contradictory interpretations of Rule 23.1. The results are inconsistent, unpredictable, and unjust to those who are denied standing. The circuit split is a difficult issue to resolve. Nevertheless, it is one that courts must determine to ensure fairness.

CONCLUSION

The contemporaneous ownership rule has a long history in American jurisprudence.[245] The Second Circuit's reliance on cases decided decades earlier to support the rule indicates confusion over the requirements for

---

[238] *See generally* FED. R CIV. P. 23.1; *Bateson*, 414 F.2d at 130.

[239] *See In re BONY*, 320 F.3d at 298; Gallup v. Caldwell, 120 F.2d 90, 90 (3d Cir. 1941); Rinn v. Asbestos Mfg. Co., 101 F.2d 344, 344 (7th Cir. 1938); *Ensign Corp.*, 1990 U.S. Dist. LEXIS 17147, at *7 (S.D.N.Y. 1990).

[240] *See Gallup*, 120 F.2d at 90; *Rinn*, 101 F.2d at 344; *Ensign Corp.*, 1990 U.S. Dist. LEXIS 17147, at *7.

[241] *See generally* Friedman, *supra* note 3 (noting billions of dollars lost by shareholders and corporations as result of corporate fraud and extensive cover-up); sources *supra* notes 1-2 (discussing aftermath of Enron directors' wrongs, including shareholder and corporate losses).

[242] FED. R. CIV. P. 23.1.

[243] *Id.*

[244] Larose, *supra* note 15, at 530-33.

[245] FLETCHER, *supra* note 6, § 5940; *see* Dodge v. Woolsey, 59 U.S. 331 (1855).

ownership and standing.[246] Current legal thought, however, shows that it need not be that complicated.[247] California, Pennsylvania, and even the ALI proposal employ statutes that work to prevent strike suits and purchased litigation.[248]

Each of these statutes utilizes the continuing wrong doctrine to determine derivative suit standing.[249] Still, they escape the dangers courts have been so wary of in the past, reducing the possibility of abusive lawsuits.[250] The key is public knowledge of the wrongs.[251] In the age of the Internet, this information can be widely disseminated, immediately and traceably.[252] As long as a purchase predates the publication of information, there is no danger of a purchased suit or abuse of the system.[253] In fact, the continuing wrong doctrine promotes justice by allowing any injured shareholders to represent their company once the media uncovers an enduring wrong.[254]

We live in the age of Enron and Worldcom, where executives can easily and discretely funnel billions of dollars out of a company for years.[255] Meanwhile, anyone with a computer and a modem can purchase stock in mere seconds.[256] These traders have much information at their disposal, though not all of it is reliable or even complete in terms of company value and executive actions. Amateur traders can conduct adequate due diligence on any purchase they make, but it may not be enough.

Average shareholders lack business expertise and have little say in corporate management. They rely on the knowledge and the character of corporate officers to properly run the corporations and manage the investments. When these directors betray their own companies,

---

[246] *See* Gallup v. Caldwell, 120 F.2d 90, 90 (3d Cir. 1941); Rinn v. Asbestos Mfg. Co., 101 F.2d 344, 344 (7th Cir. 1938).

[247] *See* Ensign Corp., S.A. v. Interlogic Trace Inc., 1990 U.S. Dist. LEXIS 17147, at *8 (S.D.N.Y. 1990) (noting American Law Institute's desire to "streamline" standing decisions).

[248] *See supra* Parts II.B, V.

[249] *See supra* Part II.B.

[250] *Id.*

[251] *See* Bateson v. Magna Oil Corp., 414 F.2d 128, 131 (5th Cir. 1969).

[252] *See generally In re* BONY, 320 F.3d 291 (2d Cir. 2002) (discussing fear of purchased suits).

[253] *See id.*

[254] *See id.* (defining continuing wrongs); FLETCHER, *supra* note 6, § 5982 (citing Schreiber v. Bryan, 396 A.2d 512 (Del. Ch. 1978)); Haberle et al., *supra* note 18, § 2332; (same).

[255] *See generally* Friedman, *supra* note 3 (noting billions of dollars lost by shareholders and corporations as result of corporate fraud and extensive cover-up).

[256] *Id.*

stockholders must defend the corporation themselves. Denying willing and able shareholders this right denies the corporation and other shareholders justice. The continuing wrong doctrine eliminates this problem and helps right corporate wrongdoing.