

June 2012

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Recommended Citation

Sprizzo, John E. (2012) "Unjustifiable Refusals to Settle and Rule 68," *St. John's Law Review*: Vol. 62: Iss. 3, Article 5.
Available at: <http://scholarship.law.stjohns.edu/lawreview/vol62/iss3/5>

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UNJUSTIFIABLE REFUSALS TO SETTLE AND RULE 68

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There is little doubt that burgeoning civil dockets in the federal courts, coupled with protracted criminal trials and discovery abuses, have put an enormous strain on the federal judicial system.¹ That circumstance has led to efforts to control discovery abuses and to discourage the filing of frivolous actions, pleadings, and motions through the imposition of sanctions. These efforts have had some positive impact, but very little, if anything, has been done about the situation in which one side or the other unjustifiably and without colorable basis refuses to settle a civil action. Lawyers and litigants are aware that the threat of continuing litigation expense can be effectively used as a pressure device to coerce an opponent into settling a matter at a cost well in excess of what the merits would warrant, but perhaps less than its defense would entail.

This Article addresses that problem and the various solutions that are now being proposed and have been proposed to deal with it, as well as an evaluation of the merits of the arguments advanced against those proposals.

The only rule which deals directly with the consequences of an unreasonable refusal to settle is, of course, rule 68.² That rule,

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¹ See, e.g., R. POSNER, *THE FEDERAL COURTS: CRISIS AND REFORM* 318 (1985) (“[t]he crisis in quantity has endangered the quality of federal justice”); Coyle, *A Day in the Life of a Judge*, Nat’l L.J., Apr. 25, 1988, at 32, col. 1 (dockets going beyond the “break point”); see also *Rehnquist Says Shortage of Judges Threatens to Clog Federal Courts*, N.Y. Times, Jan. 2, 1988, at 10, col. 3. In his year-end report on the federal judiciary, Chief Justice Rehnquist noted the high level of pending cases and new filings, and called the shortage of trial and appellate judges a “serious dilemma.” At the beginning of 1988, forty-eight federal judgeships were vacant, and a judicial advisory panel had recommended the creation of fifty-six new trial judgeships and thirteen appellate judgeships.

² Rule 16 indirectly addresses the settlement process. Under this rule, settlement and the use of extrajudicial procedures are subjects specifically to be discussed at pretrial conferences. See FED. R. CIV. P. 16(a)(5) (one objective of pretrial conference is facilitating settlement); FED. R. CIV. P. 16(c)(7) (subjects to be discussed include possibility of settlement and use of extrajudicial procedures). Any benefits from this type of judicial intervention are limited, however, because the court has no power to force parties to settle or even to compel

which is clearly inadequate to have any significant impact on the problem, currently provides that a defendant, but not a plaintiff, may make an offer of judgment at any time up to ten days before trial.³ The rule further provides that "[i]f the judgment finally obtained by the offeree is not more favorable than the offer, the offeree must pay the costs incurred after the making of the offer." Presently, however, rule 68 is not widely used as a means to dispose of cases because it does not authorize reasonable attorneys' fees as a cost and, therefore, provides no effective deterrent to unreasonable refusals to settle.⁴

The Advisory Committee on the Federal Rules of Civil Procedure has made two suggested revisions of rule 68, neither of which has been adopted. The first revision, proposed in 1983, received harsh criticism and, as a result, was followed in 1984 by a second proposal.

unwilling litigants to discuss settlement. See *Kothe v. Smith*, 771 F.2d 667, 669 (2d Cir. 1985) ("pressure tactics to coerce settlement simply are not permissible").

³ FED. R. CIV. P. 68. Rule 68 currently provides:

At any time more than 10 days before the trial begins, a party defending against a claim may serve upon the adverse party an offer to allow judgment to be taken against the defending party for the money or property or to the effect specified in the offer, with costs then accrued. If within 10 days after the service of the offer the adverse party serves written notice that the offer is accepted, either party may then file the offer and notice of acceptance together with proof of service thereof and thereupon the clerk shall enter judgment. An offer not accepted shall be deemed withdrawn and evidence thereof is not admissible except in a proceeding to determine costs. If the judgment finally obtained by the offeree is not more favorable than the offer, the offeree must pay the costs incurred after the making of the offer. The fact that an offer is made but not accepted does not preclude a subsequent offer. When the liability of one party to another has been determined by verdict or order or judgment, but the amount or extent of the liability remains to be determined by further proceedings, the party adjudged liable may make an offer of judgment, which shall have the same effect as an offer made before trial if it is served within a reasonable time not less than 10 days prior to the commencement of hearings to determine the amount or extent of liability.

Id.

⁴ See *Preliminary Draft of Proposed Amendments to the Federal Rules of Civil Procedure*, 102 F.R.D. 425, 433-34 (1984) [hereinafter *1984 Proposal*]; see also *infra* note 10 (quoting text of the proposal). The Advisory Committee discussed several reasons why this rule has not been used. First, only defendants may take advantage of rule 68 as currently drafted. Often, an award of costs is not enough to encourage defendants to use the rule. In addition, defendants may rather earn interest than make an early settlement offer. See *1984 Proposal, supra*, at 433-34; see also Simon, *Rule 68 at the Crossroads: The Relationship Between Offers of Judgment and Statutory Attorney's Fees*, 53 U. CIN. L. REV. 889, 891 (1984) (rule 68 widely considered to be a failure).

THE 1983 PROPOSAL

The 1983 proposal to amend rule 68 suggested several major changes.⁵ The new rule, renamed "Offer of Settlement," would have allowed *either* party to make an offer and also would have revised the time periods for making and accepting offers.⁶ More importantly, the proposal provided that if the judgment finally entered was not more favorable to the offeree than the unaccepted offer, the offeree would have to pay the offeror's costs and expenses

⁵ See *Preliminary Draft of Proposed Amendments to the Federal Rules of Civil Procedure*, 98 F.R.D. 339, 361-63 (1983). The 1983 proposal provides:

At any time more than 30 days before the trial begins, any party may serve upon an adverse party an offer, denominated as an offer under this rule, to settle a claim for the money or property or to the effect specified in his offer and to enter into a stipulation dismissing the claim or to allow judgment to be entered accordingly. The offer shall remain open for 30 days unless a court authorizes earlier withdrawal. An offer not accepted in writing within 30 days shall be deemed withdrawn. Evidence of an offer is not admissible except in a proceeding to enforce a settlement or to determine costs and expenses.

If the judgment finally entered is not more favorable to the offeree than an unaccepted offer that remained open 30 days, the offeree must pay the costs and expenses, including reasonable attorneys' fees, incurred by the offeror after the making of the offer, and interest from the date of the offer on any amount of money that a claimant offered to accept to the extent such interest is not otherwise included in the judgment. The amount of the expenses and interest may be reduced to the extent expressly found by the court, with a statement of reasons, to be excessive or unjustified under all of the circumstances. In determining whether a final judgment is more or less favorable to the offeree than the offer, the costs and expenses of the parties shall be excluded from consideration. Costs, expenses, and interest shall not be awarded to an offeror found by the court to have made an offer in bad faith.

The fact that an offer is made but not accepted does not preclude a subsequent offer. When the liability of one party to another has been determined by verdict or order or judgment, but the amount or extent of the liability remains to be determined by further proceedings, any party may make an offer of settlement under this rule, which shall be effective for such period of time, not more than 30 days, as is authorized by the court. This rule shall not apply to class or derivative actions under Rules 23, 23.1, and 23.2.

Id.

⁶ Proposals for either party to make a settlement offer and for a revision of time periods have appeared in both the 1983 and 1984 revisions and would be beneficial. Both parties should have the opportunity to make an offer of settlement, rather than only the defendant as in the present rule. In addition, a flexible time provision is necessary to guard against the dangers of an early strike settlement offer, or an offer too close to trial when both sides have already invested too much time and expense in the litigation. The time limits have changed in the various proposals, but allowing modification of the time periods in the sound discretion of the court would guard against most fears. Offers should be open long enough to allow parties to fairly gauge settlement options and to secure necessary approval. Also, a court in its discretion could allow limited discovery so that a decision on whether to accept a settlement offer could be made with a better factual understanding of the case.

incurred after the making of the offer, including reasonable attorneys' fees.

It was not surprising that this aspect of the new rule attracted a barrage of criticism from bar associations. Critics argued that the proposal violated the Rules Enabling Act⁷ because it constituted a substantive rather than a procedural change in that it altered the American rule that each side pays its own attorneys' fees.⁸ Civil rights attorneys in particular argued that the rule would chill enforcement of the civil rights laws because plaintiffs would accept low offers rather than risk paying the defendant's attorneys' fees.⁹ In my view, none of these arguments justified a rejection of the proposed rule, as will be discussed below, although I think it is clear that the proposal was defective in that it created a presumption that a settlement posture was unreasonable based merely on one side or the other being wrong about the value of the case for settlement purposes.

THE 1984 PROPOSAL

In response to criticism of the 1983 proposal, the Advisory Committee offered another proposal in 1984.¹⁰ Addressing the at-

⁷ 28 U.S.C. § 2072 (1982).

⁸ See, e.g., Woods, *For Every Weapon, a Counterweapon: The Revival of Rule 68*, 14 *FORDHAM URB. L.J.* 283, 344 (1986); Note, *The Proposed Amendment to Federal Rule of Civil Procedure 68: Toughening the Sanctions*, 70 *IOWA L. REV.* 237, 250-55 (1984); Note, *Current Federal Rule of Civil Procedure 68 and Official Changes: Important Impacts on Attorney's Fee Awards*, 31 *SAN DIEGO L. REV.* 209, 222 (1985).

⁹ See Simon, *The Riddle of Rule 68*, 54 *GEO. WASH. L. REV.* 1, 14 (1985).

¹⁰ See *1984 Proposal*, *supra* note 4, at 432-33. The 1984 proposal provides:

At any time more than 60 days after the service of the summons and complaint on a party but not less than 90 days (or 75 days if it is a counter-offer) before trial, either party may serve upon the other party but shall not file with the court a written offer, denominated as a offer under this rule, to settle a claim for the money, property, or relief specified in the offer and to enter into a stipulation dismissing the claim or to allow judgment to be entered accordingly. The offer shall remain open for 60 days unless sooner withdrawn by a writing served on the offeree prior to acceptance by the offeree. An offer that remains open may be accepted or rejected in writing by the offeree. An offer that is neither withdrawn nor accepted within 60 days shall be deemed rejected. The fact that an offer is made but not accepted does not preclude a subsequent offer. Evidence of an offer is not admissible except in proceedings to enforce a settlement or to determine sanctions under this rule.

If, upon a motion by the offeror within 10 days after the entry of judgment, the court determines that an offer was rejected unreasonably, resulting in unnecessary delay and needless increase in the cost of the litigation, it may impose an appropriate sanction upon the offeree. In making this determination the court

torneys' fees argument, the second proposal abandoned the approach of basing the award of such fees on the amount of the ultimately obtained judgment. Instead, the 1984 proposal allowed the court to impose "an appropriate sanction" on an offeree if an offer was rejected unreasonably. To determine the reasonableness of the refusal at the time of the offer, the 1984 proposal outlined several factors for the court to consider. These included the merit of the claim, the closeness of the issues of law and fact, the information available for evaluation, the importance of the issues for other cases, the relief reasonably to be expected, and the projected cost and delay from subsequent litigation. In addition, the proposal outlined several factors for determining the amount of sanction, including the extent of delay, the amount of costs and expenses, including attorneys' fees, interest on the offer amount, and the burden on the offeree.

This proposal unquestionably dealt with what I believe to be the principal drawback of the earlier version, *i.e.*, a presumption of unreasonableness based upon error alone. Moreover, it focused on the proper problem to be dealt with, *i.e.*, an unreasonable settlement posture or, put another way, a refusal to settle that is not colorably justified by the legal and factual merits of the claim at issue.

However, the 1984 proposal was again criticized by civil rights attorneys who feared it might chill enforcement of the civil rights laws. Critics also argued that the need to determine reasonableness

shall consider all of the relevant circumstances at the time of the rejection, including (1) the then apparent merit or lack of merit in the claim that was the subject of the offer, (2) the closeness of the questions of fact and law at issue, (3) whether the offeror had unreasonably refused to furnish information necessary to evaluate the reasonableness of the offer, (4) whether the suit was in the nature of a "test case," presenting questions of far-reaching importance affecting non-parties, (5) the relief that might reasonably have been expected if the claimant should prevail, and (6) the amount of the additional delay, cost, and expense that the offeror reasonably would be expected to incur if the litigation should be prolonged.

In determining the amount of any sanction to be imposed under this rule the court also shall take into account (1) the extent of the delay, (2) the amount of the parties' costs and expenses, including any reasonable attorney's fees incurred by the offeror as a result of the offeree's rejection, (3) the interest that could have been earned at prevailing rates on the amount that a claimant offered to accept to the extent that the interest is not otherwise included in the judgment, and (4) the burden of the sanction on the offeree.

This rule shall not apply to class or derivative actions under Rules 23, 23.1, and 23.2.

Id.

at the time of the offer would cause collateral litigation and would force the court to inquire into protected attorney-client conversations. In addition, critics raised the fear that judges might use the threat of rule 68 sanctions to coerce settlement.¹¹

Although these are valid concerns, they are not in my view sufficient to outweigh the benefits to be derived from revising rule 68. Although civil rights suits implement remedial congressional legislation, a civil rights attorney has no more right than any other attorney to extort an unfair settlement by the threat of unjustified litigation expenses, especially since the civil rights defendant faces the added coercion of paying the plaintiff's attorneys' fees if he loses.¹² The potential for collateral litigation is likewise no basis to reject the rule. Indeed, that problem is no different than that which exists under rule 11, where the courts are frequently called upon to assess the litigation posture of a party. Furthermore, since the standard for determining the reasonableness of a settlement position, as under rule 11, would be objective rather than subjective, there would be no reason to inquire into privileged attorney-client conversations.¹³ Finally, it is not a valid objection to the proposal that judges may use it as an improper method of coercing a settlement. Not only is that a dubious assumption at best, but that criticism could also be made of rule 11 or, indeed, of any rule which involves an exercise of judicial discretion. In any event, appellate review can correct such improper conduct by a district judge.¹⁴

¹¹ See Simon, *supra* note 9, at 17-18.

¹² In *Marek v. Chesny*, 473 U.S. 1 (1985), where the Supreme Court held that the attorneys' fees awardable to plaintiff under the civil rights law are to be considered "costs" within the meaning of rule 68, the Court also noted that rule 68's policy of encouraging settlements is neutral and would neither curtail the access of civil rights plaintiffs to the courts nor significantly deter them from bringing suit. *See id.* at 9-10. In fact, the Court stated, civil rights plaintiffs might benefit by being "compensat[ed] at an earl[y] date without the burdens, stress, and time of litigation." *Id.* at 10.

¹³ The court might only have to consider privileged conversations if there was a dispute between the attorney and the client as to who should pay the sanction, in which case disclosure of such communications to the court in camera would not violate the attorney-client privilege. *See* E. CLEARY, *MCCORMICK ON EVIDENCE* § 91 (3d ed. 1984).

¹⁴ *See* *Kothe v. Smith*, 771 F.2d 667, 669 (2d Cir. 1985). In *Kothe*, the plaintiff sought two million dollars in damages for medical malpractice. *See id.* at 668. The trial judge recommended that the case settle for between \$20,000 and \$30,000, and warned that he would impose sanctions on the dilatory party if the case settled for a comparable figure after the trial began. *See id.* at 669. The case was settled for \$20,000 after one day of trial, and the trial court imposed sanctions on the defendant. *See id.* The court of appeals held that pressure tactics by the trial court to coerce settlement were not permissible. *See id.* at 669. The

The only issue remaining to be examined is whether there is any legal merit to the contention that proposed rule 68 violates the Rules Enabling Act. For the reasons that follow, in my view it does not.

THE AMERICAN RULE AND THE RULES ENABLING ACT

In England, the award of court costs to the losing party includes attorneys' fees.¹⁵ In the United States, however, an American rule has evolved so that each party traditionally has borne its own attorneys' fees.¹⁶ That rule, however, has never been construed in such a way as to prevent the imposition of attorneys' costs for misconduct by litigants or their attorneys where such conduct results in harassment and needless litigation expense. Indeed, there are provisions already existing in the present rules of civil procedure that impose attorneys' fees for such misconduct which have never been thought to violate the Rules Enabling Act.

Rule 11,¹⁷ although the most widely used of these, is not the only rule providing for the shifting of attorneys' fees. For example, sanctions may be imposed on a party substantially unprepared or one failing to appear for a scheduling conference under rule 16(f).¹⁸

court noted that the plaintiff had never indicated a willingness to accept less than \$50,000 and the defendant should not have been forced to make an offer in the range suggested by the trial court. *See id.* at 669-70.

¹⁵ *See Fleischmann Distilling Corp. v. Maier Brewing Co.*, 386 U.S. 714, 717 (1967).

¹⁶ *See id.* at 717-18. The Court in *Fleischmann* cited several reasons for the American rule. First, one should not be penalized for merely defending or prosecuting a lawsuit. Such a penalty might discourage poor litigants. *See id.* at 718. Also, the difficulty of determining reasonable attorneys' fees in every case would be a burden on the courts. *See id.*

The Supreme Court recently reaffirmed its adherence to the American rule in *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240 (1975). In *Alyeska Pipeline*, the court of appeals had awarded attorneys' fees to the plaintiffs based on the court's equitable powers and the theory that the plaintiffs were acting as a "private attorney general." *See id.* at 241. The Supreme Court cited the general rule that litigants pay their own attorneys' fees. *See id.* at 257-58. Although several federal statutes utilize a private attorney general concept to authorize or mandate the award of attorneys' fees, *see infra* note 23, the Court did not construe this congressional action to allow the award of attorneys' fees whenever the courts found that the award would advance an important public policy. *See* 421 U.S. at 260-63. The Court refused to judicially change the American rule, which it characterized as "deeply rooted in our history and in congressional policy." *See id.* at 271.

¹⁷ FED. R. CIV. P. 11; *see also Oliveri v. Thompson*, 803 F.2d 1265, 1274 (2d Cir. 1986) (discussion and interpretation of rule 11), *cert. denied*, 107 S. Ct. 1373 (1987). *See generally Vairo, Rule 11: A Critical Analysis*, 118 F.R.D. 189 (1988) (overview and background of rule 11 and federal courts' sanctioning power).

¹⁸ *See* FED. R. CIV. P. 16(f) and advisory committee's note; *see also Flaherty v. Dayton Elec. Mfg. Co.*, 109 F.R.D. 617, 618-19 (D. Mass. 1986) (costs and attorneys' fees awarded

In addition, the unjustified signing of a discovery request, response, or objection may merit sanctions under rule 26(g), which is roughly analogous to rule 11.¹⁹ Attorneys are also liable for attorneys' fees in the case of a refusal to cooperate with discovery under rule 37(b)(2).²⁰ It is therefore difficult to imagine why fee shifting under rule 68 for unjustifiable refusals to settle should raise Rules Enabling Act problems.

In addition, it has been held that the judiciary has the inherent power to award attorneys' fees when a party has acted "in bad faith, vexatiously, wantonly, or for oppressive reasons,"²¹ and many statutes specifically provide for the payment of attorneys' fees, either for vexatious conduct²² or for policy reasons.²³

The Rules Enabling Act, under which the Federal Rules of Civil Procedure are promulgated, provides only that the Rules "shall not abridge, enlarge, or modify any substantive right."²⁴

when plaintiff's counsel was substantially unprepared to participate in conference); *Bar-soumian v. Szozda*, 108 F.R.D. 426, 426 (S.D.N.Y. 1985) (court costs and attorneys' fees assessed for failure to attend pretrial conferences); *Lutwin v. City of New York*, 106 F.R.D. 502, 504 (S.D.N.Y. 1985) (sanctioned for failure to obey scheduling order).

¹⁹ See FED. R. Civ. P. 26(g) and advisory committee's note.

²⁰ See FED. R. Civ. P. 37(b)(2) and advisory committee's note.

²¹ See *F.D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. 116, 129 (1974).

²² See 28 U.S.C. § 1927 (1982). This statute authorizes costs, expenses, and attorneys' fees against an attorney "who so multiplies the proceedings in any case as to increase costs unreasonably and vexatiously." See *id.*

²³ Several statutes allow for the recovery of attorneys' fees. See, e.g., Clayton Act, 15 U.S.C. § 15 (1982); Securities Exchange Act of 1934, 15 U.S.C. § 78r(a) (1982); Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1964(c) (1982 & Supp. IV 1986).

²⁴ See 28 U.S.C. § 2072 (1982). The Rules Enabling Act provides:

The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases, and appeals therein, and the practice and procedure in proceedings for the review by the courts of appeals of decisions of the Tax Court of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.

Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution.

Such rules shall not take effect until they have been reported to Congress by the Chief Justice at or after the beginning of a regular session thereof but not later than the first day of May, and until the expiration of ninety days after they have been thus reported.

All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect. Nothing in this title, anything therein to the contrary notwithstanding, shall in any way limit, supersede, or repeal any such rules here-

Since the American rule does not and has never protected a litigant or his attorney from being made to pay an opponent's attorneys' fees as a sanction for misconduct, the proposed revision of rule 68 does not effect any substantive change in the American rule.

SHIFTING ATTORNEYS' FEES UNDER RULE 68

In my view, therefore, the benefits of the proposed changes clearly outweigh any legal or policy argument that can be made against them, especially since the 1984 proposal eliminates the principal defect in the 1983 proposal by not presuming unreasonableness from what may be an honest error.

Instead, the 1984 proposal sets forth a rational, objective standard that permits the court to look at factors other than merely the difference between the amounts of the judgment and offer.²⁵ At the very least, it is an experiment that ought to be tried. If experience confirms that it is leading to too much litigation over the reasonableness of refusals to settle, an adjustment can be made to deal with that problem.

One such adjustment might be an amendment to the proposed rule providing that an inference of unreasonableness would only arise where the deviation between offer and recovery exceeded a fixed percentage. For example, the rule could provide that if the judgment obtained were twenty-five percent lower than the refused offer, the refusal would be regarded as presumptively unreasonable, which would shift the burden to the offeree to demonstrate to the court that his settlement position was rational, based on the factors outlined in the 1984 proposal. Attorneys' fees would be shifted only if that burden could not be carried.²⁶

tofore prescribed by the Supreme Court.

Id.

²⁵ This Article has argued for the sanction of costs and attorneys' fees only where there is an unjustified refusal to settle, and even then the court would have the discretion to adjust this amount in the interests of justice.

²⁶ This approach could not be used, of course, where a plaintiff or defendant seeks only injunctive relief and not quantifiable money damages. Both proposals to amend rule 68 exempt class and derivative actions from the rule's application. That exemption is hard to justify. While the court must pass upon the reasonableness of settlements reached in such actions, the court has no greater power to deal with unreasonable settlement positions in these cases than it has in any other cases. It is therefore hard to discern why lawyers and litigants should not face the consequences of misconduct in those cases as well. Certainly rule 11 contains no similar exemption.

CONCLUSION

An amendment of rule 68, as outlined above, should be adopted. The amended rule would not create a radical change in the American rule, nor would it violate the Rules Enabling Act. Instead, within the scope of the Federal Rules of Civil Procedure, it would be simply another rule which imposes a sanction for unjustified conduct. Here, that unjustified conduct would be the unjustified refusal to settle a case. While on the one hand, settlement should not be coerced, litigants should not be permitted to drag litigation out in the face of a reasonable settlement offer. Where the settlement posture is rational, a court should not interfere, but if litigants and parties take unjustifiable settlement positions, they should face the prospect of paying the costs and attorneys' fees which their adversary will incur as a result of that unreasonable conduct.