The Legal Intelligencer
THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2019
PHILADELPHIA, AUGUST 2019
An ALM Publication

INSURANCE LAW

Potential Impact of 'Avandia' on Bad Faith Litigation in Pennsylvania

BY BRYAN M. SHAY AND MADISON G. MELINEK
Special to the Legal

In its recent decision in *In re Avandia Marketing, Sales Practices & Products Liability Litigation*, 924 F.3d 662 (3d Cir. 2019), the U.S. Court of Appeals for the Third Circuit further clarified the standards governing the protection and management of a party's confidential and proprietary information that is filed with the court or offered as evidence at trial. In that case, the Third Circuit concluded that a party seeking to maintain the confidentiality of documents and information that are filed with the court—such as in an exhibit to a motion for summary judgment—or used at trial must demonstrate that the common law right of access and the First Amendment are not offended by maintaining the confidentiality of such documents at that stage in the litigation.

In actions brought under Pennsylvania's insurance bad faith statute, 42 Pa. C.S. Section 8371, confidential and proprietary information of the insurer—such as claims manuals, training and educational materials, and personnel files of the file-handler—is frequently sought in discovery and offered into evidence at trial as support for the claim that the insurer acted in bad faith. As such, although the *Avandia* decision did not arise from a claim under Section 8371, the Third Circuit's decision in that case may nevertheless have a significant impact on how bad faith actions are litigated in the Pennsylvania federal courts.

SHAY

MELINEK

BRYAN M. SHAY *is a principal in Post & Schell's insurance law department. With a practice focused on insurance coverage and bad faith litigation, Shay advises and represents national clients in a variety of complex coverage and bad faith disputes arising from both commercial and personal insurance policies. He can be reached at bshay@postschell.com.*

MADISON G. MELINEK *is an associate in the firm's insurance law department, providing counsel and representation to insurance clients, including claims professionals, agents, brokers, third-party administrators and in-house counsel on all aspects of the claims process, complex coverage, and bad faith disputes. She can be reached at mmelinek@postschell.com.*

> *"The decision clarified that courts must employ a sliding scale of burdens when considering whether a party may maintain certain documents or evidence as confidential and shielded from public access during litigation.*

DISCOVERY AND PROOF OF BAD FAITH UNDER SECTION 8371

In its decision in *Rancosky v. Washington National Insurance*, 170 A.3d 364 (Pa.

2017), the Pennsylvania Supreme Court affirmed the two-prong standard for proving an insurance bad faith claim under Section 8371 that was first articulated in *Terletsky v. Prudential Property & Casualty Insurance*, 649 A.2d 680 (Pa. Super. 1994). Under the *Rancosky/Terletsky* framework, a plaintiff must prove, by clear and convincing evidence, that its insurer lacked a reasonable basis for its conduct; and that the insurer knowingly disregarded its lack of a reasonable basis. In an effort to prove the two prongs necessary to sustain a claim under Section 8371, plaintiffs will frequently seek to demonstrate that the insurance company's file-handler(s) deviated from the insurance company's own guidelines or standards; or that they were unqualified or biased in their assessment of the plaintiff's claim. In support of these assertions, a bad faith plaintiff will often seek to discover—and later to introduce as evidence in a dispositive motion or at trial—documents such as the insurance company's claims manuals or claims-handling guidelines; training or educational materials used by the company and its file-handlers; and the personnel files of relevant file-handlers. See Richard L. McMonigle Jr., "Insurance Bad Faith in Pennsylvania," Section 14:06-14:07 at 1494-1508 (19th ed. 2019).

In response to requests for such evidence in discovery, the insurer-defendants in bad faith actions frequently seek to limit the scope of the discovery to be produced; and to protect their confidential business materials and trade secrets by the court's entry of a protective order.

According to these insurers, such actions are necessary because the documents sought by the plaintiffs frequently contain confidential personal information (in the case of personnel files); or are proprietary materials used in the course of the insurer's business, such that the disclosure of these documents to the general public would cause the insurer competitive injury. See, e.g., *Sickora v. Northwest Mutual Life Insurance*, 2001 U.S. Dist. LEXIS 16394, at *4-5 (E.D. Pa. Oct. 10, 2001).

The Pennsylvania state and federal courts have generally been amenable to reasonable limitations on the scope of bad faith discovery. For example, in *Adams v. Allstate Insurance*, 189 F.R.D. 331 (E.D. Pa. 1999), the court limited the discovery of the insurer's claims manuals to only those manuals and guidelines that were relevant to the processing of the claim in question. Similarly, in *Cantor v. Equitable Life Insurance Society of the United States*, 1998 U.S. Dist. LEXIS 8435 (E.D. Pa. June 9, 1998), the court limited the production of training materials to those materials that were used to train the personnel who were actually involved in the handling of the claim at issue. With regard to personnel files, these courts have applied a "heightened standard of relevance" for the discovery of the information in an employee's personnel file, as these files frequently contain confidential personal information. In considering such requests, some courts have required the party seeking the personnel file to obtain the information it seeks from another, less confidential source, such as a deposition of the relevant personnel. See, e.g., *Kaufman v. Nationwide Mutual Insurance*, 1997 U.S. Dist. LEXIS 18530 (E.D. Pa. Nov. 12, 1997).

The Pennsylvania state and federal courts have also entered protective orders in bad faith cases, so as to ensure that personal or proprietary information belonging to the insurer is kept confidential even when produced in discovery. In doing so, these courts have applied the familiar analysis set forth by the Third Circuit in *Pansy v. Borough of Stroudsburg*, 23 F.3d 772 (3d Cir. 1994). For example, in *Sickora*, the court found that the training materials and claims manuals were "proprietary information" that was developed at considerable expense to the insurer; and that the disclosure of the same to the general public "posed a significant risk of injury" to the insurer. Similarly, in *Saldi v. Paul Revere Life Insurance*, 224 F.R.D. 169 (E.D. Pa. 2004), the court permitted the discovery of training and educational materials, but required that the plaintiff "not exchange or disclose these documents with anyone associated with the case." Although the terms of such protective orders (or a confidentiality agreement entered into between the parties) vary from case to case, it is often the case that once these documents are deemed to be subject to the strictures of the protective order, they must be maintained in a confidential manner—such as by filing them under seal—throughout the remainder of the case. It is this requirement that was addressed—and ultimately limited—in the Third Circuit's *Avandia* decision.

THE 'AVANDIA' DECISION

In *Avandia*, the United Food and Commercial Workers Local 1776 and Participating Employers Health and Welfare Fund (UFCW) alleged that GlaxoSmithKline (GSK)—which

manufactured the diabetes drug Avandia—violated RICO and various consumer protection laws. In its subsequently filed summary judgment motion, GSK argued that UFCW's state law consumer protection claims were preempted, and that UFCW failed to identify a distinct RICO enterprise. In support of its summary judgment motion, GSK filed documents and exhibits under seal. Neither party objected to the sealing of these documents.

The district court granted the summary judgment in favor of GSK. When the court's summary judgment decision was appealed to the Third Circuit, GSK indicated that it wanted to maintain the confidentiality of the sealed documents. The district court granted GSK's request in part and denied it in part: it unsealed its summary judgment opinion, but maintained the confidentiality of the remainder of the documents. UFCW timely appealed the aspect of the orders maintaining certain documents under seal, arguing that the district court incorrectly placed a burden on UFCW by sealing the documents.

In its decision regarding the appeal, the Third Circuit reviewed the three distinct standards that concerned the sealing of documents, and distinguished the burdens imposed by each by the stage in the litigation in which the standard is to be applied. First, when considering the entry of orders preserving the confidentiality of discovery materials pursuant to Fed. R. Civ. P. 26, the Third Circuit instructed courts to apply the *Pansy* test and the several factors set forth in that opinion. Under the *Pansy* standard, the party seeking a protective order bears "the burden of justifying the confidentiality of each and every document sought to be sealed" and must show that "good cause" exists for the entry of the order. When applying this standard, a court must balance the requesting party's need for information (including the public's right to the information) against the injury that might result if disclosure is compelled. As the Third Circuit explained in *Pansy*, broad allegations of harm that are unsubstantiated by specific examples or articulated reasoning will not be sufficient to demonstrate the necessary "good cause."

The *Avandia* decision further explained that a second, heightened standard—the common law right of access standard—is to be applied to documents that are considered to be "judicial records." The common law right of access is intended to promote public confidence and understanding in the judicial system, and to diminish the possibility of injustice, incompetence, and fraud. Under this standard, a presumption of access applies to documents that have been filed with the court, or were somehow incorporated into a court's proceedings—that is, they become "judicial records." In order to maintain such documents under seal pursuant to a protective order, the party protection must show that the interest in secrecy outweighs the presumption of access. According to *Avandia*, a court that precludes public access to such documents must conduct a document-by-document review of the challenged documents and articulate the interests to be protected; make specific findings on the record concerning the effects of disclosure; and provide an opportunity for interested third parties to be heard. As under the Pansy standard, broad allegations of harm are insufficient to justify maintaining the confidentiality of documents or other evidence.

Once at trial, according to the Third Circuit, an even more stringent standard will determine whether confidential and proprietary documents may be protected from public access. This third standard, which is derived from the First Amendment, provides a presumption that the public and the press have a right of access to civil trials. In applying this standard, courts are to consider whether the place and process have historically been open to the press (the "experience" prong); and whether public access plays a significant role in the functioning of the process in question (the "logic" prong). As there is a presumption that the proceedings will be open to the public, any restriction on the right of public access—including to documents and evidence at trial—is to be evaluated under strict scrutiny. The party seeking to rebut this presumption must demonstrate an overriding interest in excluding the public based on findings that closure is essential to preserve higher values; and the restrict on public access must be narrowly tailored to serve that interest.

With regard to the District Court's decision to seal certain documents in the *Avandia* litigation, the Third Circuit held that common law right of access applied to the documents because they were filed with the district court (and thus became "judicial records"). As such, the district court was required to undertake a document-by-document review, and to articulate, on the record, findings to support its decision. Because it did not satisfy these requirements, but rather relied

on case law that only applied the Pansy analysis, the Third Circuit remanded the case and required that the district court conduct further analysis of the documents to be sealed. In so holding, the Third Circuit emphasized that the *Pansy* factors do not displace the common law right of access standard, as the Pansy factors are not sufficiently robust for assessing the public's right to access to "judicial records." The Third Circuit also cautioned that concern about a company's public image, embarrassment, or reputational injury—a consideration under Pansy—is insufficient, on its own, to rebut the presumption of public access.

HOW 'AVANDIA' MAY AFFECT DISCOVERY AND TRIAL EVIDENCE IN BAD FAITH CASES

The *Avandia* decision clarified that courts must employ a sliding scale of burdens when considering whether a party may maintain certain documents or evidence as confidential and shielded from public access during litigation. At the discovery stage, it is the *Pansy* analysis that will apply. See, e.g., *Jerome v. Philadelphia Housing Authority*, 2019 U.S. Dist. LEXIS 97517, at **5-6 (E.D. Pa. June 11, 2019). Accordingly, it is likely that insurers will still be able to protect their confidential business documents, claims manuals, training materials, and personnel information from public disclosure during discovery. However, as was true well before *Avandia*, counsel for the insurer in a bad faith claim should be prepared to articulate the reasons why the specific documents are entitled to protection (such as the expense of developing and maintaining the documents, and the fact that the documents do not relate to public health or safety) and the specific harm that public disclosure of such information would work (such as an erosion of a competitive advantage were the documents to be provided to a competitor).

In light of *Avandia*, however, insurers and their counsel must be mindful that documents—such as a claims manual or training materials—that are protected from public disclosure during discovery might not necessarily be entitled to the same protection once these documents are filed with a summary judgment motion or introduced as evidence at trial. This is because, as the *Avandia* court explained, the burden to justify such a protection becomes greater as the litigation proceeds to and through trial. Thus, although documents like personnel files may arguably still be protected in the later stages of litigation in order to avoid the public release of a non-party's personal information, documents that are protected as proprietary business information may get a closer review by the courts as the litigation proceeds to trial. Accordingly, counsel for the parties in a bad faith action should be prepared to present additional evidence supporting or opposing the continued protection of a document under a protective order, and they must understand that an order sealing or protecting a document during discovery will not necessarily require continued confidentiality on summary judgment or at trial. Moreover, the parties should expect that the courts may undertake a new, independent review of any documents previously filed under seal in connection with a dispositive motion or at trial. Finally, counsel should expect that the courts will require that any agreed-upon protective order language or confidentiality agreement should include reference to the fact that the burden of protecting the documents covered under such an agreement becomes more stringent as the litigation proceeds, and that the courts have an independent duty to reassess sealed or otherwise-protected documents as the litigation leaves the discovery phase and enters the trial phase.

Pennsylvania's insurance bad faith statute is now nearly 30 years old. Despite the age of Section 8371, however, certain aspects of how bad faith cases are litigated are still being developed by the Pennsylvania courts. These aspects include the scope and nature of discovery in a Section 8371 action, and the proof necessary to sustain a claim under Section 8371. It is not yet clear whether the *Avandia* decision will be a game-changer when it comes to the litigation of Section 8371 claims, or whether it simply maintains the status quo. Nevertheless, counsel for both claimants and insurers in actions under Section 8371 should take note—and should plan accordingly—that after *Avandia*, confidential or proprietary documents like claims manuals or training materials may be entitled to less protection from public disclosure as the litigation moves into the dispositive motion and trial phases. •