Tobacco Surcharge Suits Spotlight Wellness Reg Compliance

By **Finn Pressly and Lesley Wolf** (October 23, 2024)

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From the Affordable Care Act Section 1557 final rules to the latest mental health parity regulations, this year has seen no shortage of challenges for sponsors of employee benefit plans.

Despite these new developments, one of 2024's most unexpected issues for plan sponsors arises out of a decidedly old-school design: tobacco-user surcharges. Over the last year, plan participants have filed multiple class action complaints alleging that tobacco-user surcharges amount to illegal discrimination based on a participant's health status.

At present, this mounting wave of litigation shows no sign of slowing down, which means that plan sponsors that have implemented a tobacco-user surcharge — as well as other common wellness program designs — should take a careful look at their design.

Background

The Health Insurance Portability and Accountability Act generally prohibits group health plans from discriminating based on health status. This common-sense provision ensures that plans do not treat participants differently based on their health conditions — e.g., by imposing higher deductibles on participants who have been diagnosed with a serious illness.

However, the statute contains an important exception that allows plans to charge different premiums based on health status — but only if the premium variation is based on "adherence to programs of health promotion and disease prevention."

Consistent with this statutory exception, the U.S. Department of Labor, U.S. Department of Health and Human Services, and IRS issued tri-agency regulations — the HIPAA wellness regulations — that provide detailed instructions for compliance with this exception.

The agencies published the first round of regulations in 2006, followed by updated final regulations in 2013 that made minor adjustments as a result of the ACA. The rules were briefly in the spotlight again in 2021 when the departments released FAQ guidance reminding employers that COVID-19 vaccine incentives would need to comply with the HIPAA wellness regulations. But otherwise, the core concepts in the HIPAA wellness regulations have been in place for nearly two decades with relatively little change.

The HIPAA wellness regulations put several key guardrails around wellness programs to ensure that their terms did not amount to impermissible discrimination based on a health factor. For example, many wellness programs, including tobacco-user surcharges, are subject to regulatory limitations that cap the penalty that can be assessed against participants who do not comply with the terms of the program.

However, even with these caps in place, the complaints allege that tobacco users often pay upwards of a $1,000 extra per year in medical plan premiums. The regulations give employers the power to charge significantly higher surcharges to tobacco users, although

most employers voluntarily choose to impose lower penalties — likely as a way to maintain positive employee relations.

Importantly, the wellness regulations also impose the so-called reasonable alternative requirement on many common wellness program designs. As the name suggests, the "reasonable alternative" provides participants with a reasonable way to obtain the reduced premium through an alternative means. If the allegations in the class action complaints are correct, the reasonable alternative is the most common place where plan sponsors have failed to comply with the HIPAA wellness regulations.

Unpacking the Reasonable Alternative

If a wellness program's reward is based on either (1) performing a particular activity related to a participant's health status, or (2) achieving a health-related benchmark, the HIPAA wellness regulations require the plan to offer participants a reasonable alternative method of obtaining the reward.

If the program requires the participant to perform an activity, such as completing a 5K run, the reasonable alternative must be made available to participants who have a health factor that makes it unreasonably difficult for them to complete the activity.

If the program requires participants to achieve a particular health outcome, such as achieving a particular body mass index, the reasonable alternative must be made available to everyone, regardless of whether they have a health factor that makes meeting this standard unreasonably difficult.

If the reasonable alternative requires the participant to complete a physical activity or achieve a health outcome, the plan must offer a reasonable alternative to the reasonable alternative. To avoid this nesting-doll scenario, most plans offer a sedentary educational program as the reasonable alternative.

In practice, the reasonable alternative takes the "teeth" out of wellness program incentives. It gives participants a path for paying the reduced premium without actually completing any physical activities or changing their health.

For example, if a benefit plan charges a lower premium to participants whose cholesterol satisfies certain metrics, the plan must give all participants the opportunity to obtain the same lower premium without actually lowering their cholesterol. This usually takes the form of an educational program, or a similar type of activity that doesn't actually require the participant to change their health in any way.

To further complicate matters, if the participant completes the reasonable alternative at any point after the plan year has already begun, the plan is required to apply the discount retroactively back to the first day of the year and issue a refund of overpaid premiums.

These same rules apply to tobacco-user surcharges. If a plan charges a higher premium to tobacco users, the HIPAA wellness regulations require the plan to notify participants that the tobacco-free rate is available to any participant who completes a reasonable alternative. The notice must be included in all plan materials that discuss the surcharge.

Plans typically offer a tobacco cessation program as the reasonable alternative. Those participants who complete the program within the time required by the plan are permitted to pay the tobacco-free rate — even if they continue to actively use tobacco products. In

short, the reasonable alternative allows plan participants to pay the tobacco-free rate while actively using tobacco products.

Nearly every class action complaint filed this year accuses plans of failing to adhere to these rules when designing their tobacco-user surcharges. For example, many of the complaints allege that employers have not offered a reasonable alternative method for obtaining the tobacco-free rate in the manner required by the HIPAA wellness regulations. Or, if they do, they either failed to properly notify participants of the availability of the reasonable alternative, or they failed to implement the reduced rate on a retroactive basis.

Based on these complaints, plan sponsors looking to assess their risk of litigation should look first to their reasonable alternative and confirm that the plan properly implements these rules.

A New Era for Benefit Plan Litigation

Most of these cases are in the very early stages, and it remains to be seen how these allegations will play out in litigation and whether the plaintiffs' allegations regarding these tobacco surcharge designs are correct.

However, the timing of these cases presents a unique test case to see how courts will analyze benefits regulations in the wake of the U.S. Supreme Court's June decision in Loper Bright Enterprises v. Raimondo — not only with respect to wellness programs, but also benefits regulations generally.

Prior to Loper Bright, courts applied the long-standing Chevron doctrine, which accorded broad deference to a federal agency's interpretation of a statute. Applying Chevron deference to the HIPAA wellness regulations, it seems likely that courts would have nearly uniformly found that violation of the regulations resulted in a violation of HIPAA's nondiscrimination rules.

However, under Loper Bright, employers have greater freedom to question whether the HIPAA wellness regulations represent a reasonable interpretation of HIPAA's nondiscrimination regulations and may encourage judges to do the same.

For example, HIPAA prohibits discrimination based on a participant's health status. Without any analysis or explanation, the HIPAA wellness regulations treat tobacco usage as a "health status factor" of a participant. This interpretation has gone unchallenged for years.

To be sure, tobacco usage has been linked to several serious health conditions — but, simply using a tobacco product does not necessarily mean that an individual automatically has those health conditions. Thus, as a technical matter, it is not immediately clear that tobacco usage should be considered a health status, and we may see courts declining to defer to the agency's interpretation of health status.

In this new regulatory regime, still in its nascent stages, courts may find that tobacco usage is a lifestyle choice — not a health status — and thus outside the reach of HIPAA's nondiscrimination protections.

Asking Tougher Questions

This is also a good time for plan sponsors to revisit the utility of their wellness programs. One of the main drivers behind these programs is the theory that participation in wellness

programs includes participant health, which, in turn, reduces claims experience for self-funded plans.

In the face of this heightened litigation risk, plan sponsors should also ask themselves the most important question: Are these wellness programs actually doing anything? Once wellness programs are added to a benefit plan design, plan sponsors sometimes fail to circle back and ask important existential questions about whether they add value. For example, has claims experience been materially reduced by implementing wellness program? Has overall employee health improved as a result of these efforts?

In fact, the compliance risk is broader than the arguments presented in the recent tobacco surcharge complaints.

The HIPAA wellness regulations represent only one arm of the federal government's regulation of wellness programs. Many common wellness program designs are simultaneously subject to an entirely separate regulatory scheme under the Americans with Disabilities Act. For example, if a wellness program requires a participant to submit to a physical examination or answer disability-related questions, the program must be reviewed for compliance with the ADA.

Even the federal tax code is potentially in play; the IRS has issued guidance reminding employers to treat wellness program rewards as taxable income unless they can be excluded from income. For example, if a plan participant receives a $20 gift card in exchange for completing a wellness activity, that amount must be imputed to them as taxable income.

Next Steps

The immediate takeaway from these complaints is that plans that have implemented a tobacco-user surcharge should immediately review their design to confirm that it complies with all of the various elements of the HIPAA wellness regulations — especially with respect to the reasonable alternative.

This review should also include all other wellness programs that are potentially within the scope of these rules — namely, COVID-19 vaccine incentives, classic "points gathering" designs and flu shot programs. We also recommend a holistic benchmarking review to determine whether these programs are worth the administrative hassle and compliance risk.

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