

COMPLIANCE BULLETIN



New Wave of Lawsuits Target Health Plan Tobacco Surcharges

Numerous class-action lawsuits have recently been filed against employers alleging that health plan premium surcharges related to tobacco use violate federal compliance requirements. These lawsuits have been filed by current and former employees of major U.S. companies, such as PepsiCo, Walmart, Target and Whole Foods, who have paid more in premiums due to their tobacco use, often hundreds of dollars more per employee per year.

In general, the lawsuits assert that the health plans violated HIPAA's nondiscrimination rules by:

- Not offering a reasonable alternative standard to avoid the surcharge (or only applying the premium reduction on a prospective basis after completing the alternative standard); and
- Not describing the availability of the alternative standard in all plan materials.

Some lawsuits also assert that the collection of the tobacco premium surcharge was a breach of fiduciary duty under ERISA. The lawsuits request various forms of relief, including reimbursing employees who paid the surcharges with interest, disgorging any benefits or profits, and paying all attorney fees and costs.

Action Items

Employers may impose premium surcharges related to tobacco use if certain compliance requirements are met, including HIPAA's nondiscrimination rules. Given the recent wave of litigation, employers that impose tobacco surcharges should review whether their wellness programs are administered in accordance with these legal requirements, including making available a reasonable alternative standard to qualify for the full reward and communicating the surcharge to employees in all materials.

Highlights

- Numerous class-action lawsuits have been filed against large companies that impose tobacco surcharges.
- These surcharges require employees who use tobacco to pay higher health plan premiums than employees who do not use tobacco products.
- In general, the lawsuits allege that the surcharges violate HIPAA because employees were not provided with (or informed about) an alternative standard for qualifying for the full reward.

Alternative Standard

- To comply with HIPAA, a reasonable alternative standard for avoiding the surcharge must be available for employees who continue to use tobacco.
- Employees who satisfy the alternative standard must receive the full reward.
- The alternative standard must be disclosed in all plan materials describing the tobacco surcharge.



HIPAA Requirements

Employers commonly require tobacco users to pay an additional charge for health plan premiums, whether they use cigarettes, cigars, e-cigarettes or smokeless tobacco. To comply with federal law, tobacco surcharges must be offered through a wellness program that meets the Health Insurance Portability and Accountability Act's (HIPAA) nondiscrimination requirements. For compliance purposes, HIPAA divides wellness programs into two categories: participatory wellness programs and health-contingent wellness programs. A wellness program that includes a tobacco surcharge will fall under one of these categories, depending on how the program's surcharge is designed.

- Participatory programs remove the surcharge for employees who participate in an activity (for example, attending a smoking cessation class), regardless of whether they quit using tobacco; and
- Health-contingent programs only remove the surcharge for employees who satisfy a health-related standard (for example, not using tobacco).

Participatory wellness programs comply with HIPAA's nondiscrimination requirements without having to satisfy any additional standards as long as participation in the program is available to all similarly situated individuals, regardless of health status. [Final regulations](#) under HIPAA require health-contingent wellness programs to adhere to the following five standards related to nondiscrimination:

1. **Frequency of opportunity**—Eligible individuals must be provided with an opportunity to qualify for the reward at least once per year;
2. **Size of reward**—The total reward offered to an individual cannot exceed 30% of the total cost of coverage under the plan. However, for wellness programs that are designed to prevent or reduce tobacco use, the total reward cannot exceed 50% of the total cost of coverage under the plan;
3. **Reasonable alternative standard**—Health-contingent wellness programs must provide a reasonable alternative standard (or waiver of the otherwise applicable standard) to qualify for the full reward for anyone who does not meet the initial standard (that is, those who use tobacco products). For example, the reasonable alternative standard could include attending a smoking cessation class;
4. **Reasonable design**—Health-contingent wellness programs must be reasonably designed to promote health or prevent disease. A wellness program is reasonably designed if it has a reasonable chance of improving the health of (or preventing disease in) participating individuals and is not overly burdensome, a subterfuge for discrimination based on a health factor, or highly suspect in the method chosen to promote health or prevent disease; and
5. **Employee notice**—The availability of a reasonable alternative standard to avoid the surcharge (and, if applicable, the possibility of a waiver of the otherwise applicable standard) must be disclosed in all plan materials describing the tobacco surcharge. This disclosure must also be included in any notice that an individual did not satisfy the wellness program's standard of not using tobacco products. The disclosure must include contact information for obtaining the alternative standard and a statement that recommendations of an individual's personal physician will be accommodated.



Enforcement and Penalties

The U.S. Department of Labor (DOL) has enforced HIPAA's nondiscrimination requirements for health-contingent wellness programs for years, with some costly outcomes for employers. For example:

- In 2018, an employer [agreed](#) to reimburse its employees \$145,635 for tobacco surcharges after a DOL investigation found that the employer did not provide a reasonable alternative standard for avoiding the surcharge. It also agreed to pay a penalty to the federal government of \$14,563 for the violation; and
- In 2023, an employer agreed to reimburse its employees \$16,660 for tobacco surcharges after a [DOL investigation](#) found that the employer had not informed employees about a reasonable alternative standard for avoiding the surcharge. Before the settlement, the employer had already reimbursed its employees \$79,780 for tobacco surcharge payments. It also agreed to pay a penalty to the federal government of \$13,422 for violating HIPAA and other federal requirements.

Although the recent wave of class-action lawsuits is in its early stages, the litigation will likely result in costly outcomes for the employers involved. One such employer, Bass Pro Shops, already agreed to a \$4.95 million settlement in a lawsuit alleging its tobacco surcharge violated HIPAA's reasonable alternative standard requirements.