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Updates on Tobacco Surcharge Class Action Litigation

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In the last month, we have seen a surge in class action lawsuits filed against employers challenging health plan premiums charged to tobacco users. In this update, we provide a summary of the cases and an update on what's next for plan sponsors and fiduciaries.

In recent weeks, sponsors and fiduciaries of employee benefit plans governed by the Employee Retirement Income Security Act (ERISA) have seen a rapid proliferation of class actions challenging tobacco-use surcharges adopted by such plans to incentivize smoking cessation. The wave of lawsuits has primarily targeted large, self-funded group health plans with claims that the plans are charging discriminatory premiums to tobacco users, in violation of 29 U.S.C. § 1182(b) and its implementing regulations.[1] A recent decision from the Southern District of Ohio suggests that the Supreme Court's recent decision in *Loper Bright Enterprises v. Raimondo*, may play a role in how district courts respond to plaintiffs' tobacco-use surcharge claims.

Background on Tobacco Surcharge Litigation

Corporate wellness programs have become increasingly common in the workplace. Some employers incorporate smoking cessation programs into their wellness programs as a way to encourage employees to quit smoking or using tobacco products. ERISA expressly permits these programs so long as they comply with certain requirements set out in the statute, including limits on the size of the incentive, frequency with which a participant may qualify, and availability of the incentive.

As background, to expand access to affordable health insurance coverage, the Affordable Care Act (ACA) amended ERISA to prohibit group health plans from imposing eligibility rules based on a "health status-related factor," including "medical condition[s]" or "[m]edical history," among other factors.[2] Under this rule, a plan "may not require any individual (as a condition of enrollment or continued enrollment under the plan) to pay a premium or contribution which is greater than such premium or contribution for a similarly situated individual enrolled in the plan based on any health-related factor in relation to the individual or to an individual enrolled under the plan as a dependent of the individual."[3]

However, ERISA offers a safe harbor for certain wellness programs, permitting plans to "establish[] premium discounts or rebates or modify[] otherwise applicable copayments or deductibles in return for adherence to programs of health promotion and disease prevention."[4]

The Department of Labor's (DOL) implementing regulation addresses the method by which plan members may avoid a premium surcharge "based on whether an individual has met the standards of a wellness program."[5] The regulation states that wellness programs must be "reasonably designed to promote health or prevent disease."[6] A program will be regarded as reasonably designed if a reasonable alternative standard is provided to a member who does not meet the initial outcome-based standard. The regulation expressly approves programs that encourage smokers to enroll in cessation programs, regardless of whether the members stop smoking.

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In other words, employers can offer incentives to wellness plan members, such as premium discounts, rebates, or adjustments to co-payments or deductibles, in exchange for their participation in wellness programs, and can surcharge plan members who do not comply with the programs. One way for plans to take advantage of the safe-harbor provisions while charging participants surcharges is to offer programs designed to increase member well-being such as, for example, a smoking cessation program, through which participants can avoid the surcharges by completing the program.

Until recently, suits challenging these surcharges were rare. But the last few weeks have seen a dramatic increase in the number of cases making such allegations. In this recent wave, plaintiffs allege that employers impermissibly collect fees—sometimes upwards of $800 - $1,150 per member, per year—from plan members who disclose that they use nicotine products in order to maintain health insurance coverage. Plaintiffs contend that the surcharges violate ERISA's antidiscrimination and fiduciary provisions in two ways.

First, they assert that employers charge tobacco users a surcharge without providing members with a reasonable alternative standard, such as a smoking cessation program, through which the members can avoid the surcharge by completing the program. Relying on the DOL's implementing regulations, plaintiffs contend that members must receive the full reward once they meet the alternative standard. In other words, there must be a way for members to avoid the surcharge entirely for the full plan year (retroactively and prospectively) if they complete a cessation program at any point during the year.

Second, plaintiffs assert that, even if a plan offers a reasonable alternative standard, it is not clearly communicated to members. According to plaintiffs, DOL regulations require the alternative standard be disclosed in "all plan materials."[7]

Prognosis for Tobacco-Use Surcharge Cases: The Dismissal Order in *Department of Labor v. Macy's, Inc.*

The surcharge cases in the current wave are still in early stages, but one of the few cases preceding this group—a government enforcement suit against Macy's—might help shed light on how courts will respond to plaintiffs' theories, and in particular, on plaintiffs' reliance on DOL regulations.

On September 26, the U.S. District Court for the Southern District of Ohio in *Secretary of Labor v. Macy's, Inc.*, denied Macy's bid to dismiss an ERISA anti-discrimination claim brought against it by the DOL.[8] Macy's sought to dismiss a claim that its tobacco surcharge wellness program violated ERISA by discriminating against tobacco users.

In *Macy's*, the Secretary of Labor took the position that the tobacco surcharge wellness program did not qualify as reasonably designed under the DOL's implementing regulations because, *inter alia*, it required that a smoker be smoke-free at the conclusion of the cessation program before he or she could qualify for a refund of the surcharge.[9] According to the Secretary, being "smoke free" is not a "reasonable alternative" to the standard of being a non-smoker.[10]

After the parties had fully briefed their motion to dismiss, the Supreme Court issued the *Loper Bright* decision. In supplemental briefing, Macy's argued that, when evaluated after *Loper Bright*, the DOL's regulation, which would require a refund to an employee even if the member continued to smoke despite having participated in a cessation program, is invalid because it is inconsistent with ERISA, which requires "adherence to programs of health promotion and disease prevention."[11]

In its order denying Macy's motion, the district court ruled that Macy's argument regarding the impact of *Loper Bright* warranted further consideration by the parties and the court, and granted Macy's permission to renew its motion within 30 days to address "the significant issues presented in this litigation."[12] We will closely monitor this case to see how, if at all, any subsequent decision on this issue could affect how courts weigh *Loper*

Bright in assessing the viability of plaintiffs' theories.

Notably, Macy's is not the only employer that has been targeted by the DOL concerning tobacco-use surcharges. In September 2023, the U.S. District Court for the Northern District of Illinois entered a consent order and judgment in a suit brought by the DOL against Flying Food Group.[13] The court ruled that the company did not inform plan members that a reasonable alternative existed that would allow them to avoid paying a tobacco surcharge. The court ordered the company to reimburse plan members for the surcharges and to pay penalties under ERISA and related federal regulations. The recent explosion of private suits, however, is unprecedented.

What's Next for Plan Sponsors and Fiduciaries

The Secretary of Labor's litigation against Macy's, coupled with the consent order in Flying Food Group, may further embolden plaintiffs to bring more lawsuits against employers who apply tobacco-use surcharges in their wellness plans.

In light of the recent proliferation of these suits, employers might want to consider reviewing their plan documents to assess whether they should or do offer a reasonable alternative standard, such as a smoking cessation program. Employers might also consider evaluating how and with what frequency their plans are notifying members about the availability of reasonable alternative standards.

[1] *See, e.g.*, *Williams v. Target Corp.*, No. 0:24-cv-03748 (D. Minn.); *Baker v. 7-Eleven, Inc.*, No. 2:24-cv-01360 (W.D. Pa.); *Bokma v. Performance Food Group, Inc.*, 3:24-cv-00686 (E.D. Va.); *Keesler v. Tractor Supply Co.*, 3:24-cv-01612 (M.D. Pa.); *Rogers v. Advocate Aurora Health*, 1:24-cv-08864 (N.D. Ill.).

[2] 29 U.S.C. § 1182(a)(1).

[3] *Id*.

[4] 29 U.S.C. § 1182(b)(2)(B).

[5] 29 C.F.R. § 2590.702(c)(3).

[6] 29 C.F.R. § 2590.702(f)(4)(iii).

[7] *Baker*, No. 2:24-cv-01360, Dkt. 1 at 6 ¶ 21 (citing 29 C.F.R. § 2590.702(f)(4)).

[8] *Sec'y of Labor v. Macy's, Inc.*, No. 1:17-cv-00541, 2024 WL 4302093 (S.D. Ohio Sept. 26, 2024).

[9] *Id.* at *3.

[10] *Id.*

[11] *Id.* (quoting 29 U.S.C. § 1182(b)(2)).

[12] *Id.*

[13] U.S. Dept. of Labor, News Release, Flying Food Group Will Reimburse Health Plan Participants More Than $134,000 for Diagnostic Deductibles, Tobacco Surcharges, After Federal Investigation (Sept. 26, 2023), available at https://www.dol.gov/newsroom/releases/ebsa/ebsa20230926 (last accessed Sept. 30, 2024).

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