

*Professor Sugarman sets the issue of risk rating health insurance in the broader context of employers' interest in a healthy workforce and alternative ways to promote employee health to curb growing health care costs. He addresses the relevance of "voluntariness" to the risk-rating of health insurance, and contrasts the different roles of private life and health insurance in America. He surveys a range of objections to risk rating that draw primarily upon concerns that employees be treated as individuals, not statistics, and that what they do on their own time should not determine how they are treated at work. He further reviews the legal ramifications of risk rating in light of the still untested impact of the Americans With Disabilities Act, the 1991 Civil Rights Act Amendments, and other evolving policies. Professor Sugarman asks whether risk rating of health insurance is an "important trend" or a "temporary deviation from traditional practice."*

## EMPLOYER DISCRIMINATION AGAINST WORKERS WITH "UNHEALTHY LIFESTYLE" INDICATORS: Some Legal and Policy Issues

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### INTRODUCTION

In our culture, one's health is increasingly seen as more a matter of choice than chance. With bad health

linked to smoking, drinking too much, eating the wrong things, failing to exercise, and engaging in dangerous activities (sexual and other), commentators increasingly tie the use of health care services to personal lifestyle decisions. This awareness has engendered the question: Should those whose lifestyles are likely to require more health care pay more for health insurance?

Because we typically talk of "health insurance," much of the exhortation on this issue has been directed towards health insurers. But this call misses the mark. The reality today is that employers play the key role here. In America, more people obtain health insurance through their employment (or the employment of a family member) than through any other means. And, it is employers who decide whether or not to link lifestyle to the health plan costs that they may impose on their employees.

Although most employers have *not* priced employee group health insurance on the basis of individual lifestyle factors, some have. Not all employers who engage in what is sometimes called "risk rating" use exactly the same approach. An employer might adopt higher rates for employees who smoke than for those who don't. A similar rating system might be applied in the areas of weight, blood pressure, and cholesterol levels.

Many employers operate "wellness" programs aimed at improving the health of their employees through free health screening, exercise classes, and the like. Some wellness programs include financial payments. As an economic matter, these payments amount to the same thing as differentially priced health insurance. For example, someone who joins the wellness scheme and agrees not to smoke receives \$10 a month in cash. The two strategies can be used together—for example, by combining an across-the-board increase of \$10 a month in the employee's contribution to the health plan with a \$10 monthly incentive payment through the wellness plan for employees whose blood pressure is "normal" or who join an exercise class.

A few employers have taken an even stronger step, refusing to hire new employees based upon health-related indicators that reflect riskier personal lifestyles. Typically, after a tentative decision to hire, the prospective employee is asked to take a pre-employment physical. If, for example, high blood pressure or a high cholesterol level is discovered, the offer will not be extended. Other employers make it clear in advance that they will not hire smokers, perhaps insisting upon a blood test for nicotine to police the rule.

All three of these strategies have gained considerable recent attention. It is not yet clear if they represent a harbinger of an important trend or merely a modest, and perhaps temporary, deviation from traditional practice.

## THE WIDER CONTEXT

### Other Reasons for Employer Interest in Employee Health

Employers are concerned about employee health for a number of reasons, only one of which is the health plan cost burden. Employers are also interested in absenteeism, turnover, and general productivity. To the extent that employers believe these factors are related to employee health, they also want a healthy workforce quite apart from health care cost considerations.

### Screening for Health Factors Beyond the Insured's Control

Despite the current fascination with "lifestyle," some health risks remain largely beyond an individual's control. Some people contract diseases or suffer accidental injuries despite their best efforts at avoidance. Others may suffer from ailments because of their genetic make-up. Recent developments in genetic screening promise (or threaten) to reveal our susceptibility to many diseases.

Employers, of course, have a financial interest in employee health whether or not the employee can do anything about it. Hence, alongside the issue of lifestyle-based employment policies is the issue of whether employers should be permitted to take genetic factors into

account in the health-related employment decisions they make.

In terms of life insurance, for example, there seems to be relatively little public resistance to underwriting decisions based on an insured's mortality risk, regardless of whether that risk is under the control of the insured. Apart from certain socially objectionable status-based classifications (such as race, and, to some, gender and/or sexual orientation), all that is usually insisted upon is actuarial soundness.

Thus, it is considered a legitimate practice for a life insurer to charge more or even refuse coverage to someone who has multiple sclerosis, high blood pressure, or a family history of cancer, as long as there is a statistical basis for the differentiation.

### Is Health Insurance Different from Life Insurance?

While the income needs of a decedent's survivors are a matter of important public concern, family members of nearly all breadwinners are already partially protected through the Social Security system. On the death of a worker covered by Social Security, the system pays monthly benefits to dependent elderly spouses and to dependent minor children and their surviving caretaker parent.

In contrast to Social Security survivor benefits, basic health insurance is provided through the private sector. To be sure, the elderly and the poor rely upon Medicare and Medicaid for their health care protection, but Social Security, Medicare, and Medicaid are not risk-related in their pricing or underwriting. Indeed, suggestions that risk rating of some sort be applied to Medicare have won little support and appear to have been abandoned.

Moreover, like social insurance, group health insurance has traditionally been thought of as the general collective responsibility of those participating. This explains the early commitment to "community" rating, under which the premiums charged to employers by Blue Cross and Blue Shield were based upon the claims experience of the metropolitan area served. Group health insurance traditionally has not employed "pre-existing conditions" exclusions of the sort that individual health insurance has thought necessary to combat problems of adverse selection.

Of late, the tradition of community rating in group health insurance has broken down. Some employers (and employee groups) who realized that their claims experience was lower than average sought lower premiums (or improved coverage)—and commercial insurers happily entered the market to cater to them. Generally speaking, in order to compete, the Blues, in turn, have had to revise their practices. As a result, today, when a large company funds its health care plan through insurance, that insurance is very likely experience-rated—that is, based upon the claims experience of the employees in that firm.

## **Health Insurance Differentials and Voluntary Conduct**

Some people insist that differential treatment based on uncontrollable health factors is unfair and should not be allowed (at least in employment-based health plans). In fact, employers do not yet seem to be moving in that direction, although the increased availability of genetic screening might change things. On the other hand, many people don't find it at all unfair for employers to make distinctions based on factors within the control of the employee.

However, for those who think personal "control" is crucial to the fairness of any differential rating system, it should be recognized that some concerns are likely to be raised in the implementation of such a program. Are the high cholesterol and blood pressure levels shown by a screening test really under the control of the employee? Is smoking really a matter of choice, rather than an addiction that began in childhood? One way for employers to deal with these concerns is to grant favorable treatment both to those who display good health indicators and to those who agree to participate in a program designed to achieve healthy indicators—such as a diet or smoking cessation program.

## **Employee Concerns about Privacy and the Use of Actuarial Predictors**

Even with matters seen as being under an employee's control, other objections emerge relating to the value of privacy. When employers distinguish on the basis of lifestyle indicators, their employment, or at least its terms and conditions, depends upon a person's behavior off the job. Few deny that employers can make the workplace smoke-free or serve only healthy food in the employee cafeteria. But these behavior regulations concern the work day. Penalizing people because of what they do off the job—smoke, drink, eat poorly, or drive with unfastened seat belts—is frightening to many.

It is especially threatening when the employer cannot demonstrate that the off-work behavior affects how the employee performs on the job or uses health care services—even if the employer does have some data on general tendencies of employees with such behaviors. For example, some people who smoke off the job will get lung cancer as a result, but most won't. Moreover, many of those with indicators of health risks, such as high blood pressure, rightly insist that they are not "ill" in the conventional sense. Hence, they see themselves as being penalized, not because of their current work performance or cost to the company, but because of speculation about their future health.

Furthermore, they fear that this practice will open a Pandora's box—with the powerful enterprises of this nation having far too much influence over the private lives of ordinary citizens. Concerns about health screening are also linked by many civil libertarians to their

objections to drug testing by employers.

Risk-rated health plans and incentive schemes also raise privacy concerns in terms of the monitoring of employee compliance. Who and how many people will see our medical records? Would employees be monitored on weekends to see if they smoke or neglect to wear seatbelts?

Thoughtful employers appreciate employee concerns about their privacy. They are also concerned about the cost of monitoring risk-rated schemes. These factors together push some employers to rely solely on employees' representations of their own behavior. But if employees are dishonest, it undermines the enterprise's objectives. Therefore, employers tend to use inexpensive and easy-to-administer tests meant to indicate health risks such as blood tests, breath tests, and weight and body mass measures.

This practice has the effect of singling out employees with poorer health prospects that happen to be more easily and cheaply measured. Some people find this unfair. For example, an employee might ask: "Why am I charged more because I smoke, when the guy next to me isn't, even though he drinks too much?" Most employers who have used differential treatment in ways described here make participation voluntary. Hence employees who are eager to protect their privacy can do so. But they have to pay for that right.

Employers worried about employees with deteriorating health indicators and wanting to provide incentives for employees to maintain the desired indicators will want to conduct regular tests. While this practice may catch an employee whose lifestyle has led to a poorer health prognosis, it may also catch those whose poorer health prospects arise from job stress, the responsibility for which may rest more properly with the employer.

Finally, actuarial soundness and causation are not the same thing. For example, although a simple correlation study might show that smokers are absent from work more often than non-smokers, it may turn out that what is really being captured by the smoking variable is whether an employee is a blue collar worker or not. In other words, if the type of job performed were taken into account, smoking would no longer predict absenteeism.

## **Broader Concerns about Health Care Cost Containment**

A focus on risk rating of health insurance should not lose sight of the fact that employers are also caught up in two other health care crises that face the nation.

First, health care costs are becoming too expensive for everyone—government, employers and individuals. Second, our decentralized patchwork quilt of health insurance protection has large and growing holes in it.

In thinking about responses to these crises, employers are naturally concerned that they may be forced to shoulder new burdens they would rather avoid. So, those

proposing public action must take potential employer avoidance strategies into account. For example, it is frequently said that one powerful force in causing employers to shift from insured to self-funded plans is the passage by state legislatures of mandatory coverage in group health insurance—a requirement that doesn't apply to self-funded plans. It is also possible that governmentally enacted requirements or prohibitions with respect to risk rating would be blunted by employer reaction.

Apart from public action, employers can respond to their own interest in health care cost containment in a variety of ways. For example, they can shift more premium costs onto employees. Doing so through risk rating may be an advantage in that only some of the employees might face higher costs, and the plan could be sold to the employee group as a whole as an incentive scheme designed to reduce their overall health care bill.

But it is important to remember that employers have several other strategies available to deal with rising health care costs. These are: reducing the quality of their health care plan; shifting to provider networks that are committed to managed (lower cost) care; imposing higher deductibles and/or co-insurance requirements; and encouraging older employees who are likely to use the health plan more heavily to quit, although many large firms are committed to continuing health care benefits for retirees.

## POTENTIAL LEGAL HURDLES

### Federal Anti-discrimination Statutes

#### 1. Title VII of the 1964 Civil Rights Act

The 1964 Civil Rights Act might be invoked to prevent employers from imposing risk-rated health insurance premium charges on employees. If, for example, black employees could show that differential premiums for smokers and non-smokers, or for those with high and normal blood pressure readings, have a disparate impact on them, the use of such differentials could constitute illegal employment discrimination, regardless of the employer's intent.

Title VII of the 1964 Civil Rights Act protects various groups from employment discrimination. As the law has developed, there are two classic sorts of lawsuits that may be brought. One is the "disparate treatment" case—where an employer explicitly treats women worse than men, for example.

But protected groups may also bring cases under Title VII on what is known as the "disparate impact" theory. Despite some recent retrenchment by the U.S. Supreme Court, this basic theory, first adopted in the *Griggs* case in 1971, remains law. To illustrate, if a large proportion of an employer's smoking employees were black and fairly few black employees were not smokers, then a

policy disfavoring smokers would have a disparate impact on black employees. Similar disparate impact might be found if blood pressure readings were employed as a criteria for disfavored treatment.

To show disparate impact, claimants must show more evidence of discrimination than a mere statistically significant difference between the groups. Just how much more is not altogether clear from the cases, but let us assume that whatever stronger pattern is required could be demonstrated at least in some firms. This is by no means a speculative possibility, especially in firms whose black workers are largely restricted to and largely comprise the blue collar ranks where smoking, for example, is likely to be far more common.

Title VII plainly covers differences in employee benefits—not just job access, promotions, and salary levels—although some legal experts detect a reluctance of courts to use the disparate impact theory aggressively in the employee benefit context.

Once the claimants have proved disparate impact, the question becomes whether the employer has a business necessity for the practice. The phrase "business necessity" is rather misleading, because "necessity" is hardly required in any strict sense—a point emphasized in the 1989 *Wards Cove* case, which instructed courts to be generally deferential to sensible explanations offered by businesses for their practices.

If the claimants can show that the employer could readily accomplish its goals in a different way, that could serve to disprove business necessity for the practice in question. For example, if a firm refused to hire those with high blood pressure and this had a disparate impact on blacks, and the firm's justification was that it refused those job applicants to avoid higher health insurance costs, the claimants *might* be able to strike the practice on the grounds that the employer could adopt a less restrictive practice that didn't block job access for blacks—i.e., charge higher insurance premiums to those employees with high blood pressure.

But if the practice under attack is one that charges employees with high blood pressure more for insurance, there is no obvious alternative practice available. At that point the court would have to decide if charging risk-related premiums is a justifiable practice. Suppose the employer had studied its own employee base and determined that, holding other things equal, there was indeed differential use of its health plan benefits by those with high blood pressure. While it is not altogether clear which way the case would come out, the practice might well be found to be justified, especially if the premium differentials employed fairly reflected the differential use. Unfortunately, although the 1991 Civil Rights Act Amendments restate the "business necessity" test, they don't provide a clear answer.

In sum, under current law, although an employer might have to go to court to defend itself, if it has acted

sensibly in the face of data, it might well win a Title VII case that challenged on disparate impact grounds group health plan premium differentials disfavoring those with unfavorable health indicators, especially indicators that the employee can probably change. Nevertheless, the social reality of these examples would in all likelihood remain; the differentials would burden minority (and lower paid) employees. Because of that outcome and its legal uncertainty, it would be understandable if many employers were reluctant to use differential premiums.

## 2. The Americans with Disabilities Act (ADA)

In 1990, Congress passed the Americans with Disabilities Act (ADA), which extends federal employment discrimination protection to the disabled. Title VII of the Civil Rights Act does not apply to discrimination against persons with disabilities. Many state laws, however, protect the handicapped against employment discrimination. The issue is the potential ability of smokers, those who are overweight, and so on, to use the ADA to strike down adverse decisions concerning their employment.

At first blush it would seem that merely being a smoker, for example, does not qualify a person as disabled or handicapped under the ADA because being a smoker alone does not seem to constitute having an "impairment," a requirement under the ADA. If this is right, that is the end of the matter. The same point, perhaps, applies to other risk factors. However, under the ADA, if an employee (or prospective employee) is rejected or treated worse because he or she is "regarded as having an impairment," the employee is protected. Moreover, prior case law in this field (from prior federal law and from state laws concerning discrimination against the handicapped) generally rejects the defense that the employer fears increased costs from hiring this employee.

For example, suppose an apparently healthy person is accepted for a job subject to a pre-employment physical and that exam uncovers a congenital back problem previously unknown to and not currently bothering the job applicant. If the employer, fearing this condition will lead to a back injury and high benefit costs, rejects the applicant, this may well be illegal. The rationale is that the employer is impermissibly "regarding" the person as having an impairment, when there is nothing about the person that prevents him or her from now performing the job.

In principle, therefore, it is possible that rejecting a smoker would be subject to the same analysis. If the employer fears higher costs in the future from health claims, absenteeism and turnover from disabling conditions brought about from smoking, on this basis the smoker too may be seen as having an impairment and so be protected by the act.

It is too soon to tell how the ADA will treat this general problem. The final Equal Employment Opportunity

Commission (EEOC) regulations that implement the ADA, issued in the summer of 1991, are not terribly helpful on this score. (Some experts have suggested that in enforcing the ADA, the EEOC will, at least in the early years, focus on those who are clearly disabled now, and will tend to steer clear of the "regarded as having a disability" provision.)

It is also important to note that there is specific language in the ADA which seems to exempt from its reach certain insurance (or health plan) pricing practices that have actuarial validity. Thus, employers who might be at risk under the ADA for refusing to hire someone, may well be permitted to charge that person risk-related premiums. Unfortunately, this too remains uncertain because none of the examples in the legislative history or the EEOC regulations address this question precisely. Furthermore, regardless of how this ADA provision is interpreted, it is by no means clear that all employers who risk-rate in their group health plans have sufficient data to be exempt from ADA coverage on actuarial grounds.

On the other hand, it is also possible that employers will escape the ADA's reach if they offer lower rates (or wellness benefits) both to those with healthy indicators and those who join programs to try to improve their indicators. In this way perhaps the "regarded as having an impairment" claim can be avoided, even if the "safe harbor" for valid insurance plans proves unavailable.

### **Constitutional Limits on Public Employers**

Many workers today are public employees, and when government, at any level, is the employer, then the complaining party may have special legal grounds for attacking employment decisions based upon health indicators. Most importantly, the person denied a job, or disfavored in health insurance and/or wellness plans, might invoke constitutional rights that restrict government conduct but are inapplicable to private employers.

Most likely, claimants would assert federal and state constitutional rights of "privacy." Some state constitutions explicitly contain an individual right of privacy. Although there is no such explicit right in the U.S. Constitution, the Supreme Court has upheld individual rights rooted in the idea of privacy by reference to both the Ninth Amendment (that reserves rights to the people generally) and the idea of "due process" protected by both the Fifth and Fourteenth Amendments.

Local chapters of the American Civil Liberties Union (ACLU) in Florida, Georgia, and Rhode Island, for example, have been involved in a number of cases in which privacy rights have been raised against government employers who have discriminated against people on the basis of health indicators. This is part of a broader national ACLU project to protect worker privacy. In cases where the claimant has been denied employment, the ACLU has a clear policy to challenge adverse deci-

sions based on high blood pressure, high cholesterol counts and the like. Interviews with ACLU staff suggest that the organization has not yet adopted a firm position on whether to challenge risk rating of health plans and wellness programs.

The ACLU litigation effort has not yet led to any clear holdings by appellate courts. It has, however, caused some local governments to withdraw or modify their hiring practices. As indicated earlier, such practices plainly do raise serious privacy concerns. Yet, whether or not they will turn out to be vulnerable to legal attack on "right to privacy" grounds remains uncertain.

## State Statutes

### 1. Possible ERISA pre-emption

States often have counterparts to the federal anti-discrimination laws. It is important to note that state laws that attempt to regulate employee benefit plans are potentially invalid on the grounds that they are preempted by federal law. This law is the Employment Retirement Income Security Act (ERISA), enacted in 1972 primarily to regulate private pensions. In return for federal pension regulation, employers are exempt, under ERISA, from much more state regulation than pensions.

Although there have been conflicting decisions from various courts and agencies, there are grounds for concluding that attempts by states to apply their employment discrimination laws to the practice of risk rating in employee benefit plans would be subject to ERISA pre-emption. If this were so, states could stop employers from firing or refusing to hire those with high blood pressure, but they could not prevent employers from charging such employees more for health insurance.

### 2. Smokers' rights laws

A number of states have passed legislation protecting the rights of smokers in employment. At least four states have rejected such legislation, and several other states are currently considering enacting smokers' rights laws. This is a new phenomenon which could potentially have a sharp impact on the ability of employers to differentiate between smokers and non-smokers. Such laws could also pave the way to protections for people with poor health indicators generally—whether caused by genetics or chosen lifestyle.

The majority of states with legislation protecting the employment rights of smokers use language similar to that in traditional civil rights laws. They make it illegal for an employer to require as a condition of employment that a person abstain from smoking during nonworking hours, and they prohibit an employer from discriminating with respect to hiring, firing, compensation, terms, conditions, or privileges of employment because an employee smokes during nonworking hours.

Many states with these types of statutes make two

exceptions for employers. For example, under the laws of South Dakota, New Mexico and Colorado, employers can place restrictions on smoking during nonworking hours if these restrictions "are reasonably and rationally related to the employment activities" or if restricting smoking outside the workplace is necessary to avoid a conflict of interest. (These exceptions might, for example, permit fire departments and the American Cancer Society to refuse to hire smokers.)

Other states establish even stronger rights for smokers. For example, Kentucky not only prohibits discrimination against smokers and allows no exceptions, but it also prohibits employers from segregating or classifying employees in a way which would deprive them of opportunities because they are smokers.

Obviously, most of these statutes would preclude most employers from refusing to employ smokers, and that is the primary purpose behind them. I believe those statutes which make it illegal for an employer to disadvantage an employee with respect to compensation, terms, conditions or privileges of employment would be interpreted as intended to preclude charging smokers more in the health plan.

Providing more costly or less valuable employee benefits is covered by the "compensation, terms and conditions" concept in employment discrimination law. While some might think that because employers who charge smokers more than non-smokers for their insurance are only requiring that each employee pay for the risk he or she creates, and hence are not "discriminating," the U.S. Supreme Court has already rejected this argument in Title VII litigation. Its reason is that the core point of the discrimination laws is to have employers treat people as individuals and not stereotypically as part of a group. However, some smokers' rights laws allow employers to make distinctions between smoking and non-smoking employees in the type or cost of health or life insurance provided. The South Dakota legislation, for example, contains such a provision.

The smokers' rights movement, led by the tobacco industry, is a recent one, with most of its legislation having been passed in the last three years. The tobacco industry says its motivation is to protect the rights of smokers, but surely the industry also wants to diminish the stigma attached to smoking and to provide smokers as a group with a rallying point. The tobacco industry has engaged in extensive lobbying efforts in state legislatures in order to promote smoker's rights legislation.

The other main proponent of smokers' rights legislation is the ACLU which, as part of the effort described earlier, argues that employers should not be able to regulate the legal activities of their employees outside the workplace because it is an invasion of the employee's privacy and individual rights.

The opponents of the legislation are primarily public health groups. These groups make the policy argument

that smokers should be given incentives to quit, not expansive rights to continue a destructive habit. Another group that opposes the legislation, civil rights advocates, argues that smokers should not be a protected group because the right to smoke is not as important as other rights, such as freedom of religion, and that elevating smoking to a civil right would diminish the traditional importance of the other protected categories.

## CONCLUSION

Non-lawyers have been frustrated to discover just how uncertain the law is. In this case, however, the lack of certainty should not be surprising. After all, many of

the laws in question are new—e.g., the 1991 Civil Rights Act amendments, the ADA, and state smokers' rights laws; and the phenomenon under investigation—employer differentiation based upon employee health indicators—is also new.

For now, the more important point is this: there are legal weapons available to victims of health indicator discrimination that can be used by the courts. Whether or not courts will recognize those claims may well be influenced by public reactions to employer practices. What is needed at present is not more legal analysis but more policy analysis.