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New Wellness Program Rules for 2014

By Gene Griggs

Employers continue to look for ways to manage the cost of employee health care coverage as they navigate the turbulent waters of health care reform, and wellness programs continue to be a popular strategy. However, adoption and expansion of these programs have been hampered somewhat by questions about their effectiveness, cost, and the risk of noncompliance with the uncoordinated web of laws and regulations governing these programs. While evidence seems to be emerging that at least some wellness program designs can be an effective means for cost control and long-term savings due to improved health, recently issued final regulations under the Health Insurance Portability and Accountability Act (HIPAA) only add additional burdens to employers' compliance efforts. This article provides a quick summary of the rules, including new HIPAA rules that will be effective beginning in 2014, that must be followed to ensure your wellness program is compliant with the applicable laws and regulations.

HIPAA Nondiscrimination

HIPAA amended ERISA to generally prohibit discrimination against individual participants and beneficiaries in eligibility, benefits or premiums based on "health status–related factors," including physical and mental illnesses, claims experience, receipt of health care, medical history, genetic information, evidence of insurability, and disability. However, under the wellness program exception to HIPAA, group health plans may offer premium discounts, rebates, reduced co-payments and/or lower deductibles (generally referred to as "rewards") to participants and beneficiaries who take part in "programs of health promotion and disease prevention."

The final HIPAA nondiscrimination regulations, effective for plan years beginning after 2013, create two categories of programs under the wellness program exception: "participatory wellness programs" and "health-contingent wellness programs."

Participatory wellness programs either provide no reward or do not condition a reward on the achievement of a health standard. Examples of participatory wellness programs include:

- Reimbursing all or part of the cost of a fitness center membership;
- Reimbursing costs of participation or rewarding participation in a smoking cessation program regardless of whether the individual quits smoking; and
- Rewarding participation in a no-cost health education seminar, a health risk assessment, or a diagnostic testing program, regardless of outcomes and without requirement for further actions.

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NOW THAT WE KNOW THE BASIC RULES…
Drafting Covenants Not to Compete to Maximize the Likelihood of Enforcement

By Lee Spinks

In the last issue, we reviewed the basic rules applicable to covenants not to compete in employment contracts. Lawyers experienced in dealing with these covenants have adopted a number of drafting techniques to address the many decisions of our appellate courts that raise issues regarding enforceability. The following are just a few of these techniques that a hospital, medical practice, or other health care entity may want to consider to increase the likelihood that a covenant not to compete will be the valuable, enforceable tool intended.

1. *Describe the scope of the activities prohibited in a manner that anticipates changes in an employee's job responsibilities.* Even the best employers often overlook updating employment contracts and covenants not to compete (as employees are promoted or their job responsibilities change). Therefore, when describing the activities that the employee will be prohibited from engaging in, the description should not be limited to his or her current job responsibilities. Include a provision that the covenant will also apply to prohibit other activities that the employee is materially involved in or exposed to during the term of employment. In doing so, the prohibition on competition should apply to those activities that the employee engaged in only during a limited period of time preceding the application of the covenant. For example, if an employee was in HR initially, but then assigned to manage claims for five years, it is unlikely that the covenant could prevent the employee from providing HR services for a competitor, because the exposure of that employee to the employer's HR section is too remote in time).

2. *Draft covenants to take advantage of the "blue pencil" rule.* In North Carolina, the courts will not rewrite a portion of a covenant that is overly broad or otherwise unenforceable. Instead, the court will blue pencil or strike out the unenforceable provision and enforce only what is left. Consider the health care system with locations throughout the southeastern United States that employs a manager for a three-county region of North Carolina. Because a court might determine applying the covenant to prevent the employee from taking a competitive position in all the southeastern states is overly broad and could strike that territory, the experienced attorney will describe the territory through a series of ever-increasing areas. For example, the territory could be described as (a) the three counties in which the manager is being physically employed; (b) each other county where the manager is assigned management responsibilities in the future; (c) each county that is contiguous to any of the counties in (a) or (b); (d) a 75-mile radius of each business location in which the employee has management responsibility; (e) the state of North Carolina; and then, (f) a list of each other state where the employer has locations. This allows the covenant to adapt itself to the job responsibilities of the employee as they change over time, and allows the court to strike overly broad territories while retaining smaller territory descriptions to enforce. If, for example, that employee's responsibilities remain primarily limited to the three counties for which he or she was originally employed, and the evidence does not show significant involvement in activities throughout North Carolina or exposure to trade secret or other confidential information regarding statewide activities, then a court can blue pencil the statewide and the larger territories; it will almost surely enforce the covenant for the counties in which that employee's responsibilities were primarily performed; and may or it may not enforce the covenant as to contiguous counties or the 75-mile radius, depending on a factual examination of the effects of competition actually occurring from those areas, the scope of the employee's responsibilities, and his or her involvement in activities in those broader territories. If the defined territory had only stated "the state of North Carolina." the blue pencil rule could result in that territory being stricken, leaving no smaller territorial description within which the covenant would be enforced. On the other hand, if that employee is a valuable manager, and becomes involved in many aspects of the employer's activities throughout the state or the Southeast, by using this stair-step description of broadening territories, the covenant adapts itself accordingly.

   This same technique can be used for other aspects of the covenant. A covenant can be designed to apply for two years to a smaller territory, but only one year to a broader territory, to increase the likelihood that the court will not find the broader territory overly broad – given the duration of the covenant is shorter. Similarly, the blue pencil rule makes it more important to define the prohibited activities (those that the employee may not engage in for a competitor) by use of a "laundry list," with the caveat that the laundry list items apply only to the extent the employee actually becomes involved in those during his or her employment with the employer. For a physician employee of an orthopedic group, for example, rather than using a covenant to prevent his or her practice "of medicine" for a competitor – where the employee might later argue that this is overly broad – provide instead that the physician is restricted from competing "in the practice of medicine, and competing in each aspect of the practice of medicine in which he or she engages as an employee of employer, including but not limited to, orthopedic surgery, orthopedic medicine, pain management, and rehabilitative medicine."

3. *Provide for liquidated damages.* The obvious and most important remedy for an employer when a former employee violates a cov-

enant not to compete is to obtain a temporary restraining order and a preliminary injunction as quickly as possible, because it is impossible to accurately determine all the damages that will be incurred if the former employee is allowed to continue to compete. But because those damages are difficult if not impossible to fully calculate, it is also important to provide for liquidated damages. By definition, liquidated damages are a specified amount that are to be awarded in lieu of trying to determine the actual damages. To be enforceable, liquidated damages must be reasonable, based upon reasonable assumptions of what the damages could or would likely be, and cannot be so excessive as to be punitive in nature. The liquidated damages provision could provide for an initial larger amount for the first month a violation occurs (under the assumption that the initial violation may involve disclosures of trade secrets, interference with the employer's goodwill, or other damages that are initially substantial and will not be remedied even if a temporary restraining order or preliminary injunction is quickly entered), with a smaller fixed amount for each month thereafter that the violations continue. There are many variations to liquidated damages provisions, some of which do not involve specified dollar amounts, but instead call for the application of a formula by which damages are calculated using known or ascertainable economic factors (such as a percentage of the last twelve months of collections before termination for a physician who has departed and is now competing, or a percentage of the physician's collections derived from the period he or she violated the covenant). Some employers also use a clause that permits an employee to "buy out" of the covenant if the employee pays a significant lump sum up front before competing – an amount that fairly compensates the employer for anticipated lost income (much like the liquidated damages clause), but does provide an option by which an employee can leave and compete without relocating.

4. *Consider an "overhead recovery" clause.* It is particularly relevant to medical practices because, as they add physicians, they also add space, equipment, staff, and computer and billing capacity. They generally will also incur similar overhead expenses. The hiring cycle for physicians is somewhat unique – medical practices find it difficult to immediately replace a departing physician and may often look to residency programs, where they interview and make offers as long as a year or more before the physician being employed has completed his or her residency, passed the medical boards, and become licensed in the state of the employer. In North Carolina, an employer in such a situation can include a provision by which an employee whose employment terminates can be required to pay to the employer either a specified dollar amount or an amount that can be determined with certainty based upon a formula. This will help to compensate the employer for the lost contribution to overhead that would have otherwise been made by that employee through the collections for services he or she rendered. In practical application, many employers choose to add a provision stating that the employer will waive recovery of the lost overhead amount if the employee is retiring, is disabled, dies, or is terminated by the employer without cause. Many also use this clause to "buy time" to bring in a replacement and retain the patients and revenues that could otherwise be lost to the departing physician, by also providing that the employer waives the lost overhead amount if the former employee does not resume the practice of medicine in a specified area for two years after termination of employment. This final waiver makes it less likely that new potential employeed would decline the employment out of concern that they would be unhappy in the position and would have to pay a significant amount in order to leave, as they are assured they could leave and practice elsewhere (outside of the prescribed territory) without making the payment. The provision, written in this manner, is technically not a covenant not to compete, but it adds incentive for a departing physician not to challenge the covenant, and adds a second "tier" for recovery of damages if the former physician employee does compete.

"Even the best employers often overlook updating employment contracts and covenants not to compete."

5. *Use a "fail-safe" clause.* Health care employers, whether they be medical practices, hospital systems, or other health care providers, invest a significant amount in creating the setting within which the physician, the manager, or other employee will conduct his or her business upon being hired. The employer who relies upon covenants not to compete to protect that investment from immediate competition by a former employee places great value in the covenants not to compete. But courts can be inconsistent in their enforcement of covenants. This has led to the use of "fail-safe" clauses that are intended to recognize the value that both parties assign to the covenants. In essence, these clauses provide that both parties –employer and employee – intended at the outset that the covenants not to compete would be enforceable, and that the enforceability

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of those covenants was of significant consideration to the employer, inducing the employer to hire the employee. Therefore, if for any reason a court does not enforce a covenant not to compete in accordance with its terms, the employee agrees in the contract that the employer has not gotten all the consideration that was bargained for if the covenants not to compete are not enforceable, and in that event the employee owes to the employer a specified sum of money to make up for the lost consideration resulting from the covenants not being enforced. That sum of money often is similar or identical to the liquidated damages that would be owed if the covenant were to be enforced. These clauses have been used a number of times, and rarely does a departing employee elect to challenge the covenants not to compete when a fail-safe clause has also been used. The reason is obvious: such a clause essentially says, "If the employer wins, the employee loses; but if the employee wins and the covenant is declared unenforceable, the employee still loses, because now he or she has to pay a significant amount to the employer." Until there is a definitive decision by appellate courts on the enforceability of the "fail-safe" clauses, it is impossible to predict whether they will be enforced, but in the meantime it serves as a substantial deterrent to challenges against enforceability of covenants not to compete.

6. *Include attorney fee provision.* Until recently, an employer was not entitled to recover reasonable attorney fees incurred in the enforcement of covenants not to compete, because North Carolina statutes did not include that type of contract claim as one for which attorney fees could be recovered. Now, under recent legislation, an attorney fee provision in an employment agreement can be enforced in the context of the enforcement of covenants not to compete if the provision also provides that the employee can recover his or her attorney fees if the employee prevails. Litigation involving covenants not to compete is expensive – a great deal of fact gathering, witness interviews, preparation for hearings, drafting of pleadings, motions and briefs, and court appearances must occur in a matter of days or weeks in order to quickly pursue a claim and obtain an injunction to stop the violation of the covenants. If the employer has a valid claim, it can only recover its attorney fees by including such a provision in the contract, and doing so may be a further deterrent to the former employee pursuing competition in violation of the covenant who would then face the prospect of having to pay substantial attorney fees not only to his or her lawyer, but also to the employer's lawyer.

There are many other "tricks of the trade" in drafting enforceable covenants not to compete and similar covenants to protect an employer from damages to its goodwill, its trade secrets, and its remaining work-force. The expenses of having good covenants are really quite small when compared with the damage that can be caused by a former employee competing next door to the employer, hiring away other key employees, and making use of information and patient or customer relationships that are invaluable to the employer. This is particularly true in the increasingly competitive environment in which health care providers operate; providers are encouraged to consider the use of such covenants in their employment agreements and to periodically have those covenants reviewed and updated by competent counsel.

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A participatory wellness program must be available to all similarly situated individuals regardless of health status, but otherwise is not required to comply with the more strenuous requirements applicable to health-contingent wellness programs.

Health-contingent wellness programs require an individual to satisfy a standard related to a health factor to obtain a reward or require an individual to undertake more than a similarly situated individual based on a health factor in order to receive the same reward. Health-contingent wellness programs are divided into two subcategories: "activity-only wellness programs" and "outcome-based wellness programs."

Activity-only wellness programs require an individual to perform or complete an activity related to a health factor in order to obtain a reward, but do not require the individual to attain or maintain a specific health outcome. Examples of activity-only wellness programs include walking, diet, or exercise programs. If an individual cannot participate in the activity due to a health factor, then a reasonable alternative (or waiver of the otherwise applicable standard) must be provided in order to qualify for the reward.

Outcome-based wellness programs require an individual either to attain or maintain a specific health standard or complete an activity or other requirement related to the health factor in order to obtain a reward. These programs usually have two tiers: a measurement, test, or screening which is then followed by a program that targets individuals who do not meet a prespecified standard. Examples of outcome-based wellness programs include:

- Reward for nontobacco use or participate in a tobacco use cessation program; and
- Reward for cholesterol, blood pressure, or body mass index below a specified level or for take additional steps, such as complying with a prescribed plan of care or participating in an exercise program.

An individual who does not meet the specified health standard must be provided a reasonable alternative (or waiver of the otherwise applicable standard) in order to qualify for the reward.

Both activity-only wellness programs and outcome-based wellness programs must satisfy the following five additional requirements:

- Individuals eligible for the program must be given the opportunity to qualify for the reward at least once per year.
- The size of the reward(s) under all health-contingent wellness programs is limited to a maximum of 30% (50% for tobacco nonuse/cessation programs) of the total cost of elected coverage.
- The program has a reasonable chance of improving the health of or preventing disease in participating individuals, is not overly burdensome, is not a subterfuge for discrimination based on a health factor, and is not highly suspect in the method chosen to promote health or prevent disease.
- The full reward must be available to all similarly situated individuals and, as previously discussed, a reasonable alternative must be provided for obtaining a reward. The plan is permitted to seek verification from the individual's physician only to determine that a health factor makes it unreasonably difficult or medically inadvisable for the individual to participate in an activity, and not whether the individual can satisfy a specified health standard. Alternatives do not have to be determined in advance but must be provided upon request within a reasonable time.
- Notice of the availability of a reasonable alternative must be provided in all plan materials that describe the terms of the health-contingent wellness program, and include contact information for obtaining the alternative and a statement that recommendations of an individual's personal physician will be accommodated.

"Wellness programs...may be subject to the privacy and security rules under HIPAA."

HIPAA Privacy

Wellness programs that include health risk assessments, monitoring of health conditions, or otherwise provide medical care may be subject to the privacy and security rules under HIPAA. These rules require special handling of protected health information and prohibit employers from using information obtained from the wellness programs in making any employment-related decisions.

GINA

The Genetic Information Nondiscrimination Act (GINA) broadly restricts an employer's ability to collect, request, and use genetic information, including (1) information concerning genetic tests of an individual or the individual's family members; (2) the individual's family history of a disease or disorder; and (3) an individual's request for or receipt of genetic services. Therefore, a plan cannot provide a reward for the provision of family history information, or even collect it in connection with or prior to enrollment.

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Health and Human Services (HHS) staff has indicated informally that tests such as a body mass index, blood pressure screening, and other cholesterol screenings are not "genetic tests" under GINA. Based on the GINA's definition of a "genetic test" (an analysis of an individual's genetic material) and HHS's comments, it is probably reasonable to conclude that screenings required to determine an individual's eligibility for the wellness plan are not "genetic tests" under GINA.

ADA

The Americans with Disabilities Act (ADA) generally prohibits employers from making disability-related inquires. Examples of disability-related inquiries include questions about how often employees feel depressed; whether they have certain conditions such as asthma, cancer, heart disease, or diabetes; and how many different prescription medications they take or how much alcohol they drink. Under the ADA, the completion of a health risk assessment must be voluntary and refusal to complete one must not subject the individual to penalty. Since the failure to receive a financial inducement due to refusal to complete a disability-related assessment could be viewed as a penalty, it is unclear to what extent financial inducements can be offered for completion of a health risk assessment involving disability-related inquiries without violating the ADA.

ADEA

Mandatory programs also may raise issues under the Age Discrimination in Employment Act (ADEA). The ADEA protects individuals age 40 or older against employment discrimination based on age. Mandatory wellness programs requiring achievement of specific health targets must take into account limitations that an older employee might face or the program could violate the ADEA.

Title VII

Wellness programs generally are subject to Title VII's prohibition of discrimination based on race, color, gender, religion, or national origin. Therefore, if the program makes distinctions based on any of these criteria, such as gender-based body fat standards, the program may violate Title VII. Even if a program is designed and administered in a neutral fashion, a Title VII claim may be made under a disparate impact theory. For example, if a wellness program standard is set such that 75% of male participants meet the criteria but only 25% of female participants meet the criteria for the reward, a participant may be able to establish a Title VII disparate impact claim.

FLSA

The Fair Labor Standards Act (FLSA), which (among other things) governs overtime pay, also impacts wellness plans. Under the FLSA, time spent at an employer-sponsored meeting, training program, or similar program is generally compensable work time unless (1) attendance is outside the employee's regular working hours; (2) attendance is in fact voluntary; (3) the course, lecture, or meeting is not directly related to the employee's job; and (4) the employee does not perform any productive work during such attendance. Careful consideration should be given to whether time spent completing the program requirements is compensable time. For instance, if the health risk assessment and initial screenings are conducted during regular working hours, an employee's time spent completing those activities may be compensable time under the FLSA.

Other Considerations

Wellness programs offering health care services such as blood screenings, physical exams, or flu shots are subject to the group health plan rules under the Consolidated Omnibus Budget Reconciliation Act (COBRA), so attention must be paid to some of the COBRA traps that wellness plans can trigger. In addition, the provision of health care services through a wellness program can prevent a participant from being able to contribute to a health care savings account if the services constitute more than insignificant medical care. Furthermore, programs that provide flexible spending account credits under a cafeteria plan, or other credits or subsidies relating to a self-insured health plan, may raise additional issues under the nondiscrimination rules applicable to these types of plans.

This article is just a brief summary of the key legal issues impacting wellness programs. Plan sponsors would be well-served to have even the most seemingly simple program reviewed by legal counsel for compliance.

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