

The Nanny Corporation

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Individuals in common pools—for example, employees in firms and citizens in a jurisdiction—want managers of those pools to act paternalistically toward others because this lowers the costs of participating in the pool. The nanny state and, increasingly, the nanny corporation are simply responding to this demand. These two can be thought of as competing in the “market for nannyism” to deliver nannyism to individuals who demand it.

Where nannyism is inevitable, as it is in a world in which others pay, the question then becomes which of the two sources of nanny rules—the state or the firm—is the most efficient supplier of nannyism. This Article describes numerous reasons why corporate nannies are superior to their state analogs. For instance, corporate policies are subjected to more instantaneous feedback from labor markets, which reduces overreaching but also helps solve information problems in ways likely to reduce the sum of decision and error costs.

There is, however, no theory under which the state or firm will always be superior at imposing nanny limitations on behavior. Because of this, we might expect firms to supply nanny rules when it is efficient for them to do so, say because of better monitoring, lower agency costs, or the like, and not to do so when government rules could be supplied at lower cost for a given efficacy level. The problem, however, is that there are government rules, regulations, statutes, constitutional provisions, and case law that may distort the market from efficiency. This Article makes the case for corporate nannyism and shows how government regulation may be biased without justification in favor of the nanny state.

INTRODUCTION

*“Men want to putter about their homes;
Mr. Pullman insisted on doing the puttering himself.”¹*

In 2004, Michigan-based Weyco told employees who smoked that they had fifteen months to quit, and when four employees refused to submit to a breath test, the firm fired them.² The logic behind Weyco’s decision is simple—firms bear some of the costs of individuals smoking (including higher health insurance costs, lower productivity, increased absenteeism, and so on) and therefore have an incentive to

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¹ Ida M. Tarbell, *New Ideas in Business* 146 (Macmillan 1917) (describing the nannyism of George Pullman in his eponymous company town, Pullman, Illinois).

² See Marisa Schultz, Amy Lee, and Eric Lacy, *Workers Fume as Firms Ban Smoking at Home*, Detroit News A1 (Jan 27, 2005).

reduce these costs. Or, looking at it another way, employees who smoke raise the costs for the other stakeholders in the corporation: other employees pay higher insurance premiums or accept lower wages than they otherwise would, shareholders see lower returns, creditors are at increased risk, and so on. In economic terms, the firm is forcing employees to internalize the negative externalities they impose on other claimants of firm value. Weyco's chief executive summarized this rationale nicely: "I pay the bills around here so I'm going to set the expectations."³

Weyco is not alone.⁴ Numerous other firms are increasingly setting standards for employee conduct (beyond proscribing illegal conduct) that interfere with what seemed in the past to be private decisions, since they were made in places or at times (for example, at home) that were beyond the reach of employer monitoring and even the law.⁵ All of these actions are motivated by firm desires to reduce costs, mostly healthcare costs, for which employers are bearing an increasingly large burden.⁶ This Article defines these firm-based regulations as "nannyism" and puts them into the larger regulatory context of cost-internalization measures and paternalism.

Several academic accounts of corporate nannyism exist,⁷ but in analyzing these programs piecemeal and from a rights-based ap-

³ Daniel Schorn, *Whose Life Is It Anyway?: Are Employers' Lifestyle Policies Discriminatory?*, 60 Minutes (July 16, 2006), online at <http://www.cbsnews.com/stories/2005/10/28/60minutes/main990617.shtml> (visited Oct 3, 2009).

⁴ Sacha Pfeiffer, *Off-the-Job Smoker Sues over Firing; Says Company Policy is a Slippery Slope*, Boston Globe A1 (Nov 30, 2006) (noting that the World Health Organization, Union Pacific, and Alaska Airlines have antismoking policies).

⁵ See *id.*

⁶ Harry Wessel, *Want a Job? You May Have to Quit Smoking*, Pittsburgh Post-Gazette H1 (Jan 6, 2008).

⁷ See generally, for example, Christopher Valleau, Comment, *If You're Smoking You're Fired: How Tobacco Could Be Dangerous to More than Just Your Health*, 10 DePaul J Health Care L 457 (2007) (arguing that workers should not enjoy protection from employment discrimination based upon smoking habits); Ann L. Rives, Note, *You're Not the Boss of Me: A Call for Federal Lifestyle Discrimination Legislation*, 74 Geo Wash L Rev 553 (2006); Karen Chadwick, *Is Leisure-time Smoking a Valid Employment Consideration?*, 70 Albany L Rev 117 (2006) (discussing employment discrimination against workers who smoke on their personal time); Terry Morehead Dworkin, *It's My Life—Leave Me Alone: Off-the-job Employee Associational Privacy Rights*, 35 Am Bus L J 47 (1997) (discussing theories about how workers can seek relief from employment discrimination based upon their private relationships); Lewis L. Maltby and Bernard J. Dushman, *Whose Life Is It Anyway—Employer Control of Off-duty Behavior*, 13 SLU Pub L Rev 645 (1994) (expressing concern about the potential reach of employer regulation of worker conduct, and arguing for legislation to protect workers from discrimination based on private conduct); Marvin F. Hill, Jr. and James A. Wright, *Employee Lifestyle and Off-duty Conduct Regulation* (BNA 1993); Marvin Hill, Jr. and Emily Delacenserie, *Procrustean Beds and Draconian Choices: Lifestyle Regulations and Officious Intermeddlers—Bosses, Workers, Courts and Labor Arbitrators*, 57 Mo L Rev 51 (1992) (reviewing case law on employment discrimina-

proach⁸ (viewing corporate efforts as intrusive and negative), they miss the most important aspect of the rise of corporate nannyism. Firms do not act like nannies because the managers of the firm want to but rather because employees and owners of the firm demand that they do. Individuals in common pools—employees in firms, shareholders in firms, individuals in insurance plans, and citizens in a jurisdiction—want the managers of those common pools to act this way toward other individuals, because this lowers the costs of being in the pool. In this way, nannyism is a product, and firms are simply responding to the demand for it.

Consider a nonsmoker and a smoker who work for a firm. The nonsmoker wants the firm to take steps to reduce the incidence of smoking or charge the smoker the costs he imposes on the firm, since otherwise the nonsmoker pays for them. Paying, or cross-subsidizing, is bad for the payor not only because he is potentially sacrificing something by not engaging in the behavior (and yet paying for it in part) but also because it may encourage inefficient levels of production of the behavior in question.

Contrary to rights-based accounts, nannyism by firms is generally not premised on malice, invidious discrimination, or exploitation of unequal bargaining power between managers and employees. It is, in fact, inevitable in cases where third parties bear some costs of others' behavior. For example, the current healthcare model puts most of the costs on third parties, namely firms and the government, so we should expect each of these types of organizations to provide nannyism to reduce these costs. If firms see increased healthcare costs or labor costs (through lower productivity) as a result of employee smoking, they will rationally try to reduce smoking by employees, say by not employing smokers, or charging smokers sufficiently to offset the costs they are imposing on others within the firm (be they shareholders or other employees). The government will or should act the same when it pays. Government programs to reduce smoking or obesity are obvious examples of this, and as the government (or firms) pays more of the cost of bad behavior, we should expect more nannyism from it.

Seeing nannyism as a natural consequence of our current welfare system (either corporate- or state-based) allows us to recast the debate about nannyism. In effect, firms and the government are both

tion based upon private conduct, and arguing for a legal requirement that an employer prove that the regulated conduct affects the employer's business).

⁸ See Jeremy W. Peters, *Company's Smoking Ban Means Off-hours, Too*, NY Times C5 (Feb 8, 2005) (quoting Lewis Maltby, president of the National Workrights Institute: "Once you cross the line and allow employers to control any type of behavior that's not related to job performance, there's no limit to the harm that can and will be done.").

providers of nanny rules in what we might call a “market” for nannyism. Both providers in this market offer nanny rules in response to demand for them from individuals in common pools, be they political jurisdictions, firms, or insurance pools. These individuals, who pay more (or accept less) than they otherwise would, demand rules to force fellow employees or citizens to bear their own costs to avoid compelled cross-subsidies of costly behavior. The government can satisfy this demand with statutes proscribing certain behaviors, providing information to effect voluntary changes in behavior, or imposing taxes to force cost bearing. Firms can do all of these things too, although they may have slightly different names. Accordingly, we can think of the government and firms competing to deliver nannyism, which is demanded by individuals. Politicians compete to offer these rules to be reelected, to attract campaign contributions, and to maximize their utility. Managers do the same, but, given the constraints of the markets in which they operate, are generally directed to acting in ways that align their interests (making money) with those of shareholders.

This positive account of nannyism is a necessary (but currently missing) foundation for the normative analysis of this subject in which other scholars engage.⁹ We cannot answer the normative question of whether firms should be engaging in nannyism without knowing why they are doing it. The positive account consists of five parts that track the outline of this Article.

Part I examines the economic case for nannyism, which tells us the reasons firms are increasingly engaging in regulation of employee behaviors that are considered by some to be private. The answer is the elimination of cross-subsidies and the forced internalization of externalities imposed on fellow members of common pools. Importantly, this is the same reason governments regulate individuals’ behaviors, like smoking.

Part II describes the history of corporate nannyism, which tells us how these rules are deployed in practice, whether they are used for good or bad reasons, and whether they are checked by market forces. The key takeaway from this brief history is that corporate nannies act predominantly in cases in which employee conduct increases firm costs, and that labor markets provide a strong check on firm overreaching. Corporate nannyism is thus not pure paternalism (meaning an attempt to alter one’s preferences solely for one’s own good), but rather a more benign attempt to force individuals to bear their own costs. This was true even when labor markets were much less liquid than today.

⁹ See, for example, Hill and Delacenserie, 57 *Mo L Rev* at 169 (cited in note 7) (“Hard evidence that an employee’s lifestyle . . . affects job performance should be the rule, not the exception, before an employee’s discharge is effected.”).

Part III compares the advantages of corporate nannyism with state nannyism, which will tell us whether we should, in the marginal case, prefer nanny rules from state or corporate actors. There are reasons to believe corporate nannies are superior to their state analogs in some cases. For instance, corporate policies are subjected to more instantaneous feedback from labor markets, which reduces overreaching but also helps solve information problems in ways likely to reduce the sum of decision and error costs. This Part also shows that there is no theory under which the state or firm will always be superior at imposing nanny limitations on behavior.

Part IV surveys the regulatory environment for using nanny rules to alter individuals' behavior. The government is not only a provider of nanny rules, but it also regulates firms in providing these rules. This regulation has the potential to distort efficient outcomes unless it is premised on legitimate advantages of states in providing nannyism. This Part shows that many existing court cases, statutes, and rules stand in the way of an efficient market for nannyism. For instance, the law generally makes it more difficult to charge employees for the costs their behaviors impose on others than to fire or refuse to hire employees who engage in these costly behaviors. This means firms have reason to externalize the costs of particular behaviors, like smoking, by not hiring smokers, rather than reduce the smoking of employees through monetary incentives. This result works at cross purposes with our model of highly-subsidized employer-based health insurance. As one CEO has puzzled: "Why aren't the American employers dealing aggressively with these issues of wellness" when they are the ones footing the bill?¹⁰

And, finally, the normative questions about whether corporate nannyism is socially beneficial and suggestions for policy responses. On the normative issues, thinkers from John Stuart Mill to Milton Friedman assert that the state has no business interfering in private decisions, like whether to eat trans fats, bungee jump, or smoke.¹¹ Friedman famously said: "I don't think the state has any more right to tell me what to put in my mouth than it has to tell me what can come out of my

¹⁰ Michelle Conlin, *Hagedorn: "We Care About Our People,"* Bus Wk Online (Feb 26, 2007), online at http://www.businessweek.com/magazine/content/07_09/b4023005.htm (visited Oct 3, 2009) (interviewing Jim Hagedorn).

¹¹ John Stuart Mill, *On Liberty* 68–69 (Penguin 1974) (arguing that "the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others"); Milton Friedman and Rose Friedman, *Free to Choose: A Personal Statement* 39 (Harvest 1990) ("The economic controls that have proliferated in the United States in recent decades have not only restricted our freedom to use our economic resources, they have also affected our freedom of speech, of press, and of religion.").

mouth.”¹² This Article puts these issues largely aside, since the premise of these objections assumes that others are not bearing costs from what is going into Friedman’s mouth. In a world with third-party paying, there is inevitably nannyism. In light of this, the relevant question is only whether we should favor one nanny over another, which is just another way of asking how the market for nannyism should be regulated.

In terms of policy, the argument that there exists a market for nannyism and that firms have potential advantages in its efficient delivery bears not only on the wisdom of the existing regulations that may distort the market, but also on the current debate about eliminating employer-financed healthcare. Although moving away from this model to either an individual model or a single-payor model has virtues and vices, one benefit of the current system not yet considered is the potential that a more liberalized role for firms in the market for nannyism could reduce costly behaviors like smoking or overeating, which are the biggest drivers of health-care costs. The government massively subsidizes the delivery of health insurance through employers, but currently restricts firms’ ability to reduce healthcare costs using sensible nanny rules.¹³ This delegation coupled with restrictions might make sense if firms were deploying rules restricting behaviors that were socially efficient or would be tolerated if the government were providing the insurance directly. But this is not the case. This Article will show how healthcare cost reduction inevitably involves reducing cross-subsidies through nannyism, and given the fact that employers are, in many cases, best positioned to implement efficient nanny rules, government policy could be improved by deregulating the market for nannyism.

I. THE THEORY OF NANNYISM

A. Definitions

Regulation is generally premised on one of two theories: cost internalization or paternalism. The first of these—forcing individuals or firms to bear the costs they impose on others—is the primary basis for public and private regulation. The aim of the regulation is to reduce the negative impact of what economists call “externalities.”¹⁴ The idea is a simple one: if those imposing costs on others are forced to pay for these

¹² *Profiles in Marijuana Reform: Milton Friedman*, Marijuana Policy Project (July 31, 2008), online at <http://tv.mpp.org/shorts/profiles-in-marijuana-reform-milton-friedman-part-1> (visited Oct 3, 2009) (offering a libertarian critique of drug laws).

¹³ See Part V.

¹⁴ See Robert S. Pindyck and Daniel L. Rubinfeld, *Microeconomics* 621 (Prentice Hall 5th ed 2001) (“When externalities are present, the price of a good may not reflect its social value. As a result, firms may produce too much or too little, so the market outcome is inefficient.”).

costs, society will get the socially optimal amount of the activity generating the costs. If a factory that emits pollution that falls on a farmer's land and harms an orchard does not have to include these pollution costs in its production calculations, the factory will engage in too much production and thus too much pollution. The same logic applies to a smoker whose secondhand smoke or emphysema imposes costs on others, be they other patrons at a bar or others in a group insurance pool. In both cases, only if the individual or entity doing the harm bears the cost of its externality will it engage in the optimal levels of activity and care.

Paternalism, on the other hand, is the class of cases in which regulators write rules designed to improve an individual's circumstances without regard to the costs imposed on others. Philosophers define paternalism as "the interference . . . with another person, against their will, and justified by a claim that the person interfered with will be better off."¹⁵ Consider an individual who prefers romance novels to classics. If the regulator (perhaps a parent) is concerned about externalities alone (that is, the harm principle), then it will not try to regulate this person. What harm befalls another based on one's preferences for leisure reading? On the other hand, if the regulator believes that the person's preference ordering is suboptimal or wrong for some reason—that the person should prefer classics to romance novels—then it may try to change the person's preferences (say through brainwashing or education) or try to change the person's behavior without altering preferences (say through taxing or banning the romance novels).¹⁶ Because this type of regulation is based entirely on the well-being of the individual engaging in the conduct, philosophers call it "pure paternalism" to distinguish from cases in which other factors are at play in motivating the regulation.¹⁷

B. Complications

Even at this basic stage there are three complications that can be seen. It is important to consider them, because they are important limitations and weaknesses of regulation that are germane to the question of whether the most efficient locus of regulation lies with states or private enterprises.

¹⁵ Gerald Dworkin, *Paternalism*, in Edward N. Zalta, ed, *The Stanford Encyclopedia of Philosophy* (2006), online at <http://plato.stanford.edu/entries/paternalism> (visited Oct 2, 2009).

¹⁶ Thanks to Eric Posner for this example.

¹⁷ See generally James F. Childress, *Paternalism in Health Care and Health Policy*, in Richard E. Ashcroft, et al, eds, *Principles of Health Care Ethics* 223, 223 (Wiley 2007).

1. Symmetrical externalities.

The first complication is that externalities are not one-sided; the farmer in the example above could be thought of as imposing an externality on the factory just as the factory could on the farmer, since the farmer's hope for a good apple crop limits the amount of pollution the factory can emit when making, say, lifesaving drugs. This is the central insight of Ronald Coase.¹⁸ In a world of symmetrical externalities, the important question is how to allocate the legal rights and liabilities so that the cost of abatement falls on the cheapest cost avoider of the harm. It may be that the farmer could protect the orchard from the pollution more cheaply than the factory could reduce the pollution, and thus it would make sense for the farmer to take abatement action instead of the factory. Coase also showed that if the costs of bargaining (that is, transaction costs) are low, it does not matter whether the farmer or the factory is assigned the legal right to demand cessation of the externality, since the parties will reach an efficient bargain no matter what. Where transaction costs are high, however, putting the liability on the party most likely to be the cheapest cost avoider becomes more important.

We will return to these concepts in the context of corporate nan-nyism. To see the application, however, consider that a smoker could be seen as imposing an externality on the patrons at a bar or the patrons at the bar's preference for a smoke-free environment could be seen as imposing an externality on the smoker. If all the law did was give one party a legal right and transaction costs are low, regardless of the legal rule, the patrons could pay the smoker to go away or the smoker could pay the patrons for the right to smoke. Importantly, if the legal rule is just the threat of some liability, the parties should strike the efficient bargain, that is, price the externality at its true cost. If such bargains are difficult to strike, however, where the rule assigns rights may be determinative of conduct. The same is true when the government imposes taxes, like sin taxes on smoking, or imposes bans. These are unavoidable obligations, and therefore set the price for the externality in a command-and-control fashion, instead of through many individualized bargains.

2. Internalities.

The second complication is that costs imposed on "others" is now taken to sometimes include other selves—that is, the current self makes decisions, like smoking, that please the current self but impose costs, like cancer, on future selves. There is a growing literature de-

¹⁸ See generally R. H. Coase, *The Problem of Social Cost*, 3 *J L & Econ* 1 (1960).

voted to justifying paternalistic regulation of “internalities” or cases in which the harm is purely within an individual. Academics recommend internality-based sin taxes on smoking and eating based on the costs a person’s current self imposes on that person’s future self.¹⁹ For instance, it is well documented that individuals may suffer from various behavioral heuristics preventing them from accurately forecasting expected costs and benefits in ways that skew decisions from the optimal ones.²⁰ The idea of manipulating decisions that are perceived by outsiders to be erroneous may be good or bad from a social welfare perspective. The answer likely varies by topic, insider, outsider, and circumstance, such that the concept of nudging is unobjectionable, but the application in particular cases may be socially costly.

For the purposes of this Article, it is important to recognize the potential implication of regulatory attempts to reduce the impact of internalities. Unlike externalities, where the costs on others can be roughly determined through the aggregation of individual actions and choices, internalities are much more difficult to identify and quantify. Once we deploy Coase, we can see that the current self is not alone in imposing costs on the future self, but rather that the internality is two-sided as well. Again, the search is for the cheapest cost avoider, and this may be the future self or the current self. There is also, as in the case with the farmer and the factory, the possibility of bargaining and payments between the two selves. After all, many decisions one makes could be said to benefit the future self at the expense of the current self,²¹ and everyone is aware of the trades between selves that are made on a daily basis. Since every individual likely has different preferences of current versus future utility, different discount rates, different levels of intraself bargaining, and so on, regulators hoping to optimize an individual’s utility over a lifetime face an enormous challenge.

In addition, given the enormous information and design challenges, as well as the inevitable impingement on personal freedom,

¹⁹ See generally Ted O’Donoghue and Matthew Rabin, *Studying Optimal Paternalism, Illustrated by a Model of Sin Taxes*, 93 Am Econ Assoc Papers & Proceedings 186 (2003) (arguing for regulation of eating based on negative internalities); Jonathan Gruber and Botond Köszegi, *Is Addiction “Rational”? Theory and Evidence*, 116 Q J Econ 1261 (2001) (arguing that taxes on cigarettes “should depend not only on the externalities that smokers impose on others but also on the ‘internalities’ imposed by smokers on themselves”). See also Richard H. Thaler and Cass R. Sunstein, *Nudge: Improving Decisions about Health, Wealth, and Happiness* 4 (Yale 2008) (suggesting the concept of a “nudge,” whereby planners of systems arrange consumer options in such a way as to encourage a particular type of behavior based on decision making errors and internality problems).

²⁰ See generally Cass R. Sunstein, ed, *Behavioral Law and Economics* (Cambridge 2000).

²¹ See Gary S. Becker and Kevin M. Murphy, *A Theory of Rational Addiction*, 96 J Pol Econ 675, 676–80 (1988) (developing a model of intraself bargaining showing how individual smokers take into account future costs of smoking when making current smoking decisions).

internality-based regulations have the potential to create large unintended consequences and social costs. As shown below, internality-based arguments are often simply cloaks for pure paternalism. If they are to be used to justify regulation, it is therefore important for the regulator to be subject to a constraint on overreaching and error. The question of whether the government or private firms are likely to be more efficient regulators of internalities in this light is addressed below.

3. Mixed-motive cases.

A final complication is that many regulations will be based on mixed motives or contain elements of both cost internalization (externalities, internalities, or both) and pure paternalism. Philosophers call these cases “impure paternalism,” since the regulator is motivated in part by a consideration of the well-being of the individual being regulated (that is, pure paternalism) and in part by a consideration of the costs the person being regulated is imposing on others (that is, cost internalization).

Smoking is a good example. There are obvious externalities that may arise from an individual’s choice to smoke. It is believed that secondhand smoke increases the risk of illness for others (for example, asthma and even cancer), and in a world of health insurance and a social safety net, others in those common pools inevitably bear some of the healthcare costs, lost productivity, and other costs from smoking-related diseases. (There are internalities too, since the costs of the choice to smoke today will be borne only far in the future.) In addition, there are those who think that smoking is simply a bad choice and should be restricted, irrespective of the external or internal costs. A regulator, be it a legislator or corporate chief, may think smoking is selfish and disgusting or believe smokers are innocent rubes coerced by greedy tobacco companies, and therefore may prefer a world in which no one smoked. Unpacking the motives for regulation—externality, internality, or paternalism—is therefore quite tricky, especially since the real motives may be hidden depending on what is deemed an acceptable basis for regulation.

These mixed-motive cases are problematic. The existence of multiple motives may allow regulators to mask the real reason for a regulation in a more palatable explanation. The rulemaker’s preferences may be roughly aligned or 180 degrees divergent from the socially optimal policy, but in each case the rulemaker is likely to couch justifications for the nanny rules in benign terms linked with alleged externalities and social costs. This is because there is much less political consensus about the need for pure paternalism beyond the standard cases of mental infirmity and children. The harm principle on the other hand is quite attractive. Even libertarians should not be troubled in theory by attempts to get individuals to pay the full social costs of their

conduct. These efforts meet John Stuart Mill's test of liberty—a state may not prevent individuals from acting, except where doing so would bring harm to others.²² Extending the reach of regulation to cases where an individual cannot be said to be doing *any* harm to another is much less accepted. The genius of the internality argument is that it tries to extend the reach of paternalism based on a straightforward application of the harm principle, which even antiregulation libertarians support. Not surprisingly, an influential exposition of the internality argument was entitled “Libertarian Paternalism.”²³ If the point is not to remedy actual costs imposed or really improve individuals' lives in ways that do not impose costs on them, but rather to impose others' preferences, then these arguments are more problematic. Again, the important point this Article addresses is how to constrain the overreaching that may result from mixed-motive cases.

C. “Nannyism”

Although the discussion above about externalities, internalities, and paternalism is generally applicable to all types of regulation, the primary concern of this Article is more limited. The Article is about “nannyism,” which I define as the application of these principles of regulation to the choices made by individuals that have been historically regarded as personal and private, such as what to eat, what to drink, whether to smoke, what to do in one's spare time, and so on. Nannies take care of children and police their choices about what to play with, what to wear, what to eat, when to sleep, and other personal matters. It is this parallel policing of adults that gives rise to the term “nannyism.”

The term comes from the modern phenomenon in which political entities—pejoratively, the “nanny states”—prohibit certain types of behavior, such as riding a motorcycle without a helmet, eating trans fats, or talking on a cell phone while driving. The nanny state “began in earnest with seat-belt regulations and compulsory helmet wearing in the 1980s.”²⁴ States are not alone in acting this way, which is what this Article is about. For purposes of this Article, the analysis is restricted to predominately those seemingly “private” activities that may

²² Mill, *On Liberty* at 68–69 (cited in note 11) (arguing that “the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others”).

²³ Cass R. Sunstein and Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 *U Chi L Rev* 1159, 1195–99 (2003) (arguing for paternalistic default rules that preserve choice but offer optimal strategies).

²⁴ David Harsanyi, *Nanny State: How Food Fascists, Teetotaling Do-gooders, Priggish Moralists, and other Boneheaded Bureaucrats Are Turning America into a Nation of Children* 13 (Broadway 2007) (arguing that “nanny laws” are the result of government and a cadre of “busy-bodies” pressuring the public “into obedience”).

increase healthcare costs. The analysis may be extendable to other costs, but this may be tricky, as more and more law and social behavior is implicated, and internalization arguments can easily become difficult to untangle from excuses for invidious discrimination.²⁵ These contours are examined below.

Nannyism arises because individuals in our modern society do not bear all of the costs of their behaviors and because individuals in power inevitably try to impose some of their preferences on others.²⁶ But, as noted above, pure paternalism is generally disfavored in a free society, and therefore cost internalization provides the primary basis for regulation. If individuals who generate costs are unable to pay or, in any event, would be unable to make welfare-maximizing decisions, law looks to the other option for paying costs: third parties. The most common example in the law is the payment of these costs, either voluntarily or as legally required, by an entity, like a corporation or the government. An example of the former is the doctrine of respondeat superior; an example of the latter is the social safety net found in programs ranging from Social Security to Medicaid.

It is in this cost bearing by third parties that nannyism starts. Third parties who are liable for the costs imposed by others will inevitably engage in actions designed to reduce those costs. In fact, it would be irrational for the third parties not to try to influence the behavior of the individuals imposing the costs, since it would be subsidizing socially inefficient conduct. In effect, the third-party payor is acting as if it were the individual forced to bear all its costs, and would be expected to act accordingly.

Since conduct considered “private” inevitably produces social or group costs, nannyism is a certainty. As long as others are paying for the costs imposed by individuals, the others will want a say in conduct that purports to generate those costs. This is true whether the third-party

²⁵ There are numerous activities, behaviors, or characteristics that are protected by common and statutory law, and that are not within the scope of nannyism as defined in this Article (for example, rights of association, religion, race, sexuality, and speech).

²⁶ There are generally two choices for the payment of the social costs of activities. Most obviously, we could hold individuals or individual entities responsible for the costs they impose on others or society. This approach has been widely advocated in various literature as the most effective way of creating the optimal social incentives. If individuals bear the full costs of their actions (that is, internalize all the costs they impose on others), then we would expect the individuals to police their own conduct in ways that strike the efficient balance between utility gain and loss (or benefit and cost). Taxes are a common mechanism for doing this. But there may be many cases in which individuals cannot pay, are not sufficiently sensitive to costs, are viewed as victims, or are not the least-cost avoiders. Taxes may be regressive, individuals may be judgment proof, or other entities may be able to provide particular monitoring functions at lower cost across multiple individuals because of economies of scale and scope. Individuals may also suffer from systematic decisionmaking biases, which would blunt the perceived benefits of cost internalization.

payor is the corporation or the government. As shown below,²⁷ company towns had similar levels of nannyism, regardless of whether the owner was a firm or the federal government.²⁸ This is true today as well. Both firms and the government, which pay most healthcare expenditures, are increasingly active in policing health and safety practices in an attempt to reduce healthcare costs. To cite just one example, both firms and governments are using or considering the use of taxes on individual weight or body mass index (BMI) to try to reduce the incidence of obesity by forcing individuals to bear the full costs of their overeating.²⁹

Nannyism should also be expected to grow in proportion to the costs borne by third parties. It is therefore no surprise to see an increase in nannyism at times during which much of the responsibility for paying the social costs of conduct have shifted from individuals to the state, firms, and others. Accordingly, we should expect to see more state nannyism in jurisdictions where costs are more socialized. A recent survey in the United Kingdom supports this conclusion. In a country where all healthcare costs are borne by the state, 75 percent of citizens want more government intervention to discourage people from unhealthy eating habits.³⁰

The same trend is seen domestically, as federal, state, and local governments bear increasing healthcare costs, both directly and indirectly through lost productivity. The so-called “Twinkie tax,” a 1 percent tax on soft drinks, candy, fast food, and other “unhealthy” food is a classic example. Proposed by Yale food researcher Kelly Brownell, the tax was seriously considered by New York City, Detroit, and numerous other state and local governments.³¹ Arguments for the tax include the costs imposed on government, the inability of individuals to resist the temptations their future selves will later regret, and the costs imposed on other third parties, like airlines who pay higher fuel costs flying heavier people around.³² Another example is smoking. Both

²⁷ See Part II.A.

²⁸ See Linda Carlson, *Company Towns of the Pacific Northwest* 194 (Washington 2003) (noting the Atomic Energy Commission’s control of the local press in Richland, Washington).

²⁹ See, for example, *Obesity Boom Will Cost Tax Payers*, BBC News Online (Oct 7, 2008), online at <http://news.bbc.co.uk/1/hi/health/7656214.stm> (visited Oct 3, 2009) (showing costs to taxpayers and predicting future fat tax); *Government Unit ‘Urges Fat Tax,’* BBC News Online (Feb 19, 2004), online at <http://news.bbc.co.uk/1/hi/health/3502053.stm> (visited Oct 3, 2009) (noting that the government is considering a fat tax); Kate Schneider, *Ryanair Considers Ways to Impose a ‘Fat Tax,’* news.com.au (Apr 23, 2009), online at <http://www.news.com.au/travel/story/0,,25373653-5009000,00.html> (visited Oct 2, 2009) (discussing an airline’s plan to impose a fat tax).

³⁰ Harsanyi, *Nanny State* at 10–11 (cited in note 24).

³¹ See id. at 37–40 (recounting the history of the “Twinkie tax” concept’s development). See also Suzanne Leigh, *‘Twinkie Tax’ Worth a Try in Fight against Obesity*, USA Today A13 (Dec 1, 2004) (advocating the tax as a way to curb obesity by changing consumer and food producer incentives).

³² For a discussion, see note 154 and accompanying text.

private firms and some governments have effectively banned smoking, even if done in the privacy of one's car or apartment. As detailed below, several firms have explicit policies forbidding the hiring or employment of smokers, while in 2006, Belmont, California banned smoking anywhere in the city, even in many private residences.³³ (Ironically and somewhat perversely, *firms* in Belmont cannot charge employees who smoke extra for insurance, or fire them if they smoke, even though this policy encourages inefficient levels of smoking. Two state policies thus come into sharp conflict.)

Costs are therefore the door through which nannyism comes, but attempts to restrain them may not be objectionable to all but the most strident libertarians, unless they cross some line. Few would object to cameras installed on delivery trucks (to reduce firm liability for bad individual driving) or to government-run hospitals serving predominantly healthy food. The real line-drawing problem arises when the link between conduct and costs becomes more attenuated or falls outside of a certain conventional sphere of third-party influence. It might be obvious that a city could ban firefighters from smoking on the job, but what about at home? No one would criticize an airline that restricted pilots from drinking while flying, but what about while off duty, when there is no chance of spillover to work hours? Smoking and drinking after hours in both cases may raise costs, in terms of risk and health insurance outlays, but there is an intuition that the restrictions on private behavior are different in some way—more out of bounds.

Of course, third-party payors will have to balance the costs of imposing restrictions versus benefits of cost reduction, and this may provide a natural brake on extending nannyism too far down the causal chain. We see below that the ability to do this calculation and several other features of corporations may give them an advantage over the government at being benign and efficient nannies.

D. Good and Bad Nannies

A nanny's belief that individuals are unable to make socially efficient decisions, and thus the motivation of the nanny, could be benign or self-serving. Some nannies will be motivated by a genuine desire to help the individual or to force an individual to internalize the costs of his behavior, while some will be motivated by a desire to impose their own idiosyncratic preferences on others. In reality, most cases will involve some mix of these two motives, as the ability to distinguish between these two categories may be imperfect for even the most self-

³³ See Harsanyi, *Nanny State* at 125 (cited in note 24) (noting the ban in Belmont, which outlaws smoking everywhere in the town except in detached, single-family homes).

less nannies. It is therefore essential to enumerate some characteristics of good and bad nannies.

1. Good nannies.

In light of the discussion about the justifications for and limits of regulation, we can postulate some characteristics of good nannies or nannyism. Most obviously, nannies should act where there is a legitimate externality or, perhaps, internality. A straightforward application of the harm principle shows that regulation is justified in these cases, and even ardent libertarians concur in this assessment.³⁴

Pure paternalism may be justified in some extreme cases. Parents and guardians of the mentally infirm are easy cases. Paternalism by governments or firms should be narrowly construed in a free society given the problems discussed above. This is especially true because the cost-internalization rationale can, when broadly construed, be extended to cover lots of ground. Even reading romance novels, after all, may impose costs on others, since presumably the less well-educated are a net drain on society.

Of course, the question of what constitutes a genuine externality is where the rubber meets the road. And, since this is likely to be a much disputed and quite difficult question to answer, the importance of constraints on overreaching by nannies (to reduce the sum of decision costs and error costs) is essential. There is no abstract answer about where to draw the line between legitimate and illegitimate costs and between cases where pure paternalism is justified. The best we can hope for, perhaps, is a regime in which these decisions are made under conditions likely to improve social welfare at the minimum cost.

Another trait of a good nanny rule is where the costs imposed by the rule are linked directly with the reduction in the harm caused. Since individual regulators will inevitably have access to limited information and an imperfect ability to process the information they have, it is essential for the creation of efficient rules that the process of rulemaking be subject to information-generating feedback loops. The right answer about the optimal rule is likely to come only through experimentation, and, as shown below, linkage between costs and benefits will be essential to this process.

Good nanny rules should also be made in an environment where there is a low risk of rent seeking by the nanny and a brake on the ability of individual nannies to impose their own idiosyncratic prefe-

³⁴ See Richard A. Epstein, *The "Necessary" History of Property and Liberty*, 6 *Chapman L Rev* 1, 11 (2003) ("In modern terms, the bottom line is that the presumption of liberty can be overcome only in those cases of a socially destructive 'prisoner's dilemma' game or a genuine externality.").

rences on others, especially where the preferences meant to be changed are not linked with social costs. This is another way of saying that the good nanny will try to minimize the collateral costs and consequences of the regulation.

Finally, good nannies will take into account the existence of positive externalities that may offset negative ones, and take into account the insights of Coase mentioned above. For instance, smokers may provide benefits as well as costs, and considering only the latter is likely to result in an inefficient social outcome. Once the social cost is isolated, it is also important to apply a Coasean least-cost-avoider analysis to design the optimal regulatory regime. The discussion below considers the relative strengths and weaknesses of state and corporate nannies at complying with these traits.

2. Bad nannies.

There are two ways in which nannyism, whatever its source, may be socially suboptimal. The first type of bad nanny is one with good intentions that makes mistakes in calculating the social costs and benefits from particular behaviors. There are a variety of miscalculations that are possible. Nannies may reasonably believe externalities exist when they do not (false positives) or that there are no externalities from a particular behavior when in fact there are (false negatives). Even when externalities are plain, nannies may systematically miscalculate the costs imposed on society by individual behaviors, including failing to consider the potential for unintended consequences from restricting individual liberty. Thus, nanny rules can be either under- or overinclusive, or, given heterogeneous preferences among regulated individuals, have differential impact on behavior and imperfect enforcement, both at the same time. These potential errors will be especially apparent because nannies have limited resources for determining the costs and benefits of particular rules. In light of these potential errors, the optimal nanny will be one that minimizes the sum of decision costs and error costs. A comparison along this dimension between corporate and democratic nannies is made below.

The second type of bad nanny is one that uses a position of power to try to impose selfish and potentially socially costly preferences on others. The only difference between this group and the first group of bad nannies is the intent of the nanny; the “mistakes” may be the same, but the motivation will be different and the mistakes will be deliberate in a sense. Examples of bad nannyism are familiar, including most famously Prohibition, where do-gooders known as the “temperance movement” succeeded in banning the sale and consumption of alcohol, but underestimated human nature and the criminal consequences of driving alcohol underground. The Temperance Movement

believed that alcohol consumption imposed costs on society,³⁵ which it certainly does, but erred in imposing a regulatory regime that was disproportionate to the actual costs of the conduct. The government as nanny believed that it could reduce the costs imposed by drinking without raising other costs and distorting natural behaviors in unpredictable ways. In other words, the cost-benefit calculation done by the regulator excluded the dynamic costs that arose from the regulation itself.

Distinguishing between bad nanny types (or between good and bad nannies) is difficult. The more difficult it is to sort *ex ante* between good and bad, the greater the opportunity for nannies to rent seek and profit from imposing nanny rules. The most obvious example of this is the “Bootleggers and Baptists” theory.³⁶ Both those who sell alcohol illicitly (bootleggers) and those who oppose drinking on moral grounds (Baptists) have incentives to restrict the sale of alcohol, either entirely or, less ambitiously, on Sundays. The economic and moral arguments generate an “unholy alliance” that politicians can exploit by taking money from the former and using the arguments of the latter to get votes.

The exploitation of moral- or social-cost arguments for private economic (or political) gains is not limited to politicians. Businesses can use government power for this end, too. For instance, the first child labor laws in England were proposed to Parliament by a blue-ribbon commission composed of mill owners who, by virtue of their technological advantage over rival mills, could afford to and in fact preferred to raise the costs of labor by reducing its supply.³⁷ It is also true today, cutting both for and against nanny rules. Tobacco companies and the ACLU have teamed up to support legislation restricting the ability of employers to ban smoking outside of the workplace. Tobacco companies obviously want to maintain their market, while the ACLU wants to protect privacy interests in general. This modern application of “Bootleggers and Baptists,” call it “Cigarette Vendors and Constitutional Defenders,” is based on the economic interests of the tobacco companies and the political views of the ACLU. This alliance of interests similarly provides politicians with the lucrative go-between possibilities—they can take money from tobacco companies while claiming to support the restrictions on corporate nannyism with rhetoric about privacy and the Bill of Rights. In any event, this public

³⁵ See, for example, Jack S. Blocker, David M. Fahey, and Ian R. Tyrrell, eds, *Alcohol and Temperance in Modern History: An International Encyclopedia* 402 (ABC-CLIO 2003) (noting the Massachusetts Society for the Suppression of Intemperance’s view that alcohol use was “part of a pervasive deterioration in the virtue of [the] citizenry”).

³⁶ See Bruce Yandle, *Bootleggers and Baptists: The Education of a Regulatory Economist*, 7 Regulation 12, 13 (May/June 1983).

³⁷ Clark Nardinelli, *Child Labor and the Factory Arts*, 40 J Econ Hist 739, 740–41 (1980).

choice-like story makes it difficult to unpack the virtue of the restrictions on individual liberty.³⁸

3. Finding the efficient nanny.

In light of these mixed motives and the difficulty in interpreting them, the best one can probably say is that we can only tell good from bad, or one type of bad from another, based on outcomes. Nanny rules that persevere and do not generate widespread consensus about excessive burdens are generally good, while others are bad. The problem, of course, is that sorting *ex post* in this way will be biased by the sensitivity of nannies to political or market forces. If these forces are weak, socially inefficient rules may survive, even if they are known to be such, unless the cost of the inefficiency is enough to overcome this weakness. In light of this, it is essential to assign the locus of nannyism to those situations or entities that will be subjected to the most rigorous political or market checks.

When there are monopolies of power, there is by definition less constraint on action, by either political or market forces. Politicians who face no election threat or who have constituents with very high costs of moving jurisdictions are less likely to deliver nanny rules that come close to efficiency; corporations that are monopsonists in the labor market are similarly subject to less oversight that would help constrain bad nannyism. Firms are subject to much greater oversight by labor, product, and capital markets than politicians are by elections, and therefore should be preferred nannies, all else being equal.

But first let us consider the ways in which corporations are increasingly engaging in nannyism. The history of corporate nannyism supports the claim that the deployment of paternalist rules by firms is tied to externalities imposed by employees and is, even in relatively illiquid labor markets, dramatically constrained by market forces.

II. CORPORATE NANNYISM

The history of corporate nannyism is about economics, not domination. By tracing the rise of modern nannyism by firms back to its origins—in so-called “company towns”—the motivations of and constraints on firm nannyism are plain. Corporate nannies have historically focused on cases of cost internalization, since incidences of pure paternalism are extremely rare in the historical record, and where such incidences existed and were excessive, they were instrumental in causing the firm imposing them to fail.

³⁸ For additional discussion, see Part II.C. See also note 98 and accompanying text.

A. Origins

The first large-scale manifestation of corporate nannyism as we think of it today was in the development and operation of “company towns” during the early industrial revolution.³⁹ Company towns, like Pullman, Illinois, and Coulee Dam, Washington, were communities in which a single business built, owned, and operated the entire town. These towns appeared throughout the industrializing West (England, France, America, Sweden, and Germany) during the 1830s, and were common in some locations and in some industries until the 1940s.⁴⁰ This was an era that combined rapid industrialization and the exploitation of natural resources in remote locations⁴¹ with the development of various social movements concerned with improving public morality. The combination of Victorian sensibilities, business growth, and physical isolation provided a perfect formula for business owners to take a strong nanny approach to workers.

Companies provided everything for employees in company towns—homes, stores, parks, roads, entertainment, medical clinics, and on and on—all of which were owned by the business enterprise, often a single entrepreneur, like George Pullman or Frank Gilchrist. Many company towns paid for public amenities, like sewage, garbage collecting, and gas lighting, that only the “most affluent suburbs of the period could afford.”⁴²

To paraphrase Adam Smith, these amenities were not provided out of benevolence but instead out of self-interest on the part of the firm. Companies needed to build towns with amenities on-site to attract workers to remote locations for difficult and often dangerous work in mining, timber, or construction.⁴³ Even in relatively straightforward industries, like mills, historians attribute the provision

³⁹ A leading historian of company towns defines the nanny corporation in this context as “one in which the paternalism of the owner extended beyond the bare-bones architectural requirements of factories or mines.” John S. Garner, *Introduction*, in John S. Garner, ed., *The Company Town: Architecture and Society in the Early Industrial Age* 3, 4 (Oxford 1992) (labeling such places as “model company town[s],” in which there were numerous public amenities and programs to aid the residents).

⁴⁰ See *id.* at 3; Carlson, *Company Towns of the Pacific Northwest* at 191–98 (cited in note 28) (discussing life in a company town in the post–World War II period).

⁴¹ “Mining companies establishing themselves in isolated areas often found it necessary to provide housing for workers in order to get them to come.” James B. Allen, *The Company Town in the American West* 7 (Oklahoma 1966) (explaining the economic rationale for the company town).

⁴² See Garner, *Introduction* at 7 (cited in note 39) (noting the presence of an arcade, market buildings, park, and gardens).

⁴³ See Allen, *The Company Town* at 6–7 (cited in note 41) (explaining that despite the remote location of the towns, they often developed into cohesive communities with shops, social groups, and religious organizations).

of amenities to the fact that “[m]ill owners had to furnish housing to obtain a labor force.”⁴⁴

Self-interest (not benevolence or busybodiness) also explained the link between firm ownership of the town and firm intervention in the seemingly private lives of employees.⁴⁵ Firm ownership of the physical and human capital in company towns led inexorably to nannyism to control costs and maintain the firm’s investment. As one historian describes it, “[g]enerosity . . . brought intrusiveness.”⁴⁶ Company town bosses “used their power as the owners of the village to control their employees,”⁴⁷ because it was cost-effective and efficient for them to do so.⁴⁸ Nannyism was not about “seek[ing] to reform the laboring classes or correct social evils,” but was about minimizing the firm’s labor and other costs—in short, it was a “ploy to attract and retain workers.”⁴⁹

From the perspective of the firms, nannyism was justified because firms were paying for nearly all the costs of running the town and feeding and caring for employees, as well as bearing all of the costs of misbehavior on the part of employees. Drunkenness led to absenteeism or accidents and mistreatment of one’s home, which was owned by the firm, and caused the firm to spend money to preserve its investment in it and the other homes surrounding it. Companies did not expect to recoup investments in towns through direct income, but rather viewed amenities as “subsidies to the employee” for which it therefore had the right to “demand certain concessions” from employees.⁵⁰

Control was pervasive. Companies regulated drinking, smoking, gambling, cleanliness, speech, association rights, and also, more generally, morals. Companies would monitor employees in public and private settings, and would fire those who, in the view of the firm’s

⁴⁴ Margaret Crawford, *Earle S. Draper and the Company Town in the American South*, in Garner, *The Company Town* 139, 144 (cited in note 39) (noting that mills provided housing and public amenities, creating the conditions for company control of the towns).

⁴⁵ Owners often couched their nannyism in benevolent and moral terms—“We keenly and genuinely feel our responsibility toward that which has been entrusted to us. We believe in the dignity of man and the worth of the individual.” Allen, *The Company Town* at 123 (cited in note 41) (quoting James Bryson, manager of the company that ran Valsetz, Oregon). But these are laid bare by the economic realities of the situation.

⁴⁶ Crawford, *Earle S. Draper* at 146 (cited in note 44) (noting that the companies used their control, for example, to regulate residents’ sexual activities).

⁴⁷ *Id.* at 144.

⁴⁸ To be sure, some owner-nannies took a “genuine interest in the welfare” of their workers, meaning the owners derived some personal utility from trying to impose their values on others. See Garner, *Introduction* at 4 (cited in note 39).

⁴⁹ *Id.* at 8.

⁵⁰ Allen, *The Company Town* at 122–23 (cited in note 41) (discussing the companies’ view that living in the town was a privilege, and that in return, the companies could expect, for example, that town property would not be used for unwelcome union organizing activity).

bosses, were “straying from the path of virtue.”⁵¹ Workers were also disciplined for trivialities, like failing to maintain their homes and yards in good condition. One company town boss, Frank Gilchrist of Gilchrist, Oregon, “drove around town, upbraiding those whose yards weren’t clean and tidy.”⁵² Gilchrist did this because he was highly subsidizing the rent of employees’ homes—it was partially *his* yard—and he presumably had strong personal preferences for tidiness.⁵³ Firms also regulated private behaviors inside homes. The owner of one mill “made a practice of walking around [workers’ houses] at nine o’clock every night to knock on the doors of those who were still up to tell them to put out the lights and go to bed.”⁵⁴ These policies led historians of company towns to characterize some entrepreneurs as “playing God” with their workers.⁵⁵

There were many reasons for playing God, many of which were directed at the firm’s bottom line. Nannyism helped recruit employees and reduce turnover, since it was often accompanied by generous welfare programs, and it was frequently associated with safe, cheap, and happy places to live and work.⁵⁶ For example, after a tremendous increase in absenteeism and turnover at a molybdenum mine in Climax, Colorado, the president of the firm, Arthur Bunker, ordered a nanny program, called “Design for Man,” to be implemented to “stabilize employment.”⁵⁷ The company provided numerous welfare programs and amenities, and, lo and behold, turnover was reduced.⁵⁸ Nannyism also helped businesses “maintain their financial investment in buildings and grounds” as well as the human capital deployed by the firm.⁵⁹

The link between ownership and control, or, in economic terms, the cost-bearing function and the cost-prevention function, is supported by the fact that the level of nannyism in company towns was proportional to the amount of the firm’s ownership stake in the town. Towns that provided lots of free amenities, like housing and recreational facilities, were

⁵¹ Carlson, *Company Towns of the Pacific Northwest* at 189 (cited in note 28).

⁵² *Id.* at 193.

⁵³ *Id.* at 210 (“In Gilchrist, Oregon, the lumberman who subsidized his employees’ rent was the same man who personally chastised workers who didn’t maintain their yards to his satisfaction.”).

⁵⁴ Crawford, *Earle S. Draper* at 146 (cited in note 44).

⁵⁵ See, for example, Carlson, *Company Towns of the Pacific Northwest* at 193 (cited in note 28).

⁵⁶ See Garner, *Introduction* at 4 (cited in note 39) (noting the amenities commonly found in a “model company town”).

⁵⁷ Allen, *The Company Town* at 124 (cited in note 41).

⁵⁸ See *id.*

⁵⁹ Garner, *Introduction* at 4 (cited in note 39). The construction of a new mining town at Tyrone, New Mexico by the Phelps Dodge Corporation in 1914 cost about \$1 million or about \$162 million in 2007 dollars, not to mention the ongoing costs of upkeep. See Allen, *The Company Town* at 115–16 (cited in note 41).

ruled by “benevolent despot[s],” while “[a]t the other extreme were towns that furnished few amenities but imposed few controls.”⁶⁰

On the surface, company towns were deemed to be successful experiments in a new kind of worker-manager relationship, and as visions for a new way of improving social welfare. Observers in the 1860s and 1890s remarked about the social progress and “upliftment” created by the “pleasing environments” of company towns.⁶¹ The corporate nanny was born as an alternative to government nannyism for improving individual social welfare. There were sensible reasons why outsourcing nannyism to private firms might have been socially optimal at the time of the company town. Most obviously, many of these towns were remote and government monitoring of behavior would be much more costly and not necessarily better than private monitoring and enforcement.⁶²

Corporate nannyism in company towns ended when company towns fell out of fashion. One theory for their demise blames excessive nannyism. Overbearing nannyism undoubtedly played a role in the demise of certain towns. Corporate chiefs, like George Pullman, were known as “meddlesome and oppressive,”⁶³ and this undoubtedly contributed to conflict between workers and management in company towns.⁶⁴ It is widely believed that “[p]aternalism was Pullman’s undoing,”⁶⁵ but not because all corporate nannyism was inefficient. Pullman’s problem was excessive nannyism. Worker mobility constrained arbitrary and capricious corporate nannyism, even when the firm had a large ownership stake in workers and their possessions. Employees had exit options, and these were effective substitutes for their lack of

⁶⁰ Crawford, *Earle S. Draper* at 147 (cited in note 44) (illustrating the spectrum of company town owners).

⁶¹ Garner, *Introduction* at 5 (cited in note 39) (noting that many of the company towns’ aspects inspired the planned communities that came later, such as Garden City).

⁶² When the government operated company towns, it acted in the same way as private firms. Government-run company towns, like Coulee Dam, Washington (near Grand Coulee Dam), had strict controls on the type of businesses in town and the types of behavior that were acceptable by residents. See Carlson, *Company Towns of the Pacific Northwest* at 192–93 (cited in note 28). Historical accounts conclude that “[t]he federal government also was well known for its paternalism [in company towns it managed].” *Id.* at 194.

⁶³ Garner, *Introduction* at 4 (cited in note 39). Some historical accounts criticize company town nannyism as being a “haphazard and piecemeal endeavor erratically applied according to the inclinations of individual owners and managers.” Crawford, *Earle S. Draper* at 146 (cited in note 44) (noting that a variety of different practices existed in different towns). One example of a “benevolent despot” was Ellison Smyth, who ran Pelzer, South Carolina. Smyth, who hated dogs, provided housing free of charge and countless amenities for his workers, but “indulged his own prejudices by restricting after-dark activities and banning dogs from the village.” *Id.* at 146–47 (quoting Smyth as saying that “dogs are in ninety-nine cases out of a hundred worthless and troublesome”).

⁶⁴ See, for example, Garner, *Introduction* at 6–7 (cited in note 39) (noting the example of the 1894 strike in Pullman, Illinois).

⁶⁵ *Id.* at 7.

voice in the affairs of the town.⁶⁶ “[S]killed labor was relatively unfettered,”⁶⁷ and this was reinforced by the fact that workers in company towns had few owned possessions to tie them to particular locations.⁶⁸ The ability of workers to opt out of oppressive company towns was so easy and prevalent that historians refer to claims of capture of employees by firms in company towns as “an exaggeration”—“[w]orkers unsatisfied with their situation could pick up and leave.”⁶⁹

By the 1920s, more workers were choosing to do so, since the booming economy made other options attractive. Workers recognized the tradeoff between firm-provided amenities and wages, and many “would [have] prefer[red] a larger paycheck,”⁷⁰ and so opted for work that would provide cash in lieu of amenities. Firms were finding out that buying loyalty with amenities, which were coupled with nannyism, was unsustainable, especially when nannyism was not proportional to the costs being imposed on the firm. Pullman failed in part because of market constraints on excessive nannyism.

The history of company towns provides strong foundational support for the claims made below about the role of corporate nannyism in modern America.⁷¹ Nannyism arose not out of bias or for ulterior motives, but rather to control costs being borne directly by the firm. The level of nannyism on the part of firms was directly proportional to the impact that behavior had on the firm’s bottom line, meaning firms that were not paying for things like healthcare costs did not engage in nanny-like regulations of health. In addition, labor markets provided a check on excessive nannyism. Where corporate chiefs meddled too much, workers fled, preferring cash to amenities plus nanny rules, thereby providing a market check on inefficient nannyism.

⁶⁶ For a general theoretical discussion of the value of the ability to remove one’s support from an organization (“exit”) or to register protests regarding one’s grievances to an organization (“voice”) as a way of addressing an organization’s shortcomings, see Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* 3–5 (Harvard 1970) (explaining how dissatisfied stakeholders can use the options of “exit” and “voice” and presenting questions regarding the “interplay” of these two options).

⁶⁷ Garner, *Introduction* at 6 (cited in note 39) (noting the mobility of certain workers in the mid-nineteenth century). Lack of labor mobility for unskilled workers may have made their options fewer and therefore their potential for abuse at the hands of corporate nannies more likely. But this assumes that company town managers could tailor degrees of nannyism proportional to workers’ labor mobility. Although this may have been true, there is no evidence of it in the leading historical accounts. It is also less likely for modern corporate nannies, which do not use tailored nannyism and generally compete in very liquid labor markets.

⁶⁸ *Id.* (noting workers’ lack of property or possessions, and hence their geographical mobility).

⁶⁹ See *id.* (arguing that, because of the portability of their labor skills and few ties to property, it is an “exaggeration” to characterize company town workers as a “proletariat”).

⁷⁰ Crawford, *Earle S. Draper* at 155 (cited in note 44).

⁷¹ See Part II.A.

B. Henry Ford's "Sociological Department"

Not all corporate nannies of this era were operating company towns.⁷² Henry Ford deployed a vast "Sociological Department" to supervise the private conduct of Ford employees, none of whom were living in homes paid for directly by Ford Motor Company or shopping in company stores. The deployment and eventual disbandment of the Sociological Department, however, comports with the history of company towns described above.

Ford instituted his nanny program in direct response to adverse labor conditions. The assembly line manufacturing process he instituted was wonderfully efficient and productive, but it made the work monotonous. And as a result, from the years 1911 to 1913, Ford Motor suffered extremely high employee absenteeism and turnover. Ford responded in January 1914 by offering employees a dramatic increase in pay—the famous \$5 day—but reasonably worried that some workers might spend the windfall in ways that would undermine his labor-efficiency goals. Ford also believed that workers from healthy, stable, and harmonious homes made more productive workers.⁷³

Ford set up a "Sociological Department"⁷⁴ to ensure the precondition that workers "not debauch the additional money [they] receive[]" under the \$5 day.⁷⁵ Workers who drank, did not save, or otherwise did not comport with Ford's views of the good life would not qualify for the wage.⁷⁶ In fact, employees did not automatically qualify for the \$5-a-day pay increase. Instead, they had to undergo provisional monitoring by the Sociological Department. Two years after the pay increase

⁷² For example, the Ford Motor Company provided free legal services to protect employees from dishonest real estate agents. See Ford R. Bryan, *Friends, Families & Forays: Scenes from the Life and Times of Henry Ford* 279 (Wayne State 2002) (describing the many procedures Ford introduced to improve family life by "encouraging family stability, home ownership, and the budgeting of income"). The Company also established the "Employees' Savings and Loan Association" as a bank the employees could use, in an effort to encourage thrift and saving. Steven Watts, *The People's Tycoon: Henry Ford and the American Century* 204–05 (Knopf 2005) (describing the work and responsibilities of Ford's sociological investigators). Furthermore, the Company had physicians available around the clock to tend to sick employees. *Id.* at 205.

⁷³ Watts, *The People's Tycoon* at 201 (cited in note 72).

⁷⁴ Ford was inspired to start the Sociological Department when he visited his friend Percival Perry, who manufactured and sold Ford cars in England and had started a similar program that included an increase in wages to combat worker dissatisfaction. Bryan, *Friends, Families & Forays* at 276–81 (cited in note 72) (chronicling the transition of the company from one with no labor policy to one that created the Sociological Department).

⁷⁵ Stephen Meyer, III, *The Five Dollar Day: Labor Management and Social Control in the Ford Motor Company, 1908–1921* 124–25 (SUNY 1981) (describing a cursory interview with a cohabitant to determine a worker's fitness for the enhanced pay program).

⁷⁶ In Ford's words, an eligible worker "must show himself sober, saving, steady, industrious and must satisfy the superintendent and staff that his money will not be wasted in riotous living." Ford R. Bryan, *Henry's Lieutenants* 207 (Wayne State 1993).

was implemented, 90 percent of company employees had qualified. Qualification could be revoked at any time, however, if officials believed the employee was engaging in undesirable behavior. If the department found that an employee was not living up to standards, he would be put on a six-month probation period and his pay would be cut. If, at the end of that time period, significant improvement had not taken place, he would be fired.⁷⁷

The Department deployed a team of 150 to investigate the lifestyle of each Ford employee and ensure that they were not participating in activities that would make them ineligible for the wage increase, such as smoking, drinking, gambling, and prostitution.⁷⁸ Inspectors also examined employees' spending and saving habits.⁷⁹ If inspectors detected problems, they were able to offer employees advice on issues including childcare, money management, alcohol abuse, personal hygiene, and house maintenance.⁸⁰ Ford used the Sociological Department to "shape the character, domestic life, and financial habits of Ford workers."⁸¹ His goals, although couched in moralistic terms, were predominantly economic—the purpose was to reduce the uncertainty of labor costs that arose because of the introduction of assembly-line manufacturing.

Ford's Sociological Department was well received by many of the Progressive Era industrial leaders and politicians of the time, who believed that it would help resolve the tensions between workers and industrialists and reform workers into more responsible citizens.⁸² Reformers Ida Tarbell and John R. Commons were particularly fond of Ford's efforts.⁸³ In 1915, however, the Congressional Commission on Industrial Relations became concerned with Ford's efforts to assume "so large a measure of responsibility, not only for the labor conditions in its plants, but also for the social and moral surroundings of its employees."⁸⁴ In his testimony, Ford justified his programs as an earnest effort to improve the lives of his workers.⁸⁵ Ford's program received additional criticism from many newspapers, the majority of which

⁷⁷ K.C. Crain, *Fit for \$5 a Day? The Company Will Decide*, *Automotive News* 44 (June 15, 2003).

⁷⁸ Rudolph Alvarado and Sonya Alvarado, *Drawing Conclusions on Henry Ford* 42–43 (Michigan 2001) (describing Ford's historic pay increase and the ways in which it affected the workings of the Company and the lives of the employees); Bryan, *Friends, Families & Forays* at 278 (cited in note 72).

⁷⁹ Watts, *The People's Tycoon* at 203 (cited in note 72).

⁸⁰ *Id.* at 204.

⁸¹ *Id.* at 205.

⁸² *Id.* at 212.

⁸³ Watts, *The People's Tycoon* at 222–23.

⁸⁴ *Id.* at 219–20 (describing the public debate about the propriety of corporate intrusion into employees' lives).

⁸⁵ *Id.* (quoting Ford's claim that his social programs reflected "a heartfelt, personal interest in the welfare of his employees").

were concerned that his programs were overly paternalistic, raising workers' wages, but treating them like children in exchange.⁸⁶

The Sociological Department came to an end when Ford opened the River Rouge plant in 1920. Ford manager Charles E. Sorensen claimed that the department would interfere with production, and Henry Ford claimed to have tired of the experiment.⁸⁷ By the time Ford wrote his memoirs in 1922, his views on nannyism and the work of his Sociological Department had completely changed. He wrote:

[P]aternalism has no place in industry. Welfare work that consists in prying into employees' private concerns is out of date. Men need counsel and men need help, oftentimes special help; and all this ought to be rendered for decency's sake. But the broad workable plan of investment and participation will do more to solidify industry and strengthen organization than will any social work on the outside. Without changing the principle we have changed the method of payment.⁸⁸

Ford's reflection is revealing—he notes that Ford Motor Company continued to invest in worker retention, but shifted from nannyism to inclusion (called participation) in the firm's decisionmaking process.⁸⁹ The move to corporate democracy from corporate nannyism reflected broader trends in society, not the least of which was the rise of powerful labor unions, which aggressively pushed for worker protection from termination (thus undermining the essential threat that made corporate nannyism possible) and more control over the firm. Ford's competitors also started to be able to offer competitive wages, and thus the thickening of the labor market also dramatically reduced Ford's control over workers. Just as in the case of company towns, the ability to sell one's labor down the street at another similar firm provided a natural brake on the reach of the corporate nanny.

After Ford's grand experiment, corporate nannyism abated. There were undoubtedly cases of firms trying to force employees to internalize their costs, but the power of unions and the highly liquid labor markets in this country constrained this behavior to isolated cases. In addition, the biggest driver of modern corporate nannyism—healthcare costs—was much less of a concern. Prevailing social norms at the time, like widespread acceptance of smoking, and external factors, like dramatically lower healthcare costs on average, were sufficient to make any corporate concern over employee behavior much less impor-

⁸⁶ Id at 220.

⁸⁷ Bryan, *Friends, Families & Forays* at 281 (cited in note 72).

⁸⁸ Henry Ford, *My Life and Work* 130 (Garden City 1922).

⁸⁹ See id.

tant for firms. Moreover, it was not until the 1980s revolution in the way executives were compensated that “shareholder value” became the rallying cry of managers and the be-all, end-all of firm management. In a world in which maximizing the value of shares is paramount, firms will inevitably care more about employee behavior and things like health-care costs, since these costs go right to the bottom line of firm profitability. It is to this modern era of corporate nannyism that we now turn.

C. The Modern Corporate Nanny

Corporate nanny activities today are concerned with activities associated clearly with firm costs—they are focused only on cost internalization. As discussed below, firms cannot engage in much pure paternalism, since doing something that by definition is against the will of an employee will likely impose costs on the firm, say in the form of higher labor costs. The net of paternalism in relatively liquid markets is thus likely negative for the firm, since the firm will feel the higher labor costs but not capture any benefits from the paternalism (by definition). In other words, pure paternalism, such as it exists, is destructive of firm value, and therefore shareholders and other claimants on firm value should oppose it vigorously. (As noted above, it is difficult to determine what is pure versus impure paternalism based on self-serving public comments of the nanny. As such, the best hope for avoiding the former and promoting efficient use of the latter is subjecting the nanny to discipline for errors.)

More specifically, corporate nannies today are concerned mostly about employee healthcare costs and issues.⁹⁰ Healthcare costs include direct costs, such as insurance costs, as well as indirect costs, such as lost productivity, absenteeism caused by illnesses, and other secondary costs. The reasons are plain. These costs go directly to firms’ bottom lines, are large and growing, are susceptible to nanny rules, and other potential externality-causing firm activities have fallen by the wayside. Unlike the era of company towns, most firms do not own employee housing, own the shops where employees buy everything, or provide services like parks, hospitals, and recreational facilities.

⁹⁰ Firms are also increasingly deploying nanny-like programs to encourage a variety of other “good” behaviors. For example, Pacificare gives employees bonuses (in the form of prizes, like iPods) for taking classes on managing personal finances, learning about art, teaching their children not to watch television or play video games, and so on. See Ariana Eunjung Cha, *Firms Make It Their Business to Push Health: Incentives, Monitoring Aimed at Cutting Costs*, Wash Post A1 (Feb 20, 2005) (describing the measures taken by companies to defray health insurance premiums through incentives to live healthier). These programs are unobjectionable, since the stakes are low, but they amount to penalizing employees who do not do these things.

About 60 percent of Americans employers offer health benefits,⁹¹ and in 2006, firms spent nearly \$500 billion on employee health insurance.⁹² Since employers are paying—and paying a lot—they obviously have a strong interest in improving employee health. This interest is growing because healthcare expenditures are rising rapidly: from 1960 to 2000, healthcare costs rose as a percent of all wages and salaries from about 1 percent to 8 percent.⁹³ According to the Kaiser Family Foundation, a nonprofit research firm, health insurance premiums have risen about 10 percent per year since 2000.⁹⁴ As of 2005, healthcare costs as a percentage of total payroll costs ranged from about 7 percent to nearly 17 percent, with a median of about 11 percent.⁹⁵ For larger firms (that is, those with over five hundred employees), the average healthcare costs as a percentage of the total payroll costs was about 14 percent.⁹⁶

In addition, US firms are believed to be at a disadvantage on the global market, since companies in other nations pay much less in healthcare costs. (The US average is about 13 percent of total payroll spent on health benefits, compared with about half of that or less for Japan, Germany, and the United Kingdom.⁹⁷)

Two of the biggest causes of these costs are smoking and obesity,⁹⁸ and firms are beginning to compete with the government in trying to

⁹¹ Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits: 2007 Annual Survey*, 3 (Kaiser Family Foundation 2007), online at <http://www.kff.org/insurance/7672/upload/76723.pdf> (visited Oct 3, 2009) (collecting information on company-funded health insurance).

⁹² Centers for Medicare & Medicaid Services, Office of the Actuary, *National Health Expenditures* table 5 (2006) (calculated as Private Business Expenditures less “other private” and “other public”).

⁹³ Department of Commerce, Bureau of Economic Analysis, *National Income and Product Accounts Table: 1960–2006* tables 2.2A & 7.8 (2008), online at <http://www.bea.gov/national/nipaweb/SelectTable.asp> (visited Oct 3, 2009).

⁹⁴ Ariana Eunjung Cha, *Firms Make It Their Business to Push Health: Incentives, Monitoring Aimed at Cutting Costs*, Wash Post A1 (Feb 20, 2005).

⁹⁵ See Kaiser Family Foundation, *Employer Health Insurance Costs and Worker Compensation* figure 3 (Mar 2008), online at <http://www.kff.org/insurance/snapshot/chcm030808oth.cfm> (visited Oct 3, 2009) (illustrating healthcare costs as a percentage of payroll from 1999 to 2005).

⁹⁶ See id at figure 6.

⁹⁷ International Social Security Association, *Social Security Programs throughout the World* (2006), reprinted in Sarah Axen and Elizabeth Carpenter, *The Employer Health Care Burden*, New America Foundation (May 2008), online at <http://www.newamerica.net/files/Employer%20Burden%20-%20issue%20brief.pdf> (visited Oct 3, 2009) (contrasting the percentage of employer payroll spent on healthcare benefits by US firms (13 percent) when compared to firms in other countries, including Japan (3.7 percent), Germany (6.7 percent), Canada (4.5 percent), and the UK (1.9 percent)).

⁹⁸ Both smoking and obesity are correlated with an increased risk of diabetes, hypertension, heart disease, stroke, and other chronic and debilitating conditions. See generally Roland Sturm, *The Effects of Obesity, Smoking, and Drinking on Medical Problems and Costs*, 21 Health Affairs 245 (March/April 2002) (observing that obesity and smoking are associated with 36 and 21 percent increases in healthcare costs, respectively).

control them. Obesity, for example, was estimated to have increased healthcare costs and lost productivity by over \$70 billion in 1994,⁹⁹ and the percentage of adults classified as obese has increased from about 14 percent then to almost 21 percent in 2001.¹⁰⁰ The percentages are undoubtedly much higher today. More recent estimates ballpark the cost of obese individuals at over \$700 per individual per year compared with individuals of normal weight.¹⁰¹ Not surprisingly, the severely or morbidly obese impose even greater costs on others. A study by Thomson Health Care estimated the extra costs of these individuals as nearly \$2,500 per person per year.¹⁰² Studies also find that less than 15 percent of these extra costs are financed through patient out-of-pocket payments.¹⁰³ This means overweight people impose significant direct and indirect externalities on healthier people in common-insurance pools or with common employers.

Smoking causes similar externalities. A 2002 study by the Centers for Disease Control found that annual productivity losses and healthcare costs were \$3,391 per smoker.¹⁰⁴ To put this number into the corporate context, if Walmart employees smoke at the average rate for US adults, Walmart would face an additional \$1.4 billion in expected healthcare costs compared with a zero-tolerance policy for smoking.¹⁰⁵ In the aggregate economy, this figure would be over \$100 billion.¹⁰⁶

⁹⁹ A.M. Wolf and G.A. Colditz, *The Cost of Obesity: The US Perspective*, 5 *Pharmacoeconomics* 34, 36 (1994) (compiling the direct and indirect costs of obesity in the 1990s).

¹⁰⁰ Ali H. Mokdad, et al, *The Spread of the Obesity Epidemic in the United States, 1991–1998*, 282 *JAMA* 1519, 1520 (1999) (quantifying and chronicling the increase in obesity in America); Ali H. Mokdad, et al, *Prevalence of Obesity, Diabetes, and Obesity-Related Health Risk Factors, 2001*, 289 *JAMA* 76, 77 (2003) (same).

¹⁰¹ Eric A. Finkelstein, Ian C. Fiebelkorn, and Guijing Wang, *National Medical Spending Attributable to Overweight and Obesity: How Much, and Who's Paying?*, Health Affairs Web Exclusive W3-219, W3-222 exhibit 2 (2003), online at <http://content.healthaffairs.org/cgi/reprint/hlthaff.w3.219v1.pdf> (visited Oct 3, 2009) (calculating the spending increases stemming from being obese and determining that the spending increase is \$732 per year). See also Associated Press, *Company to Charge 'Unhealthy' Workers More for Insurance* (July 1, 2007), online at <http://www.foxnews.com/story/0,2933,287616,00.html> (visited Oct 3, 2009) (citing a Thompson Health Care study estimating the extra healthcare costs of moderately obese individuals as about \$700 per individual per year).

¹⁰² See Associated Press, *Company to Charge 'Unhealthy' Workers More for Insurance* (cited in note 101).

¹⁰³ Finkelstein, Fiebelkorn, and Wang, *National Medical Spending Attributable to Overweight and Obesity*, Health Affairs Web Exclusive at W3-223 ex 4 (cited in note 101).

¹⁰⁴ Centers for Disease Control and Prevention, *Press Release: Smoking Costs Nation \$150 Billion Each Year in Health Costs, Lost Productivity* (Apr 12, 2002), online at <http://www.cdc.gov/media/pressrel/r020412.htm> (visited Oct 3, 2009) (outlining the health and economic effects of smoking).

¹⁰⁵ Walmart has about 2 million employees. Fortune Global 500, *The List* table 1 (July 21 2008) (ranking the fifty largest employers worldwide). About 20 percent of US adults are smokers. See Centers for Disease Control and Prevention, *Cigarette Smoking among Adults—United*

To combat these and other externality-causing behaviors, firms are using a variety of voluntary (carrots) and involuntary (sticks) incentives.¹⁰⁷ As discussed below, legal uncertainty and regulatory distortion have limited experimentation somewhat to date, but more and more firms are deploying nanny rules designed to force employees to internalize the costs they are imposing on others.

1. Carrots.

Numerous companies have adopted voluntary programs designed to improve employee health and offset the more than \$4,000 per year in increased healthcare costs from obesity and smoking.¹⁰⁸ For example, IBM has a variety of “rebate” programs that pay employees to act in ways likely to drive down health insurance costs. Specifically, IBM pays employees who agree to eat healthy, exercise, and not smoke \$150 per year (\$300 if they get their entire family to do the same). The system is voluntary and involves self-reporting progress through an online application.¹⁰⁹ Similar programs exist at Aetna (\$345 per year for completing online courses in health and weight management¹¹⁰), Dell (incentive program for employees to fill out an annual health

States, 2004 (Nov 11, 2005), online at <http://www.cdc.gov/mmwr/preview/mmwrhtml/mm5444a2.htm> (visited Oct 3, 2009).

¹⁰⁶ This is based on a labor force of 150 million. See Central Intelligence Agency, *The World Factbook: United States*, online at <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html> (visited Oct 3, 2009).

¹⁰⁷ It is also possible that firms could “charge” employees for things like obesity indirectly through lower wages for the lower productivity that accompanies the condition. There is some evidence for this. The literature on obesity-based wage differences finds that heavier individuals earn less than lighter ones, and that these differences are based on lower productivity levels. See generally Charles A. Register and Donald R. Williams, *Wage Effects of Obesity among Young Workers*, 71 Soc Sci Q 130 (1990) (analyzing the possibility of a wage penalty for obesity); José A. Pagán and Alberto Dávila, *Obesity, Occupational Attainment, and Earnings*, 78 Soc Sci Q 756 (1997); John Cawley, *An Instrumental Variables Approach to Measuring the Effect of Body Weight on Employment Disability*, 35 Health Services Res 1159 (2000). This method of cost internalization is likely insufficient. It may be illegal for firms to lower wages for the health-related aspects of certain conditions or behaviors. It also applies only to behaviors or conditions that manifest themselves in productivity losses. Finally, it is not transparent to the worker, so there are no obvious incentives for employees to lose weight or change the behavior.

¹⁰⁸ Larry Hand, *Carrots & Sticks: Employers Prod Workers to Adopt Behaviors that Improve Health*, Harv Pub Health Rev 4, 5 (Winter 2009), online at http://www.hsph.harvard.edu/news/hphr/files/winter09_incentivesWEB.pdf (visited Oct 3, 2009) (noting that 19 percent of all large employers offered wellness programs in 2006).

¹⁰⁹ See IBM Press Room, *IBM's New Children's Health Rebate for Employees Helps Families Attain a Healthy Lifestyle: Extends Company's Wellness Incentive Programs, Enabling Employees to Earn \$150 Cash Incentive* (Oct 24, 2007), online at <http://www-03.ibm.com/press/us/en/pressrelease/22496.wss> (visited Oct 3, 2009).

¹¹⁰ WBGH.org, *Best Employers Gold Winners 1* (June 17, 2005), online at http://www.wbgh.org/healthtopics/best_employer_docs/best_employers_gold_winners_617.pdf (visited Oct 3, 2009).

survey and participate in a health-improvement program¹¹¹), Pacificare Health Systems (\$390 per year for participating in an online health-training program¹¹²), and many other firms.

Carrots may seem more appealing than sticks, but the two are largely indistinguishable. For one, there is no practical economic difference between “rebates” and “fines” without first defining a baseline level of cost. Imagine there are two individual employees, each of whom is charged \$100 for health insurance by the firm. The first individual volunteers for the health improvement program, earning a \$10 “rebate” on insurance costs, while the second employee does not. The first employee is paying \$90, while the second is paying \$100. The situation is no different than setting the insurance costs at \$90 and fining the second individual \$10 for not joining the program.

Another related reason is that in a world of rebates or fines, individual disclosures will unravel so that what seems voluntary may not indeed be voluntary. To see this, imagine again a firm with two employees, one of whom is a smoker and the other is not. The firm puts the individuals in a common-insurance pool, such that the blended insurance rate paid by each is the same and assumes that one of them is a smoker, but does not identify which one. If the firm provides voluntary opportunities for the nonsmoker to signal this good attribute, the implication is that the other employee is a smoker, even if that employee does not say anything about whether she is or is not. This may be optimal for the firm, but it highlights that voluntary programs can have the effect of quickly sorting employees (that is the point), and as a result revealing as much about volunteers as nonvolunteers. As such, any losses suffered by the nonvolunteers, such as privacy losses, will be the same in an environment of carrots as they would be as sticks.

There are some differences between carrots and sticks, which are evident when we examine the sticks used by firms today.

2. Sticks.

Involuntary programs, or sticks, are more varied than voluntary ones. Corporations currently deploy “no hiring” policies, mandatory health assessments, and penalties, including financial penalties and termination, for certain behaviors. Because, as discussed below, legal risk and uncertainty is undoubtedly higher for firms deploying these programs than voluntary ones, they are rarer and are often led by individu-

¹¹¹ Dell Press Release, *Dell Wellness Participants See Health Improvements, 10 Percent Decrease in Expenses* (Nov 15, 2006), online at http://www.dell.com/content/topics/global.aspx/corp/pressoffice/en/2006/2006_11_15_aus_000?c=us&l=en&s=corp (visited Oct 3, 2009).

¹¹² Cha, *Firms Make It Their Business to Push Health*, Wash Post at A1 (cited in note 90).

al managers who feel passionately about them. Typical is Jim Hagedorn, the CEO of Scotts Miracle-Gro, who admits that this “is an area where CEOs are afraid to go.”¹¹³ He argues, however, that as healthcare costs have exploded (Scotts’ annual healthcare bill soared 42 percent in four years, amounting to 20 percent of the company’s net profits), and “the government and health-insurance industry weren’t doing anything to solve the crisis,” companies “paying the bills” were the ones who needed to take action.¹¹⁴ According to both him and others, these actions also increasingly needed to be sticks. In the experience of Scotts, docking pay worked much better than wellness programs offering incentives like gym discounts or healthy-eating bonuses. As the Benefits Chief of Scotts said, “We tried carrots . . . [c]arrots didn’t work.”¹¹⁵

The different types of mandatory programs currently deployed by firms can be seen by comparing the range of firm policies aimed at deterring smoking. The simplest program is to implement a “no smokers” hiring policy like Alaska Airlines has had since the mid-1980s and Union Pacific has had since 2004.¹¹⁶ Firms like Weyco, mentioned above, take this a step further by not only hiring only nonsmokers, but also firing current employees who fail nicotine tests. (As part of its no-hiring policy, Alaska Airlines told applicants they would be tested for nicotine use, but there is no public evidence that they ever were.¹¹⁷) A slightly less aggressive approach is to charge higher insurance premiums for smokers. Several employers—such as J.P. Morgan Chase, Northwest Airlines, Pepsi Co, and Meijer—do this. One prominent example is Navistar International Corporation, which charges smokers \$50 per month to help defray increased health-insurance premiums.¹¹⁸ Weyco’s program was recently expanded to include the spouses of employees; if a husband or wife fails a monthly nicotine test, the employee pays an additional \$80 per month penalty until the spouse quits smoking.¹¹⁹

¹¹³ See Michelle Conlin, *Get Healthy—Or Else: Inside One Company’s All-out Attack on Medical Costs*, Bus Wk 58 (Feb 26, 2007) (describing the procedures a company used to improve healthiness in the employees).

¹¹⁴ Id. See also Conlin, *Hagedorn: “We Care About Our People,”* Bus Wk Online (cited in note 10) (“I told my people that you cannot expect us, the company, to just continue to pay these kinds of increases and not say to our people you are partly responsible.”).

¹¹⁵ See Conlin, *Get Healthy—Or Else*, Bus Wk at 58 (cited in note 113).

¹¹⁶ Peters, *Company’s Smoking Ban Means Off-hours, Too*, NY Times at C5 (cited in note 8) (reporting on a new company policy that subjected employees to nicotine tests and describing the many critics who believe this is an unjust invasion of privacy).

¹¹⁷ Id.

¹¹⁸ Cha, *Firms Make It Their Business to Push Health*, Wash Post at A1 (cited in note 90).

¹¹⁹ Hilary Smith, *The High Cost of Smoking*, MSN Money (Sept 3, 2008), online at <http://articles.moneycentral.msn.com/Insurance/InsureYourHealth/HighCostOfSmoking.aspx> (visited Oct 3, 2009).

Importantly, if the \$3,000 per year, per employee (or more) cost of smoking noted above¹²⁰ is a reasonable estimate, the \$50 per month penalty (\$600 per year) used by Navistar does not reflect the full costs imposed by the smoking employee. The difference may be because of a different, local estimate of the costs of smoking or an estimate that the incentive provided by the penalty is sufficient to deter all smokers (say, because social norms will fill the gap once a program is implemented).

This may also suggest that the optimal level of smoking or obesity at the firm level is not zero, or, to say it another way, that individuals in the common pool do not demand complete cessation of the offending and costly behavior. This might be because employees who impose costs might also have unique benefits that offset these costs, on average, at the level set by the firm. Smokers might be particularly productive workers, for example,¹²¹ and the firm may be simply summing the benefits and costs to find the optimal level of deterrence. Another possibility is that the individuals demanding nanny rules are unwilling to bear the costs on them from a more draconian program. Significant and valuable liberty interests, for one, might be at stake in more aggressive programs, and individuals who are forced to bear the costs of the behavior may weigh these in any deterrence calculation. Or, to put it another way, the firm might reasonably believe that forcing smokers to internalize all of their costs would send negative signals to the labor market that might raise the firm's labor costs, even among nonsmokers. For example, nonsmokers might not want to work for a firm that charges smokers because the policy may signal a possible increase in costs to nonsmokers through other intrusive programs. The signal could be simply that the firm is likely to have a low tolerance for any cross-subsidies, perhaps due to productivity or other considerations beyond smoking that the employee might be concerned about. Someone who is a shirker or a skydiver might reasonably believe a non-smoking policy reveals that this is a place where they should not work.

Another possibility is that employers do not bear the full insurance-based costs of employee health, and are therefore not properly incentivized to reduce behaviors to their optimal level. For example, the federal government pays most healthcare for individuals over the age of sixty-five through a mandatory program under Medicare.¹²² This

¹²⁰ See note 104 and accompanying text.

¹²¹ Nicotine is a stimulant, so it has been shown to increase cognitive function and stamina. Kate Devlin, *Nicotine Offers New Hope for Alzheimer's Treatment*, Daily Telegraph (London) 11 (July 14, 2008). It also increases metabolism, so smoking is common among ballet dancers, since it allows them to remain very thin, a requirement of employment. See Suzanne Martin, *Stop Blowing Smoke—Here's How*, Dance Magazine 31 (Aug 2004).

¹²² Social Security Act, 42 USC § 1395 et seq.

means that illnesses that manifest after that age are not part of the employer calculation, since the employer does not have to pay for them. A final possibility is that firms are risk averse, especially in light of the legal uncertainty of the rules limiting corporate nannyism discussed below, and thus are slowly deploying nanny rules to build acceptance in the labor market before moving to full internalization of costs.

Some firms have gone far beyond hiring policies or insurance penalties for employee behaviors like smoking or being obese. For example, Clarian Health developed a mandatory wellness program that, starting in 2009, will charge employees based on their obesity.¹²³ Employees with BMI scores over 30 will be charged \$10 per paycheck, along with \$5 each for tobacco use, cholesterol over 130, blood pressure above 140/90, and glucose levels over 120. Western & Southern Financial Group charges employees whose BMI is too high a tiered fee between \$15 to 75 a month; the charge can be adjusted if the BMI improves.¹²⁴ So far, more companies have focused on tobacco use than obesity, but BMI is another simple (though potentially inaccurate and certainly incomplete) way to measure an employee's health risks.

Firms have also implemented more comprehensive programs covering a wider range of behaviors, including those of employees' families. Scotts has taken the most innovative and comprehensive approach so far. Employees are required to take an exhaustive and highly personal health-risk assessment, answering questions like: "Do you smoke? Drink? What did your parents die of? Do you feel down, sad, hopeless? Burned out? How is your relationship with your spouse? Your kids?" If employees balk, they are forced to pay additional monthly health-insurance premiums (about \$40 per month) on the theory that silence is a signal of poor quality or that penalties are necessary to force disclosure.

The surveys are not just for sorting. Once employees fill out the assessment, the firm analyzes the physical, mental, and family health histories of each employee, cross-references that information with insurance-claims data, and then sets up each "at risk" employee with a health coach and action plan. To ensure that personal information is not used for illicit purposes, firms routinely use third-party vendors to handle the programs. Those who do not comply with the action plan pay an additional healthcare penalty (about \$67 per month).¹²⁵ This

¹²³ See Associated Press, *Company to Charge 'Unhealthy' Workers More for Insurance* (cited in note 101) (describing the policy as being "on the bleeding edge").

¹²⁴ Jena McGregor, *Being Unhealthy Could Cost You—Money*, *Bus Wk Online* (Aug 2, 2007), online at http://www.businessweek.com/bwdaily/dnflash/content/aug2007/db2007081_804238.htm (visited Oct 3, 2009).

¹²⁵ See *id.*

plan was designed to charge employees for not doing something to make themselves healthier, regardless of whether they actually have more insurance claims or cost the company more money. This design was used because, at the time, employers were forbidden from passing along increased healthcare costs to individual employees based on their particular characteristics. Federal law, known as HIPAA, was recently changed to allow companies to pass along a portion of the extra cost for insuring their employees. As discussed below, this is likely to increase the use of penalty programs that directly link payments to individualized costs.

Health assessments, like those run by Scotts, are eerily reminiscent of Ford's Sociological Department, and even CEOs concede the programs have "Big Brother" overtones. Participation rates are very high, however, and having programs run by a third party, which most companies do, alleviates some privacy concerns and reduces the potential for abuse. In addition, the programs have been extremely successful. In its early stages, the Scotts program has already been successful in making employees healthier (and in purely business terms, cheaper). Deadly latent health problems have been revealed and corrected; several employees have lost a significant amount of weight; 30 percent of tobacco-using employees have quit (as of February 2007); and a "get healthy" peer pressure fills the office.¹²⁶

More generally, review of over seventy published studies on corporate wellness programs finds that every dollar invested in them yields about \$3.50 in benefits from reduced healthcare costs and improved productivity through reduced absenteeism.¹²⁷ The research data suggest that certain characteristics are clearly associated with increased costs (for example, excessive body weight and high levels of stress), while others are more speculative (for example, cholesterol, alcohol abuse, and hypertension). The uncertainty about what works and what does not points out the need for experimentation and deployment in an environment in which data will be available and in which those responsible for implementing the programs will have the incentives to collect and process it in an efficient manner. These issues will be discussed below.

These benefits are not enough, however, to conclude that corporate nannyism is a good thing. It might be, for instance, that governments could accomplish similar or better improvements at lower cost. Governments and firms are, in fact, competitors in providing nanny rules to force internalization of costs, and this means that we need an

¹²⁶ See Conlin, *Get Healthy—Or Else*, Bus Wk at 58 (cited in note 113).

¹²⁷ See Steven G. Aldana, *Financial Impact of Health Promotion Programs: A Comprehensive Review of the Literature*, 15 Am J Health Promotion 296, 316 (2001).

analysis of the potential comparative advantages of firms before we can conclude that corporate nannyism is a good thing.

III. THE ADVANTAGES OF CORPORATE NANNYISM

Although nannyism is ubiquitous in a world of third-party payors, it is subjected to widespread criticism. There are dozens of books, articles, and think-tank white papers devoted to exposing excessive nannyism and arguing for its elimination from our society.¹²⁸ The criticisms focus almost entirely on state-sponsored nannyism. Critics ignore two things: first, nannyism by third-party cost bearers is inevitable and potentially social-welfare maximizing, insofar as individuals are forced to bear the costs of their activities; and second, nonstate entities, like business corporations, are increasingly engaging in nannyism. With these things in mind, the only relevant question is: who is the most efficient nanny?

One response might be that firms should simply act as nannies when it is efficient for them to do so and not act in this manner when it is not. This approach ignores, however, that the government is a competitor in the “market for nannyism” and may put in place laws or rules that may bias the market in favor of government provision of nannyism and against firm provision of the same. This is a perverse result. The government subsidizes employer-provided health insurance (through numerous tax benefits for firms and employees) but then restricts the ability of corporations to regulate behaviors that will impact those health insurance costs. This dynamic is discussed below.

This Part offers several reasons why the nanny corporation may be superior to the nanny state at writing efficient rules, and thus undermines any policies biasing the delivery of nannyism away from corporate actors.

A. Constraining Overreaching

Just as nannyism is inevitable, so too is the risk of overreaching.¹²⁹ If the nanny does not accurately measure the size or source of externalities, either out of self-interest or mistake, the rules it sets will be socially inefficient. The first advantage that corporations have over the state in making rules designed to internalize socially costly actions by individuals is the constraint on overreaching provided by competitive markets for capi-

¹²⁸ See, for example, Harsanyi, *Nanny State* at 124–26 (cited in note 24) (describing the rationale for nanny laws and the vehement pushback from some interest groups); Rives, 74 *Geo Wash L Rev* at 563–67 (cited in note 7) (arguing for the adoption of an “unambiguous federal statute” against employer “lifestyle discrimination”); Chadwick, 70 *Albany L Rev* at 138–41 (cited in note 7) (favoring state laws “which protect[] smoker privacy”).

¹²⁹ It is in light of the tendency of some nannies to get carried away, the difficulty in making optimal nanny regulations, and the imperfect nature of monitoring nanny agents, that corporate nannies are superior to their state analogs.

tal, labor, and products. Nanny rules are inevitably implemented by imperfect agents (either of the citizens or shareholders), and markets provide more discipline over inevitable agency costs than political elections.¹³⁰ Although this argument is relatively straightforward, it is worth unpacking it a bit to see the full advantage of firms along this dimension.

1. Opt out.

At the most basic level, competition for labor should constrain firms from imposing restrictions on employee conduct that are excessive or out of relation to the costs that conduct imposes on the firm's owners. Corporations face relentless and finely tuned labor markets in which they are constantly making tradeoffs between benefits and wages on the one hand and demands and requirements on the other hand. Firms that miscalculate—say, by imposing too much cost on workers or by forcing them to internalize costs where there are none—will find their labor costs increase, and as a result, their competitive position compromised.

The brief history of company towns in America shows the power of labor markets to constrain overreaching by corporate nannies, even in cases where labor markets functioned only modestly well. Company towns were isolated geographically, attracted specialized labor, and were therefore often monopsony buyers of labor over large geographic and skill areas. And yet, the ability of individual employees to leave oppressive company towns was a significant factor in limiting corporate nannyism and led to the downfall of several company towns. Today, where labor markets are much more liquid and there are no employers with monopsony power in labor markets, the discipline is even more powerful. The fact that nanny rules are now used exclusively to reduce fairly obvious firm costs—like healthcare—supports this claim.

A key feature that provides a brake on overreaching is the ability for employees to opt out by leaving the control of the nanny. This will be much easier with corporate nannies than state ones. Employees can go to another firm much more easily than they can go to another jurisdiction; the switching costs are simply much lower. Very few individuals have firm-specific human-capital commitments, while nearly everyone has jurisdiction-specific commitments. Houses, friends, family, and so on, are often tied to locations, as well as the very powerful

¹³⁰ The idea that market discipline constrains agency costs is not a new one. See Richard H. McAdams, *The Political Economy of Criminal Law and Procedure: The Pessimists' View*, in Paul H. Robinson, Kimberly Kessler Ferzan, and Stephen P. Garvey, eds, *Criminal Law Conversations* 6 (Oxford 2009) (“[M]arket discipline is probably more reliable than electoral politics at driving into extinction an entity that is bad at controlling agency costs.”).

sense of place that many people feel. With job turnover at an all-time high and the age of the Company Man long gone, these costs are much lower for employees than citizens.¹³¹

The ability to opt out of a political jurisdiction will depend, of course, on the locus of the nanny rule in question. The more localized the rule, the lower the switching costs for individuals, all else being equal, since it is much easier to move streets than cities than states than countries. The smaller the political entity deploying the nanny rule, the more it looks like a firm and therefore has some of the advantages of corporate nannyism. Of course, investments in communities are almost always going to be much higher than investments in firms; houses are typically larger and stickier investments than investments in firm-specific human capital. (As such, we might expect jurisdictions with lots of renters to be more accountable to their principals and thus write more efficient nanny rules, all else being equal.)

Firm nanny rules also offer more opt-out options than state ones. In the case of firm health-related penalties, individuals can also opt to pay for their own insurance. In firms with pay-as-you-smoke policies, individuals can choose to pay the smoking penalties. Or, if the firm charges higher insurance premiums for smokers, the individual can buy individual insurance outside of the employment relationship. This is not an option in the case of state bans or in state-sponsored insurance schemes. Individuals simply cannot opt out of government-mandated health plans (such as Medicare, which is effectively mandatory for individuals over sixty-five¹³²), and especially if there is a federally mandated single-payor healthcare system.

Governments also have a monopoly on the application of legal force through the police power, and therefore can make opting out impossible in some cases. Governments can and have historically enforced some nanny rules through criminal sanctions, meaning the price of the opt-out option can be the loss of liberty.¹³³ This may be

¹³¹ The opt-out option is seen clearly in the case of the Weyco smoking ban. About twenty employees have kicked the habit as a result of the threat, but others have chosen to leave. One employee quit on the grounds that the policy, which told her what she could and could not do in her own house, was offensive to her. "You feel like you have no rights. You're all alone. It's the most helpless feeling you can imagine." Peters, *Company's Smoking Ban Means Off-hours, Too* (cited in note 8) (discussing privacy concerns and slippery slope arguments stemming from the instance of a company actually testing to enforce its no-smoking policy). Other employees like Christine Boyd, who smoked for 10 years, decided that choosing her job over cigarettes was "a no-brainer." Id.

¹³² See generally Mark V. Pauly, *Means-testing in Medicare*, Health Affairs Web Exclusive W4-546 (2004), online at <http://content.healthaffairs.org/cgi/reprint/hlthaff.w4.546v1.pdf> (visited Oct 3, 2009) (noting that wealthy seniors receive largely the same Medicare benefits for the same price as less-wealthy seniors, and arguing for means-tested pricing).

¹³³ For an egregious case, see *A.L.A. Schechter Poultry Corp v United States*, 295 US 495 (1935). The Schechter brothers, Jewish butchers from Brooklyn, were indicted for over sixty

efficient in some sense, if the greater penalties are calibrated with less enforcement. Even then, however, there may still be proportionality and just-deserts arguments about the penalties, and the risks of error in determining the externalities will be much greater.

2. Accountability.

Corporate nannies are also subject to significantly greater oversight than government ones. This can be seen by comparing the accountability of politicians, who design, deploy, and implement state nanny rules, and firm managers, who do the same for corporate nanny rules. The mechanisms and frequency of accountability are different and stronger in the case of managers. Politicians are generally disciplined only through periodic political elections, while in firms there are two ways in which managers are held to task for their decisions.

First, like politicians, corporate bosses face episodic “elections,” since they are usually terminable at will by the board of directors, which in turn is elected every year (or more often) by the shareholders. But these corporate “elections,” be they formal or informal, take place more frequently, are likely to be influenced by nanny policies, and are more effective at replacing disloyal or incompetent agents.

Most obviously, the average tenure for CEOs of the thousand largest public companies (about four years) is less than half that of the average member of Congress (about ten years).¹³⁴ The weakness of electoral discipline in politics is also evidenced by the fact that most incumbent politicians win reelection. For the past four decades, close

counts of violating the National Industrial Recovery Act. They violated certain provisions of the “Code of Fair Competition for the Live Poultry Industry of the Metropolitan Area in and about the City of New York,” id at 527 n 5, including competing too hard and allowing customers to select birds to be killed, id at 527–28 (as required by certain religious precepts). Historical accounts put much of the blame on the statute, which was overturned by the Supreme Court, and on unions, which lobbied to force nonunion firms out of business. There was also a strongly anti-Semitic tone to the regulations and prosecution. See Amity Shlaes, *The Forgotten Man: The New History of the Great Depression* 203–04 (Harper Perennial 2008) (noting that the East Coast poultry trade was often run by Jewish immigrants). In other words, externality arguments—health and unfair competition—were used to justify socially inefficient and undesirable preferences.

¹³⁴ The average tenure in the 108th Congress was nine years and eleven months. See *108th Congress: A Profile*, C-Span.org, online at <http://www.c-span.org/congress/profile.asp> (visited Oct 3, 2009). The longest-serving member served forty-seven years in the House and forty-four years in the Senate. Id. No CEO has had that long a run. In addition, Senate terms are six years in themselves, which is longer than the expected run for any CEO. See Matthew Kirdahy, *CEO Turnover Increased in 2007*, Forbes.com (Mar 7, 2008), online at http://www.forbes.com/2008/03/07/executive-ceo-tenure-lead-manage-cx_mk_0307turnover.html (visited Oct 3, 2009) (citing study showing the average tenure of a CEO who left in 2007 was six years). See also Caroline McCarthy, *AT&T CEO Whitacre Announces Retirement*, CNET News, (Apr 27, 2007), online at http://news.cnet.com/ATT-CEO-Whitacre-announces-retirement/2100-1036_3-6179818.html (visited Oct 3, 2009) (noting that Edward Whitacre, who was retiring after 17 years as CEO, was the then longest serving CEO in his industry).

to 95 percent of congressional incumbents have been reelected.¹³⁵ Political scientists report that only 15 percent of congressional races were competitive in 2002 to 2004, meaning the winner won less than 60 percent of the vote.¹³⁶ Similar results obtain in political races at nearly all levels of government. It is possible that these results are evidence that politicians calibrate the amount of nannyism nearly perfectly, but this is unlikely. For one, the existence of a vibrant antipaternalist movement suggests significant overreaching that is not manifest at the ballot box.

In addition, nanny issues may not be sufficient to move elections, and, in any event, politicians need satisfy only 50 percent plus one of the electorate to be reelected. This means not only that elections will not check abuse against minority views (say, in favor of smoking or being obese), but also that the minorities will not be able to opt out of any majoritarian rule. If anything, discipline may arise in a sort of punctuated-equilibrium model in which voter frustration with nannyism may get so severe as to impact an election. Another way of saying this is that employees voting with their feet will determine what “excessive” is, and that the costs for employees to move between firms are much lower than the costs of individuals moving jurisdictions or voting out incumbent politicians.¹³⁷

The discipline brought upon politicians by elections comes at much greater intervals, so it reflects the judgment of voters in a lumpy fashion, as opposed to hiring and firing decisions, which happen daily for firms. This lumpiness means not only that political outcomes will lag citizen preferences, but also that nanny issues may get lost in the numerous factors that influence elections when they come. The point is obvious, but to see it, imagine that the only constraint on the nanny rules of a firm was an election of the CEO every four years. This election might be about a firm’s antismoking policy, but it would also likely be about the return to shareholders, compliance with laws, and other bigger-picture issues. Corporate human resources policies are not judged collectively, episodically, and in an aggregated fashion, but are evaluated every time the firm interacts with its employees or the labor

¹³⁵ See Alan I. Abramowitz, Brad Alexander, and Matthew Gunning, *Incumbency, Redistricting, and the Decline of Competition in U.S. House Elections*, 68 *J Pol* 75, 75 (2006) (describing increasing success of incumbents from 87 percent in the late 1940s to 99 percent at the turn of the century).

¹³⁶ See *id.* at 81–82 & figure 3 (researching the decline in competitiveness of House elections and probability of reelection).

¹³⁷ While both employment decisions and individual decisions to move in or out of jurisdiction are complicated by a variety of other factors, it will be easier to isolate the cause and effect of corporate policies. Firms can and do run experiments of sorts to test the impact of changes in one element of an employment package on the cost of labor. Corporate policies are much more easily changed than law, and the ability to see an immediate impact makes this possible.

market.¹³⁸ In short, CEOs are also constantly evaluated by the labor market in ways that politicians generally are not.

Second, corporate managers are compensated with high-powered incentives tied to the firm's economic performance, which in turn will be influenced by continual feedback of labor (and, to a lesser extent, capital and product) markets, which will in turn be impacted by any nanny rules. So if a firm implements an antismoking policy that raises labor costs without offsetting increases in productivity or reductions in healthcare expenses, and thus puts the firm in a worse cost position vis-à-vis competitors, this can be expected to reduce the firm's financial performance and therefore managers' compensation. It is, of course, possible that this negative will be offset by other moves the firm makes, say launching a great new project, but analysts and investors incorporate all firm information into stock prices,¹³⁹ so increased labor costs will make the firm worse off than it would be otherwise, and this will be reflected in the firm's value.

Politicians are, in contrast, paid a flat fee, and their pay is not tied directly in any way to the efficiency of any nanny policy. A similar mistake in the implementation of a government-imposed no-smoking policy may generate political discontent, but unless it reaches some critical mass, it is not priced by the political market. Politicians do see the impact of their votes (in the aggregate) in the fundraising market. Those with views popular with moneyed interests (either individuals or groups) will find they are more likely to hold on to their seats and will have more money to pass out to help others get elected, thus improving their status within the party. This market is unlikely to be highly responsive to the feedback on nanny laws, however, since there are many political sides of nanny issues for politicians that they can use to extract contributions. The existence and intensity of these sides need not be correlated with the social cost of a particular nanny policy. The ACLU and tobacco companies or fast food firms may press strongly for anti-nanny legislation in ways that dominate other interests. In other words,

¹³⁸ Anup Malani points out how political accountability might be the same as corporate accountability, by noting how laws are just local amenities, like nice weather or a vibrant music scene, and have a measurable impact on movements of citizens in and out of a jurisdiction. See generally Anup Malani, *Valuing Laws as Local Amenities*, 121 Harv L Rev 1273 (2008). Accepting this as true, the accountability is still much less for political actors. While a human resources executive sees the impact of a particular employment policy—say, increased premiums for overweight employees or a no-smoking policy—every time they make any employment decision, the politician who passes a law banning smoking is unlikely to be able to tie this directly to net losses in population, and even if this is possible, it is only likely to be significantly attenuated from the decision, and thus a much less powerful signal.

¹³⁹ This, of course, assumes at least the semi-strong version of the efficient capital markets hypothesis. See generally Eugene F. Fama, *Foundations of Finance* 133–67 (Basic Books 1976) (unpacking the efficient capital markets hypothesis).

market prices are continual distributions, while political prices are lumpy ones, which necessarily provide more slack for overreaching.

3. Legal restrictions.

Firms also face much more stringent legal restrictions on their conduct than government entities deploying nanny rules. Unfaithful or inept agents are subject to greater legal risk if they are firm managers than if they are politicians. Firm managers are subject to a panoply of legal regimes designed to insure their fidelity to the owners of the firm (that is, the shareholders). For instance, managers can be sued by the firm or the firm's owners for breach of various fiduciary duties, be subjected to SEC enforcement proceedings, and be indicted for any criminal conduct, such as diverting shareholder monies for personal use. By contrast, the only meaningful constraint on political behavior beyond elections is criminal charges for bribery. The burden of proof is higher in criminal cases, and this, coupled with the fact that there is no private right of action against politicians, means there are relatively few cases brought compared with litigation on corporate attempts to police behavior.¹⁴⁰

Existing state law also will protect against the worst potential abuses of nanny rules by opportunistic agents. Consider, for example, an employee whose pension is about to vest and is fired on the ground that her smoking habit is inconsistent with a newly enacted firm policy against employing smokers. Two well-established bodies of law, one state and one federal, make this kind of opportunism illegal and untenable for firms. The federal pension law, ERISA, for example, explicitly prohibits firms, even in at-will regimes, from engaging in employment decisions that intentionally would deprive individuals of federally guaranteed pensions.¹⁴¹ In addition, state common law, even in at-will regimes, clearly provides for relief in situations in which monies or benefits that are already earned are taken from employees under the guise of employment decisions.¹⁴² There is some state-by-state variation in what counts as "earned," with some states holding that bonuses or contractual promises—for example, an increase in

¹⁴⁰ See Westfall Act, 28 USC § 2679(b)(1) ("The remedy against the United States . . . [provided by the Federal Tort Claims Act] is exclusive of any other civil action or proceeding for money damages by reason of the same subject matter against the employee whose act or omission gave rise to the claim."). See also *Wuterich v Murtha*, 562 F3d 375, 386 (DC Cir 2009) (finding Representative John Murtha immune from charges of libel, invasion of privacy, and defamation because the statements he made to reporters were "directly tied to his congressional political agenda").

¹⁴¹ Employee Retirement Income Security Act of 1974 (ERISA), Pub L No 93-406, 88 Stat 829, codified at 29 USC § 1001 et seq.

¹⁴² See, for example, *Wakefield v Northern Telecom, Inc*, 769 F2d 109, 112–13 (2d Cir 1985) (holding that a firm cannot fire an employee to deny an already-earned commission).

compensation after remaining at a firm for a certain period—are protected from firm opportunism.¹⁴³ So, at a minimum, employees should feel at least as well protected from nanny rules being used as an end-run around their employment rights in their state or federal law regime as they would if there were no nanny rules.

4. Solving the “Bootleggers and Baptists” problem.

Finally, firms will be able to better sort between the types of regulation—paternalism and cost internalization—in ways that will minimize the risk of regulators imposing socially costly preferences on others. As discussed above, most cases where regulation may be justified will be based on mixed motives of these two types or, in other words, cases of impure paternalism. As such, there is a real danger that regulators will use cost-internalization arguments to impose their own idiosyncratic preferences on individuals in ways inconsistent with the socially optimal result. This is analogous to the Bootleggers and Baptists problem, where politicians justify a ban on an activity (like liquor sales on Sundays) that is in the interest of a particular group (like bootleggers) and justified by the arguments of another group (like Baptists), but is divergent from the preferences of the people. The risk here is that regulations will not only impose social costs, but that they will persist because of the capture of politicians by interest groups and that they will corrupt the political process.

Insofar as this concern is significant, corporate nannies are likely to minimize the possibility of abuse. As noted above, corporations are very unlikely to act out of pure paternalism, since the firm would feel only the increased costs of trying to control their employees (that is, employees will demand higher wages when forced to do something against their will). The discipline of labor (and other) markets will constrain the ability of managers to impose their own idiosyncratic preferences on individual employees.¹⁴⁴ As such, if firms act out of pure paternalism (whether or not the arguments are couched in those turns or in cost-internalization ones), they will have to pay more in labor markets, without any offsetting gains. Accordingly, firms that perse-

¹⁴³ Compare *Monge v Beebe Rubber Co*, 114 NH 130, 133 (1974) (“[A] termination by the employer of a contract of employment at will which is motivated by bad faith or malice or based on retaliation is not the best interest of the economic system or the public good and constitutes a breach of the employment contract.”) with *Dandridge v Chromcraft Corp*, 914 F Supp 1396, 1406 (ND Miss 1996) (noting that in Mississippi “at-will employment relationships are not governed by a ‘covenant of good faith and fair dealing’ which gives rise to any quasi-tort cause of action for wrongful termination”).

¹⁴⁴ This argument is akin to one made by Gary Becker, who showed how labor markets can help reduce discrimination based on, among other things, race. See Gary S. Becker, *The Economics of Discrimination* 43–45 (Chicago 2d ed 1971).

vere will focus almost entirely on cases in which individual employees impose costs on the firm's stakeholders.

This conclusion is supported by the history of company towns, which shows that nannyism was closely linked with the cost-bearing function of employer-provided services. It is also supported by the fact that we do not observe firms acting in purely paternalistic ways. Not since the days of Ford's Sociological Department have we seen firms with an explicit program of paternalism, and today's firms are exclusively acting like nannies in cases, like healthcare, productivity, and so on, where the costs to the firm are large and directly linked with employee behavior.

A final point is worth mentioning. It is something of a puzzle as to why we do not see firms acting more aggressively as impure paternalists. There are many ways in which corporations could impose nanny restrictions aimed at reducing behavior that imposes costs on other workers, and yet firms do not do it. For example, parenting imposes huge costs on individual employees, and yet we do not see employees deploying no-children policies or otherwise discouraging employees from reproducing.¹⁴⁵ Raising children may be in society's interest, but it may not be in an individual firm's interest, and this might be the kind of case in which we would expect firms to externalize their costs (for example, their future labor costs) onto the rest of society by hiring only childless employees. But we do not see this. There are several reasons why this is case.

First, the conclusion that childless employees are lower-cost employees may be erroneous. Children may bring stability to a family and make workers happier; children may raise an employee's costs, and therefore require them to work harder; children may make workers care more about society, and therefore make them more trustworthy. There are many potentially offsetting benefits from children, and it is not surprising that firms, who face these tradeoffs every day, may reach different conclusions than outsiders.

Second, this example shows how constrained firms are in acting paternalistically, either out of pure or impure motives. As noted above, firms have only an interest in restricting behavior where there are obvious cost-reduction benefits. The benefits must also be large, since nanny policies send a complicated mix of signals to labor markets that may undermine any of the expected gains. A policy may identify the firm in negative ways to prospective employees, and therefore raise labor costs in ways that neutralize or even exceed the benefits expected from the policy. A no-child policy, for instance, may suggest that the firm is ruthless or stingy or uncaring, and thus raise the costs

¹⁴⁵ Some firms may do this indirectly, say by requiring very long work hours, but these cases are limited, and, in any event, may simply influence the choice of spouse.

of employment for even individuals without children. In addition, a policy like this is a negative option, in that accidents do happen, and risk-averse individuals who do not plan on having children may still put negative value on it. The bottom line is simply that firms are highly constrained in practice on their ability to deploy nanny rules, even where law has nothing to say on the matter.

B. More and Better Tailoring

A second advantage of corporate nannies compared with state ones is that the rules are more likely to be narrowly tailored to impose costs on individuals in amounts equal (or nearly so) to the costs these individuals impose on others (be they shareholders or other citizens). Information about the efficacy and efficiency of nanny rules is relayed to corporate managers much more frequently than through political elections and with much greater power than it is for politicians making similar decisions in light of managers' high-powered incentives. These two arguments can be thought of as the frequency and amplitude of the feedback loop.

Firms use nanny rules to reduce specific costs of the firm, such as healthcare costs, labor costs, or legal risk. When rules are imposed, the impact on costs is felt quickly and is readily observable by the firm's managers. The discipline is not just binary (have or do not have) but continuous, since the feedback loop from markets will give the firm's managers precise information about the impact of the rules. For example, a no-smoking policy will quickly impact a firm's operating costs. The policy will almost certainly lower insurance costs, but it will undoubtedly have other effects as well. It may cause the firm's wages to rise, as the firm may have to pay more to attract workers who will be subject to the policy (and are uniquely valuable to the firm) or who put some value on employers not having these rules. These latter employees may be concerned about their externality-causing behaviors being captured by future rules or believe that the nannyism signals something else unattractive about the firm—say, a low tolerance for shirking. Pointing in the other direction, the firm's productivity may increase as the result of healthier and happier employees, say, by reducing absenteeism caused by smoking-related illnesses.

The cause and effect will be highly salient for a firm's managers, who are compensated based on defined metrics, which are highly sensitive to the outcomes of nanny rules. This is likely true up and down the hierarchy. For example, a human resources manager may be paid a cash bonus based on the cost efficiency of her management of the firm's healthcare budget, and therefore will have the right incentives to force employees to internalize the costs they impose on the firm. And, at the top, the CEO's pay, which is highly correlated with firm

financial performance, will be highly sensitive to the aggregate impact of nanny rules on firm costs and performance.

Politicians may have similar aims (improving health in a jurisdiction), but they face no similar optimization constraint. Politicians are not incentivized to optimize rules, but merely get them right enough to satisfy enough voters to win an election or garner enough political support for horse-trading of various sorts. For the saliency reasons mentioned above, this fact means political nannyism is unlikely to be well calibrated, since there is likely to be nothing but a very crude voter check on the accuracy of nanny rules.

There is an information or data component to this, an error component, and an accountability component, and private parties are likely to outperform their public counterparts in each. In terms of information, the government is not trading off directly against wages and productivity, so it will be more difficult to quantify metrics against which to measure the costs of nanny rules. For example, a no-smoking policy imposed by the government would be designed to improve overall health of the smoking citizenry, perhaps measured by total healthcare expenditures they add, but there is a very complicated tradeoff here in knowing the social externality. Most obviously, healthcare costs of a particular jurisdiction, be it federal, local, or state, will represent only a share of the total costs, and thus jurisdictions will not have perfect incentives to adopt the right level of control. Third-party insurance could solve this problem to some extent, since the insurers would presumably adjust premiums to reflect their best estimates of the costs of various behavioral choices. But this kind of pricing function likely only exists for nongovernment insurers, since these prices are the only ones set by market forces.

Firms are also likely to see the benefits of behaviors in ways that governmental entities will not. There may be, for example, an upside (say, increased cognitive function and thus productivity) from smoking. Firms will see this benefit directly and be able to weigh it against the increased healthcare and other costs that smokers impose on the firm. The state, which also pays for substantial healthcare costs, sees the downside from a ban, but the upside from smoking is nonexistent or much more attenuated. A smoker-friendly jurisdiction might attract workers in industries where this productivity difference is large, and this might increase the size and efficiency of the tax base. But unless these gains are very large or distributed fairly evenly across the jurisdiction (both of which are unlikely), the gains from a smoking ban will swamp any offsetting benefits from a smoker-friendly policy. This is an especially likely outcome because of the nature of electoral politics discussed above. There is no reason to believe that industries in which there would be these types of benefits will be powerful, especially

since there are likely to be businesses pitted against businesses, workers pitted against workers, and so on.

This discussion points to another corporate advantage—sorting by employees will be better than sorting by citizens, thus allowing optimization of rules and a lower cost of deploying nanny rules. Blanket rules, be they by firm or by jurisdiction, will be easier to implement, but have the downside of being under- or overinclusive. Effective sorting, however, can help solve this problem—firms where smokers impose no externalities or where the gains from smoking exceed the costs can hire smokers, while those where they do can refuse. It is much more difficult for cities and states to do this. Smaller jurisdictions will be better along this dimension, all else being equal, but since firms are generally smaller than political subdivisions, this means nanny rules are less likely to be under- or overinclusive. Firms are also more likely to attract individuals with similar preferences on smoking, eating, or other health-related issues. Firm cultures—being healthy, loving the outdoors, and so on—are routinely advertised to the labor market; it is much more difficult for cities, which are larger and more diverse, to do this.

Not only will firms have better and more continuously updated information in the form of feedback from markets, they also will have an advantage in their ability to correct the inevitable errors that will be part of optimizing programs designed to reduce or eliminate externalities. As noted above, the calculations about what causes externalities, how big they are, and what is the best way to reduce them (given the heterogeneity of individual utility functions and the inevitable unintended consequences of these kinds of judgments) are likely to be impossible to make in the abstract. Trial and error is the only possible method of achieving the optimal rules, especially when conditions will be highly localized.¹⁴⁶ Along this dimension, firms are bound to be far superior because, among other things, of the dispersal of decisionmaking authority—individual managers are making finely tuned labor market decisions constantly and get immediate feedback from the market—and the greater number of individuals and firms creating and testing rules.

One example of this is the possibility that policies discouraging bad behavior may backfire by encouraging individuals to engage in the conduct being discouraged. There are stories suggesting that this is the case for government policies banning smoking or drinking alco-

¹⁴⁶ The limits of human knowledge in the face of complex problems and the ability for markets of dispersed agents to achieve efficient results through trial and error is the central insight of the work of, among others, F.A. Hayek. See F.A. Hayek, *The Fatal Conceit: The Errors of Socialism* 76 (Chicago 1991) (W.W. Bartley, III, ed) (“The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design.”).

hol.¹⁴⁷ Firm nanny rules may not suffer from this problem, since they will not be legal bans but merely corporate policies, which may not generate the same rebellious reaction. In addition, if the reaction does obtain in the corporate context, firms will be able to adapt more quickly by altering or eliminating the nanny rule.

Not only will feedback be better, but the ability to respond to market signals will be easier and faster. Firm decisions are made by fiat: what the CEO says goes. This means nanny rules can be deployed, changed, and abandoned with much greater frequency and ease. The more general point here is that the lower the transaction costs in using and adjusting nanny rules, the more responsive they are likely to be to efficiency concerns. Dictators would have this advantage in the political realm, as would smaller governments and jurisdictions, where decisionmaking is quicker and less costly. There will, of course, be some slack in the feedback loop because the cost of monitoring firms is not zero. The relevant question is not whether firms are perfect along this dimension, but instead whether they are better compared with the alternatives. (The potential that slack may be greater in the aggregate for corporate nannies than government ones is discussed below.)

C. Broader Scope

A third advantage of corporate nannies is the ability to more easily implement nanny rules that cover behavior at all times, making them more likely to cause internalization of all costs by individuals. A state or local government could ban smoking in public places or even in one's home, but this would not prevent smoking in non-covered locations and, given limited and imperfect enforcement mechanisms, would not fully impose externalities on smokers. State-imposed nanny laws are, for this reason, likely to be broad but shallow—they can cover every individual with one law, but this law will be temporally and spatially limited. By contrast, a firm can adopt a policy that would capture smoking done at any time and place by requiring individuals to be nonsmokers as a condition of employment or imposing on smokers an increased health insurance premium or other cost. The rule would be narrow but deep, in that it would be only one employer but would cover all incidences of smoking. Whether a series of narrow and deep corporate rules improves social welfare more than a broad but shal-

¹⁴⁷ See Harry G. Levine and Craig Reinerman, *Alcohol Prohibition and Drug Prohibition: Lessons from Alcohol Policy for Drug Policy*, in Jefferson M. Fish, ed, *Drugs and Society: U.S. Public Policy* 43, 48–49 (Rowman & Littlefield 2005) (noting that while the volume of alcohol consumption fell as bulky beer became too hard to transport, the consumption of spirits increased and perceptions of drunkenness increased concomitantly).

low law is an empirical question. But corporate rules are likely to be more effective if widely adopted. There may be, however, barriers to widespread adoption (discussed below) or duplicative costs from this method of deployment. This discussion merely highlights this advantage of corporate nannyism, all else being equal.

1. Broad government policies.

The government can, of course, write laws that are broad and deep. It is not obvious, however, that this is superior to a narrow and deep strategy deployed by many firms. There are two general ways in which the government can write broad and deep laws. First, the government could ban the behavior and enforce the ban with civil or criminal penalties. Returning to the example of smoking, the state could simply outlaw the manufacture, sale, and use of tobacco products. This approach, however, does not preserve choice and, in a world with heterogeneous preferences among individuals and imperfect information, is likely to be suboptimal for that reason, except in cases where the costs are clearly dwarfed by any potential benefits and there are or are likely to be close substitutes for the behavior. (A ban on the sale of trans fats might be a good example of a compelling case that meets this criteria.) Mistakes, which may be inevitable given the complexity of these issues, will be much more costly in the case of bans, if for no other reason than the fact that socially beneficial choices will be unavailable for some period of time. In addition, bans may give rise to more negative unintended consequences. The experience with the ban on alcohol during Prohibition provides a ready example of how social policy of this sort is plagued by the potential for unintended consequences to overwhelm any benefits of the ban, and how individuals' longstanding preferences are not easily manipulated by governments.

The other manner in which the government can be both broad and deep is through the use of penalties, better known as Pigouvian taxes.¹⁴⁸ A tax on a pack of cigarettes penalizes smoking no matter where or when the smoker chooses to smoke. At first taxes seem like an elegant solution, since in addition to spatial and temporal benefits, they can be adjusted, can be used in experiments to estimate optimal levels, and can be tailored to optimal levels based on different levels of enforcement by the government. There are numerous problems

¹⁴⁸ A Pigouvian tax, named after economist Arthur Pigou, are those levied to remedy activities that cause negative externalities. See William J. Baumol, *On Taxation and the Control of Externalities*, 62 *Am Econ Rev* 307, 307–08 (1972) (arguing that for externalities of the public goods variety, like pollution, Pigouvian taxes are sufficient to achieve an efficient allocation of resources).

with the use of taxes in both theory and practice, however, that dramatically limit their effectiveness and efficiency in this context.

2. Shortcomings of government taxes.

a) *Setting the tax.* First, for taxes to work well at causing individuals to internalize their externalities, they must be set at the right level—that is, at approximately the level of the total social cost imposed by each individual. There are, however, no easy answers to the questions of which actions impose externalities, what the size of these externalities are, or what the impact of internalization will be on unobservable elements of individual utility functions. In other words, decision costs and error costs are likely high when third parties make assessments about externalities, especially when, as noted above, the feedback from externality estimates to actual costs and benefits is noisy or impossible to quantify.

A simple example of this can be seen in the current debate about the best solutions to the issue of global warming. The conventional wisdom among economists is that carbon emissions impose an externality on others, by contributing to an increase in global temperatures, which it is believed will cause a litany of harms to befall humanity. There is, however, much dispute about the existence of these externalities and even more dispute about their size. So while economists generally support a Pigouvian tax on carbon emission to force internalization of harms caused, there is a huge range in expert estimations of the size of the externality (and thus the needed size of the tax). Consider two estimates from leading researchers in this area: William Nordhaus argues that a tax of about \$30 per ton of carbon (rising to about \$85 in 2050) is about right, while Nicholas Stern concludes that a tax of about \$300 per ton is necessary to optimize private carbon emissions.¹⁴⁹ The merits of this debate are beyond the scope of this Article; the point here is simply that these calculations are messy and highly uncertain, even when millions of dollars and bright minds are at work in estimating the answers.¹⁵⁰

¹⁴⁹ Compare William Nordhaus, *Critical Assumptions in the Stern Review on Climate Change*, 317 *Science* 201, 201 (2007) (analyzing a number of current assumptions and calculations regarding the economics of climate change) with Nicholas Stern, *The Economics of Climate Change: The Stern Review* (Cambridge 2006).

¹⁵⁰ Another example of this forecasting problem can be seen in Europe's carbon emissions market. The cap-and-trade system was highly sensitive to the number of initial permits, and the process for determining this number was based on political compromise. The number of permits was set too high, which drove the price to near zero and caused the market, designed to force firms to internalize their costs, to nearly collapse. See James Kanter, *Carbon Prices Tumble as Global Downturn Bites*, *NY Times* (Jan 21, 2009), online at <http://greeninc.blogs.nytimes.com/2009/01/21/carbon-prices-tumble-as-global-downturn-bites> (visited Oct 3, 2009) (noting that when

While the scale of most nanny regulations will be smaller and the calculations less complex, the problems inherent in estimating the actual social or firm-specific costs from, say, smoking remain daunting. As noted above, actuarial tables will reflect some of these, and insurance companies are as well placed as anyone to make estimates, but the complicated nature of healthcare payments in this country, coupled with the other benefits and costs of banning smoking or eating trans fats, make any attempt to exactly quantify the costs of behaviors very difficult. This perhaps explains the variation in policies of various political entities—some, but not all, localities ban “unhealthy” choices, and those that do ban choose a wide range of methods.

Firms, of course, will face these same problems in designing their own internal nanny regulations. The difference in expected efficiency is derived from getting the right answers, not through deliberation and study, but rather through market-based and market-disciplined experimentation. It is only through repeated experimentation and tinkering that the optimal Pigouvian taxes can be discovered. This is especially true since the calculation involves not only macro issues, like healthcare costs, but also localized data and information, like employee happiness and productivity. Pigouvian taxes implemented by governments could be equally efficient if set and updated as often as corporate policies, if based on feedback from market experiences, and if magnified by the high-powered incentives that drive firm manager conduct. None of these factors, however, obtains in the current process of setting sin taxes, either at the legislative or executive level.

b) What to tax. Second, the questions about what to tax are significant. Say a government wanted to reduce obesity through taxation. The most common suggestion is to tax food; the Twinkie tax discussed above is a classic example. The government could tax foods with lots of sugar or carbohydrates or fats, but these components are only loosely correlated with obesity. Putting aside issues of regressivity and political feasibility (considered immediately below), it is not clear that even an omniscient government could determine how much to tax a Twinkie in order to optimize social consumption of them. Food is just one of many inputs that determine weight (another important one is exercise), and taxing it alone without consideration of the others is likely to impose large social costs without clear benefits. Taxing inputs instead of outcomes is likely to be both under- and overinclusive and,

the permit system began, the market was not aware of the permit surplus, but that when traders recognized the excess supply they bid the price of permits down to nearly zero); Carter F. Bales and Richard D. Duke, *Containing Climate Change: An Opportunity for U.S. Leadership*, Foreign Aff 78, 80 (Sept/Oct 2008) (describing the cause of the improper permit allocation as a combination of bad data and efforts by EU member states to shield their local industries from real cuts).

given the other incentives for government tax authorities, doubtfully will be correlated with externalities.

Taxing food will also be hopelessly complicated. Food is composed of numerous ingredients and is not inherently good or bad. A candy bar eaten by an obese child every day is likely to have one effect, while one eaten by a marathon runner another, and the tax will thus not likely capture the externalities (positive and negative) in each case. In addition, the administrative burden in trying to ascertain the costs and benefits of each food or each ingredient is likely to be daunting, if not impossible. Food taxes, like other taxes, are likely to generate substantial political opposition from powerful interests on the supply and demand side, especially because any taxes are likely to be highly regressive.¹⁵¹ Moreover, the inevitable compromises inherent in the tax-setting process are likely to distort the cost-allocation process from the optimal one, assuming we could know what that is.

Taxing food may also lead to perverse consequences. Recent research suggests that the best way to reduce obesity is to *lower* food prices, not raise them. Professors Charles Courtemanche and Art Carden find that the presence of so-called big box retailers (that is, Walmart, Sam's Club, Costco, and so on) lowers overall food prices, which in turn increases the consumption of fruits and vegetables, leading to "reductions in body mass index (BMI)."¹⁵² This study simply highlights the difficulty in taxing inputs instead of focusing on outputs. Another series of studies supports this argument by comparing the types of foods that are healthy and unhealthy. The studies find that energy-dense food is less healthy but also less expensive, while less energy-dense foods are more healthy and more expensive.¹⁵³ From this, the authors argue that imposing higher taxes on food, without regard to this tradeoff, would have negative distributional consequences.

The obvious solution to these problems is to tax weight, since that is what allegedly imposes social costs. But this may be politically very

¹⁵¹ An example is the recent failure of Governor David Paterson's proposed 18 percent tax on non-diet sodas in New York State, which was withdrawn after widespread disapproval. See *Paterson Admits Obesity Tax Plan Has Failed*, wcbstv.com (Feb 13, 2009), online at <http://wcbstv.com/politics/obesity.tax.soda.2.934147.html> (visited Oct 3, 2009) (reporting that the New York City Health Commissioner supported the proposal, but that it was dropped because it would never have passed the state legislature).

¹⁵² See Charles Courtemanche and Art Carden, *The Skinny on Big Box Retailing: Wal-Mart, Warehouse Clubs, and Obesity* *1 (working paper, Aug 15, 2009), online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1263316 (visited Oct 4, 2009) (documenting the effects of big box companies on alcohol consumption, smoking, exercise, eating out, and food consumption).

¹⁵³ Adam Drewnowski and Nicole Darmon, *Food Choices and Diet Costs: An Economic Analysis*, 135 J Nutr 900, 900 (2005) (explaining how obesity is linked to socioeconomic factors); Adam Drewnowski, *Obesity and the Food Environment: Dietary Energy Density and Diet Costs*, 27 Am J Prev Med 154, 154 (2004).

difficult to do. Political consensus would have to be garnered, and it would have to overcome inevitable interest groups for obese individuals, scientific claims about genetic predisposition, and socioeconomic claims about access to and affordability of high-quality and healthy foods. The need to achieve political consensus and resistance to taxes generally are two more reasons government programs are likely inferior to corporate programs. There has been some movement toward directly taxing obesity in other countries—the United Kingdom is considering a tax on healthcare rates tied to body mass index—but it is not a serious part of the current debate on healthcare costs here in the US.¹⁵⁴

Enforceability of a weight tax would also be difficult. One can imagine all sorts of possible ways of government monitoring of individual weight, but the real and political costs are likely to be very high. For example, the government could set up weigh stations, say at federal, state, or local agencies or doctors' offices, and mandate every individual in a family weigh in before paying their taxes. The silliness of this idea is reinforced by the fact that almost 40 percent of the population (who are statistically likely to be more obese and to be on the government's healthcare dime) pay no taxes.¹⁵⁵ It also ignores the problem inherent in single-time weigh-ins: individuals would have incentives to binge diet before weigh-ins, as every pound means dollars. This kind of behavior is unlikely to be healthy, but would be very likely in this regime. Moreover, testing like this would inevitably raise Fourth Amendment challenges, since these tests would arguably be "searches," thereby raising the cost of developing these programs.

Firms, by contrast, can easily deploy low-cost and regularized mechanisms for measuring weight (or, more likely, body mass index), since employees generally report to an office or place of work each day. In fact, some firms are already doing this.¹⁵⁶ Stepping on to a scale periodically at work may seem intrusive to some, but it is far less costly than the government model described above. The same result obtains for smoking, drug use, or other dangerous activities.

c) *Whom to tax.* Third, broad, state-imposed taxes are regressive, and thus likely to impact poor individuals more harshly than wealthier ones. For example, assume the government determines that the social

¹⁵⁴ *Government Unit 'Urges Fat Tax,'* BBC News Online (cited in note 29).

¹⁵⁵ See Tax Policy Center, *Distribution of Tax Units with Zero or Negative Individual Income Tax Liability by Cash Income Level*, Brookings Institution table T08-0208 (Aug 15, 2008), online at <http://www.taxpolicycenter.org/numbers/Content/PDF/T08-0208.pdf> (visited Oct 4, 2009) (showing that 37.8 percent of Americans have no federal income tax liability).

¹⁵⁶ See Cindy Krischer Goodman, *More Employers Looking at Their Roles in Obesity*, Miami Herald Online (Sept 22, 2009), online at <http://www.miamiherald.com/news/southflorida/story/1247040.html> (visited Oct 4, 2009) (noting that "about 40 percent of U.S. companies have implemented obesity-reduction programs").

cost of the average individual consuming a Twinkie or a pack of cigarettes is \$2. Wealthy individuals may not alter their behavior because of the small amount of the tax (leading to under-internalization), while poorer individuals will be disproportionately effected. While it is difficult to say that there can be over-internalization, since presumably no smoking or consumption of Twinkies might be a good thing, the economic impact for poorer individuals may be of concern, and therefore help mobilize opposition to this type of tax regime.

Company-imposed “taxes” on unhealthy or otherwise costly activities might be regressive too, since flat fees for certain activities would have the same impact that state-imposed taxes would. But, unlike political taxes, firm penalties may be easily tailored to the individuals’ wealth in ways that would optimize the externality tax. For example, firms could impose Pigouvian taxes on weight or smoking or other unhealthy activity by increasing insurance premia for employees proportional to wage levels. This would be impossible to do with a Twinkie tax or cigarette tax, since sales of all such products would have to be taxed differently depending on the buyer’s income. The government could optimize in the same way firms could by using the tax code instead of sales taxes, but this would involve general taxes unrelated to specific activities, would involve steep administrative costs, and, in any event, would not cover many individuals who pay no income taxes. Firms not only can impose Pigouvian taxes but they have incentives to do so, since they are not fundraising with nanny taxes but are trying to assign costs where they arise. If firms over- or underassign these costs, the impact will be felt in the firm’s labor or other costs.

d) How taxes are spent. Fourth and finally, the money from political taxes can be (and is likely to be) diverted from paying for the costs imposed by a given activity to pay for some other government program, and, as a result, the amount of regulation will not be proportional to the harm caused by the activity, but rather to the political power of the relevant interest groups. For example, the billions of dollars in settlements states received from cigarette companies were intended to help offset increased state medical costs for smokers, but most of these monies were diverted to other purposes.¹⁵⁷ It might be argued that this diversion merely frees up additional monies that would have been spent on the other purposes to be spent on health.

¹⁵⁷ According to a March 2005 GAO report, in 2004 about 50 percent of these funds were used to balance state books or for general purposes, while about 20 percent were used for “health.” See GAO, *Tobacco Settlement: States’ Allocations of Fiscal Year 2004 and Expected Fiscal Year 2005 Payments* GAO-05-312, 10 (2005), online at <http://www.gao.gov/new.items/d05312.pdf> (visited Oct 5, 2009) (systematically determining how states used the funds received from tobacco litigation).

There is no evidence to support this claim of fungibility, but it is possible. That said, the argument misses the point. By delinking the raising of monies from the cost those monies are supposed to offset, the probability that the externality tax will be set at the socially optimal level is reduced. This is because the tax rate (or cost imposed) is unlikely to be set correctly at first, and without a linkage between money in and costs reduced, the feedback effect that would help establish the optimal tax rate is lost.¹⁵⁸ This feedback is powerful for firms, since nanny taxes are useful only insofar as they directly offset behavior-specific costs. If firms charge too much for smoking, labor costs will rise and the firm will be disadvantaged vis-à-vis other firms. There is also no evidence or reason to believe managers are using nanny taxes as a way of aggrandizing power or lining their own pockets. If managers wanted to do this, there are much easier and better ways.¹⁵⁹

The argument for the greater accountability of corporate nannies here is premised on the assumption that what the nanny does with the money ex post influences the setting of the nanny level ex ante.¹⁶⁰ If the costs are not fed back to the rule-setting mechanism, there is less constraint on agents from taking monies saved by the nannyism for personal (as opposed to their principals') use. This is a familiar agency-cost problem, and the argument here is that agency costs are lower in the corporate context than the state context, especially when it comes to the deployment of revenues raised or saved.

Some related problems are that the state may sue to recoup costs that are ultimately paid by the federal government, and therefore delink the imposition of costs and benefits. This may also happen within different branches of government within a particular jurisdiction. A good example of this problem is seen in the experience of the State of West Virginia, which litigated against the manufacturer of OxyContin

¹⁵⁸ It does not really matter what the rule setter does with the money it collects or saves, as long as the amount of the externality is set appropriately. So, if a nanny had a computer that revealed perfectly the societal cost of smoking, the nanny could set the Pigouvian tax or adjust a ban in ways so as to impose exactly that cost on individual smokers. If this is set correctly, the state could burn the money or give it away to the poor in Ethiopia, and still achieve the optimal level of internalization.

¹⁵⁹ Most of the corporate law literature is devoted to addressing the problems of managerial graft and shirking that arise from the agency costs of the modern corporate form. See generally, for example, Lucian Bebchuk and Jesse Fried, *Pay without Performance: The Unfulfilled Promise of Executive Compensation* (Harvard 2004). Others criticize the conclusions of this research, see, for example, M. Todd Henderson, *Paying CEOs in Bankruptcy: Executive Compensation When Agency Costs Are Low*, 101 Nw U L Rev 1543, 1544 (2007). To be sure, if CEOs want to profit at the expense of shareholders, paying themselves excessively or consuming excessive perks would be a far more profitable mechanism than using nanny rules.

¹⁶⁰ This problem is especially acute in cases in which the government uses litigation to recoup payments made from the parties allegedly responsible for causing the harm in the first place.

to recoup the costs imposed by abuse of the drug. The attorney general of West Virginia appointed four law firms to sue the manufacturers, ultimately collecting settlements totaling \$10 million. The suit was brought on behalf of West Virginia's Medicaid program, but the attorney general's office kept the \$6.7 million that was not paid to the law firms in the case.¹⁶¹ According to press accounts, "The federal government, which pays a significant portion of the state's Medicaid bills, remains furious the program received none of the settlement."¹⁶²

Firms have not sued for recoupment, and therefore are not susceptible to the shortcomings of litigation incentives. Instead, firms focus almost entirely on ex ante nanny regulations. And, whether firms engaged in this kind of activity or in traditional Pigouvian taxes, there is no chance of diversion, since cost savings run directly to the firm's bottom line.¹⁶³ In addition, any monies likely to be raised and saved by firms are trivial in comparison to firm value. Accordingly, the possibility of biasing firm-value decisions, say by sabotaging labor markets to increase firm revenues, is difficult to imagine, since CEOs have high-powered incentives to maximize firm value. By contrast, political officials do not have the same high-powered incentives, and therefore the potential for manipulation and self-serving conduct is much higher. For example, in the case from West Virginia above, the attorney general is accused of routing the state's prosecution of the case, and \$3.3 million in fees, to law firms that helped fund his campaign.¹⁶⁴ In addition, the amounts at stake (from either settlements or sin taxes) are large compared with state budgets.¹⁶⁵

A related problem is that state-imposed taxes are likely to be much stickier than corporation-imposed taxes. While a firm can adjust a nanny "tax" on smokers or skydivers or the obese on a daily basis depending on feedback from the labor market, idiosyncrasies of individual cases, and new evidence about the existence and magnitude of external-

¹⁶¹ Kimberley A. Strassel, *Challenging Spitzerism at the Polls*, Wall St J A11 (Aug 1, 2008).

¹⁶² See *id.*

¹⁶³ If a weakness in this argument is executive pay, then that is a problem with executive pay that should be resolved on those terms.

¹⁶⁴ See Strassel, *Challenging Spitzerism at the Polls* (cited in note 164).

¹⁶⁵ For instance, state taxes on just tobacco were about \$19 billion in 2008, see Reuters, *FDA Tobacco Bill Could Cost U.S. States*, reuters.com (Apr 14, 2009), online at <http://www.reuters.com/article/domesticNews/idUSTRE53D67S20090414> (visited Oct 3, 2009), while "[t]he estimated direct and indirect costs associated with smoking exceed \$75 billion annually," *Chronic Disease Burden and Expenditures in the United States: A Report from State and Territorial Health Agencies* 4 (Chronic Disease Directors Nov 2004), online at <http://www.chronicdisease.org/files/public/StateExpendituresReportDraft112904.pdf> (visited Oct 5, 2009). For information about state budgets, see Elizabeth McNichol and Iris J. Lav, *New Fiscal Year Brings No Relief from Unprecedented State Budget Problems*, Center on Budget and Policy Priorities 5 table 1 (Sept 3, 2009), online at <http://www.cbpp.org/files/9-8-08sfp.pdf> (visited Oct 5, 2009).

ities, political entities cannot be so nimble. Removing taxes requires political consensus, which is often difficult to build on tax issues, especially when the effect will be depriving the jurisdiction of revenues.

An example of the potential for diversion, resulting mismatch, and stickiness of taxes is the current regime in Pennsylvania for taxing alcohol. In 1936, after a major flood killed twenty-four people and caused millions in property damage in Johnstown,¹⁶⁶ the legislature instituted a *temporary* tax of 10 percent on all alcohol sales to raise the \$41 million needed to rebuild the city.¹⁶⁷ The goal was achieved five years later, but the tax did not die. In fact, it survives today, nearly seven decades after its purpose was achieved. And it was raised over the years, standing at 18 percent today.¹⁶⁸ The tax, which raises over \$200 million per year, is not used to offset the externalities from alcohol consumption—for example, paying for abuse treatment centers, victims of alcohol-related crimes, and so on—but rather goes into the general public fisc for legislators to hand out as they see fit.¹⁶⁹ The de-linkage from costs, the tendency to use so-called sin taxes for other purposes, and the stickiness of this tax all undermine the claim of Pigouvian tax efficiency in the case of nanny laws.

Taxes may be either too low or too high—the point is they are not implemented based on actual costs, and therefore are likely to be socially inefficient. Moreover, it is unlikely that the taxes would be too low. To be sure, Americans generally abhor taxes,¹⁷⁰ but sin taxes are a

¹⁶⁶ This is not *the* Johnstown Flood; that was in 1889. See Associated Press, *Johnstown Marks Flood Centennial*, NY Times A18 (June 1, 1989) (noting that “[t]he 1889 flood was created when, after days of rain, the earthen South Fork Dam collapsed and unleashed 20 million tons of water from a reservoir that was a summer resort for millionaire industrialists”).

¹⁶⁷ See *Drinkers Still Pay Flood Relief Tax Enacted in 1936*, WGAL.com (July 12, 2005), online at <http://www.wgal.com/news/4711497/detail.html>? (visited Oct 5, 2009) (showing how the tax still exists and is generating hundreds of millions of dollars per year that are going into the general treasury).

¹⁶⁸ See *id.*

¹⁶⁹ See *id.*

¹⁷⁰ Compare Rick Klein and Kate Barrett, *Anti-tax ‘Tea Parties’ Protest President Obama’s Tax and Spending Policies*, ABC News (Apr 15, 2009), online at <http://abcnews.go.com/Politics/Story?id=7337117&page=1> (visited Oct 5, 2009) (describing the spontaneous organization of over 750 “tea parties” to protest profligate government spending and inevitable tax *increases*) with Gary Langer, *Of Taxes and Tea*, ABC News: The Numbers (Apr 15, 2009), online at <http://blogs.abcnews.com/thenumbers/2009/04/of-taxes-and-te.html> (visited Oct 5, 2009) (questioning the suggestion that “tea parties” evidence some widespread discontent with tax levels, in light of polling data that suggests 61 percent of Americans think their *current* tax rate is “fair”). See also Robert Schlesinger, *Sorry, Tea Party Movement, Polls Say Americans Don’t Mind Taxes*, US News & World Rep (Apr 15, 2009), online at <http://www.usnews.com/blogs/robert-schlesinger/2009/4/15/sorry-tea-party-movement-polls-say-americans-dont-mind-taxes.html> (visited Oct 5, 2009) (noting that the recent Gallup poll data is “only the second time in more than half a century [that] a plurality of Americans (48–46 percent) think that they’re paying the proper amount of taxes”).

notable exception to this rule,¹⁷¹ and once sin taxes become sources of general revenue, the only constraint on them is high-cost political action. As for other potential nanny taxes (non-sin, non-minority) these are likely to face significant political opposition since people generally dislike paying taxes. For example, taxes on weight would impact a large percentage of the population,¹⁷² and would therefore likely be opposed by strong political forces.¹⁷³ This obstacle will be much lower for employer-imposed fees or taxes designed to achieve the same goals. In fact, as discussed above, employer programs can be disguised in ways that make them more palatable (that is, carrots instead of sticks) than any potential government program.

D. Greater Experimentation

Increased experimentation in the design and implementation of nanny rules is another advantage corporate nannies may have over state ones. Given the uncertainty about the existence and size of externalities, as well as the uncertainty about the optimal way of forcing their internalization, a policy that encourages experimentation with different types and degrees of nannyism is preferable to a one-size-fits-all approach.¹⁷⁴ Corporate nannyism is bound to result in more experimentation on the margin than political nannyism for several reasons. Most obviously, there are many more firms than political subdivisions, and

¹⁷¹ See Robert A. Sirico, *Sin Taxes: Inferior Revenue Sources*, Budget & Tax News (The Heartland Institute July 2004), online at http://www.heartland.org/policybot/results/15293/Sin_Taxes_Inferior_Revenue_Sources.html (visited Oct 5, 2009) (stating that sin taxes appeal “to voters who view [them] as a way of discouraging consumption of certain objectionable products”). For specific examples, see *Americans Overwhelmingly Support Increase in State Alcohol Taxes*, AlcoholPolicyMD.com (May 2004), online at http://www.alcoholpolicymd.com/press_room/polls/alcohol_tax_poll.htm (Oct 5, 2009) (reporting survey data that shows support for alcohol taxes to fund programs aimed at preventing underage drinking); Gary King, et al., *African Americans' Attitudes toward Cigarette Excise Taxes*, 93 Am J Pub Health 828, 831 (2003).

¹⁷² See National Center for Health Statistics, *Obesity and Overweight* (CDC Apr 2, 2009), online at <http://www.cdc.gov/nchs/fastats/overwt.htm> (visited Oct 5, 2009) (reporting that 67 percent of noninstitutionalized, adult Americans over 20 years of age are “overweight or obese”).

¹⁷³ Although there is some evidence that obesity is higher among arguably politically weaker individuals, see Jennifer L. Black and James Macinko, *Neighborhoods and Obesity*, 66 Nutr Rev 2, 14 (2008) (concluding from a literature search that neighborhoods with lower economic status have higher rates of obesity), there are two problems with this potential rebuttal. First, the correlation between lower income and lower political power is questionable in light of policies and technologies that increase the influence of groups, including minorities and other concentrated interests. Second, although rates are higher among the poor, the obesity problem is far more widespread than that: almost 70 percent of Americans are overweight or obese according to the Centers for Disease Control. See National Center for Health Statistics, *Obesity and Overweight* (cited in note 172).

¹⁷⁴ See Hayek, *The Fatal Conceit* at 151 (cited in note 146) (discussing how “time’s arrow” preferably selects certain “patterns of activities”).

therefore, assuming a constant level of innovation and use among all third parties, we would simply expect this to result in more nanny rules.

There is also reason to believe that rates of innovation and use will be much higher among corporations. As discussed below, there are some limits placed on the reach of nanny rules imposed by federal and state laws, including constitutional provisions. These laws will fall more heavily on state nannies, because of the state-actor limit on the reach of constitutional prohibitions. For example, constitutions in New Jersey, New York, California, and elsewhere define certain health conditions, like obesity and high blood pressure, as protected. This limits the ability of states somewhat, either in lawmaking or in employment considerations, to engage in externality discrimination. Private employers are not as obviously affected by this limitation since no state action is generally involved in private business decisions. (Some state statutes and constitutional provisions apply specifically to private employers.¹⁷⁵)

Innovation is likely to be much higher in private firms for another reason—the lack of a need for broad political consensus to enact nanny regulations. Political entities in this country are democracies, while firms are dictatorships. While a majority of legislators (and thus the population) in a particular jurisdiction must support a new nanny rule, firms can implement new rules without debate, explicit approval from those affected, or a vote of owners. Building a political consensus on, say, banning smoking in a jurisdiction, is costly, in that legislators must first educate themselves on the issues, then convince their constituents and each other about the merits of the ban, and finally manage the interest group struggle that such a ban will surely engender. The time, money, and political capital necessary to achieve consensus on nanny issues will undoubtedly be significant, especially compared with how a firm would approach the same rule. Shareholders vote (by selling shares) not on corporate policies but corporate outcomes. This means that there is no input on employment policies by either workers or owners, but merely a check on them based on market reactions (of either labor costs or share price). Since the accountability check is *ex post* rather than *ex ante*, there will be, all else being equal, more experimentation.

The point made above about the cost of nanny rules hitting a firm's bottom line quickly and clearly also points in the direction of more experimentation. When decisionmakers have feedback about what works and what does not work, they are more likely to engage in numerous small experiments, since the impact can be measured and

¹⁷⁵ See, for example, Cal Civ Code § 3428 (West) (requiring private providers of health care services or those who reimburse health care costs to “have a duty of ordinary care to arrange for the provision of medically necessary health care service to its subscribers and enrollees”).

good policies adopted and expanded, while bad policies are abandoned. Experimentation is also encouraged by the fact that managers' compensation is highly correlated with outcomes and managers are insulated from removal for mistakes, unless the decisions were not made in good faith or result in large drops in firm performance. To be sure, politicians can take polls, both *ex ante* and *ex post*, on the desirability of nanny rules. However, politicians may not want to wait for *ex post* polls, since the damage to reputation may already have been done, and *ex ante* polls may not be as informative about true preferences. In addition, it is not clear that polling is an effective way of measuring the efficiency of rules intended to internalize costs. It may be that a majority of individuals in a jurisdiction favor a smoking ban simply because they do not like the smell of smoke, but the ban might impose large dead-weight losses on society. In the corporate context, where labor costs would be immediately impacted by a similar ban, the identification of costs and benefits of the policy would be more obvious.

A final point about experimentation is worth mentioning—firms are likely to adopt “good” nanny rules deployed by other firms. Corporate policies will be publicly disclosed, and this will allow other firms to adopt policies that work. And, since competitors will want to match cost-saving policies and firms in other industries will want to lower costs as well, efficient nanny rules will be copied quickly and ubiquitously. There will no doubt be copying by political jurisdictions too, and we have seen some of this as smoking bans and other nanny laws have proliferated over the past few years. Given the point above about political consensus, it would not be unreasonable to suggest that corporate nanny rules will be more viral than state ones. But, at a minimum, there is no reason to believe corporate cascades will be less likely than political ones.

E. Better Monitoring

In terms of practically designing and enforcing nanny rules, firms may have a significant advantage over the state when it comes to monitoring individuals, since most employees are physically at their place of employment for many hours per day. Imagine a state and a firm that both want to charge individuals differential healthcare premiums based on their body mass index. (The United Kingdom, which pays health costs for all citizens out of tax revenues, has considered this, as have several private American corporations.¹⁷⁶) While the firm can require employees to literally step on the scale at set or random inter-

¹⁷⁶ See Associated Press, *Company to Charge 'Unhealthy' Workers More for Insurance* (cited in note 101).

vals when they come to work, the state would have to mandate doctor visits at the same intervals or send health inspectors to individuals' homes to enforce the policy. This would add enormous costs to the healthcare system, which may even swamp the benefits of the internalization effort in the first place. Although the idea of health inspectors visiting homes sounds Orwellian, some governments are doing exactly this. Taiwan deploys inspectors to check up on individuals who meet certain criteria established by the national health authorities.¹⁷⁷

To be sure, the monitoring advantage will depend on the type of nanny regulation. The state may have monitoring advantages for certain types of regulations for three reasons. First, the state has already deployed numerous government officials, like police officers, who may be better positioned to monitor certain activities. A ban on cell phone use while driving is a good example of when this is probably true. The police or, more and more, traffic cameras are a more effective and efficient way to enforce this rule than if individual firms deploy a redundant force to monitor employees while driving to and from work and on off days. Some firms have a no-cell-phone-while-driving policy, but these likely piggyback on state or local ordinances, in that individuals getting tickets for this may face job consequences. There are some cases in which firms have actually fired individuals for violating this policy, without any state involvement.¹⁷⁸ But these are likely to be rare and serve more as a statement of principle or a very weak deterrent.

When evaluating nanny rules along the dimension of deterrence, it is important to keep in mind that the state has an advantage in the type and severity of penalties it can impose. And since deterrence is simply the product of the probability of detection and the expected penalty, the state can, all else being equal, achieve greater deterrence. The state can imprison violators of nanny rules, while firms can impose only quasi-fines or loss of employment. This means that the state can get

¹⁷⁷ See, for example, *Interview: Uwe Reinhardt & Tsung-mei Cheng*, Frontline (PBS Apr 15, 2008), online at <http://www.pbs.org/wgbh/pages/frontline/sickaroundtheworld/interviews/reinhardt.html> (visited Oct 6, 2009) (comment of Tsung-mei Cheng) (“So currently the rules are, say, if a patient goes to see a doctor [a certain amount], . . . the person then gets a visit from the government, the Bureau of National Health Insurance, and they have a little chat.”).

¹⁷⁸ For example, BP has such a cell phone policy. See BP, *Understanding the Driving Standard by Element*, online at http://www.bp.com/liveassets/bp_internet/china/bpchina_english/STAGING/local_assets/downloads_pdfs/uv/Understanding_the_Driving_Standard_by_Element.pdf (visited Nov 22, 2009). This might sound extreme, but consider the potential liability that firms face from this behavior. In a recent case, International Paper paid over \$5 million to settle a claim alleging that its employee, using a cellphone while driving, caused an accident in which a woman lost an arm. See Janet L. Conley, *Cell Phone Use in Car Leads to \$5.2 Million Payout by Employer*, Law.com (Feb 13, 2008), online at <http://www.law.com/jsp/article.jsp?id=1202815251120> (visited Oct 6, 2009).

more deterrence with less enforcement costs.¹⁷⁹ Whether this balances out the argument about lower monitoring costs for the firms described above will depend on the type of nanny rule—in some cases (like the cellphone ban) it will, while in others (obesity rules) it may not.

Although a characterization of which nanny rules are more efficiently provided by the state and which by private firms is beyond the scope of this Article, some boundaries are clear. It would be difficult for a firm to monitor whether individual employees are consuming trans fats sold by restaurants or food companies; it would be much less costly and more effective for the government to simply ban the use of trans fats in foods. On the other hand, charging smokers higher insurance premiums is something firms can do much more efficiently, since they can easily test individuals at work randomly for smoking. (The state could try to achieve the same result through the use of Pigouvian taxes on smoking, but, as discussed above, this is unlikely to be as efficient as corporate efforts.)

We can be confident that firms will choose to implement nanny rules when they have some comparative advantage or can free ride on the efforts of the state. In this way, corporate nannyism is likely to be a complement to, rather than substitute for, state nannyism. In other words, there is a market of sorts for the provision of nanny rules by firms, and insofar as the playing field is level, we should expect the market to sort rules efficiently.

F. Less Politics

A final suite of benefits of corporate nannyism arises because corporate nannyism involves fewer political considerations, meaning outcomes are less likely to be abused by powerful political interests. The first of these is the practical advantage that comes from the fact that there is an existing and fairly powerful political movement devoted to restraining the nanny state. As mentioned above, political consensus is needed to adopt state nanny rules, whereas CEOs can adopt them via fiat. And there are political forces strongly opposed to extensions of state nannyism. There are numerous websites, magazines, and books devoted to nothing but resisting the nanny state. David Harsanyi's recent exposé—*Nanny State*—is typical of this genre,¹⁸⁰

¹⁷⁹ Deterrence is the product of the expected penalty and the probability of being caught. This means that the nanny can reduce the need for monitoring by increasing penalties. Since the state has the ability to raise penalties higher than firms, this means that in some instances it may be able to reduce monitoring costs below that of firms. See Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J Polit Econ 169, 170 (1968) (presenting a formal model for the replacement of criminal law enforcement with higher sanctions, keeping the crime rate constant).

¹⁸⁰ See generally Harsanyi, *Nanny State* (cited in note 24).

as is *Reason* magazine,¹⁸¹ and, for that matter, the Libertarian Party. Even when antinannyism is not central, it is often significant. A large number of articles and positions taken by right-leaning commentators, scholars, think tanks, and politicians contain a healthy dose of libertarian thinking on state regulation of individual behaviors.¹⁸²

Opposition at the same level does not currently exist for corporate nannyism, so it is simply easier at this point for firms to adopt nanny rules. Proposed extensions of nanny rules in the political sphere are met with resistant politicians, interest groups, and commentators on the other side of the issue; there are no analogs that consistently oppose corporate nannyism. There have been some attempts to push back against nanny efforts by firms to date,¹⁸³ but these have been small, disorganized, timid, and largely unsuccessful compared with resistance to state analogs.

Some individual employees have filed lawsuits to contest nanny rules or particular outcomes (usually getting fired), but these rarely succeed.¹⁸⁴ (These cases are discussed more fully below.) Where these cases do succeed, there is usually some state statute or constitutional provision that undergirds the argument; this is another type of push back, as discussed above. Although law can be useful in this regard, it is by far the exception and not the rule when the current landscape of corporate nannyism is examined.

Since employee acquiescence in corporate nannyism may be in part caused by a collective action problem, unions or collective bargaining would seem to provide a potential counterweight. As a practical matter, unions are far weaker today than they were just a few decades ago, representing just 8 percent of the nongovernmental workforce compared with 35 percent in 1950.¹⁸⁵ So even if one ex-

¹⁸¹ See, for example, Julian Sanchez, *Save Me from Myself! Parentalism and the Fear of Freedom*, Reason.com (July 12, 2005), online at <http://reason.com/archives/2005/07/12/save-me-from-myself> (visited Oct 6, 2009) (criticizing state nannyism as “the attempt to avoid the burdens of responsibility by denying our own freedom”).

¹⁸² See generally, for example, Morris M. Kleiner, *A License for Protection*, 29 Regulation 17 (Fall 2006) (asking “[w]hy has occupational regulation grown?”).

¹⁸³ See *From Incentives to Penalties: How Far Should Employers Go to Reduce Workplace Obesity?*, Knowledge@Wharton 3 (Jan 9, 2008), online at <http://knowledge.wharton.upenn.edu/articlepdf/1876.pdf> (visited Oct 6, 2009) (noting that “[s]ome employees or ex-employees have sought protection in the federal Americans with Disabilities Act (ADA), claiming their obesity is a disability, but so far without much success,” but that “some viable legal strategies remain open for obese people seeking redress through the disabilities Act”).

¹⁸⁴ See, for example, id.

¹⁸⁵ Bureau of Labor Statistics, *Union Affiliation of Employed Wage and Salary Workers by Occupation and Industry*, table 3 (Jan 28, 2009), online at <http://www.bls.gov/news.release/union2.t03.htm> (visited Oct 6, 2009) (creating a table to show the percentages of the workforce represented by and involved in unions); Steven Greenhouse, *Labor Leader Sounds Do-or-Die*

pected the degree of corporate nannyism to vary based on the level of unionization in an industry or across firms, unions would apply very little brake on this trend given their relatively weak position overall in the economy. This weak position means that even unionized firms may be able to impose nanny rules with low costs and resistance, since their relative competitive position will drive employment policies. In other words, firms will either impose nanny rules to force individuals to internalize costs or, if they cannot because of union pushback, reduce some other form of employee compensation. Since this latter tactic is likely to apply across the board, the existence of unions will lead, on the margin, to a subsidy for cost externalizers.

Another political consideration that cuts in favor of corporate nannyism is the potential for state nannyism to pervert the political process. This might happen in several ways. For one, money raised and saved from nanny regulations can be diverted from its intended purpose to other purposes that satisfy the preferences of legislators or other constituencies. Since agency costs are undoubtedly higher in the political environment, this risk is especially likely to arise. If this happens, it not only may cause an inefficient level of nannyism, but it also may erode public confidence in the political process, at least for the constituencies that are not benefiting from the redirection. The West Virginia attorney general diverting funds from nanny settlements and the misallocation of cigarette settlements are just two of the many examples of this and the negative effect they can have.

Ironically, if these opportunities for rentseeking by political actors arise, this may lead to nanny rules that underdeter socially costly or destructive behavior. For example, if the state imposes a Pigouvian tax on cigarettes and this tax becomes a source of significant revenue for the state, the state may have suboptimal incentives to set the right level of the tax. Once the behavior becomes a profit source, the state has the incentive to optimize the return from the behavior, not to minimize the social costs of the behavior. It may be, for instance, that banning the sale of cigarettes is socially optimal, but politicians would have an incentive to keep them legal solely for the money.

This result is difficult, if not impossible, to imagine in the case of firm-based nanny rules, which are not about raising revenue but reducing costs, are not divertible (since there is but one bottom line and firm managers are constrained by legal duties and reputation from expropriation), and would be competed away in labor markets if excessive. In addition, unlike other firm policies, cost reductions through

Warning, NY Times A10 (Feb 19, 2001) (“That is the lowest level since the number of unionized workers peaked at 35 percent in the 1950’s.”).

nanny rules cannot be used to raise barriers to entry or otherwise create anticompetitive positions.

IV. OBJECTIONS AND DISADVANTAGES

This Part raises some potential objections and limits to corporate nannyism.

A. Externalities

In most cases, it is reasonable to believe firms will act to externalize costs onto others in society. After all, the genesis of most regulation is based on this tendency. Environmental law, consumer protection law, products liability law, and so on, are all largely about forcing firms to internalize their externalities. One might therefore think firms would have incentives to externalize the costs of employee behaviors, such as smoking or overeating. The most obvious way for firms to do this would be to refuse to hire these individuals, thus lowering their labor costs (assuming the policy does not otherwise affect the labor costs of nonsmokers) and presumably raising the costs for firms that hire smokers. This point is related to the observation made above about how labor market discipline is likely to reduce the room for maneuver of idiosyncratically paternalistic bosses. These bosses may therefore do more screening and less curing than is socially optimal.

There are several reasons why this concern is not significant and, where it is, is made worse by government policy. Most obviously, this kind of conduct is not what firms are actually doing. Very few firms have policies against employing smokers, obese individuals, skydivers, or others whose behaviors are likely to increase firm costs. Even those firms that do adopt no-smoker policies, like Weyco, cited in the Introduction, generally put in place programs to help cure smokers of their cost-creating behavior. Weyco, for instance, did not fire employees immediately, but rather gave them almost a year and a half to break their habit.¹⁸⁶ As noted above, other firms provide support, such as counseling, cessation programs, gym memberships, and so on, to help employees comply with regulations or simply improve their health.

The reason firms do not generally have no-smoker or no-overweight-people policies or the like is because if the firm could identify the costs of behavior and require employees to bear them fully, the firm would be indifferent to the behavior. A smoker who is charged the full additional amount of insurance and other costs the

¹⁸⁶ See Schultz, Lee, and Lacy, *Workers Fume as Firms Ban Smoking at Home*, Detroit News at A1 (cited in note 2) (noting that Weyco “told current employees who smoked that they had 15 months to quit”).

smoker imposes on other firm stakeholders is exactly the same as a nonsmoker, all else being equal. This indifference principle coupled with the fact that behavior bans are likely to impose significant costs on firms militates against policies of this sort. Firms are likely to bear large costs from firing existing workers (who violate the new policy), as well as from sending a signal to the labor market about the way the firm makes decisions. While some prospective employees might value a firm's commitment to avoid cross-subsidization of bad behavior, others may be concerned that the policy is the proverbial camel's nose in the tent in terms of other limitations on employee behavior. After all, firms go out of their way to show they are employee friendly, and nannyism is likely to be a counterweight to that reputation under some circumstances. In other words, "bans" are more expensive than "taxes," all else being equal, since banning has a potentially negative connotation, and taxes, if well calibrated, can force internalization while tolerating diverse preferences among workers.

As shown below, insofar as firms do engage in bans, as opposed to taxes, they are likely the result of inefficient government regulation of the market for nannyism. Current law (both federal and state) limits the ability of firms to charge employees for the full costs of their behaviors but does not generally prohibit employment decisions based on traits that are not protected. For example, it is not illegal anywhere to refuse to hire someone because he is overweight or a smoker,¹⁸⁷ but if someone is hired, it may be illegal to fire him for this reason, and it is unlawful to charge him more than 20 percentage points more for insurance than other workers,¹⁸⁸ even though the real costs of insuring them is many times greater. The law therefore encourages arguably the worst form of discrimination under the guise of protecting against discrimination. This suggests that the appropriate regulation may be at

¹⁸⁷ As discussed below, some states have so-called lawful product statutes that may give a cause of action to an applicant that is denied an employment opportunity because of engaging in the use of a legal product, like cigarettes. See note 214 and accompanying text. In practice, however, these laws will have much less bite at the hiring stage than the firing stage. Employers can screen out smokers in covert ways without asking about smoking habits, and few denied a job will sue to get it unless told explicitly the reason for the decision. By contrast, fired workers have both better information about firm policies, more leverage, an easier case to make, and may be in worse financial circumstances.

¹⁸⁸ See Valleau, 10 DePaul J Health Care L at 459 n 15 (cited in note 7) (noting that under the Health Insurance Portability and Accountability Act, a premium differential based on health factors must not be "more than 10–20 percent of the total cost of employee-only coverage"). But see Lisa Mascaro, *Bigger Premium Discounts Seen as a Reward—And a Problem*, Las Vegas Sun (Sept 27, 2009), online at <http://www.lasvegassun.com/news/2009/sep/27/bigger-premium-discounts-seen-reward-and-problem> (visited Oct 6, 2009) (describing a recently introduced amendment to the healthcare reform bill "that would allow employers to offer deep discounts—up to 50 percent—on insurance if employees stay trim, quit smoking or otherwise lead healthy lives").

the employment decision, and removing limits on charging for actual insurance costs. Of course, the line here will be somewhat blurry and the latter will be much easier to enforce than the former. This is discussed more fully below.

Even if the current insurance scheme is remedied, another problem remains. One reason why firms do not fully internalize the social costs of their rules is the existence of government welfare policies. Since firms do not pay all of the healthcare costs of employees over the lifespan of the employee, and since healthcare problems from particular ailments may arise after insurance lapses, firms may not have the optimal incentives to deter particular behaviors. For example, the federal government pays most healthcare for workers over the age of sixty-five through an effectively mandatory Medicare plan.¹⁸⁹ This means that firms can put some healthcare costs onto the federal government, and therefore are not incentivized to set nanny rules to reduce behaviors to the optimal level. To solve this problem fully, one would have to do away with government subsidies or charge differential amounts based on behaviors or conditions.

B. Liberty Interests

A related concern is that firm rules may not value certain democratic or other nonmonetary interests of the people. The government must, as a matter of political necessity, take into consideration the benefits of smokers in ways that are broader than firms' considerations. For instance, interests of personal liberty, social cohesion, and state legitimacy may be implicated by Draconian state policies designed to eliminate smoking. If these are large, government nannyism might be more effective on the margin.

Consider liberty interests. Citizens, whether they engage in the targeted behavior or not, may value the liberty interest inherent in choice. These values are very difficult to measure in the abstract, to aggregate, or to trade off. Some of these values and concerns will be part of firm-level calculations, as regulated by the labor market. Happiness, for one, will be something integral to a firm's calculation of the intrafirm social welfare calculation. Other values, like liberty interests, however, will not be relevant, except insofar as they impact employee utility directly and in ways observable by firms. If these interests are

¹⁸⁹ Medicare, the health insurance policy for Americans over the age sixty-five, is effectively mandatory for individuals over sixty-five. See note 132 and accompanying text. Opting out of the program is extremely expensive because, in part, it requires forgoing all other government retirement benefits, as well as paying very high amounts for personal insurance. See Social Security Administration, *HI 00801.002, Waiver of HI Entitlement by Monthly Beneficiary* (Aug 30, 1993), online at <http://policy.ssa.gov/poms.nsf/links/0600801002> (visited Oct 6, 2009).

significant, labor markets should force firms to take them into consideration. After all, firms already spend considerably to satisfy employees' nonmonetary preferences. For example, firms offer pleasing work environments, fringe benefits, support services, company picnics, and numerous other perks designed to make employees happier in their work and lives. To be sure, these are selfish acts on the part of the firm to increase productivity, but they are directly in response to individuals' demands for happiness at work. A smoking ban, say one that prohibited smoking at any time, that would alienate workers and make them feel unfairly monitored by their firm, would be no different than the firm failing to provide comfortable chairs—workers will leave the firm or demand higher wages to offset the loss of utility.

Market constraints may work well where the nonmonetary utility is sufficiently large for individuals to factor into employment decisions on the margin,¹⁹⁰ but may not where the interests are collectively large but individually small. This is the familiar collective action problem, and it may inhibit the ability of labor markets to reflect these preferences of individual employees. In these cases, however, there remain political backstops that can account for these preferences. Unions, legislatures, or courts can intervene to recognize and protect interests that are not relevant to firm employment decisions but that impose costs on society. Here the law merely acts to internalize to the firm the negative externalities it is imposing on society by not taking into account individual preferences in its attempt to internalize to the individual employee her costs imposed on the firm. For example, citizens in a particular jurisdiction may value the freedom from monitoring of their private lives very highly, but not enough for any individual to resist monitoring by an employer. In this case, there may be political pressure to restrict this kind of monitoring by employers. There is a danger that this type of political check will be used in ways that tip the balance of the playing field in the direction of state power and state provision of nannyism, since this enables the state (and the politicians who run it) to keep power, extract campaign contributions from lobbyists and citizens, and so on. In addition, political consideration may inevitably represent concentrated political interests—this is part of the “Bootleggers and Baptists” or “Cigarette Vendors and Constitutional Defenders” problem. This question is considered below.

¹⁹⁰ As in other contexts, not everyone has to be sophisticated or sensitive to these issues, since the marginal buyers will be the price setters.

C. Monopsony

Tailoring through a feedback loop may not work if firms are monopsonists in the labor market. This is just another way of saying that nannyism will be well calibrated only when there are restraints on the power of the rule setter. This is true whether the nanny is the firm or the government. If either party has a monopoly over labor or citizenship, there is less restriction on what they can do and therefore more possibility of abuse or errors going uncorrected.

No employer, however, has sufficient leverage in the labor markets to impose costs on employees without risk to the employer. Unlike in product markets where firms can conceivably have monopoly positions, there are no firms who are the only ones that can employ particular skills. Microsoft utterly dominates the personal computer market, but computer engineers and programmers have innumerable other options, including rival firms, different computer industries, the government, academia, and self-employment. The examples of the company towns described above provide nice support for this claim. Despite the remote location of these towns and much less robust labor markets (due to higher transportation costs, less labor market mobility, fewer employers, less skilled labor, macroeconomic conditions, and so on), company towns found they could not get away with arbitrary rules that did not reflect the preferences of their employees.¹⁹¹

D. Error Costs

There is also the possibility that if firm nanny rules are widely deployed, the sum of error costs (in the feedback loop) will be greater than those in the political context. This is an application of the Hand Formula to nannyism: many corporate rules with small error costs may exceed a few political rules with larger error costs. This is an empirical question that cannot be answered in the abstract. At this time, however, there are many more political rules than corporate ones, and it seems like there is convergence between what political and corporate forces want to regulate. This was true in the era of company towns, when both corporate and government nannies acted similarly, and there is every indication that the things one is interested in regulating—smoking, obesity, dangerous activities—the other is as well.

¹⁹¹ Historians note that “[w]orkers unsatisfied with their situation could pick up and leave.” Garner, *Introduction* at 6 (cited in note 39).

E. Invidious Discrimination

In addition, there is a risk that the kind of corporate nannyism defended in this argument will be extended to invidious or otherwise unacceptable forms of discrimination, such as “no Republicans” or “no homosexuals” policies. Although some employees or citizens may have a preference for this kind of discrimination,¹⁹² society may reasonably want to discourage individuals from acting on their preferences for this type of discrimination, because it is actually not demanded or because the cost borne by the individuals discriminated against exceeds the benefits of those doing the discrimination. There are some examples in the case law and press about firms firing individuals for such things as adultery,¹⁹³ but the nanny rules as defined in this Article are different. This type of discrimination is not part of the “market for nannyism” because it is not inevitable: governments cannot engage in this kind of discrimination because of existing statutes, and therefore the arguments about competition with firms does not obtain. Only those behaviors that directly lead to costs and are controlled by both the government and private firms are those covered by this argument.¹⁹⁴ Moreover, where there is invidious discrimination, on its face or in its impact, the government can intervene, either with a statute or judicial doctrine, to limit firm opportunism or abuse.¹⁹⁵ Thus attempts to use cost internalization as a pretext for satisfying preferences for racial, gender, or other socially destructive forms of discrimination are illegal or can easily be made so. If the class of invidious discrimination is expanded to, say, obesity, it should be recognized that this will crowd out private provision of nanny rules, which may reduce the efficiency of social policies designed to control them.

F. Coercion

Another potential objection is that some nanny programs couched in voluntary terms may be more coercive for lower-income employees.

¹⁹² See Becker, *The Economics of Discrimination* at 13–18 (cited in note 144).

¹⁹³ See, for example, *Marcum v McWhorter*, 308 F3d 635, 637 (6th Cir 2002) (holding that a police officer fired for having an adulterous relationship with a married woman was not deprived of constitutionally protected rights).

¹⁹⁴ There are reasons to believe that even invidious discrimination is not problematic. Employers compete in markets for labor, and assuming these are liquid and there are no monopsonist buyers of labor, these markets constrain excesses, such as not hiring short people. If a firm refuses to hire short people, it will be losing the opportunity to hire productive workers, its labor costs will rise, and it will be disadvantaged vis-à-vis competitors who draw from the entire labor pool. Firms will therefore have incentives not to discriminate in ways that are not related to productivity or other costs.

¹⁹⁵ For example, firms are prohibited by federal law from intentionally interfering with an employee’s receipt of pension benefits. See note 141 and accompanying text.

According to Mark A. Rothstein, director of the Institute for Bioethics, Health Policy and Law at the University of Louisville School of Medicine, current corporate nannyism amounts to a “tax that some of the lower-paid workers perhaps can’t afford.”¹⁹⁶ The regressivity problem exists with any cost-bearing rules, however, whether a firm or the state is imposing them. Unless one has a theory about why the political process is more likely to avoid this problem than the labor market, the argument fails. And certainly society’s experience with some sin taxes, which fall disproportionately on the poor, are an example of government failure in this regard. While firms will not always get it right or be superior to government in this regard, as discussed above, there are ways firms can adjust policies and pay to take account of these problems in ways that would be difficult for political entities to do.

G. Netting Externalities

A more general objection might be that costly behaviors by individuals are not correlated, and that there might be a benefit from merely letting one individual’s cost-imposing behavior cancel out another’s. So, if all employees were either, say, smokers or obese skydivers, the costs imposed on each group by the other would be offset, and therefore the efficient strategy would be not to impose any cost-shifting scheme. This scenario is possible, but seems highly unlikely. Risky behaviors, either health or activity related, are likely correlated, so employees can be roughly divided into cost bearers and cost imposers. In any event, if the objection is true, firms are likely well positioned to figure this out and are more likely than governments to be able to discriminate against employees by group when it is not true.

H. Enlightenment

A final potential objection is the question of whether the potentially corrosive impacts of nannyism on individual and social well-being that have been documented are worse in the corporate or political context. Immanuel Kant described the potential dark side of nannyism in his 1784 essay, *An Answer to the Question: What is Enlightenment?*¹⁹⁷ Kant argued that the objects of nannyism were living in a perpetual state of “immaturity,” which in turn created a caste of “guar-

¹⁹⁶ See Cha, *Firms Make It Their Business to Push Health*, Wash Post at A1 (cited in note 90).

¹⁹⁷ Kant’s essay was a response to a question—“What is enlightenment?”—posed to readers of the German periodical *Berlinische Monatsschrift*. Kant had the winning essay, and it was published in the December 1784 issue. See Immanuel Kant, *An Answer to the Question: What Is Enlightenment?*, in James Schmidt, ed, *What is Enlightenment?: Eighteenth-century Answers and Twentieth-century Questions* 58, 58 (California 1996).

dians” who would act opportunistically and to the detriment of the governed.¹⁹⁸ The end result was a society of “placid creatures” and “autocratic despotism and of an avaricious or overbearing oppression.”¹⁹⁹ Kant’s critique is in accord with later criticisms of collectivism by F.A. Hayek and others.²⁰⁰ But this critique applies not only in cases of mass nannyism, but also in microcases, like at the firm level.

The experience at some company towns demonstrates Kant’s concerns. In a description of company towns in the West, James Allen concludes that “employees frequently neglected their yards and houses, having learned to depend upon the company for everything.”²⁰¹ Kant called individuals in this state unenlightened “domestic animals,” and argued that any society composed of them would be unable to flourish.²⁰² Allen goes on to describe how corporate nannyism as practiced in company towns also led to suboptimal investments on the part of citizens: “Since the company was supposed to take care of house maintenance, . . . many residents refused even to care for small items, feeling almost as if they had been cheated if they did some work which the company ought to . . . do.”²⁰³ Perhaps more perversely, nannyism also created a creep toward equal outcomes, regardless of merit or even need. Allen quotes an official from the company town of Hannah, Wyoming, on the demand for company-supplied equality: “If we did something for Mrs. Jackson, we could almost bet our last bottom dollar that the next morning Mrs. Tacalon, or Scarapelli, would be there wanting the same identical things, even though they didn’t need it.”²⁰⁴ Benefits became obligations when dissociated from the typical decisions of individuals operating in a world of scarcity.

The inefficiency of the collectivist urge was something that some firms managed well, while others, like Pullman’s company town, did not. Given the state of society at the time, Allen concludes that “[p]aternalism was a necessity, . . . but one which most would gladly eliminate when all economic factors permitted such a move.”²⁰⁵ The parallel to modern corporate nannyism is direct and apt. Firms might prefer a world in which individuals paid most healthcare costs or the state did, thus relieving them of their obligation to force individuals to bear the costs of their behavior. While possible, neither of these is likely in

¹⁹⁸ *Id.* at 59.

¹⁹⁹ *Id.* at 58–59.

²⁰⁰ See generally Friedrich A. Hayek, *The Road to Serfdom* (Chicago 1944).

²⁰¹ Allen, *The Company Town in the American West* at 125 (cited in note 41).

²⁰² Kant, *An Answer to the Question: What is Enlightenment?* at 58–59 (cited in note 197).

²⁰³ Allen, *The Company Town in the American West* at 126 (cited in note 41).

²⁰⁴ *Id.*

²⁰⁵ *Id.* at 127.

the short run, given the rather intractable nature of the healthcare debate in this country. That said, these two non-firm options are the stated positions of dominant political parties, and one might eventually be enacted into law in one form or another. While firms might prefer this outcome, since it would relieve them of the hassle of managing nanny programs and the potential risk from mismanaging them, it might be a negative for society to allow firms to opt out of the market for nannyism.

There is reason to believe, however, that the nanny state will be worse at creating docile bodies than the nanny corporation. For one, the state has a monopoly on physical violence, and therefore individuals who violate state nanny rules can have their liberty infringed. Although if calibrated correctly, this increased punishment might simply provide additional deterrence at lower cost than firms can provide—this result is highly dependent on getting the nanny rules right. There are many examples of individuals being jailed for violating state nanny regulations that seem to represent the influence of those with political power more than efficient cost-internalization methods.²⁰⁶

In choosing the lesser of two evils—worker sheep or citizen sheep—another reason to favor corporate nannyism is that there are participation benefits in public life that might be corroded by excessive nannyism by governments. A democratic government relies on having informed constituents who are used to educating themselves and making reasoned decisions. Firms, by contrast, rely more heavily on command-and-control hierarchies in which the average worker can succeed simply by following orders. The fear of overextension that Kant worried about is less likely to come to pass in the corporate context. In addition, the barriers to adoption are much lower in the case of firms, while the market check is lower in the case of the government. So if we want lots of nanny rules with discipline, we should, all else being equal, choose corporations as the favored deliverer of nannyism in the market.

* * *

These advantages and disadvantages do not point solely in the direction of favoring corporate nannyism over state nannyism in all, or even most, cases. The discussion simply points out some potential advantages and disadvantages of corporate rules in certain circumstances. Firms might be expected to supply nanny rules when it is efficient for them to do so, say, because of better monitoring, lower agency costs, or the like, and not to do so when government rules could be

²⁰⁶ See note 133 and accompanying text (discussing the “Sick Chicken” case, *A.L.A. Schechter Poultry Corp v United States*, 295 US 495 (1935)).

supplied at lower cost for a given efficacy level. So, looking at the provision of nanny rules in the market for nannyism, it would be reasonable to conclude that the mix of nanny rules maps to this efficiency. The problem, however, is that there are government rules, regulations, statutes, constitutional provisions, and case law that may distort the market from efficiency. It is to this issue that we now turn.

V. REGULATION OF NANNYISM

The market for nannyism, like the market for altruism,²⁰⁷ is somewhat unique, in that the government is both a participant in and regulator of the market. This creates the possibility the government will discriminate in favor of state regulation based on factors other than the relative efficiency of the state versus firms in deploying nanny rules. The government's bias might be based on questions of power, ideological assumptions, ignorance, or some other theory. If there are reasons why private firms are likely to be better or worse than governments in implementing and enforcing nanny rules, then some bias in favor of one or the other may be justified. The discussion above, however, shows that there are some potential advantages of corporate nannies in particular cases, while government nannies may be superior in other cases. Unfortunately, this Part shows that the current regulatory environment for corporate nannies is both highly uncertain and biased against firm nannies. Although there have been some recent changes moving in the direction of more freedom for firms to use nanny rules, the playing field is still strongly tilted against corporate nannies.

This is a perverse result. The government highly subsidizes employer-provided health insurance by providing tax benefits for employers and employees. The subsidy is not buying what it could, however, since employers, who, as this Article's argument shows, may be highly efficient nannies in some cases, are prohibited from acting rationally and in a socially efficient way to reduce costly behaviors of individuals. The end result is a situation in which the government must substitute second-best policies, like sin taxes and outright bans, or encourage behaviors that dramatically reduce healthcare expenditures, which the government either pays directly (for the elderly and poor) or indirectly (for everyone through the tax subsidy).

Regardless of whether a nanny is a corporation or the state, the policy concerns are the same. The big issues are the sum of decision costs and error costs in the evaluation of externalities and the implementation of nanny rules; the magnitude of derivative social welfare

²⁰⁷ See generally M. Todd Henderson and Anup Malani, *Corporate Philanthropy and the Market for Altruism*, 109 Colum L Rev 571 (2009).

losses, such as privacy losses; and the ability of individuals or groups to impose their own idiosyncratic (and socially wasteful) preferences on others without sufficient safeguards. Unless there is a theory about why these issues are systematically worse for the private as opposed to public sector, then government should not distinguish between the delivery mechanisms for nannyism. This Part shows how federal and state law discriminates against corporate nannies, and how changing these policies could improve social welfare.

A. Codified Law

1. State law.

While most states follow the common law employment-at-will regime,²⁰⁸ which allows an employee to be terminated at any time with or without cause, twenty-nine states and the District of Columbia have laws on the books restricting the ability to fire an employee for certain legal, off-duty activities.²⁰⁹ While some of the statutes provide leeway, for example, allowing firms to charge differential insurance premiums based on tobacco use, the impact of these laws has been to significantly chill the use of nanny rules by firms. Jack Welch, former CEO of GE, told a CEO deploying an aggressive nanny program: “Man, you have balls of steel.”²¹⁰ The CEO admitted that a “lot of people are watching to see how badly we get sued.”²¹¹ A suit would bring bad publicity, impose legal costs on the firm, and would, if lost, mean that the investments in the program would have been wasted. The hard costs on the downside highlight a central problem with uncertainty in this area. Firms that innovate in nanny rules will pay these costs but will not be able to capture all of the benefits from the innovation, since other firms can easily copy successful policies.

These so-called “lifestyle discrimination statutes” fall into one of two general categories: (1) those protecting use of lawful products or engaging in legal activities, and (2) those protecting tobacco or alcohol

²⁰⁸ Robert Sprague, *Fired for Blogging: Are There Legal Protections for Employees Who Blog?*, 9 U Pa J Lab & Emp L 355, 360 (2007) (noting that all fifty states and the District of Columbia, except Montana, have adopted employment-at-will).

²⁰⁹ See Cha, *Firms Make It Their Business to Push Health*, Wash Post at A1 (cited in note 90) (noting that “[t]hirty states . . . have laws preventing discrimination against smokers” and “[t]hirteen states prohibit employers from regulating alcohol use during non-work hours”). See also Jason Bosch, *None of Your Business (Interest): The Argument for Protecting All Employee Behavior with No Business Impact*, 76 S Cal L Rev 639, 654 (2003) (“Approximately twenty-eight states have recognized the failure of the market to protect employees’ off-the-job interests and adopted specific protections against at-will abuses.”).

²¹⁰ Conlin, *Get Healthy—Or Else*, Bus Wk at 58 (cited in note 113).

²¹¹ See *id.*

only. In the first category, there are a total of ten states,²¹² with five making it unlawful for an employer to treat an employee or applicant less favorably because of the individual's off-duty, off-premises use of any lawful product or lawful consumable product. These statutes thus protect employees who use tobacco, alcohol, or any other "product" that might be objectionable to an employer. For example, the Illinois Right to Privacy in the Workplace Act bans employment discrimination based on an employee's or applicant's use of lawful products off the premises of the employer during nonworking hours.²¹³ Like ten other states with similar statutes,²¹⁴ however, the statute seems to, but does not clearly, allow employers to pass higher health insurance costs onto employees who use tobacco.²¹⁵

The other four states with broad regimes make it unlawful for an employer to treat an employee (and in some states, an applicant) less favorably because of any "lawful activity."²¹⁶ Presumably this includes not only the act of using a lawful product but also activities unrelated to products, such as skydiving, engaging in political activities, and so on.

Some states have specific exceptions from lawful activity statutes that allow companies to charge employees who smoke higher health-care insurance premiums. The ten are: Illinois, Indiana, Minnesota, Montana, New York, North Carolina, South Dakota, West Virginia, Wisconsin, and Wyoming.²¹⁷ In addition, nineteen states²¹⁸ expressly

²¹² There are six "lawful product statutes": Illinois, 820 ILCS Ann 55/5 (West); Minnesota, Minn Stat Ann § 181.938 (subd 2) (West); Montana, Mont Code Ann § 39-2-313; Nevada, Nev Rev Stat § 613.333; North Carolina, NC Gen Stat § 95-28.2; and Wisconsin, Wis Stat Ann § 111.321 (West). There are four "lawful activity statutes": California, Cal Lab Code § 96(k) (West); Colorado, Colo Rev Stat Ann § 24-34-402.5 (West); New York, NY Lab Law § 201-d (McKinney); and North Dakota, ND Cent Code § 14-02.4-03.

²¹³ 820 ILCS 55/5 (West).

²¹⁴ Ten states allow employers to pass on higher insurance charges to particular employees based on their tobacco use: Illinois, 820 ILCS 55/5(c) (West); Indiana, Ind Code Ann § 22-5-4-1 (Mitchie); Minnesota, Minn Stat Ann § 181.938(3)(c) (West); Montana, Mont Code Ann § 39-2-313(5); New York, NY Lab Law § 201-d(6) (McKinney); North Carolina, NC Gen Stat § 95-28.2(d); South Dakota, SD Cod Laws § 60-4-11; West Virginia, W Va Code § 21-3-19; Wisconsin, Wis Stat § 111.321; and Wyoming, Wyo Stat § 27-9-105.

²¹⁵ After the act was passed by the Illinois legislature in 1991, the governor wrote an official message explaining that the bill in no way interferes with programs designed to promote health among employees as "[t]hese programs are beneficial and should be encouraged." See Letter from Jim Edgar, Governor of Illinois, to the Illinois House of Representatives (Sept 23, 1991), reprinted in *Right to Privacy in the Workplace Act*, Ill HR Bill No 1533 (1991).

²¹⁶ "Lawful activity statutes" are found in four states: California, Cal Lab Code § 96(k) (West); Colorado, Colo Rev Stat Ann § 24-34-402.5 (West); New York, NY Lab Law § 201-d (McKinney); and North Dakota, ND Cent Code § 14-02.4-03.

²¹⁷ See note 214.

²¹⁸ These states are: Colorado, Colo Rev Stat Ann § 24-34-402.5 (West); Connecticut, Conn Gen Stat § 31-40s; District of Columbia, DC Code § 7-1703.03; Illinois, 820 ILCS 55/5 (West); Minnesota, Minn Stat Ann § 181.938 (West); Missouri, Mo Rev Stat § 290.145; Montana, Mont Code Ann § 39-2-313; Nevada, Nev Rev Stat Ann § 613.333 (Mitchie); New Jersey, NJ Stat Ann

recognize exceptions based on particular employees' job responsibilities (for example, an employer's restriction of off-duty smoking by a cessation-of-smoking coordinator for a local hospital) or the nature of the employer's business (for example, the American Cancer Society's prohibition of off-duty smoking).

At the other extreme, the other broad category of statutes comprises those in which specific products are singled out for special treatment. There are seventeen states with statutes prohibiting employers from discriminating against employees who smoke, meaning they cannot be fired, not hired, paid less, or penalized in any way for smoking off duty.²¹⁹ Connecticut's "smoker's rights" law is typical:

No employer or agent of any employer shall require, as a condition of employment, that any employee or prospective employee refrain from smoking or using tobacco products outside the course of his employment, or otherwise discriminate against any individual with respect to compensation, terms, conditions or privileges of employment for smoking or using tobacco products outside the course of his employment, provided any nonprofit organization or corporation whose primary purpose is to discourage use of tobacco products by the general public shall be exempt from the provisions of this section.²²⁰

In addition, thirteen states prohibit employers from discrimination against or regulating individuals using alcohol during nonwork hours.²²¹ These statutes seem to have little purpose other than to interfere with the employment-at-will relationship, unlike Title VII which aims to prevent discrimination on factors unrelated to business judgment. Twen-

§ 34:6B-1 (West); New Mexico, NM Stat Ann § 50-11-3; New York, NY Lab Law § 201-d (McKinney); North Carolina, NC Gen Stat § 95-28.2; North Dakota, ND Cent Code § 14-02.4-03; Oregon, Or Rev Stat § 659A.315; Rhode Island, RI Gen Laws § 23-20.10-14; South Dakota, SD Cod Laws § 60-4-11; West Virginia, W Va Code § 21-3-19; Wisconsin, Wis Stat § 111.35; and Wyoming, Wyo Stat § 27-9-105.

²¹⁹ These states are: Connecticut, Conn Gen Stat § 31-40s; District of Columbia, DC Code § 7-1703.03(a); Kentucky, Ky Rev Stat Ann § 344.040 (Banks-Baldwin); Louisiana, La Rev Stat Ann § 23:966 (West); Maine, 26 Me Rev Stat Ann § 597 (West); Mississippi, Miss Code § 71-7-33; New Hampshire, NH Rev Stat Ann § 275:37-a (Equity); New Jersey, NJ Stat Ann § 34:6B-1 (West); New Mexico, NM Stat Ann § 50-11-3; Oklahoma, 40 Okla Stat Ann § 500 (West); Oregon, Or Rev Stat § 659A.315; Rhode Island, RI Gen Laws § 23-20.10-14; South Carolina, SC Code Ann § 41-1-85 (Law Co-op); South Dakota, SD Cod Laws § 60-4-11; Tennessee, Tenn Code Ann § 50-1-304; Virginia, Va Code § 2.2-2902; and West Virginia, W Va Code § 21-3-19. Many of these states are ones with a strong tobacco presence (like Virginia, West Virginia, South Carolina, and so on).

²²⁰ Conn Gen Stat § 31-40s(a). Employers can, of course, continue to ban smoking at their business locations, even if the employee is not on duty. Conn Gen Stat § 31-40q(d).

²²¹ See Cha, *Firms Make It Their Business to Push Health*, Wash Post at A1 (cited in note 90) ("Thirteen states prohibit employers from regulating alcohol use during non-work hours.").

ty-one states²²² have no statutory protection at all, so employment remains purely at will, subject to the federal antidiscrimination acts.

The bulk of the lifestyle discrimination statutes were passed in the early 1990s, stemming from an interest in protecting employee privacy (particularly with respect to an employee's sexual preferences) and forcing employers to base their decisions on business- or performance-related reasons. They were initially passed in "pro-employee" states like California, Illinois, and New York, as well as rural Western "pro-privacy" or libertarian states like North Dakota, Nevada, Montana, and Colorado.²²³ After the early 1990s, almost no lifestyle discrimination statutes were passed until recently, when the Michigan House approved a "Workers Activities" bill in direct response to Weyco's policy of firing smokers.²²⁴ This is another kind of risk, since a seemingly permissive legal regime is always subject to change, and any subsequent change would make investments in the firm's programs wasteful.

The hodgepodge of state statutes creates a highly uncertain environment for firms. Even in states in which smoking is explicitly protected as a nonterminable behavior, there remain questions about whether firms can charge smokers differently for the costs they impose. In addition, for firms with employees in multiple jurisdictions, firms must set their policies based on the most restrictive state law.

As mentioned above, these state laws also sit uncomfortably next to state (and federal) policies aimed at reducing harmful activities, like smoking. This is true at both the state and federal level. For instance, in Connecticut, it is illegal to smoke in most public places, even with the consent of the owner,²²⁵ but, as the statute excerpted above shows, firms are not permitted to try to discourage smoking through forcing employees to bear the cost of their behavior. The result is a regulatory

²²² These states are: Alabama, Alaska, Arizona, Arkansas, Delaware, Florida, Georgia, Hawaii, Idaho, Iowa, Kansas, Maryland, Massachusetts, Michigan, Nebraska, Ohio, Pennsylvania, Texas, Utah, Vermont, and Washington. See National Conference of State Legislatures, *Off-duty Conduct* (cited in note 212), citing Gudas, *State Lawful Products Statutes* (cited in note 212) (presenting the table that forms the basis for the National Conference of State Legislatures site but containing some out-dated data).

²²³ See Valleau, 10 DePaul J Health Care L at 484 n 140 (cited in note 7) (detailing the sequence of enactment by year).

²²⁴ The workers' rights bills are the Employee Privacy Protection Act, Mich HB 4532 (2007); the Job Applicant Credit Privacy Act, Mich HB 4887 (2007); the Respect for Physical Differences Act, Mich HB 4926 (2007); and the Employee Family Health Privacy Act, Mich HB 4927 (2007). On May 15, 2008, the legal activity bill passed the House 63-45; separate bills included in the overall package would also prevent employers from firing, refusing to hire, or discriminating against employees based on their credit history, physical appearance, or health passed by narrower margins. See Tim Martin, *Michigan House Oks Worker Activity Bill*, Associated Press (May 15, 2008).

²²⁵ See generally Conn Gen Stat § 19a-342, § 31-40q.

regime that tries to discourage smoking, through bans and sin taxes, while preventing perhaps the most efficient source of smoking cessation incentives from helping with this regulatory effort. The same schizophrenic regulatory regime exists in numerous other states, most notably, California. In fact, it is illegal to smoke in private residences in some parts of California,²²⁶ while firms are legally prevented from charging smokers the obvious costs they impose on other workers, owners, and other claimants on firm value.²²⁷

One explanation for the difference may simply be the distrust of private enterprise and their ability to act in ways that are not socially destructive or externalize firm costs onto society. The argument above shows how this distrust, while perhaps warranted in some contexts, is highly constrained in the employment situation. This is not to say that there will be no errors or bad conduct by firms. The relevant comparison is not nirvana but the next-best alternative, which is either do nothing or the second-best, state nannyism.

The water is further muddied by the overlay of federal law, various constitutional protections, and case law interpreting state and federal law. The next Parts take on these issues.

2. Federal law.

Three federal statutes speak directly to the leeway granted corporate nannies. The Health Insurance Portability and Accountability Act²²⁸ (HIPAA), the Americans with Disabilities Act²²⁹ (ADA), and the Employee Retirement Income Security Act of 1974²³⁰ (ERISA), provide background rules consistent with a narrow conception of the role of private nannies. While none of these statutes speaks directly to the deployment of nanny rules by corporations, the language of each has been used to justify or criticize nanny rules as deployed.

a) HIPAA. The nondiscrimination provisions of HIPAA generally prohibit group health plans (like those offered by firms) from charging individuals different premiums or contributions or imposing different deductible, copayment, or other cost sharing requirements

²²⁶ See Associated Press, *California Town Approves Ban Making Smoking Illegal in Condos, Apartments*, Fox News (Oct 10, 2007), online at <http://www.foxnews.com/story/0,2933,300658,00.html> (visited Oct 7, 2009).

²²⁷ See Cal Lab Code § 96(k).

²²⁸ Health Insurance Portability and Accountability Act, Pub Law No 104-191, 110 Stat 1936 (1996), codified at 42 USC § 201.

²²⁹ Americans with Disabilities Act, Pub L No 101-336, 104 Stat 327 (1990), codified at 42 USC § 12101 et seq.

²³⁰ Employee Retirement Income Security Act of 1974, Pub L No 93-406, 88 Stat 829, codified at 29 USC § 1001 et seq.

based on a “health factor.”²³¹ Basically, an employer paying more for Employee A than Employee B for healthcare is prohibited from passing along that higher cost to A in the form of higher premiums, deductibles, or copayments. Since this federal law is supreme, even for private firms, it provides a strong deterrent for any corporate nanny rules (both carrots and sticks) that would have the effect of forcing individuals to internalize the costs they impose on others in group health plans.

There are two narrow exceptions that give firms some leeway in designing nanny programs. First, if a wellness program offers a reward that is *not* based on an individual satisfying a standard related to a health factor, then the program automatically complies with the non-discrimination requirements.²³² Examples of non-health factor programs are: reimbursing gym memberships; participating in health screenings or diagnostic testing which provide a reward based on participation and not outcome; a program that encourages preventative care by waiving the co-payment or deductible requirement for the costs of prenatal care or wellness visits; or a program that reimburses smoking cessation classes without regard to the result.²³³ In other words, providing information or nonjudgmental carrots is protected by HIPAA under a theory that these are the least likely to be abused; they are, of course, the least likely to be effective too. Companies’ experience with carrots has been disappointing, as voluntary programs do not force a change in individual incentives.²³⁴

A second exception tries to ameliorate this limitation. The HIPAA regulations include an exception to the antidiscrimination rule for “bona fide wellness programs.”²³⁵ The term was, however, undefined for many years, resulting in no reduction in uncertainty for firms wanting to charge employees for their conduct. In addition, at least three federal departments—the Departments of Treasury, Labor, and Health and Human Services—were potential enforcers of firm

²³¹ See Internal Revenue Service, Employee Benefits Security Administration, and Centers for Medicare & Medicaid Services, *Nondiscrimination and Wellness Programs in Health Coverage in the Group Market*, 71 Fed Reg 75014, 75015 (2006) (“[A]ny restriction on a benefit or benefits must apply uniformly to all similarly situated individuals and must not be directed at individual participants or beneficiaries based on any health factor of the participants or beneficiaries.”). See also Tiffani P. Hiudt, *Towards a Smoke-free Workforce: A Roadmap for Private Employers*, 21 Health Lawyer 26, 28 (2009); Department of Labor, *FAQs about the HIPAA Nondiscrimination Requirements*, online at http://www.dol.gov/ebsa/faqs/faq_hipaa_ND.html (visited Oct 8, 2009).

²³² See 71 Fed Reg at 75017, 75035 (cited in note 231).

²³³ See Christy Tinnes, *DOL, Treasury, & HHS Issue Final Wellness Program Rules*, Groom Law Group (Dec 18, 2006), online at http://www.appwp.org/documents/glg_wellness122106.pdf (visited Oct 8, 2009).

²³⁴ See note 115 and accompanying text.

²³⁵ See 71 Fed Reg at 75017 (cited in note 231).

compliance with HIPAA regulations. This additional complexity prevented many firms from experimenting with nanny programs, despite the fact that these departments stated that they would not take any enforcement action against a firm that sought to comply in good faith with the regulations. This promise was, according to businesses, cold comfort for the average risk-averse corporation.²³⁶ In other words, standards (instead of specific rules) resulted in overdeterrence, especially since the first firm to test these standards would bear all of the litigation costs and risks, while other firms could easily copy the result if successful.

To reduce uncertainty inherent in these standards, in 2001, the government undertook a rulemaking to “implement and clarify” the term “bona fide wellness program.”²³⁷ When the proposed HIPAA exceptions were published on January 8, 2001, the three departments proposed three options as the upper limit which employers could charge or reward employees under a bona fide wellness program: 10, 15, or 20 percent.²³⁸ The departments explicitly rejected the idea of allowing employers to pass on the full cost associated with a health factor because it “might be so large as to have the effect of denying coverage to certain individuals” and the administrative burden of the calculations could be too great.²³⁹ The approach finally adopted, however, was simply to remind companies about the pledge by the three departments not to bring enforcement actions. Since the pledge was not legally binding and the contours of what would be “bona fide” were highly uncertain, especially in light of conflicting state and federal statutes and case law, there is no public information about any firms charging increased health insurance premiums until 2006,²⁴⁰ when the wellness program regulation adopted a rule instead of a standard.

In this rule, finalized in 2007, the departments went with a 20 percent limit to give employers “a greater opportunity to encourage healthy behaviors through programs of health promotion and disease

²³⁶ See Jena McGregor, *Being Unhealthy Could Cost You—Money*, Bus Wk Online (Aug 2, 2007), online at http://www.businessweek.com/bwdaily/dnflash/content/aug2007/db2007081_804238.htm (visited Oct 8, 2009).

²³⁷ See Internal Revenue Service, Pension and Welfare Benefits Administration, and Health Care Financing Administration, *Notice of Proposed Rulemaking for Bona Fide Wellness Programs*, 66 Fed Reg 1421, 1421 (2001).

²³⁸ Id at 1432.

²³⁹ Id at 1422.

²⁴⁰ See Associated Press, *Employers Charging Smokers Extra for Health Insurance*, USA Today.com (Feb 16, 2006), online at http://www.usatoday.com/money/workplace/2006-02-16-smokers-cost-more_x.htm (visited Oct 8, 2009) (noting that “[a] growing number of private and public employers are requiring employees who use tobacco to pay higher premiums,” including “Meijer, Gannett, American Financial, Pepsi and General Mills”).

prevention.”²⁴¹ It was only when the HIPAA regulations clearly stated that companies could charge employees up to an additional 20 percent in their premiums for activities like smoking that firms like Clarian announced policies charging employees for smoking, BMIs over 30, and other health violations.²⁴²

This modest move in the direction of encouraging corporate nannyism is significant, but still limits the ability of firms to charge employees the full amount of the costs they impose. For example, in 2007, the healthcare cost per person was about \$7,500,²⁴³ but smokers add about \$3,400 in additional costs and obese individuals add another \$700 per year.²⁴⁴ Assuming healthcare insurance premiums are proportional to costs, this means an obese smoker would have to be charged over 50 percent more than a nonsmoker of average weight to equalize premiums according to cost. (Smokers alone would have to be charged over 40 percent more than nonsmokers.) But HIPAA limits premium differences to 20 percent, meaning firms will be unable to force individuals to bear all their costs, which in turn means that there will be socially inefficient levels of smoking. It also may lead to a perverse result, since firms may rationally choose to fire those individuals for whom they cannot charge the full costs of their behavior. The federal rule, which is designed to protect them, may result in less choice and lower levels of protection than one that permits firms discretion on how much to charge.

One might argue that the federal limit of 20 percent should simply be raised to a higher amount, maybe 50 percent, which is the estimate for a sort of worst-case scenario for destructive personal behavior (that is, an obese smoker). The problem with this, of course, is that the optimal level is impossible to know in advance without lots of experimentation, is subject to rapid changes depending on innumerable circumstances, will likely vary widely by firm and by individual,²⁴⁵ and, if set incorrectly, will generate significant under- or overdeterrence. A much better approach would be to allow firms to adapt to local circumstances, update continuously, and experiment with different pro-

²⁴¹ 71 Fed Reg at 75018, 75036 (cited in note 231). Under this exception a wellness program that charges employees more for smoking is lawful as long as the extra charge does not exceed 20 percent of the total cost of health insurance coverage for the employee.

²⁴² See McGregor, *Being Unhealthy Could Cost You—Money*, Bus Wk Online (cited in note 236).

²⁴³ See Kaiser Family Foundation, *Trends in Health Care Costs and Spending* (Sept 2007), online at <http://www.kff.org/insurance/upload/7692.pdf> (visited Oct 8, 2009).

²⁴⁴ See note 101 and accompanying text.

²⁴⁵ Fees or programs tied to particular individual characteristics, like weight, smoking, diet, exercise regime, and so on allow a firm to tailor programs to specific individuals by the groups they are in.

grams to find what is effective. Employers could be checked (imperfectly) by ex post litigation when policies are used for invidious purposes.

b) *ADA*. The ADA, which prohibits employers from discriminating in employment and benefits against a qualified individual with a disability, may also inhibit efficient pricing of health externalities.²⁴⁶ The ADA prohibits medical inquiries or examinations of applicants and employees regarding the existence, nature, or severity of a disability unless it is job related.²⁴⁷ All employees, and not just those with disabilities, are covered by the ADA and therefore are not required to answer questions about past medical history. Standing alone, these provisions might provide significant impediments to the kind of high-powered programs that require health surveys and treat employees differently who have differences that are potentially genetic.

The ADA, however, accepts most wellness programs if (1) participation is voluntary, (2) any health information obtained remains confidential and separate from other employment records, and (3) health information obtained is not used to limit health insurance coverage eligibility or to take adverse employment action.²⁴⁸ The voluntariness requirement has been very broadly interpreted by the Seventh Circuit; anything short of “Don Corleone’s ‘Make him an offer he can’t refuse’” will be considered voluntary.²⁴⁹ Further limiting the ADA’s applicability to wellness programs is case law, including Supreme Court precedent, holding remediable addictions, like smoking, not to be a disability within the coverage of the ADA.²⁵⁰ These requirements are not as strict as the HIPAA wellness program guidelines, so if a company is adhering to HIPAA, the ADA will likely be satisfied.

Nevertheless, the ADA is commonly used as a cause of action in litigation arising from nanny rules, and it often survives a motion to dismiss. This means implementing firms will bear litigation costs in many, if not all, cases, and thus deploy fewer rules than they otherwise

²⁴⁶ See generally 42 USC § 12101 et seq.

²⁴⁷ 42 USC § 12112, 12113.

²⁴⁸ Jon McLaughlin, *What Relevance Does the ADA Have to HIPAA-regulated “Bona Fide Wellness Programs”?*, Ill Bus L J (Feb 10, 2007), online at http://iblsjournal.typepad.com/illinois_business_law_soc/2007/02/hippa_wellness_.html (visited Oct 8, 2009).

²⁴⁹ *Henn v National Geographic Society*, 819 F2d 824, 826 (7th Cir 1987) (discussing the voluntariness inquiry in an age-discrimination case stemming from an early-retirement program instituted by National Geographic).

²⁵⁰ See *Rose v Home Depot U.S.A., Inc*, 186 F Supp 2d 595, 615 n 7 (D Md 2002) (determining that vasomotor rhinitis, in this case, was not sufficiently impairing to qualify as a disability and ruling that failure to take proper measures to diagnose and treat the condition precludes a claim under the ADA). See also *Sutton v United Airlines, Inc*, 527 US 471, 494–95 (1999) (Ginsburg concurring) (holding that “correctable disabilities” are per se outside the scope of the ADA), superseded by statute on other grounds, ADA Amendments Act of 2008 (ADAAA), Pub L No 110-325, 122 Stat 3553, codified at 42 USC § 12101 et seq.

would in the absence of the law. Getting this calibration right will be difficult, and it is unlikely that multiple courts imposing different rules across jurisdictions are likely to come to the most efficient use of the statute, especially since it seems redundant with other statutes and not clearly about wellness programs.

c) *ERISA*. The law protecting pensions and other employee benefits, known as *ERISA*, may also inhibit free contracting over the allocation of social costs from employee behaviors. *ERISA* was enacted to protect the interests of employee benefit plan participants by requiring disclosure of financial and other information to employees, establishing standards of conduct for fiduciaries, and providing access to federal courts.²⁵¹ Its provisions can be used to prohibit employers from discriminating against employees with regard to benefits or taking action against them to keep them from receiving benefits entitled to them by federal law or corporate contract. For example, § 510 makes it unlawful for any employer to “discharge, fine, suspend, expel, discipline, or discriminate against a participant . . . for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan.”²⁵² So an employee who has, say, pension and healthcare rights pursuant to a contract with the firm that is covered by *ERISA* may be unable to fire or otherwise influence the employee because of the rights granted by federal law in these benefits.

Very few cases exist on this question, but those that do suggest that the question of whether *ERISA* applies to nanny rules, like a no-smoking policy, is a factual question that is not appropriately raised at the motion to dismiss phase. In a recent federal case from Massachusetts, the district court allowed an *ERISA* claim to go to a jury in the case of a new hire who was allegedly dismissed (or, in the view of the defendant firm, never hired at all) for failing to submit to a nicotine urine test. According to the court,

[S]ection 510 does not apply to those instances where “the loss of benefits was a mere consequence of, but not a motivating factor behind, a termination of employment.” . . . And[] section 510 “relates to discriminatory conduct directed against individuals, not to actions involving the plan in general.”²⁵³

²⁵¹ See 29 USC § 1001 (announcing the purpose and scope of *ERISA*).

²⁵² Employee Retirement Income Security Act of 1974 § 510, Pub L No 93-406, 88 Stat 829, codified at 29 USC § 1140.

²⁵³ *Rodrigues v Scotts Co LLC*, 2008 WL 251971, *4 (D Mass) (citation omitted) (ruling on a complaint alleging that enforcement of a no-smoking policy is unlawful under Massachusetts law and *ERISA*).

Neither of these is capable of resolution at the motion to dismiss stage, meaning litigation costs in defending plans will be significant.

d) *Other federal statutes.* Several other federal statutes are commonly deployed by employees seeking redress for terminations or other adverse employment events. Most of these create colorable claims, meaning they have the potential to impose costs on, and therefore be used to extract settlements from, employers, but have been largely unsuccessful in court.²⁵⁴

The Rehabilitation Act of 1973,²⁵⁵ however, provides a greater potential deterrent to employer nanny programs. Section 504 of the Act prohibits discrimination based on any “disability” in any program receiving federal monetary assistance.²⁵⁶ Although narrower than the ADA in its coverage of employers, there is case law suggesting that the scope of potential liability is broader. There are state cases interpreting the Act or analogous state provisions suggesting that (morbid) obesity,²⁵⁷ alcoholism or drug use,²⁵⁸ and nicotine addiction (that is, smoking) are protected handicaps under the Act, and therefore cannot be the basis of employment decisions of any kind if the employee is “otherwise qualified” for the job.

²⁵⁴ Fired employees have also tried to invoke Title VII of the Civil Rights Act of 1964, which prohibits discrimination in employment on the basis of race, color, religion, sex, and national origin. Title VII of the Civil Rights Act of 1964, Pub L No 88-353, 78 Stat 253, codified at 42 USC § 2000e et seq. These efforts have largely failed. While disparate impact arguments can be made, the Supreme Court held in *New York City Transit Authority v Beazer*, 440 US 568 (1979), that a policy of refusing to hire individuals with past narcotic addiction was constitutional. Id at 594. The Court held that the restriction bore a “manifest relationship to the employment” and this was sufficient to rebut plaintiff’s claims of racial disparate impact. Id at 587 n 31.

²⁵⁵ Pub L 93-112, 87 Stat 355, codified at 29 USC 701, et seq.

²⁵⁶ 29 USC § 794. See also id at § 793 (requiring parties of a contract in excess of \$2,500 to “take affirmative action to employ and advance in employment qualified individuals with disabilities”).

²⁵⁷ *State Division of Human Rights v Xerox Corp*, 480 NE2d 695, 698 (NY 1985) (rejecting defendant’s claims of mutability and holding that obesity is a protected handicap under a state statute using language from the Act).

²⁵⁸ Current use of drugs and alcohol is not generally protected by courts or in state statutes, but prior use often is. See 29 USC § 705(20)(C)(v) (defining the term disability to exclude individuals whose current use of alcohol or drugs inhibits them from performing the duties of a job). Some state statutes expressly exclude these individuals from the definition of handicap. See, for example, Ariz Rev Stat Ann § 41-1461(2) (West) (excluding those who are currently using drugs from the disability category). But courts are split on the issue. Compare *Doe v Roe, Inc*, 539 NYS2d 876, 879–80 (NY S Ct 1989) (holding that a drug addiction is a handicap); *Clowes v Terminix International, Inc*, 538 A2d 794, 804 (NJ 1988) (holding that alcoholism is a handicap); *Connecticut General Life Insurance Co v Department of Industry, Labor & Human Relations*, 273 NW2d 206, 213 (Wis 1979) (same) with *Welsh v Municipality of Anchorage*, 676 P2d 602, 603 (Alaska 1984) (holding alcoholism is not a handicap).

B. Case Law

As is evident from the discussion about the interpretation of ERISA, courts are influential in defining the law in this area, and, it turns out, in creating additional uncertainty and confusion for firms who may want to innovate with nanny rules. This Part briefly surveys forty-two cases on health-related employment actions based on nanny rules over the last four decades. This survey is not a complete picture of all cases on this subject, but it does include the most significant cases and a fairly drawn sample from all the state and federal cases.²⁵⁹

Of the randomly drawn cases in the survey, courts upheld the employer's (either a private firm or a governmental entity acting in an employment capacity) nanny rule about 60 percent of the time.²⁶⁰ Although employers are more likely to win than lose these cases, this win rate is sufficiently low to create a significant amount of uncertainty about judicial treatment of these programs.

The complaints in these cases involved only state law in about 70 percent of the cases, with the rest being federal claims or, in one case, both state and federal causes of action. The federal and state breakdown largely tracks the nature of the employer in question: 75 percent of the cases brought against private (that is, nongovernmental) employers alleged only state law claims, while 65 percent of the cases brought against governments as the employers alleged only federal law claims.

1. State law.

Although employers win in their defense of nanny rules more often than not, state common law is replete with cases in which employees have been able to win back their jobs or get damages for nanny-based dismissals. There are four primary theories under which plaintiffs prevail: (1) the lack of a business purpose; (2) the existence of a protected handicap; (3) the violation of a privacy interest; or (4) the failure to consider less burdensome alternatives.

First, several cases hold that employer policies, such as banning smoking, must be in furtherance of a legitimate business purpose. Like business-purpose tests in other areas of law,²⁶¹ this reasoning just begs

²⁵⁹ Searches for cases involving claims of discrimination based on lifestyle choices and firm nanny policies were made using the Westlaw ALLCASES database for the period 1945 to present. Cases were sorted and categorized by hand by two research assistants and the author.

²⁶⁰ Private employers win about 80 percent of the cases, while public employers win about 50 percent.

²⁶¹ See, for example, Patricia B. Hsue, Comment, *Lessons from United States v. Stein: Is the Line between Criminal and Civil Sanctions for Illegal Tax Shelters a Dot?*, 102 Nw U L Rev 903, 912, 917 (2008) (noting the indeterminacy of "legitimate business purpose" in the context of tax evasion).

the question of what is “legitimate” and what is a “business purpose.”²⁶² The answers are not at all clear on the face of particular firm policies and there is no codification, so the contours of permissible and impermissible conduct are found only in state common law cases. For example, courts in Indiana and North Dakota hold that a private employer’s ban on employee smoking and drinking during nonworking hours was not reasonably related to the furtherance of the firm’s business.²⁶³ A New Jersey court reached the same conclusion for an employee dismissed because of obesity.²⁶⁴ The reasoning in these cases is conclusory at best, as they define “reasonable” based on the outcome of the case—what the court believes is reasonably related to the firm’s interests can only be gleaned from the result. In general, however, courts describe off-duty regulations as reasonable only if there is some direct threat from the conduct to the firm’s business.²⁶⁵ For example, the *Best Lock Corp v Review Board*²⁶⁶ court cites with approval a Wisconsin case in which the employer was able to show that its no-drinking policy was a sine qua non for obtaining vehicle insurance in its business delivering supplies to taverns, and thus overcame the plaintiff’s discrimination claim.²⁶⁷ This ground of decision should be sufficient to justify the reasonableness of health insurance cost-reducing schemes, since the argument is nearly identical, but few courts have seen this connection. In both cases, the firm policy (against drinking or smoking or such) is needed to reduce the firm’s expected costs—that is, from operating without a license, from incurring tort liability as a result of drunk driving, or from higher health insurance for unhealthy workers. After all, the state licensing scheme is just a backdoor method for reducing the firm’s and society’s costs.

Some courts in other jurisdictions do come out the other way. Most courts uphold the restrictions indirectly. In some cases, the court finds that the behavior in question spilled over from off-duty to on-duty hours, where every court permits the banning of activities such as drink-

²⁶² Although these tests have been around for a long time, they have fallen out of favor precisely because they do not offer business planners sufficient certainty to plan their affairs efficiently. See *Weinberger v UOP, Inc*, 457 A2d 701, 715 (Del 1983) (rejecting the business purpose test because it reduces the certainty of transactions and does not provide minority shareholders with “meaningful protection”).

²⁶³ *Best Lock Corp v Review Board*, 572 NE2d 520, 527 (Ind Ct App 1991); *Olson v Job Service North Dakota*, 379 NW2d 285, 288 (ND 1985).

²⁶⁴ See generally *Gimello v Agency Rent-A-Car Systems, Inc*, 594 A2d 264 (NJ Super Ct 1991).

²⁶⁵ See, for example, *Best Lock Corp*, 572 NE2d at 524 (discussing the meaning of “reasonable relationship” in an action for unemployment compensation).

²⁶⁶ 572 NE2d 520 (Ind Ct App 1991).

²⁶⁷ See *Gregory v Anderson*, 109 NW2d 675, 681 (Wis 1961) (holding that the degree of impact on a business from employee conduct is relevant to the propriety of the employer’s regulation of that conduct).

ing alcohol or smoking.²⁶⁸ In others, it is because the behavior is covered by other state or federal rules, such as drinking alcohol before piloting a commercial airliner.²⁶⁹ Finally, some courts approve employer discrimination, but only in cases where linked directly with a bona fide occupational qualification, such as firemen or cement workers not smoking.²⁷⁰

A few cases, however, find simply that the employer is entitled to adhere strictly to an employment at-will regime, unless the conduct in question is covered by a specific state statute or constitutional provision protecting it. Typical is *Stevens v Inland Waters, Inc.*,²⁷¹ where a Michigan court held that an employee fired for being a smoker was not entitled to the protection of the Michigan Handicappers' Civil Rights Act.²⁷² The court held that smoking or nicotine addiction is not a handicap within the meaning of the Act, because it does not "substantially limit[] a major life activity."²⁷³

Although these cases support a private employer's rights to terminate employees who drink alcohol or smoke or eat too much, the reasoning misses the point that firms banning smoking are simply responding to a demand for nannyism in an attempt to reduce healthcare costs. Reducing healthcare costs should be a sufficient business reason to justify these decisions when it is given that these employees impose large costs on other stakeholders of the firm.

Second, a few courts, especially in California and New York, hold that certain behaviors or individual characteristics are protected handicaps that trump background at-will employment rules. In both states, for example, courts hold that high blood pressure, without regard to cause, is a protected handicap under state law.²⁷⁴ The same results obtain for obesi-

²⁶⁸ See, for example, *Tucker v Astro Aluminum Heat Treating Co.*, 2005 Cal App Unpub LEXIS 11220, *22 (granting summary judgment because plaintiff did not sufficiently demonstrate implausibility of the employer's nondiscriminatory reasons for firing based on drinking with spillover into work hours).

²⁶⁹ See *Pedersen v Omni Air International Inc.*, Minn App Unpub LEXIS 1079, *2 (2007) (holding employer rules and FAA regulations expressly prohibited this conduct).

²⁷⁰ With regard to firemen, it is incompatible with the employer's mission, and with regard to cement workers, it is because the dust in the air at the workplace can, when coupled with smoking, lead to illnesses. See, for example, *Wood v South Dakota Cement Plant*, 588 NW2d 227, 230-31 (SD 1999) (holding that an off-duty, off-premises no-smoking policy is permissible if it is rationally related to employment responsibilities and activities).

²⁷¹ 559 NW2d 61 (Mich App 1996).

²⁷² See *id.* at 62. Section 202(1)(b) of the Handicappers' Civil Rights Act, Mich Comp Laws § 37.1202(1)(b), provides that an employer shall not "[d]ischarge or otherwise discriminate against an individual with respect to compensation or the terms, conditions, or privileges of employment, because of a [handicap] . . . that is unrelated to the individual's ability to perform the duties of a particular job or position."

²⁷³ *Stevens*, 559 NW2d at 65.

²⁷⁴ See *In re Arnot Ogden Memorial Hospital*, 67 AD2d 543, 547-48 (NY App Div 1979) (rejecting an applicant based on successfully treated high blood pressure as impermissible dis-

ty in a couple of states.²⁷⁵ For example, in a New York case, the court held that an overweight employee was protected by a state antidiscrimination law that protected both correctable and noncorrectable “diseases.”²⁷⁶ The court found that obesity was covered by the law and that discrimination based solely on an individual’s weight is impermissible.

These cases raise the obvious question of where one draws the line between protected and unprotected physical ailments. Several cases, for example, hold that diseases like AIDS and cancer are protected against the typical employment at-will regime.²⁷⁷ Distinguishing between behaviors or characteristics that are susceptible to incentives should not be difficult in most cases. The baseline this Article uses is whether the nanny rules are inevitable, regardless of the provider. So both governments and firms are currently trying to reduce smoking and overeating through various measures, and thus policies protecting these behaviors are obviously counterproductive. The same cannot be said of various genetic diseases. There will be cases in which claims are made about genetic predispositions to obesity or the like, but courts will be incapable of making these judgments and thus should steer clear of attempting to fashion policy based on armchair science. As discussed above, giving firms wide discretion here—say, to charge by the pound—will increase the chances of reducing overall healthcare costs while preserving choice for individuals. And, if it turns out that firms systematically overreach in ways that externalize unavoidable costs onto society, legislatures or courts can address these abuses. A survey of the cases suggests that this has not occurred.

Third, courts occasionally invoke privacy considerations to find in favor of employees subjected to firm nanny rules. Although employer drug testing is a longstanding and widely accepted practice, notwithstanding privacy considerations, an extension of similar testing to smoking, obesity, high blood pressure, and other behavior-driven physical conditions is more controversial. A few recent cases have allowed plaintiffs to proceed to jury trial on claims that firm nanny policies invade employees’ privacy. In *Rodrigues v Scotts Co.*,²⁷⁸ the plaintiff employee’s urine was tested and found positive for nicotine, and so,

crimination); *American National Insurance Co v Fair Employment and Housing Commission*, 32 Cal 3d 603, 610 (1982) (holding high blood pressure is a protected handicap under California Fair Employment Practice Act); *Pecci v S.A. Cook Factory Showroom*, 132 AD2d 935, 936 (NY App Div 1987) (holding hypertension is a protected handicap).

²⁷⁵ See *Gimello*, 594 A2d at 278; *Xerox*, 480 NE2d at 695.

²⁷⁶ *Xerox*, 480 NE2d at 698–99.

²⁷⁷ See *Burris v City of Phoenix*, 875 P2d 1340, 1346 (Ariz Ct App 1993) (holding cancer is a protected handicap under Arizona law); *Raytheon Co v Fair Employment and Housing Commission*, 212 Cal App 3d 1242, 1250 (1989) (holding that AIDS is a physical handicap under California law).

²⁷⁸ 2008 WL 251971 (D Mass).

under Scott's no-smoking policy, he was fired.²⁷⁹ The district court rejected the firm's motion to dismiss on the grounds that the plaintiff had a colorable claim under a Massachusetts privacy statute.²⁸⁰ Courts reach similar results under Pennsylvania and New York tort law.²⁸¹

Finally, there is some precedent for courts imposing on firms an obligation to provide alternative accommodations for employees before permitting termination for behaviors like smoking or excessive drinking of alcohol. For instance, in *Haltom v Southland Title of Orange County*,²⁸² the trial court observed that the employer had an obligation under California law to explore reasonable accommodations for an alcoholic employee.²⁸³ Many firms have deployed these programs alongside hiring restrictions or cost imposition schemes.

Meanwhile, courts interpreting lawful activity statutes have tried in some cases to limit their reach, while using rhetoric that is expansive in the ways it might protect employees. For example, in the only published decision analyzing and applying the Colorado Lawful Activities Statute²⁸⁴ the federal court upheld the firing of an employee who disparaged his employer in a letter to the editor of a local newspaper, and in doing so noted that the statute "was meant to provide a shield to employees who engage in activities that are personally distasteful to their employer, but which activities are legal and unrelated to an employee's job duties."²⁸⁵ The court went on to explain that the statute was meant to protect the job security of "homosexuals who would otherwise be fired by an employer who discriminates against gay people, members of Ross Perot's new political party who are employed by a fervent democrat, or even smokers who are employed by an employer with strong anti-tobacco feelings."²⁸⁶

In short, the state legal landscape is highly variable, confusing, and subject to change at any time, since states cannot credibly precommit to legislate or not legislate on a particular subject. The confusing and contradictory precedents are made even less clear by the relatively small number of cases in general and in any particular jurisdiction. The small sample size reduces the accuracy of forecasting. The result is significant uncertainty for firms, as well as little ground to

²⁷⁹ Id at *1.

²⁸⁰ See id at *3, citing Mass Gen Laws ch 214, § 1B.

²⁸¹ *Borse v Piece Goods Shop, Inc*, 963 F2d 611, 621 (3d Cir 1992) (holding that an employee discharged for failing to take a drug test could state an invasion of privacy claim under Pennsylvania tort law if the testing revealed personal information unrelated to the workplace).

²⁸² 2008 WL 4151837 (Cal Ct App).

²⁸³ Id at *5.

²⁸⁴ Colo Rev Stat § 24-34-402.5.

²⁸⁵ *Marsh v Delta Air Lines, Inc*, 952 F Supp 1458, 1462 (D Colo 1997).

²⁸⁶ Id (emphasis added).

estimate the predictability of the current legal environment. In addition, as noted above, the variance across states means employers with employees in multiple jurisdictions will have to adjust firmwide policies to the most restrictive state policy on the legality of nanny rules.

Federal law, which we turn to next, is clearer and in some cases more permissive, but also discriminates against private provision of nanny rules.

2. Federal law.

Plaintiff employees invoking federal law do so under the range of federal statutes discussed above (for example, ERISA and ADA), as well as constitutional protections, like the “right to privacy” or the Due Process Clause. (Federal cases involve public employers more often, such as firemen and school teachers, which means constitutional arguments have potentially more bite.²⁸⁷) Federal cases are somewhat supportive of employer attempts to force employees to internalize their costs, but these precedents are still far from settled in that direction and, because federal law is more often invoked against public employees, are of less value to private employers. In fact, one might recharacterize the judicial treatment of public-employer cases as government favoritism of one of the providers of nannyism in the market, namely, the government. Whatever the case, the numerous federal cases do not resolve favorably enough in the direction of employers, either public or private, to make the adoption of nanny rules a safe bet.

There are several theories under which courts reject employer attempts to force employees to bear the costs of their conduct. In *Cook v Rhode Island*,²⁸⁸ a morbidly obese attendant at a state-run hospital was not hired when she reapplied for her position after a voluntary absence of some time.²⁸⁹ The hospital claimed that her obesity would interfere with her ability to perform her job and would “put her at greater risk of developing serious ailments,” which would in turn “promote absenteeism and increase the likelihood of workers’ compensation claims.”²⁹⁰ The

²⁸⁷ The “state action doctrine” means actions by public employers will implicate more constitutional rights than private ones. See, for example, *Briggs v North Muskegon Police Department*, 1984 US App LEXIS 13815, *5 (6th Cir) (holding that the termination of a police officer for cohabitation with a married woman who was not his wife was unconstitutional). This additional scrutiny for government agencies acting in an employment (as opposed to governance) function makes no sense. The Supreme Court seems to be in accord in general terms. See, for example, *Engquist v Oregon Department of Agriculture*, 128 S Ct 2146, 2151 (2008) (holding that a government employee’s constitutional rights are not as robust when government is acting as an employer).

²⁸⁸ 10 F3d 17 (1st Cir 1993).

²⁸⁹ Id at 20–21.

²⁹⁰ Id at 21.

plaintiff sued under the Rehabilitation Act, alleging that she suffered from a disability and was not hired solely for that reason.

The jury returned a verdict for the plaintiff,²⁹¹ and the appeals court affirmed, rejecting the defendant's counterarguments of mutability and voluntariness.²⁹² In affirming the jury verdict, the court opened a wide door for potential plaintiffs by holding that not only are actual disabilities protected but also cases in which the employer merely believes the employee is disabled within the meaning of the Rehabilitation Act.²⁹³ In other words, the employer was forced to pay hundreds of thousands of dollars in damages, as well as litigation costs, because it, no doubt correctly, believed that the plaintiff's weight was likely to impose costs on other employees and the state.

As in *Cook*, cases are often permitted to go to the jury in this area of law. A challenge to the Scotts Company employment policies discussed above is indicative.²⁹⁴ Scotts adopted a nicotine-free policy, both at and away from work, for its employees. Scotts's justification for its policy "was to save money on medical insurance costs and to promote healthy lifestyles among its employees."²⁹⁵ The plaintiff employee's urine was tested and found positive for nicotine, so he was fired. His suit, bringing claims under a state privacy law and ERISA, survived a motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure. To wit, by terminating his employment, Scotts interfered with his attainment of benefits and rights under Scotts's ERISA plans for which he would have become eligible but for the termination. The court allowed the case to go to the jury, notwithstanding the fact that the plaintiff was employed, if at all, for a period of only a few days. In addition, ERISA requires that the "the loss of benefits was a mere consequence of, but not a motivating factor behind, a termination of employment," and that it "relates to discriminatory conduct directed against individuals, not to actions involving the plan in general."²⁹⁶ That the plaintiff's claim survived under a statute designed to prevent firm opportunism with respect to employee pension benefits suggests the extent to which courts will sometimes go to prevent the deployment of nanny rules.

In those cases in which federal courts uphold nanny rules, they often avoid the difficult issues of privacy or discrimination by enforcing

²⁹¹ *Id.*

²⁹² *Cook*, 10 F3d at 23–25, 28 (finding the counterarguments to be "as insubstantial as a pitchman's promise").

²⁹³ *Id.* at 22.

²⁹⁴ *Rodrigues*, 2008 WL 251971 at *1.

²⁹⁵ *Id.*

²⁹⁶ *Id.* at *4.

private contracts about the behavior in question. In two unpublished opinions, circuit courts upheld the termination of employees accused of consuming alcohol on the ground of breaching a contractual agreement with their employer not to do so or to complete alcohol treatment.²⁹⁷ If these weak precedents predict future court decisions, firms should ground their nanny regulations in specific employee contracts.

Significant uncertainty remains nevertheless, as there are open questions on important issues, like whether smoking, obesity, high blood pressure, and so on, are disabilities within the meaning of the ADA, Rehabilitation Act, and other federal statutes.²⁹⁸ To make matters worse in terms of expected litigation costs for employers planning on using nanny rules, courts generally emphasize using a case-by-case approach for each employee and situation.²⁹⁹

C. Going Forward

This Part has shown that state and federal statutes and case law create significant uncertainty about the legality of private nanny rules, even in the absence of state action. This bias in the delivery mechanism of nannyism demanded by individuals in common pools means that the firms will be deterred from meeting this demand on the margin. Coupled with the disadvantages of government entities in delivering nanny rules, this means that there may be insufficient amounts of nanny rules, and the ones that are produced may be suboptimal. If the barrier to the creation of a cost-internalizing rule is higher in the case of government rules, as is probably the case in some instances, then a bias against firm provision of nanny rules means too few will be provided by producers in the market for nannyism. And, if the mechanisms of accountability, feedback, and tailoring described above are better for corporate nannies, then the rules that are promulgated by government entities (when corporate ones are deterred) are likely to be less efficient than if the market playing field were level.

The case for corporate nannyism set forth above does not necessarily obtain in all cases, so it would be premature and likely errone-

²⁹⁷ See generally *Cole v Exxon Mobil Corp*, 142 Fed Appx 52 (3d Cir 2005) (holding that an agreement by which alcoholics attend rehabilitation is lawful); *Wobser v PPG Industries, Inc*, 2000 WL 178177 (9th Cir) (holding that a contractual agreement between an employer and an employee not to drink is enforceable).

²⁹⁸ Compare *Equal Employment Opportunity Commission v Watkins Motor Lines, Inc*, 463 F3d 436, 443 (6th Cir 2006) (holding obesity is not an ADA impairment unless it stems from a physiological condition) with *Cook*, 10 F3d at 28 (holding obesity is an impairment under the Rehabilitation Act).

²⁹⁹ See *Aldrich v Boeing Co*, 146 F3d 1265, 1270 (10th Cir 1998) (“Whether an impairment ‘substantially limits’ a major life activity depends on the individual and the impairment. Such determinations are not susceptible to per se rules.”).

ous to suggest that all of the statutes and case law described above are wrongheaded. It is equally absurd, however, that legislatures and courts protect something like “smokers’ rights” from the discipline of the market. It is one thing to be cautious about legal bans or taxes that might fall disproportionately on the poor, but arguments for restricting private firms from forcing individuals to internalize their costs make no sense, especially when the government may inevitably be forced to take the same steps. And, the existence of *bans* on private nannyism that exist side-by-side with legal and overt state nannyism is even less defensible. The public choice story told above may be the driver of these laws, and, if so, reason enough for their repeal.

This does not mean, however, that all antidiscrimination provisions are inefficient or that there is no place for some employment protections or safeguards. Statutes, like ERISA, and common law cases enforcing vested benefits or pensions against opportunism survive easily in this analysis, so too might laws requiring firms to put in place safeguards—like third-party administration—that minimize the risk of abuse by individual firms or managers. The law might also sensibly prefer firm-based taxes to bans in some cases, since the former are less likely to result from a firm’s desire to externalize its costs. This is not to say that bans on hiring based on certain individual behaviors should be forbidden, but merely to point out that the risk of cost externalization is greater in these cases. The social benefits, say from reducing smoking, might be sufficient to offset these concerns, especially if there is little social benefit from the behavior. The simple point of this Article is that voters and politicians should be sensitive to the issues of nanny efficiency when enacting provisions that prevent firms from acting like nannies.

CONCLUSION

Individuals in common cost-bearing pools, such as political jurisdictions or firms, demand nannyism to reduce subsidizing costly behavior on the part of other individuals in the pool. Instead of viewing nannyism as necessarily the product of irrational or rentseeking behavior on the part of decisionmakers, be they politicians or managers, this account views them as simply responding to the demand for nannyism by individuals. In this way, corporate regulations banning certain individual behaviors, such as smoking, are simply a response to a demand from firm stakeholders, such as employees and investors, to reduce firm costs.

Viewing nannyism in this way allows one to see that firms and the government are competitors in the delivery of cost-reducing regulations of individual behaviors. This then allows one to examine the relative comparative advantages and disadvantages of these competitors in the market. This Article has shown how firms have heretofore undervalued advantages in delivering nannyism through nanny-type

regulations. Chief among these is the constraint provided by labor, product, and capital markets in constraining firms from overreaching, or from diverting the benefits of nanny regulations away from paying the costs imposed by the behavior in question. Firms can also write broad prohibitions in ways that are sometimes more difficult for governments. States, on the other hand, may have advantages both in the severity of the penalties that can be employed (and thus less need for enforcement costs) and in reaching behaviors, such as consuming specific foods like trans fats, that may be difficult for firms to observe.

From this, one might conclude that firms should simply provide nanny protections when it is efficient for them to do so and likewise for the state. The market for nannyism is unusual, however, in that the government is not only a producer of nannyism, but also a regulator of the market for nannyism. This Article has shown how a variety of state and federal statutes, regulations, and judicial decisions may distort the market by limiting firm provision of efficient nanny rules or creating sufficient uncertainty for firms to reduce innovation in this area.

For a social policy with broad support—like reducing smoking incidence in the population—the relevant question should be which provider of nannyism is better on the margin at deterring the behavior. While government and firm nannyism are not necessarily substitutes and can work together, policymakers should be attuned to how best to allocate the burden of nannying. At present, firms are inhibited from charging smokers the full cost they impose on the firm and its stakeholders by federal and state law. These barriers should be removed, and the cost of smoking, overeating, skydiving, and so on, should be freely set by the market.

There will inevitably be line-drawing problems, since society can be thought of as one big subsidy of everyone's bad behaviors. This re-characterization of corporate nannyism elides this objection by focusing only on those behaviors where third-party payors inevitably are involved in trying to reduce the behavior in question. When comparing corporate nannyism with state nannyism on these issues—say reducing smoking or obesity—it is clear that the former may often be superior. This conclusion is relevant not only for the federal and state law described above, but also for the ongoing debate about who pays for healthcare in this country and how much we all pay. For example, the proposal to move away from the employer-based health insurance model has many virtues, but this Article points to a strong counterargument: if nannyism is inevitable for solving some healthcare cost problems, firms may be the preferred and more efficient provider.