COMPLIANCE ALERT

EPIC Insurance Brokers & Consultants

COBRA SERIES, PART II: SMALL COMPLIANCE BITES 1-4

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QUICK FACTS

- COBRA provides certain individuals the right to continue health coverage under an employer-sponsored plan when they experience specified events, called qualifying events (QE).
- When a qualified beneficiary (QB) experiences a QE due to termination of employment, COBRA requires a covered employer to offer continuation coverage unless it terminated the employee for gross misconduct.
- COBRA does not define gross misconduct; the term is defined by the courts. Employers should carefully weigh decisions to deny COBRA coverage due to gross misconduct and should consider consulting counsel.
- A spouse or dependent who loses health coverage due to divorce or legal separation is generally entitled to continue coverage under COBRA. The QE occurs on the date of the legal divorce or separation, even if coverage is lost prior to that event.
- Medicare entitlement of a covered employee is rarely a QE because it does not usually cause a loss of health plan coverage for active employees. Special rules apply to family member QBs and in situations where Medicare entitlement occurs before or after COBRA is elected.
- Special COBRA rules apply to business reorganizations, such as mergers and acquisitions. The rules spell out whether and when a selling or buying group has COBRA obligations.

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) provides certain health plan participants the right to continue coverage for a limited time if they experience a COBRA qualifying event (QE).

This article is the second in a series on COBRA compliance. The first article outlined general COBRA concepts, including covered employers, qualified beneficiaries (QBs), QEs, duration of coverage, and notification requirements. This article reviews four COBRA-related topics in small bites that employers should understand in order to maintain compliance and avoid penalties.

BITE ONE – DENIAL OF COBRA RIGHTS DUE TO GROSS MISCONDUCT

When QBs experience a QE due to voluntary or involuntary termination of employment, COBRA requires covered employers to offer continuation coverage. However, a covered employer may deny COBRA continuation coverage if it terminates a covered employee due to his or her gross misconduct. Further, when an employer terminates a covered employee for gross misconduct, there is no QE for the covered employee, spouse, or dependent children.

Unfortunately, COBRA does not define gross misconduct, and depending on jurisdiction, courts have defined the term differently. Courts have generally agreed that ordinary misconduct, such as excessive absenteeism or poor performance, does not constitute gross misconduct that would support denying COBRA election rights. An employer bears the burden of defending a gross misconduct denial, which may be a high bar.

Prevailing on a gross misconduct COBRA denial in court can be risky and costly, so most employers do not invoke this exception. The costs of wrongly denying COBRA rights can lead to an award of retroactive COBRA coverage as well as penalties of up to $110 per day. Therefore, employers determined to withhold COBRA election rights due to allegations of gross misconduct should first consult with qualified legal counsel to discuss the risks and benefits.

BITE TWO – DROPPING COVERAGE IN ANTICIPATION OF DIVORCE

A spouse or dependent who loses health coverage due to divorce or legal separation (if a plan does not cover legally separated spouses) from the covered employee generally may continue coverage under COBRA. However, sometimes (most often during open enrollment) an employee will drop – or attempt to drop – coverage for a spouse before finalizing a divorce or legal separation. In such a case, the QE does not occur until the official, legal date of the divorce or separation.

COBRA regulations state that if a covered employee eliminates or reduces his or her spouse’s coverage in anticipation of their divorce (or legal separation), then upon receiving notice of the divorce (or legal separation) a covered employer must make COBRA coverage available to the spouse as of the date of the divorce (or legal separation). Because COBRA coverage must be available as of the date of the divorce (or legal separation), this can result in a coverage gap, but it preserves the spouse’s and dependents’ COBRA election rights.

A good practice to avoid potential COBRA issues is to send a letter to spouses and dependents who have been dropped from health coverage to advise them that they no longer have coverage, and instruct them to notify the employer when the divorce (or legal separation) occurs to protect their COBRA rights. The letter does not need to refer to legal separation unless, under the terms of the plan, it causes a loss of coverage. In addition, the initial COBRA notice should include a description of the “in anticipation of” divorce (or legal separation) policy, especially if the plan requires a spouse to prove that the loss of coverage was in anticipation of divorce (e.g., a copy of the divorce petition showing the date legal action commenced).

BITE THREE – DROPPING COVERAGE DUE TO MEDICARE ENTITLEMENT

A covered employee's entitlement to Medicare is a listed QE in the COBRA statute, but it’s a QE only for the covered spouse and children – not for the covered employee. Under the Medicare Secondary Payer rules, most group health plans are prohibited from making Medicare entitlement an event that causes a loss of coverage. Consequently, Medicare entitlement of the covered employee is rarely a QE because it does not usually cause a loss of plan coverage for active employees.

A special rule extends COBRA coverage to a duration of 36 months (from 18 months) for covered spouses and children if the covered employee experiences a QE (i.e., a termination of employment or reduction of hours) within the 18-month period after the employee becomes entitled to Medicare.

When any QB (including the covered employee) first becomes entitled to Medicare after electing COBRA coverage, his or her COBRA coverage can be terminated early (i.e., before the end of the maximum coverage period). However, the COBRA rights of other qualified beneficiaries in a family unit who are not entitled to Medicare (for example, the spouse and dependent children of a Medicare-entitled former employee) are not impacted by this rule.

When any QB (including the covered employee) is entitled to Medicare before electing COBRA, he or she still has the right to elect COBRA coverage. The COBRA offer cannot be withheld because of Medicare entitlement. Also, employers may not terminate coverage early because of Medicare entitlement.

BITE FOUR – COBRA AND BUSINESS REORGANIZATIONS

Business reorganizations, such as mergers and acquisitions, can have a profound impact on COBRA obligations, but parties often overlook COBRA obligations and fail to include any direction in the reorganization documents. These omissions can result in tremendous COBRA difficulties.

A QE occurs when a business reorganization causes employees and family members to lose health plan coverage sponsored by a covered employer. Questions then arise: Who is responsible for offering COBRA coverage – the buyer or the seller? What happens if the seller no longer offers health plan coverage? What if neither party offers health plan coverage?

IRS regulations state that:

- If a seller (including any other member of its controlled group) maintains a group health plan after the sale, the selling group must provide COBRA coverage to the M&A QBs (the health plan participants who experience a QE as a result of the sale and QBs already on COBRA continuation coverage as of the sale).
- If a seller (including any other member of its controlled group) no longer maintains any group health plan in connection with the sale, then the buying group must provide the COBRA coverage under its group health plan if:
  - the buyer maintains a group health plan; and
  - in the case of an asset sale, the buyer is a successor employer.

  A buyer is a successor employer when the seller ceases to provide any group health plan in connection with the sale, and the buyer "continues the business operations associated with the assets purchased without interruption or substantial change."

- The parties may allocate the responsibility to make COBRA coverage available to M&A QBs via contract, such as the purchase and sale agreement. However, if the party that is assigned responsibility for COBRA fails to perform under the contract, then the party that has the obligation to offer COBRA coverage under the regulations retains responsibility.

In the case of a stock sale, covered employees who continue to be employed by an acquired group do not legally experience a termination of employment. Rather, these employees remain employed by the same employer who employed them before the sale. Consequently, such employees did not terminate employment as a result of the sale, and are therefore not M&A QBs – there is no COBRA obligation in this scenario.

The above information is only a brief summary of the COBRA rules relative to mergers and acquisitions. The best practice is to include the Human Resources Department in the business reorganization planning process at the beginning, and to identify and allocate COBRA obligations in the purchase and sale agreement. These two steps should help prevent complications down the road.

KEY TAKEAWAYS

COBRA provides significant protections for plan participants who lose health coverage due to QEs. While the overall concept of COBRA is simple, COBRA administration can be very complicated in real life scenarios. COBRA failures can be very expensive due to statutory penalties and potentially large medical claims an employer might have to pay. Thus, health plan sponsors should take time to understand their COBRA responsibilities.

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For further information on this or any other topics, please contact your EPIC benefits consulting team.