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COBRA Provisions of the American Recovery and Reinvestment Act of 2009

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by [Paul Borden](#), [Michael T. Frank](#), [Timothy G. Verrall](#), [Yana S. Johnson](#)

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The recently enacted *American Recovery and Reinvestment Act of 2009* (the "Act") includes several new requirements that will impact the COBRA responsibilities of employers maintaining group health plans. In broad terms, the Act's COBRA-related provisions do two things, both related to individuals involuntarily terminated between September 1, 2008 and December 31, 2009: (1) provide for a subsidy of COBRA premiums for a nine-month period and (2) require certain additional notifications relating to the COBRA subsidy.

Background: Summary of Basic COBRA Requirements.

"COBRA" is an acronym that refers to the Consolidated Budget Reconciliation Act of 1985 and more specifically to the health care continuation requirements included in the act. COBRA requires group health plans maintained by employers with 20 or more employees to provide elective continuation coverage to employees and their beneficiaries upon the occurrence of certain "qualifying events" such as termination or employment, reduced working hours, death, or divorce (among others). Continuation coverage is available on a self-pay basis for up to a specified period of time (i.e., 18, 29, or 36 months) depending on the circumstances. Beyond the substantive rights COBRA creates, it also obligates the administrators of group health plans to provide to plan participants and their beneficiaries notices detailing the substantive continuation rights and the administrative procedures applicable to the exercise of those rights.

Both ERISA and the tax code impose penalties for failures to timely provide the required notices or to make COBRA coverage available. Penalties may be assessed of up to \$110 per day under ERISA, and an excise tax penalty of up to \$100 per day (up to \$200 per day if more than one qualified beneficiary is affected) under the tax code. Also, participants (or the Department of Labor) may sue to secure COBRA coverage (or the benefits it would have offered) and recover the related attorneys' fees, and ERISA also permits the recovery of "other relief" that may entail substantial damages depending on the circumstances.

Premium Subsidy.

An employee, his or her spouse, and any dependent children are generally entitled to continuation coverage under COBRA if the employee is terminated and otherwise would lose coverage under the employer's group health plan. Because the cost to terminated employees of COBRA coverage^[1] is often significantly more than the cost to active employees, many eligible individuals do not take advantage of their rights or cannot afford to maintain their coverage for their full period of entitlement. The Act helps to mitigate this cost issue by providing a subsidy for COBRA premiums for any "assistance eligible individuals" whose employment involuntarily terminates between September 1, 2008, and December 31, 2009. Assistance eligible individuals are individuals who are eligible for COBRA due to an involuntary termination occurring during the subsidy period, including any such individuals who might have previously waived COBRA coverage or let their coverage lapse.

The subsidy is available for up to the earlier of (i) the date that is nine months after the first day of the first month that the subsidy becomes available to the individual or (ii) the end of the assistance eligible individual's maximum period of COBRA entitlement (which could be 18, 29, or 36 months depending on the circumstances).

The subsidy covers 65% of the COBRA premium costs. Assistance eligible individuals are obligated to cover the remaining 35%. From the employer's perspective, the subsidy means that only 35% of the costs of COBRA coverage can be passed through for assistance eligible individuals during the subsidy period.

The Act also applies to state COBRA-like continuation coverage and other government-sponsored continuation programs. The Act does not apply to flexible spending accounts under cafeteria plans.

Election Rights.

Recognizing that the original COBRA election period for assistance eligible individuals terminated in 2008 has already ended, the Act creates an extended election process to give all assistance eligible individuals who are not already receiving COBRA benefits on February 17, 2009, a second opportunity to elect to receive them. The extended election period begins on February 17, 2009, and ends on the 60th day following the day on which the employer provides notice of the extended election right. This means that delaying distribution of election notices to assistance eligible individuals will extend the window they have for making a COBRA election.

The Act supplements the existing COBRA notice requirements by obligating employers to supply a notice of the extended election and subsidy rights no later than April 18, 2009. The notice can be distributed on a stand-alone basis or a discussion of the new COBRA rights for assistance eligible individuals can be incorporated into existing COBRA notices and election forms and redistributed. The Department of Labor is required to issue model notices by March 19, 2009, but employers are free to develop their own form of notice. The notices can be distributed in the same manner as other disclosures required by ERISA, although electronic distribution may be problematic under the Department of Labor's guidance on electronic communications with benefit plan participants and beneficiaries. Mailing paper notices to the last known address of potential assistance eligible individuals via first-class mail should be an acceptable alternative. As with the "standard" COBRA notice requirements, an employer's failure to comply with the foregoing notice obligations can trigger substantial penalties under ERISA and the tax code.

Reimbursement.

The entity entitled to reimbursement from the government for COBRA premiums not paid by the employee depends on the type of plan. For multiemployer group health plans, it is the plan itself that has reimbursement rights. The employer is entitled to reimbursement for self-funded health plans other than multiemployer plans. However, for insured health plans (other than multiemployer plans), the insurer providing the coverage is the entity entitled to reimbursement. Reimbursement is via payroll tax credits. It is unclear how this mechanism will work with entities other than the employer.

Assistance eligible individuals who previously paid full COBRA premiums are entitled to be refunded premiums from the entity entitled to reimbursement for the amount they paid in excess of their 35% responsibility or else to receive a credit against future COBRA premiums in an equivalent amount. The Act includes specific deadlines for providing reimbursements or credits.

Other Issues.

- **Employment and Severance Agreements.** For any individuals with existing COBRA subsidy rights (e.g., through an employment agreement or severance plan or package), attention must be paid to the interaction between the new statutory subsidy and the existing subsidy. At present, it is not clear whether the statutory subsidy will be available if the employer already provides free or reduced-cost COBRA coverage or if an assistance eligible individual (or another person or entity other than the employer) pays less than 35% of the COBRA premium.
- **Coverage Options.** The Act allows (but does not require) employers to permit assistance eligible individuals 90 days to change their coverage options. Employers should decide now whether or not to permit these changes or to direct assistance eligible individuals into a

specific coverage option.

- **Taxation.** The COBRA subsidy is generally not taxable to the assistance eligible individual. However, the Act includes a phase-out for this exclusion for individuals whose modified adjusted gross income exceeds specified limits. In this situation, an assistance eligible individual whose income exceeds the threshold may recognize additional taxable income by receiving the subsidy. Individuals who would otherwise qualify for the subsidy can elect to permanently waive their right to receive it by providing written notice to the employer, plan, or insurance carrier, as applicable.
- **Other Coverage.** Assistance eligible individuals only remain eligible to receive a subsidy until they secure other health coverage or exhaust their maximum COBRA entitlement. Assistance eligible individuals are required to notify the employer, plan, or insurance carrier (as applicable) if they secure other coverage disqualifying them from receiving the subsidy. A failure to provide this notice in a timely manner will trigger a penalty on the assistance eligible individual; the penalty is payable to the employer, plan, or carrier.
- **Expedited Review.** The Act includes an expedited 15-day review process under which an individual may request review by the Secretary of Labor of a denial of coverage as an assistance eligible individual. The standard of review will be *de novo*.
- **Pre-Existing Conditions.** The Act suspends the usual “significant gap in coverage” rule applicable under HIPAA with respect to limitations on plan coverage of preexisting conditions. For a qualified beneficiary who elects COBRA continuation coverage under the extended election period, above, the period that (i) begins on the date of the qualifying event, and (ii) ends with the beginning of the special notice period described above, is disregarded for purposes of determining the 63-day period under the rules that limit group health plans from imposing pre-existing condition limitations. Thus, an assistance eligible individual with what would otherwise be a significant gap in coverage (i.e., no health coverage for more than 63 days) cannot be subjected to a preexisting condition limitation on that basis alone.

Action Items.

To determine the appropriate course of action to satisfy the new COBRA requirements adopted by the Act, employers sponsoring group health plans should consider the following:

- **Identify “Assistance Eligible Individuals”:** The COBRA subsidy is generally available to any qualified beneficiary (i.e., employee, spouse, and/or dependent child) whose qualifying event was connected to an employee’s involuntary termination of employment between September 1, 2008, and December 31, 2009. This would include individuals who might have been affected by reductions in force and other involuntary terminations in late 2008 and all of 2009.
- **Prepare Updated Notices:** Existing COBRA notices will not discuss the new rights created by the Act. As a result, employers will need to either update their existing notices to include the required content or else create stand-alone supplemental notices. A model notice will be available from the Department of Labor within the next month, but employers may design their own notices.
- **Distribute Notices:** Notice of the extended COBRA rights available under the Act must be communicated to the assistance eligible individuals no later than April 18, 2009. Notices can be distributed in accordance with the standard ERISA requirements applicable for COBRA-related disclosures. It is important to have a reliable process for disseminating the updated notices so that the employer can demonstrate its efforts to ensure actual receipt by the assistance eligible individuals. There may be practical complexities associated with contacting former employees and their families, so employers should be vigilant in dealing with notices returned by the postal service and use reasonable efforts to locate current address information.
- **Deferred Compensation Issues.** To the extent an employee has a contractual “legally binding” right to a COBRA subsidy you should consult a legal adviser for compliance under Section 409A of the tax code.

Note: This Alert is a brief summary of some of the highlights of the new COBRA legislation. For further information, contact Paul Borden, Mike Frank, Tim Verrall or Yana Johnson.

[1] Generally, employees may be required to pay 102% of the premium for continuation coverage.