

## Employee Benefits & Executive Compensation ADVISORY

February 5, 2010

### COBRA Credit Expansion Enacted as Part of Department of Defense Appropriations Act

An expansion of the COBRA premium subsidy originally adopted as part of the American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law by the President on December 19, 2009, as part of H.R. 3326 – Department of Defense Appropriations Act, 2010 (the “Defense Act”).

In addition, the Department of Labor (DOL) has issued model notices and a FAQ on its Web site, which you can find at <http://www.dol.gov/ebsa/COBRAmode notice.html>.

This advisory summarizes the COBRA provisions of the Defense Act and highlights actions that are needed now in order to comply with the new law.

#### Summary of COBRA Subsidy Expansion:

The Defense Act expands the COBRA subsidy provisions in ARRA as follows:

- (1) The Defense Act changes the eligibility sunset date for the ARRA subsidy from December 31, 2009, to February 28, 2010. [**Note:** The administration’s budget proposal and other pending legislation, if enacted, would extend this date further, possibly until December 31, 2010.] In addition, the Defense Act clarifies that eligibility for the COBRA subsidy is conditioned only on a qualifying event that is the involuntary termination of employment occurring on or before the new February 28, 2010, sunset date *without regard to when the COBRA coverage period actually begins*. This is a change from the original ARRA subsidy legislation and guidance, which conditioned eligibility for the subsidy on both the involuntary termination of employment occurring and the COBRA period beginning on or before the original December 31, 2009, sunset date. Thus, under the Defense Act, the 15-month subsidy period discussed below (which is applicable only to the COBRA period) may not commence until some time in the future, to the extent that commencement of the COBRA period arising from such involuntary termination of employment is deferred until a later date.

**Illustration:** Bob is involuntarily terminated on January 1, 2010; however, his employer continues his coverage on the exact same terms and conditions in effect prior to the termination until March 31, 2010. Bob’s employer does not count the extension until March 31 as COBRA coverage. Bob may then elect to have 18 months of COBRA continuation coverage beginning April 1, 2010. If the Defense Act had continued to apply the eligibility rules of the original ARRA subsidy language, Bob would not be eligible for any subsidy because both his qualifying event *and* his COBRA period did not occur on or before the February 28 sunset date. However, under the Defense Act, Bob will be eligible for the COBRA subsidy because his involuntary termination of employment giving rise to a COBRA period actually began prior to the sunset date. It is apparently irrelevant that Bob’s COBRA period doesn’t begin until after the sunset date.

**Note:** It remains to be seen whether the IRS and/or the DOL will take action to limit the application of the subsidy. For example, the IRS could take action to prohibit payroll tax credits after a specific year. In addition, it is unclear whether a deferred “COBRA” continuation coverage period that begins more than 18 months after the termination of employment qualifies as “COBRA” coverage as otherwise required by federal law. In order to be subsidy eligible, the continuation coverage offered must be “COBRA” continuation as required by federal (or state). Under COBRA’s rules, an event that would otherwise constitute a qualifying event but does not cause a loss of coverage before the end of the maximum COBRA period is not a “qualifying event” that would otherwise give rise to a COBRA period. For example, if a plan continues the coverage of a terminated employee for 24 months following termination on the same terms as before the termination, the plan would arguably have no obligation to provide any additional continuation coverage under COBRA. It is unclear, though, whether this rule applies where the plan purposefully defers the COBRA period to a later date.

- (2) The Defense Act expands the ARRA premium subsidy period for Assistance Eligible Individuals (AEIs), as defined by ARRA, up to 15 months (increased from the nine months previously provided under ARRA). This is not an additional 15 months; it is merely a six-month extension of the nine-month period previously provided under ARRA.
- (3) For AEIs who exhausted their nine-month COBRA subsidy period immediately preceding the “transition period” and then failed to pay a premium for any “period of coverage” during their “transition period,” the Defense Act allows such individuals to retroactively reinstate coverage to the extent the subsidized premium for such periods is paid by the later of February 17, 2010, or 30 days after provision of the Special Notice described in Section (5) below. The “period of coverage” and the “transition period” are described in more detail below.
- (4) For AEIs who exhausted their nine-month COBRA subsidy period immediately preceding the “transition period” (see box below) and then paid a full premium without regard to the subsidy for any “period of coverage” during their “transition period,” the Defense Act applies the same refund/credit rules for overpayments described in the original ARRA legislation

**What is the “transition period”?** In order to identify the AEIs described in (3) and (4) above, one must understand the term “transition period.” The Defense Act defines the transition period as any “period of coverage” beginning prior to December 19, 2009, and during which the extended subsidy period applies by virtue of the Defense Act. ARRA defines “period of coverage” as a month or shorter period for which a premium payment is required. The literal interpretation of the Defense Act’s definition of transition period, read in light of ARRA’s definition of “period of coverage,” would suggest that only those who exhausted the subsidy prior to December 19, 2009, and who then first failed to pay the premium for the period of coverage beginning prior to December 19, 2009, would be in the “transition period” and otherwise eligible for the retroactive assistance described in Sections (3) and (4) above. The statute’s definition would appear to exclude those whose nine-month subsidy expired after the December 19 enactment date, even though they may not have yet received a notice of the Defense Act’s provisions prior to the premium due date for subsequent months. The DOL, however, has taken a more expansive view with regard to this issue and modified the definition of the transition period in its model notices and FAQs. Under the modified definition, the transition period is any period or periods of coverage following the end of the nine-month ARRA subsidy period and before the revised notice under the Defense Act is provided, without regard to whether the transition period began before or after December 19, 2009. The net result, as described by the DOL, is that any AEI who exhausted his/her original nine-month ARRA subsidy period has until the latest of the following three dates to pay a premium for periods of coverage in the transition period: (i) February 17, 2010, (ii) 30 days after notice of the Defense Act’s rules is provided or (iii) the end of the usual and normal premium payment period, including any grace period, whichever is later, to pay a premium for periods

of coverage in the transition period. In essence, the DOL's modification provides those in their transition period a longer grace period in which to pay the premiums for certain periods of coverage.

(5) Notice of the Act's amendments to ARRA must be provided to the following individuals (the "Notice Group"):

- All AEIs on COBRA on or after October 31, 2009. This notice is due no later than February 17, 2010.
- All qualified beneficiaries whose qualifying event was a termination of employment that occurred on or after October 31, 2009. If the qualifying event occurred on or before December 19, 2009, the notice is due by February 17, 2010. If it occurred after December 19, 2009, then the general election notice timeline applies (i.e., 44 days after the qualifying event).

**Note:** In addition, DOL takes the position that a notice revised according to the Defense Act must be sent to ALL qualified beneficiaries, regardless of the event, if the event occurred on or after October 31, 2010, and the qualified beneficiary has yet to receive an election notice.

- All AEIs who are entitled to the transition relief described in Sections 3 and 4 above. The notice must inform the individuals of the right to reinstate (in the event they failed to timely pay a premium during the transition period) or the right to a refund or credit (in the event they overpaid). This notice must be sent within 60 days of the first day of the individual's transition period. Note: the transition may have started prior to December 19, 2009. For example, if an AEI exhausted his nine-month subsidy period on November 30, then his transition period began December 1, 2009. Thus, notices of the transition relief must be sent no later than 60 days after December 1, 2009.

### DOL Model Notices:

The DOL issued three model notices to help plan sponsors and administrators satisfy the notice obligation:

- Updated General Notice (full election notice revised according to Defense Act)
- Premium Assistance Extension Notice (short notice designed to notify those within Notice Group who have already received a notice with the old ARRA language in it)
- Alternative Notice

The DOL's model notices simplify the approach by breaking the Notice Group into two categories: Those who have received a notice with old ARRA language in it (except the Special Group identified below) and those who have yet to receive an election notice (and the Special Group). The following is a more detailed overview of the notices.

First, the DOL issued the Updated General Notice. The Updated General Notice is provided to anyone in the Notice Group (regardless of the type of event) who has yet to be provided an election notice. In addition, the Updated General Notice must be provided to qualified beneficiaries whose qualifying event was a termination of employment that occurred in December, but whose COBRA period started January 1, 2010, or later ("Special Group"). Individuals in the Special Group will have 60 days from the date of the new notice to make their election.

**Note:** Although not clear, if individuals in the Special Group already received a notice that contained the Defense Act's amendments to ARRA, a new election notice and a new 60-day period would presumably not be necessary.

Second, the DOL issued the Premium Assistance Extension Notice. This Premium Assistance Extension Notice, which is a short notice that describes the Defense Act's provisions, must be provided to everyone else in the Notice Group. Those who receive this notice are presumably not entitled to a new 60-day election period. Note: The due date to provide this notice might differ. For example, an AEI who is entitled to transition relief is entitled to notice within 60 days of his/her transition period, while an AEI whose subsidy period has not yet expired is entitled to this notice by February 17, 2010.

Third, the DOL issued the Alternative Notice. The Alternative Notice is used by those subject only to state continuation coverage requirements.

The DOL has indicated that use of the model notices is not required. The underlying obligation is to notify the Notice Group of their rights under the Defense Act within the applicable time frames. Plan sponsors and administrators have flexibility in how they satisfy this obligation. Plan sponsors and administrators must decide whether the notice obligation can be satisfied more efficiently and effectively with one or more customized notice or the model notices.

### **What Needs to Be Done Now:**

Just as with the original ARRA subsidy rules, the Defense Act requires plan administrators and third party vendors to work together to (i) identify the recipients of a notice required by the Defense Act (the Notice Group), (ii) revise notices accordingly and (iii) distribute the notices as required by the Defense Act. Although plan administrators generally have 60 days to provide notice, it is recommended that you revise and send appropriate notices as soon as possible in order to avoid unnecessary heavy lifting in future months that may be caused by delay.

### **Other New Developments:**

Further possible changes to COBRA are being considered by the Congress. Section 3302 of H.R. 2947, the Jobs for Main Street Act, 2010, as passed by the House contains further expansion and modification of the COBRA credit. It is not clear whether the Senate will consider this legislation. Also, the President's proposed budget would extend the subsidy period until December 31, 2010.

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## Members of Alston & Bird's Employee Benefits & Executive Compensation Group

Robert A. Bauman  
202.756.3366  
[bob.bauman@alston.com](mailto:bob.bauman@alston.com)

James S. Hutchinson  
212.210.9552  
[jamie.hutchinson@alston.com](mailto:jamie.hutchinson@alston.com)

Nancy B. Pridgen  
404.881.7884  
[nancy.pridgen@alston.com](mailto:nancy.pridgen@alston.com)

Saul Ben-Meyer  
212.210.9545  
[saul.ben-meyer@alston.com](mailto:saul.ben-meyer@alston.com)

Lindsay Jackson  
202.756.3002  
[lindsay.jackson@alston.com](mailto:lindsay.jackson@alston.com)

Thomas G. Schendt  
202.756.3330  
[thomas.schendt@alston.com](mailto:thomas.schendt@alston.com)

Philip C. Cook  
404.881.7491  
[philip.cook@alston.com](mailto:philip.cook@alston.com)

David C. Kaleda  
202.756.3329  
[david.kaleda@alston.com](mailto:david.kaleda@alston.com)

John B. Shannon  
404.881.7466  
[john.shannon@alston.com](mailto:john.shannon@alston.com)

Patrick C. DiCarlo  
404.881.4512  
[pat.dicarlo@alston.com](mailto:pat.dicarlo@alston.com)

Laurie Kirkwood  
404.881.7832  
[laurie.kirkwood@alston.com](mailto:laurie.kirkwood@alston.com)

Maya D. Simmons  
404.881.4601  
[maya.simmons@alston.com](mailto:maya.simmons@alston.com)

Ashley Gillihan  
404.881.7390  
[ashley.gillihan@alston.com](mailto:ashley.gillihan@alston.com)

Johann Lee  
202.756.5574  
[johann.lee@alston.com](mailto:johann.lee@alston.com)

Carolyn E. Smith  
202.756.3566  
[carolyn.smith@alston.com](mailto:carolyn.smith@alston.com)

David R. Godofsky  
202.756.3392  
[david.godofsky@alston.com](mailto:david.godofsky@alston.com)

Blake Calvin MacKay  
404.881.4982  
[blake.mackay@alston.com](mailto:blake.mackay@alston.com)

Michael L. Stevens  
404.881.7970  
[mike.stevens@alston.com](mailto:mike.stevens@alston.com)

Anna Grant  
404.881.7124  
[anna.grant@alston.com](mailto:anna.grant@alston.com)

Emily W. Mao  
202.756.3374  
[emily.mao@alston.com](mailto:emily.mao@alston.com)

Laura G. Thatcher  
404.881.7546  
[laura.thatcher@alston.com](mailto:laura.thatcher@alston.com)

Anne Tyler Hamby  
404.881.4839  
[annetyler.hamby@alston.com](mailto:annetyler.hamby@alston.com)

Sean K. McMahan  
404.881.4250  
[sean.mcmahan@alston.com](mailto:sean.mcmahan@alston.com)

Kerry T. Wenzel  
404.881.4983  
[kerry.wenzel@alston.com](mailto:kerry.wenzel@alston.com)

John R. Hickman  
404.881.7885  
[john.hickman@alston.com](mailto:john.hickman@alston.com)

Michael G. Monnolly  
404.881.7816  
[mike.monnolly@alston.com](mailto:mike.monnolly@alston.com)

H. Douglas Hinson  
404.881.7590  
[doug.hinson@alston.com](mailto:doug.hinson@alston.com)

Craig R. Pett  
404.881.7469  
[craig.pett@alston.com](mailto:craig.pett@alston.com)

### ATLANTA

One Atlantic Center  
1201 West Peachtree Street  
Atlanta, GA 30309-3424  
404.881.7000

### CHARLOTTE

Bank of America Plaza  
Suite 4000  
101 South Tryon Street  
Charlotte, NC 28280-4000  
704.444.1000

### DALLAS

Chase Tower  
Suite 3601  
2200 Ross Avenue  
Dallas, TX 75201  
214.922.3400

### LOS ANGELES

333 South Hope Street  
16th Floor  
Los Angeles, CA 90071-3004  
213.576.1000

### NEW YORK

90 Park Avenue  
New York, NY 10016-1387  
212.210.9400

### RESEARCH TRIANGLE

Suite 600  
3201 Beechleaf Court  
Raleigh, NC 27604-1062  
919.862.2200

### SILICON VALLEY

Two Palo Alto Square  
Suite 400  
3000 El Camino Real  
Palo Alto, CA 94306-2112  
650.838.2000

### VENTURA COUNTY

Suite 215  
2801 Townsgate Road  
Westlake Village, CA 91361  
805.497.9474

### WASHINGTON, D.C.

The Atlantic Building  
950 F Street, NW  
Washington, DC 20004-1404  
202.756.3300

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