

Issue Brief

## COBRA – Merger & Acquisition (M&A) Considerations

**April 2020**

For employers involved in mergers and acquisitions (M&As), benefits are just one of the many factors employers must consider and handle. Many employers going through an M&A transaction address benefits later in the process than they should, but COBRA is often not addressed at all; and failing to offer COBRA risks civil penalties as well as medical claims coverage costs for affected individuals. When a merger or an acquisition takes place, generally the seller must offer COBRA, unless the seller discontinues all group health plans or the parties agree contractually to different terms. If the seller discontinues all group health plan offerings, then the obligation may transfer to the buyer. The obligations differ a bit depending upon whether a stock or an asset purchase took place.

**General COBRA Rules for M&As**

For employers subject to COBRA continuation rules (employers with 20 or more employees), the IRS has provided detailed regulations regarding the handling of COBRA liability in the case of a merger or an acquisition (26 CFR 54.4980B-9). Under the regulations, the responsibility for making COBRA coverage available to M&A-qualified beneficiaries is determined according to the following rules:

1. If the seller maintains a group health plan after the sale, then a group health plan of the seller must provide COBRA coverage.
   * If the seller offers multiple group health plans and discontinues a group health plan in connection with the M&A transaction (e.g. for a certain division), the seller remains obligated to offer COBRA to the extent that the seller continues offering any group health plan following the transaction.
   * When there is a controlled group under §414 rules due to 80% or more common ownership, the seller might include more than just the entity being sold. For example, if Company A and Company B are part of the same controlled group and Company A is sold, both Company A and Company B are considered the "seller." Therefore, if Company B continues to maintain a group health plan following the transaction, Company B’s plan will probably be obligated to offer COBRA.
2. If the seller ceases to maintain any group health plan in connection with the sale, then a group health plan of the buying group must provide the COBRA coverage if: (i) the buying group maintains a group health plan; and (ii) in the case of an asset sale, the buyer is a successor employer.
   * In the case of a stock sale, if the buyer maintains a group health plan, the buyer is obligated to offer COBRA.
   * In the case of an asset sale, if the buyer maintains a group health plan, the buyer is obligated to offer COBRA only if the buyer is a successor employer. The buyer is considered a successor employer if the seller: (i) discontinues all group health plan coverage following the transaction; and (ii) the buyer“continues the business operations associated with the assets purchased…without interruption or substantial change.”
3. The parties may contractually allocate the responsibility to make COBRA coverage available. However, if the party that is contractually assigned responsibility for COBRA fails to perform, then the party that has the obligation to provide COBRA coverage under the regulations remains responsible for making COBRA coverage available.

**M&A Qualified Beneficiaries**

In terms of who must be offered COBRA, M&A-qualified beneficiaries include:

* those qualified beneficiaries who were already receiving COBRA coverage before the transaction under a plan of the seller; and
* those qualified beneficiaries who experience their qualifying event in connection with the sale.

COBRA continuation rights are triggered for up to 18 months for an employee if there is a loss of coverage due to a termination of employment or reduction in hours. In a stock purchase, employees continuing employment with the acquired corporation after a stock sale have no qualifying event because there is no termination of employment. Similarly, in an asset purchase, if the buyer is a successor employer, employees continuing with the buyer after the asset sale have no qualifying event. In other words, although employees who lose their job (and coverage) in connection with the transaction are likely to have COBRA continuation rights for up to 18 months, those who are employed by the buyer following the transaction often will not, even if the buyer doesn’t offer group health plan coverage.

For COBRA participants who were under the seller’s group health plan(s) prior to the M&A transaction, COBRA will need to be made available for the remainder of the maximum coverage period (from the original qualifying event date). If there will be a change in coverage (e.g. due to seller discontinuing its group health plan(s)), communication should be provided to COBRA participants about available coverage options, the cost of such coverage, and where to send monthly premiums. If this is not provided well in advance of the transition, flexibility should be provided regarding payment deadlines.

**Additional Considerations**

For small employers (fewer than 20 employees) who are not subject to federal COBRA continuation requirements prior to the M&A transaction, applicable state continuation requirements should be considered. Such requirements vary broadly from state to state. In addition, after an M&A transaction, small employers may immediately become subject to COBRA if, for example, the small employer becomes part of a larger entity or controlled group of entities via a merger or stock purchase. Small employers should not automatically assume that coverage continuation requirements do not apply.

In the case of a bankruptcy under Chapter 11, COBRA continuation rights may be triggered for certain retirees and their related qualified beneficiaries if the employer has a retiree health plan in place at the time of the bankruptcy. A retiree is entitled to coverage for life. The retiree’s spouse and dependent children are entitled to coverage for the life of the retiree, and, if they survive the retiree, for 36 months after the retiree’s death. If the retiree is not living when the qualifying event occurs but the retiree’s surviving spouse is covered by the group health plan, then that surviving spouse is entitled to coverage for life. Bankruptcies often result in M&A transactions, in which case such COBRA continuation obligations could transfer to the buyer if the seller discontinues group health plan coverage in connection with the acquisition.

**Summary**

The COBRA rules applicable to M&A transactions are fairly complex, so we strongly recommend that the legal advisors involved in the business transaction be involved in addressing these issues. In addition, it is worthwhile to coordinate with carriers (or stop-loss vendors) prior to the transaction to ensure there are no issues with providing coverage to COBRA-qualifying beneficiaries in accordance with these rules and/or the terms negotiated between the M&A parties.

*While every effort has been taken in compiling this information to ensure that its contents are totally accurate, neither the publisher nor the author can accept liability for any inaccuracies or changed circumstances of any information herein or for the consequences of any reliance placed upon it. This publication is distributed on the understanding that the publisher is not engaged in rendering legal, accounting or other professional advice or services. Readers should always seek professional advice before entering into any commitments.*