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COBRA Provisions in 2009 Recovery Act Require Immediate and Significant Changes

by

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The American Recovery and Reinvestment Act of 2009 (the "Recovery Act") that was signed into law on February 17, 2009 by President Obama creates temporary but significant changes to the COBRA health coverage continuation rules that apply to most employers' health plans.¹ These changes are effective March 1, 2009 for plans with calendar month COBRA coverage periods (which is the case for nearly all employers). It is therefore crucial for an employer (and its outside COBRA administrator if there is one) to focus on these changes *right now* and begin implementing the necessary adjustments to not only the employer's COBRA procedures but also its payroll system.

The COBRA changes are intended to encourage and assist individuals who are involuntarily terminated during the period beginning September 1, 2008 through December 31, 2009 to elect COBRA under their former employer's group health plan. The Recovery Act calls these individuals "assistance eligible individuals," or "AEIs." The encouragement to elect COBRA is a 65% federal subsidy of COBRA premiums for a period of up to nine months and the assistance is a second opportunity for some of these individuals to elect COBRA.

The mechanics of the subsidy are complex and the new reporting and disclosure requirements are burdensome.² To help employers quickly understand the new rules so that they can immediately begin making the necessary changes

¹ The group health plan continuation of coverage rules under COBRA apply to non-governmental employers with 20 or more employees. Most states have similar continuation rules that apply to non-governmental employers with less than 20 employees. The Recovery Act changes also apply to group health plans that are subject to a state's continuation of coverage rules, as well as governmental health plans that are subject to the Public Health Service Act continuation rules. This article focuses on the Recovery Act changes that apply to group health plans that are subject to COBRA although similar changes apply to plans subject to the Public Health Services Act or to a state continuation of coverage statute. In no event do the changes apply to a health flexible spending arrangement under an employer's cafeteria plan.

² Although the new rules create temporary administrative burdens, they don't increase an employer's health plan costs. The initial House version of the new rules included a provision permitting employees who terminate employment and lose group health plan coverage on or after age 55, or after working at least 10 years for the employer, to continue COBRA coverage under the employer's

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to their COBRA procedures and payroll systems, this article focuses on the following main features of the required changes:

- Determining who is an AEI;
- The subsidy amount and mechanics;
- The special election period;
- The duration of the COBRA subsidy; and
- The new reporting and notice requirements.

Unfortunately, there are many unanswered questions with the new rules and some rules are still to be developed through subsequent governmental agency guidance. The full extent of an employer's new obligations is therefore currently unsettled. Accordingly, employers must remain diligent during the next several weeks and be ready to make the necessary adjustments as the new rules continue to develop.

Determining Assistance Eligible Individuals

As noted above, the individuals who are eligible for the Recovery Act changes are qualified beneficiaries (including covered employees and their spouses and dependent children) who lose coverage under an employer's group health plan due to a covered employee's involuntary termination of employment during the period from September 1, 2008 through December 31, 2009. However, because individuals who are involuntarily terminated for gross misconduct are not eligible for COBRA, they are also not eligible for the Recovery Act's subsidy or the special COBRA election rights (discussed further below). Likewise, only those individuals who are "qualified beneficiaries" under COBRA are eligible for the COBRA subsidy and election rights. COBRA qualified beneficiaries are limited to the covered employee who was involuntarily terminated and the covered employee's opposite sex spouse under the federal Defense of Marriage Act and the covered employee's dependent children. The Recovery Act changes are therefore not available for a former employee's domestic partner, same-sex spouse or non-dependent children even if one of those individuals lost coverage due to the former employee's involuntary termination. The Recovery Act changes also do not apply to any other type of COBRA qualifying event, such as an employee's reduction of hours, voluntary termination, death or divorce.

Although an "involuntary termination" is a key requirement for the subsidy, the Recovery Act fails to include a definition for this all-important term. It is expected that the IRS will provide much needed guidance on this requirement. One issue among many that the IRS will need to address is whether participation in a voluntary reduction in force window is an "involuntary termination" for purposes of the new rules.

It is important to recognize that qualification as an AEI can be retroactive. As mentioned above, individuals who are involuntarily terminated on or after September 1, 2008 (and their family members who are "qualified beneficiaries") are eligible for the Recovery Act changes. In many cases, these individuals were previously offered COBRA coverage but failed to elect it before their respective COBRA election deadlines. Others may have elected COBRA coverage but allowed it to lapse by failing to keep paying premiums. The new rule's retroactive eligibility will give these individuals a second opportunity to begin or resume COBRA coverage, and presumably many will take advantage of that opportunity

group health plan (but on a non-subsidized basis) until age 65. Fortunately, that permanent and costly provision failed in the Senate. On the other hand, the Recovery Act does include a non-subsidized COBRA period extension for individuals who are Trade Adjustment Assistance individuals under COBRA or who are covered by an underfunded defined benefit pension plan that is under the control of the PBGC, but that extension expires on December 31, 2010.

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due to the 65% subsidy.³ When that happens, the individual's subsidized COBRA coverage is effective March 1, 2009, thereby creating a gap in health plan coverage between the date coverage was previously lost under the employer's group health plan and March 1, 2009. However, the Recovery Act requires that this gap in coverage be ignored for purposes of the plan's pre-existing condition limitations.⁴

There is also no earnings limitation on qualification as an AEI. However, if an AEI's federal adjusted gross income exceeds \$125,000 (or \$250,000 if the AEI is married and files a joint tax return), the individual must repay part of the COBRA subsidy by adding it to the tax liability on his or her federal tax return. This required payment increases as adjusted gross income increases and is fully-phased-in (that is, the entire COBRA subsidy must be repaid) when adjusted gross income exceeds \$145,000 (or \$290,000 in the case of a joint tax return). Despite this repayment requirement, a person with adjusted gross income in excess of the above amounts remains an AEI who may wish to take advantage of the Recovery Act changes (for instance, if the individual previously failed to timely elect COBRA coverage or allowed it to lapse). However, the individual may permanently waive the subsidy if he or she believes adjusted gross income will exceed the above amounts and would prefer not to incur the repayment obligation and tax liability. The IRS is to issue guidance on how employers are to provide this waiver opportunity.

If an employer rejects a former employee's claim that he or she is an AEI, the former employee can appeal the decision. The appeal, however, is not to the employer but is instead to the Department of Labor. The Department of Labor must rule on the individual's appeal within 15 business days. If the appeal is denied, the individual can file a lawsuit under ERISA to be treated as an AEI. However, the Recovery Act directs the reviewing court to give deference to the Department of Labor's denial of AEI status.

The Subsidy Amount and Mechanics

As mentioned above, the amount of the subsidy is 65% of the COBRA premium under the employer's group health plan. As the following discussion demonstrates, although the subsidy is paid by the federal government, substantial employer involvement is required.⁵

Calculating the Subsidy

The 65% federal subsidy means that an AEI is only required to pay 35% of a plan's regular COBRA premium to maintain COBRA coverage. The Recovery Act permits another person (such as a state agency in a domestic relations matter) to pay the individual's 35% share of the premium. However, the individual's former employer is expressly prohibited from paying any of the 35% portion of the premium. Presumably, this restriction also applies to any affiliate of the former employer.

³ The special notice and election rules for this second COBRA election are discussed further below.

⁴ Under the HIPAA pre-existing condition restrictions, a gap in coverage of 63 days or longer permits a plan to disregard the prior health plan coverage as "creditable coverage," which in turn could permit the imposition of pre-existing condition exclusions under the plan. By disregarding the gap in coverage, the Recovery Act ensures that a pre-existing condition limitation is not triggered by an AEI's failure to initially elect COBRA or the lapse of the AEI's COBRA coverage. This requirement to disregard the gap in coverage will also apply to the HIPAA certificate of creditable coverage that the plan must give to the AEI.

⁵ This discussion assumes that COBRA premiums are paid monthly under the employer's health plan, which is likely the case for most employers.

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There are some important limitations that apply when determining the subsidy amount. The most significant is that the subsidy is determined based on what the AEI actually pays to the employer’s plan for COBRA coverage. As a result, if the employer’s plan does not charge the AEI the full COBRA premium (perhaps due to a severance agreement that either waives COBRA premiums for a period of time or only requires payment of part of the COBRA premiums), the federal subsidy is reduced (or worse, is completely eliminated when there is a waiver of COBRA premiums). For example, if a plan’s normal COBRA premium for family coverage is \$500 but due to an agreement with an AEI the employer permits the AEI and his or her family to maintain COBRA coverage for \$300, the federal subsidy is limited to 65% of \$300, or \$195. The employer has therefore in effect shifted part of the subsidy (that is, 65% of the remaining \$200 COBRA premiums, or \$130) from the federal government to itself. In the case of a complete COBRA premium waiver, the entire subsidy is shifted from the federal government to the employer. *Employers that subsidize COBRA premiums for any employees who are AEIs (or who the employer expects to become AEIs before the end of the year) may therefore wish to determine if it is feasible to temporarily replace the employer’s subsidy with the federal subsidy. If so, immediate action is required.*

The type of continuation coverage made available by an employer may also have an effect on the subsidy amount. For instance, if an employer’s plan extends coverage to an individual’s domestic partner, same-sex spouse or non-dependent children, the subsidy may not be available for the portion of the COBRA premium that is attributable to that coverage.⁶ In addition, if an AEI is eligible for continued coverage under a retiree health plan in lieu of COBRA coverage and that AEI elects the retiree coverage, the subsidy is not available.

The Subsidy Mechanics

The Recovery Act utilizes a two step process to implement the subsidy. This process helps ensure that the desired effect of the new rules (that is, enrollment in COBRA coverage by AEIs) is immediate.

Under the first step, the employer initially covers the 65% subsidy by only charging an AEI 35% of the COBRA premium. Therefore, if the employer’s health plan is insured, the employer must use its own funds to pay the remaining 65% portion of the COBRA premium to the insurance company. If the employer’s health plan is self-insured, the employer is using a greater share of its funds to cover health plan claims since it is in effect giving the AEI a 65% COBRA premium discount.

The second step is a repayment from the federal government to the employer for the 65% COBRA subsidy. This is accomplished through a credit for the subsidy amount on the employer’s payroll tax liabilities (that is, a credit against the amount of the employer’s share of FICA taxes and the amount of its required employee withholding taxes, all of which are paid either monthly or semi-weekly and are reported on a quarterly basis using IRS Form 941). If the total payroll tax liability on the IRS Form 941 is insufficient to fully offset the total subsidy amount for that quarter, the U.S. Treasury will repay the excess amount to the employer or it will credit the excess amount to the next quarter’s payroll tax liability. The IRS has revised the Form 941 to accommodate this process.

⁶ Further guidance is needed on this issue. Notwithstanding this issue, it is clear that domestic partners, same-sex spouses and non-dependent children are not AEIs and therefore they don’t have a separate, individual right to COBRA subsidized coverage under the Recovery Act.

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Due to the March 1, 2009 effective date of these new rules, immediate employer action is needed to make the necessary changes in its COBRA procedures and payroll system to accommodate this two-step process. The most pressing issue is the requirement that an AEI be allowed to commence or continue COBRA coverage starting on March 1, 2009 at a 65% discount from the regular COBRA premium amount. Fortunately, the Recovery Act recognizes that employers cannot make the necessary changes that quickly, and it therefore provides a two-month grace period (that is, for March and April) during which an AEI can be charged the full COBRA premium. However, the employer must either reimburse the AEI for the 65% discount within 60 days after the AEI pays the full COBRA premium, or it can credit the amount of the AEI's overpayment toward future COBRA premium payments if the employer reasonably expects that the overpayment will be fully utilized within 180 days. Starting May 1, 2009, this grace period is no longer available and the AEI cannot be charged more than 35% of the COBRA premium.

Special Election Period

The ability of AEIs to qualify for the COBRA subsidy on a retroactive basis (that is, individuals who were involuntarily terminated on or after September 1, 2008 and their "qualified beneficiaries" are entitled to the subsidy) and to have a second chance at COBRA coverage necessitates a special election period. The special election period created by the new rules started on February 17, 2009 and it does not end until 60 days after the date on which notice regarding the COBRA subsidy and the special election period (this notice is discussed further below) is provided to the AEI. If the AEI elects COBRA coverage within this special election period, then as noted above, the COBRA coverage first becomes effective March 1, 2009. Further guidance is still needed establishing the due date of the initial premium for this coverage. It's possible that, as is the case under the regular COBRA rules, the due date will be 45 days after the special COBRA election is made.

It is important to remember that the special election period and the availability of the second COBRA election does not depend on eligibility for the subsidy. Thus, the special election opportunity must be provided regardless of whether the employer expects an AEI's adjusted gross income to exceed the limits described above. Meanwhile, there may be AEIs who are in the middle of their regular COBRA election periods but who have not elected COBRA by the February 17, 2009 enactment date of the Recovery Act. It appears that the special election period applies to these individuals as well, thereby resulting in an extended COBRA election period. If the individual nonetheless elects COBRA before the regular COBRA deadline, COBRA coverage would be effective as of the regular pre-March 1, 2009 COBRA beginning date, but the subsidy would still not begin until March 1, 2009. On the other hand, if the individual misses the regular COBRA election deadline but meets the deadline for the special election period, the individual will have a gap in coverage between the date COBRA would have otherwise begun and March 1, 2009.

It is also important to note that nothing in the new rules extends an AEI's original COBRA period. As a result, the maximum COBRA coverage period that is available to an AEI is still determined by the date on which the AEI lost coverage under the employer's health plan due to the involuntary termination of employment. This is the case even if the AEI takes advantage of the second COBRA election opportunity provided by the special election period. Accordingly, the special election period does not restart the AEI's maximum COBRA period.

Duration of the Subsidy

The duration of the 65% subsidy for an AEI is generally nine months. As a result, after nine months of subsidized coverage, the AEI must pay the full COBRA premium (or such lesser amount as the employer may require) in order to continue COBRA coverage.

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There are two circumstances under which the subsidized COBRA coverages terminates before nine months. First, if an AEI becomes *eligible* for certain other health plan coverage during the nine month subsidy period, the subsidy is no longer available after the date of such eligibility. As a result, the AEI does not need to actually enroll in the other coverage in order for early termination of the subsidy to occur. However, an AEI does not become eligible for other coverage until the expiration of any applicable waiting period (such as a 90-day service requirement under a new employer's health plan). In order to trigger early termination, the other coverage must be either Medicare or coverage under another employer's group health plan (such as the plan of the AEI's new employer or the plan of a spouse's employer) that does not consist solely of dental or vision coverage, an employee assistance plan, a health flexible spending account or an on-site clinic that only provides first-aid, preventive and wellness care. Early termination will occur even if the AEI is subject to a pre-existing condition limitation under the other group health plan.

The Recovery Act requires that the AEI notify the employer in writing when the AEI becomes eligible for Medicare or other group health plan coverage. The Department of Labor is to issue rules governing the form and timing of this AEI notice. Failure to give timely notice makes the AEI liable for a federal penalty equal to 110% of the subsidy that was paid on the AEI's behalf after eligibility for the subsidy ceased, subject to waiver of the penalty if the AEI can demonstrate "reasonable cause" for not timely giving notice.

The second circumstance that terminates the subsidy early is any event that leads to early termination of an AEI's COBRA coverage (such as the failure to timely pay the AEI's 35% share of the COBRA premium or the employer's termination of its group health plans). Accordingly, nothing in the Recovery Act modifies the normal COBRA duration rules.

It will be important to keep in mind the distinction between these early termination rules. For instance, if an AEI becomes eligible for another group health plan but the AEI is subject to a pre-existing condition limitation under that plan, the AEI's subsidized coverage stops. However, the AEI is still entitled to pay the full COBRA premium and maintain COBRA coverage until COBRA coverage is no longer required under the normal COBRA rules (such as when the AEI actually becomes covered under another group health plan).

Reporting and Notice Requirements

The implementation of the Recovery Act's COBRA subsidy triggers not only new filing obligations with the IRS but also new COBRA notice requirements.

IRS Filings

The Recovery Act's subsidy mechanics creates new IRS filing requirements for employers. The IRS has revised Form 941 to accommodate the new subsidy/payroll tax credit mechanism. A link to the revised Form 941, along with a set of questions and answers about the new Form and an employer's recordkeeping requirements, can be found on the IRS Web site at www.irs.gov/newsroom under news release 2009-15. Employers should immediately analyze the revised Form 941 and the information on the IRS Web site and begin revising their payroll systems and recordkeeping procedures to comply with the Form 941 changes.

In addition, employers will be required to periodically file with the IRS a new and separate report listing the Social Security number and subsidy amount of each former employee receiving the subsidy, as well as the type of coverage in which the former employee is enrolled (that is, single or family coverage). That report will include an attestation by the employer that each individual included on the report is an AEI. Further, the new report will require that the employer state each AEI's expected subsidy amount for the next payroll reporting period. The Treasury Department is in the process of developing the details of this new reporting requirement.

"Notice of the new subsidy and the special election period must be provided . . . by April 18, 2009."

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COBRA Notices

Aside from these two new IRS filing requirements, the Recovery Act creates two new COBRA notice requirements.

1. Special Election Period Notice for Pre-February 17, 2009 AEIs. A new notice is required to implement the special election period for those individuals who became AEIs before the February 17, 2009 Recovery Act enactment date (that is, individuals who lost coverage due to involuntary termination and who did not have a COBRA election in effect on February 17, 2009). Notice of the new subsidy and the special election period must be provided to these AEIs by April 18, 2009. As mentioned above, these individuals will then have 60 days after the notice is provided to elect COBRA, and such coverage will be retroactively effective to March 1, 2009 (or, if applicable, to the AEI's regular COBRA effective date if the AEI is still within his or her initial COBRA election period and elects COBRA before that regular election deadline).

The Recovery Act requires that the Department of Labor issue a model notice by March 19, 2009 that employers can use to satisfy this special election notice requirement. While awaiting the model notice, employers should review their employment and COBRA records and identify those former employees/AEIs who are entitled to the special election notice (that is, each former employee who lost coverage under the employer's group health plan due to an involuntary termination of employment during the period September 1, 2008 through February 16, 2009). Because a former employee/AEI's spouse and any dependent children (if they were enrolled in the employer's health plan when coverage was lost) have independent COBRA election rights, a separate special notice and COBRA election opportunity must be provided to each of them as well. Further, unless subsequent Department of Labor guidance provides otherwise, it appears the special notice must be provided to each pre-February 17, 2009 AEI even if that AEI has already elected COBRA. Although the special election period would not apply to that AEI, the special notice is still needed to inform the AEI about the new 65% COBRA subsidy that is effective for the AEI starting on March 1, 2009.

2. Revised COBRA Notice for Post-February 16, 2009 Qualifying Events. The Recovery Act also requires that a plan's regular set of COBRA notices and election forms that are sent to persons experiencing a COBRA qualifying event between February 17, 2009 and December 31, 2009 be revised to include information about the new subsidy. Alternatively, an employer can create a supplemental notice with the required information and include it with the regular set of COBRA notices and forms. It is important to note that unless subsequent Department of Labor guidance permits a different result, this new disclosure requirement is not limited to AEIs but instead it applies to all persons experiencing a COBRA qualifying event (which would include loss of health plan coverage due to circumstances such as a voluntary termination of employment, a reduction of hours, death or divorce).

As with the special notice, the Department of Labor is to issue a model notice with the required supplemental subsidy information by March 19, 2009. As soon as the model notice is issued, employers will need to use it to either revise their existing COBRA notices or to create a supplemental notice, and begin including

"For COBRA qualifying events that occur on or after January 1, 2010, the employer will return to its pre-Recovery Act COBRA notices."

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that revised or supplemental notice in the COBRA packets that are sent to individuals who lose health plan coverage due to a COBRA qualifying event occurring from February 17, 2009 through December 31, 2009. In the case of an individual who experienced a COBRA qualifying event on or after February 17, 2009 but who already received the old version of the COBRA notice, the employer will need to send the revised or supplemental notice to that individual as well.

For COBRA qualifying events that occur on or after January 1, 2010, the employer will return to its pre-Recovery Act COBRA notices. Although the revised or supplemental notice is no longer required for qualifying events that occur on or after January 1, 2010, the subsidy mechanism and IRS reporting requirements discussed above will continue on through 2010 until all persons who became AEIs by the end of 2009 have exhausted their subsidized COBRA coverage.

3. Content of Notices. The Recovery Act specifies that the following information must be included in both the special election notice and the revised or supplemental COBRA notice:
 - The forms necessary to establish the individual's eligibility for the COBRA subsidy. Hopefully the forthcoming model notice will clarify what is needed to comply with this requirement.
 - The name, address and phone number of the plan administrator and any other person maintaining relevant information relating to the COBRA subsidy.
 - A description of the individual's obligation to inform the plan in writing when the individual becomes eligible for other group health plan coverage or Medicare, and a description of the 110% penalty for failing to notify the plan.
 - A description "displayed in a prominent manner" of the individual's right to the COBRA subsidy and the conditions that apply to eligibility for the subsidy.
 - An explanation of the individual's ability to elect a less expensive coverage option under the employer's health plan than the option in which the individual was enrolled when coverage was lost, if the employer decides to permit this optional change in coverage.⁷
4. Penalties. The failure to provide either the special election notice or the modified or supplemental COBRA notice triggers the normal statutory penalties. These consist of the ERISA penalty of up to \$110 per day that a court can order be paid to an affected individual for each day the notice is late. In addition, the IRS can assess a per notice excise tax of \$100 per day for each day the notice is late (or \$200 per day in the case of a notice covering more than one COBRA qualified beneficiary). The failure to timely comply with the Recovery Act's new notice requirements will therefore trigger potentially significant monetary penalties.

Conclusion

Each employer (and its outside COBRA administrator, if it uses one) needs to focus immediately on the these new COBRA subsidy and disclosure rules and

⁷ The Recovery Act permits but does not require an employer to allow AEIs to change to less expensive coverage options outside of a plan's open enrollment period. Due to the administrative complexities that are likely triggered by implementing this optional provision, it is unlikely an employer will choose to allow it.

"Hopefully, the Department of Labor will issue the required model notices sooner than March 19 so that employers have adequate time to ensure compliance with the new COBRA notice requirements."

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Consult your attorney for advice appropriate to your circumstances.

start implementing the necessary changes to its COBRA procedures and payroll systems so that it is in compliance with the various deadlines mentioned above. Hopefully, the Department of Labor will issue the required model notices sooner than March 19 so that employers have adequate time to ensure compliance with the new COBRA notice requirements. In the meantime, employers should begin the process of determining those individuals who must receive the special election period notice by the April 18, 2009 deadline and also implementing the changes required to ensure that AEIs are only paying 35% of the COBRA premium by the May 1, 2009 deadline.