

WHAT YOU NEED TO KNOW



## COBRA Liability in Mergers and Acquisitions

The Consolidated Omnibus Budget Reconciliation Act (COBRA) requires certain group health plans to make continuation coverage available to certain individuals who would otherwise lose group health plan coverage due to a qualifying event. Employers who go through business reorganizations, such as mergers and acquisitions (M&A), will need to know whether COBRA continuation coverage must be offered and whether the group health plan of the seller or buyer must provide COBRA continuation coverage.

### General Rules

Under IRS regulations, if the seller and buyer negotiated their COBRA liability by contract as part of the sale, then the contract will determine who has an obligation to offer COBRA coverage.

If the employer who is contractually responsible for providing COBRA coverage fails to perform or if the contract is silent on COBRA coverage obligations, then the seller's group health plan has the duty to offer COBRA coverage as long as the seller maintains a group health plan post-sale.

If the seller doesn't maintain a group health plan post-sale, then the answer depends on whether it's a stock sale or an asset sale.

In a stock sale, if the seller doesn't maintain a group health plan post-sale, then the buyer is responsible for offering COBRA coverage.

In an asset sale, if the seller doesn't maintain a group health plan post-sale and the group health plan's termination is connected with the asset sale, then the buyer is responsible for offering COBRA coverage if the buyer continues business operations associated with the assets purchased without interruption or substantial change.

Below are IRS [regulations](#)' Q&As and examples that illustrate these general rules.

### Buyer and Seller Negotiate COBRA Liability

**Q-7:** In a business reorganization, are the buying group and the selling group permitted to allocate by contract the responsibility to make COBRA continuation coverage available to M&A qualified beneficiaries?

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**A-7:** Yes. Nothing in this section prohibits a selling group and a buying group from allocating to one or the other of the parties in a purchase agreement the responsibility to provide the coverage required under [§§54.4980B-1 through 54.4980B-10](#). However, if and to the extent that the party assigned this responsibility under the terms of the contract fails to perform, the party who has the obligation under Q&A-8 of this section to make COBRA continuation coverage available to M&A qualified beneficiaries continues to have that obligation.

### Buyer and Seller Do Not Negotiate COBRA Liability

**Q-8:** Which group health plan has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries in a business reorganization?

**A-8:** (a) In the case of a business reorganization (whether a stock sale or an asset sale), so long as the selling group maintains a group health plan after the sale, a group health plan maintained by the selling group has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to that sale. ...

**Example 2.** (i) Selling Group *S* consists of three corporations, *A*, *B*, and *C*. Each of *A*, *B*, and *C* maintains a group health plan for its employees (and their families). Buying Group *P* consists of two corporations, *D* and *E*. *P* enters into a contract to purchase all of the stock of *C* from *S* effective July 1, 2002. As of June 30, 2002, there are 14 qualified beneficiaries receiving COBRA continuation coverage under *C*'s plan. *C* continues to employ all of its employees and continues to maintain its group health plan after being acquired by *P* on July 1, 2002.

(ii) Under these facts, *C* is an acquired organization and the 14 qualified beneficiaries under *C*'s plan are M&A qualified beneficiaries. A group health plan of *S* (that is, either the plan maintained by *A* or the plan maintained by *B*) has the obligation to make COBRA continuation coverage available to the 14 M&A qualified beneficiaries. ...

### Seller Does Not Maintain a Group Health Plan After a Stock Sale

**Q-8:** Which group health plan has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries in a business reorganization?

**A-8:** ... (b)(1) In the case of a stock sale, if the selling group ceases to provide any group health plan to any employee in connection with the sale, a group health plan maintained by the buying group has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to that stock sale. A group health plan of the buying group has this obligation beginning on the later of the following two dates and continuing as long as the buying group continues to maintain a group health plan (but subject to the rules in [§54.4980B-7](#), relating to the duration of COBRA continuation coverage)—

- (i) The date the selling group ceases to provide any group health plan to any employee; or
- (ii) The date of the stock sale.

(2) The determination of whether the selling group's cessation of providing any group health plan to any employee is in connection with the stock sale is based on all of the relevant facts and circumstances. A group health plan of the buying group does not, as a result of the stock sale, have an obligation to make COBRA continuation coverage available to those qualified beneficiaries of the selling group who are not M&A qualified beneficiaries with respect to that sale. ...

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**Example 4.** (i) Selling Group *S* consists of three corporations, *A*, *B*, and *C*. Buying Group *P* consists of two corporations, *D* and *E*. *P* enters into a contract to purchase all of the stock of *C* from *S* effective July 1, 2002. Before the sale of *C*, *S* maintains a single group health plan for the employees of *A*, *B*, and *C* (and their families). *P* maintains a single group health plan for the employees of *D* and *E* (and their families). Effective July 1, 2002, the employees of *C* (and their families) become covered under *P*'s plan. On June 30, 2002, there are 25 qualified beneficiaries receiving COBRA continuation coverage under *S*'s plan, 20 of whom are M&A qualified beneficiaries with respect to the sale of *C*. (The other five qualified beneficiaries had qualifying events in connection with a covered employee whose last employment before the qualifying event was with either *A* or *B*.) *S* terminates its group health plan effective June 30, 2002 and begins to liquidate the assets of *A* and *B* and to lay off the employees of *A* and *B*.

(ii) Under these facts, *S* ceases to provide a group health plan to any employee in connection with the sale of *C* to *P*. Thus, beginning July 1, 2002 *P*'s plan has the obligation to make COBRA continuation coverage available to the 20 M&A qualified beneficiaries, but *P* is not obligated to make COBRA continuation coverage available to the other 5 qualified beneficiaries with respect to *S*'s plan as of June 30, 2002 or to any of the employees of *A* or *B* whose employment is terminated by *S* (or to any of those employees' spouses or dependent children).

### **Seller Does Not Maintain a Group Health Plan After an Asset Sale**

**Q-8:** Which group health plan has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries in a business reorganization?

**A-8:** ... (c)(1) In the case of an asset sale, if the selling group ceases to provide any group health plan to any employee in connection with the sale and if the buying group continues the business operations associated with the assets purchased from the selling group without interruption or substantial change, then the buying group is a successor employer to the selling group in connection with that asset sale. A buying group does not fail to be a successor employer in connection with an asset sale merely because the asset sale takes place in connection with a proceeding in bankruptcy under Title 11 of the United States Code. If the buying group is a successor employer, a group health plan maintained by the buying group has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to that asset sale. A group health plan of the buying group has this obligation beginning on the later of the following two dates and continuing as long as the buying group continues to maintain a group health plan (but subject to the rules in [§54.4980B-7](#), relating to the duration of COBRA continuation coverage)—

- (i) The date the selling group ceases to provide any group health plan to any employee; or
- (ii) The date of the asset sale.

(2) The determination of whether the selling group's cessation of providing any group health plan to any employee is in connection with the asset sale is based on all of the relevant facts and circumstances. A group health plan of the buying group does not, as a result of the asset sale, have an obligation to make COBRA continuation coverage available to those qualified beneficiaries of the selling group who are not M&A qualified beneficiaries with respect to that sale.

**Example 8.** (i) Selling Group *S* provides group health plan coverage to employees at each of its operating divisions. *S* sells substantially all of the assets of all of its divisions to Buying Group *P*.

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*P* hires most of *S*'s employees on the date of the purchase of *S*'s assets, retains those employees in the same positions that they had with *S* before the purchase, and continues the business operations of those divisions without substantial change or interruption. *P* provides these employees with coverage under a group health plan. *S* continues to employ a few employees for the principal purpose of winding up the affairs of *S* in preparation for liquidation. *S* continues to provide coverage under a group health plan to these few remaining employees for several weeks after the date of the sale and then ceases to provide any group health plan to any employee.

(ii) Under these facts, the cessation by *S* to provide any group health plan to any employee is in connection with the asset sale to *P*. Because of this, and because *P* continued the business operations associated with those assets without substantial change or interruption, *P* is a successor employer to *S* with respect to the asset sale. Thus, a group health plan of *P* has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the sale beginning on the date that *S* ceases to provide any group health plan to any employee. (A group health plan of *S* retains this obligation for the several weeks after the date of the sale until *S* ceases to provide any group health plan to any employee.)

### **Seller Does Not Maintain a Group Health Plan After an Asset Sale and There is No Successor Employer**

**Example 7.** (i) Selling Group *S* provides group health plan coverage to employees at each of its two operating divisions. *S* sells the assets of one of its divisions to Buying Group *P1*. Under the terms of the group health plan covering the employees at the division being sold, their coverage will end on the date of the sale. *P1* hires all but one of those employees, gives them the same positions that they had with *S* before the sale, and provides them with coverage under a group health plan.

(ii) Under these facts, a group health plan of *S* has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the sale to *P1*. (If an M&A qualified beneficiary first became covered under *P1*'s plan after electing COBRA continuation coverage under *S*'s plan, then *S*'s plan could terminate the COBRA continuation coverage once the M&A qualified beneficiary became covered under *P1*'s plan, provided that the remaining conditions of Q&A-2 of [§54.4980B-7](#) were satisfied.)

(iii) Several months after the sale to *P1*, *S* sells the assets of its remaining division to Buying Group *P2*, and *S* ceases to provide any group health plan to any employee on the date of that sale. Thus, under Q&A-1 of [§54.4980B-7](#), *S* ceases to have an obligation to make COBRA continuation coverage available to any qualified beneficiary on the date of the sale to *P2*. *P1* and *P2* are unrelated organizations.

(iv) Even if it was foreseeable that *S* would sell its remaining division to an unrelated third party after the sale to *P1*, under these facts the cessation of *S* to provide any group health plan to any employee on the date of the sale to *P2* is not in connection with the asset sale to *P1*. Thus, even after the date *S* ceases to provide any group health plan to any employee, no group health plan of *P1* has any obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the asset sale to *P1* by *S*. If *P2* is a successor employer under the rules of paragraph (c) of this Q&A-8 and maintains one or more group health plans after the sale, then a group health plan of *P2* would have an obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the asset sale to *P2* by *S* (but in such a case employees of *S* before the sale who continued working for *P2* after the sale would not be M&A qualified beneficiaries). However,

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even in such a case, no group health plan of *P2* would have an obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the asset sale to *P1* by *S*. Thus, under these facts, after *S* has ceased to provide any group health plan to any employee, no plan has an obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the asset sale to *P1*.

## Small Employer Plan Exception

Certain small employer plans are excepted from COBRA. To be excepted from COBRA, a plan must be maintained by an employer who employs fewer than 20 employees on at least 50 percent of its typical business days during a particular calendar year.

However, under [IRS Revenue Ruling 2003-70](#), a small employer plan otherwise excepted from COBRA is subject to COBRA with respect to qualified beneficiaries who experience a qualifying event during a period when the plan is not a small employer plan.

## Failure to Offer COBRA Continuation Coverage

If a seller or buyer has the obligation to offer COBRA continuation coverage and fails to offer it, then it should consult with its attorney as soon as possible about correcting the failure. The plan sponsor could be subject to a variety of consequences for failure to offer COBRA continuation coverage, including IRS excise tax penalties, ERISA penalties of \$152 per day for failure to provide certain notices, and potential lawsuits.

## Employer Play-or-Pay Responsibilities in a Merger or Acquisition

Mergers and acquisitions may raise issues under the ACA's employer shared responsibility provisions. The IRS provides limited [guidance](#) on what an employer should do when a buyer uses a different measurement method than a seller used for its employees.

Although the IRS guidance is preliminary and does not cover an employer's options in detail, it appears that there may be three options available:

1. Treat the acquired employees like transferred employees (if the acquired employee is in a stability period at the time of the sale, then the acquired employee will retain that status through the end of the stability period; if the acquired employee is not in a stability period at the time of the sale, then the acquired employee's status will be determined under the buyer's measurement and stability periods).
2. Continue to apply the measurement method used by the seller to the acquired employees during a transition period following the transaction's closing. After the transition period, apply the buyer's measurement method to the acquired employees.
3. Treat the acquired employees as new hires so the buyer would treat the acquired employees under its measurement method in the same manner as any other newly hired employees.

Because there is limited IRS guidance on these options, an employer should consult with its attorney before choosing one of these approaches.

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## Best Practices in COBRA Planning for Mergers and Acquisitions

Before entering into a merger or acquisition, an employer should consult with its attorney so that negotiations can adequately address COBRA liability.

Although a buyer and seller may allocate the responsibility to provide COBRA coverage by contract, if an employer does not satisfy its contractual obligation, then the employer with the obligation under the COBRA regulations will retain its obligation to provide COBRA continuation coverage.

Employers should be aware of the limits to contractually reallocating COBRA liability. In an asset sale, if a seller ceases to offer a group health plan in connection with the sale and before the end of the maximum COBRA period, and the buyer becomes the successor employer, then the COBRA liability will spring to the buyer despite contrary contract provisions. Similarly, in a stock sale, COBRA liability will spring to the buyer despite contrary contract provisions, if the seller doesn't maintain any group health plan post-sale.

7/16/2018

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## COBRA Liability in Mergers & Acquisitions Flow Chart

