
# Lowenstein Sandler's Executive Compensation and Employee Benefits Podcast: Just Compensation

**Episode 62**

**By Megan Monson, Taryn E. Cannataro, Zachary Bocian**

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**Megan Monson:** Welcome to the Lowenstein Sandler podcast series. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcast or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud, or YouTube. Now, let's take a listen.

**Taryn E. Cannataro**: Welcome to the latest episode of Just Compensation. I'm Taryn E. Cannataro, counsel of Lowenstein Sandler's Executive Compensation, Employment and Employee Benefits Group. I'm joined today by my colleagues, Megan Monson and Zachary Bocian, who I will let introduce themselves.

**Megan Monson**: Hi, I'm Megan Monson. I'm a partner in the same practice group as Taryn. Pleasure to be here today.

**Zachary Bocian**: Hi, I'm Zach. I am an associate in the same practice group as Megan and Taryn.

**Taryn E. Cannataro**: In case you're not aware, COBRA, if a company is required to offer it, gives workers and their families who lose their health benefits the right to choose to continue group health benefits provided by their group health plan for limited periods of time under certain circumstances.

Today, we're tackling federal COBRA obligations in M&A transactions, specifically the Treasury regulations that address whether buyer or seller has the obligation to make COBRA continuation coverage available to certain seller employees that the regulations refer to as M&A-qualified beneficiaries.

We'll cover the key definitions, who qualifies, how the regulations allocate the COBRA obligations between seller and buyer, and what deal practitioners need to know.

Please note that this episode focuses on employer-sponsored group health plans of private sector employees subject to federal COBRA rules, which generally applies to employers who have 20 or more employees. Individual states may have their own mini-COBRA rules, which could apply to those that are not covered by federal COBRA. State mini-COBRA rules are outside the scope of this episode.

As always, this is intended to be a high-level discussion and not legal advice. Please consult your advisors about how these rules apply to your specific facts and circumstances.

Before we get into the details, Megan, why is it important for deal teams to be mindful of the special COBRA rules that apply in the M&A context? For our purposes going forward, we're going to refer to these as the M&A COBRA rules.

**Megan Monson**: It's important to understand what these obligations are in the context of a transaction, and particularly early on, because the analysis feeds directly into the purchase agreement. The regulations permit the selling group and buying group to allocate responsibility with respect to whom is providing COBRA continuation coverage under whatever document governs the terms of the transaction.

However, just because there's a contractual agreement amongst the parties, that doesn't eliminate the underlying regulatory obligation to actually provide COBRA to M&A-qualified beneficiaries, and who bears that obligation is going to vary based upon the nature of the transaction, along with other factors that we'll get into.

If, and to the extent that the party that was contractually assigned the responsibility under whatever the deal document was, fails to perform their obligation, even though it's been contracted out, the party that has the default obligation under the regulations will continue to hold that obligation, so will have potential liability if the parties don't honor what they've agreed to in the transaction document.

It's important to understand who bears both the regulatory obligation, and then based on that, how do you want to allocate and address that responsibility in a transaction or purchase agreement?

**Taryn E. Cannataro**: Thanks, Megan. Let's start with the basics. How do the M&A COBRA regulations classify a transaction?

**Megan Monson**: I'll start off with saying that a lot of the rules that we're going to talk about today are really complicated and use a lot of technical terminology under the Treasury regulations, so we're going to try to break it down and distill it in a way that's a little bit more digestible and easy to understand.

For purposes of the M&A COBRA regulations and thinking about what transactions would be relevant here, the Treasury regulations talk about a business reorganization, which is either a stock sale or an asset sale. A stock sale is the transfer of stock in a corporation that causes the corporation to become a different employer or a member of a different controlled group of corporations. On the other side, an asset sale is a transfer of substantial assets, such as a plant or division or substantially all assets of a trade or business.

Now, there can be some ambiguity in determining whether a transaction is a stock sale or an asset sale for these purposes as the asset sale definition does not provide concrete guidance as to what constitutes substantially all of the assets of the trade or business. But a good rule of thumb is, is it really being assets that are sold or is it the underlying stock of a corporation that's being sold? And the nature of the transaction is a critical piece of the analysis into determining who has the responsibility with respect to qualified COBRA M&A beneficiaries.

**Taryn E. Cannataro**: Zach, what makes someone an M&A qualified beneficiary?

**Zachary Bocian**: Sure. An M&A qualified beneficiary is someone whose qualifying event occurred prior to or in connection with the sale, and who either is a covered employee, or whose qualifying event occurred in connection with a covered employee, whose last employment before the qualifying event, was associated with the assets or company being sold.

If there's been more than one qualifying event with respect to the current right to COBRA continuation coverage, you look to the first qualifying event. This tracing exercise matters because if a buying group obligation arises, that is the controlled group of corporations or group of trades or businesses under common control that includes the acquirer, it's limited only to M&A-qualified beneficiaries rather than all previous employees on COBRA.

**Taryn E. Cannataro**: Does the sale itself trigger new COBRA obligations?

**Megan Monson**: That's a great question, Taryn. Typical lawyer answer, it depends. In this context, it depends on the transaction type. In a stock sale, a covered employee who is employed by the acquired organization before the sale and continues employment with the acquired organization after the sale, does not experience a termination of employment as a result of the sale.

In that instance, the sale in and of itself is not a qualifying event for the employee, or the employee's spouse, or dependent children, regardless of whether group health coverage is provided after the sale.

**Zachary Bocian**: Asset sales are different though. An asset sale can be a qualifying event for a covered employee whose employment immediately before the sale was associated with the purchased assets if that employee's employment is terminated in connection with such sale, and the employee loses coverage under a selling group health plan. It can also be a qualifying event for the employee's spouse and dependents who were covered under a selling group plan immediately before the sale and also lose coverage.

There are, however, two key exceptions under which an asset sale will not be a qualifying event. First, the buying group is a, what we call a successor employer, and the employee is employed by the buying group immediately after the sale. Or second, the individual does not lose coverage under a selling group health plan after the sale.

Unless one of those exceptions applies, the asset sale is a qualifying event, even if the buyer hires the employee or the employee continues working in the acquired business. That's because hiring alone does not make the buyer a successor employer. Successor employer status requires that the buyer continue the seller's business operations without interruption or substantial change.

**Taryn E. Cannataro**: This sounds like it could get a bit tricky. What are some traps that practitioners fall into?

**Zachary Bocian**: The big one here is assuming the buyer picks up all COBRA obligations just because it hires the seller's employees. That's wrong. The buying group's regulatory obligation arises only in specific circumstances.

In a stock sale, it arises only if the selling group ceases to provide any group health plan to any employee in connection with the sale.

In an asset sale, the same cessation must occur, and the buying group also qualifies as a successor employer by continuing the business operations associated with the purchased assets without interruption or substantial change.

If the selling group maintains any group health plan after the sale, the general rule applies, and a selling group plan has the regulatory obligation. The buyer's hiring of employees standing alone, again, does not transfer that obligation.

**Megan Monson**: On the flip side, don't always assume the seller always keeps the obligation just because the qualifying event happened before closing. The regulations contemplate that the obligation can shift to the buying group's plan if the selling group ceases to have any group health coverage to the employee. That is something that is not uncommon in an asset sale where all of the employees are transferred, and hired by the buyer, and no longer offer any sort of benefit plans or are not continuing operations.

When conducting diligence for the buying group, it's important to confirm, one, that the federal COBRA obligations apply and identify any state continuation overlay. Two, inventory the covered population, that is the M&A qualified beneficiaries. Three, identify each person's first qualifying event, current coverage, and remaining continuation period. Four, determine whether the selling group will continue to maintain a group health plan after the closing of the transaction. And five, in an asset sale, determine whether the buying group is a successor employer.

It is also important to determine who will have the administrative obligations, such as holding records, sending notices, processing elections, tracking premiums and grace periods and responding to participant questions.

As you can see, there are a lot of things to consider in determining, one, who has the obligation, and two, what information is needed to assess what that's going to look like post-closing.

**Taryn E. Cannataro**: Thanks, Megan. Can you talk us through the allocation rule?

**Megan Monson**: The general rule is this. In 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 selling group plan has the regulatory obligation to make COBRA continuation coverage available to M&A-qualified beneficiaries with respect to that sale. The sale does not restart or extend any pre-sale qualified beneficiary COBRA continuation coverage, and it does not otherwise eliminate pre-sale COBRA obligations.

**Taryn E. Cannataro**: Zach, what happens when the seller does not keep a plan?

**Zachary Bocian**: In a stock sale, if the selling group ceases to maintain any group health plan to any employee, a buying group plan has the regulatory obligation to make COBRA continuation coverage available to M&A-qualified beneficiaries with respect to that stock sale. That obligation begins on the later of, the date the selling group ceases to provide any group health plan to any employee, or the stock sale date, and continues for each individual's applicable continuation period as long as the buying group continues to maintain a group health plan.

The sale does not create a new COBRA continuation coverage period, and the buying group does not, as a result of the stock sale, have the obligation for selling group qualified beneficiaries who are not M&A-qualified beneficiaries with respect to the sale.

**Megan Monson**: In an asset sale there's an additional requirement. The buying group must also be a successor employer of the selling group by continuing the business operations associated with the purchased assets without interruption or substantial change. A buying group does not fail to be a successor employer merely because the asset sale occurs in a Title XI bankruptcy proceedings. I will say, in most asset sales, at least that we encounter, there would be a successor employer for these purposes.

If these conditions are met, a buying group plan has the regulatory obligation for M&A-qualified beneficiaries with respect to that asset sale beginning on the later of the cessation date of coverage or the asset sale date and continuing through each individual's otherwise applicable continuation period as long as the buying group continues to maintain a group health plan during such continuation period.

**Taryn E. Cannataro**: Does a change in the responsible plan restart the COBRA continuation period?

**Zachary Bocian**: That's a great question, Taryn. No, the M&A rules may change which plan is responsible, but they do not restart the COBRA clock. If the sale itself creates a qualifying event, the period is measured from that event.

Otherwise, a beneficiary already on COBRA gets only the remaining balance of the applicable maximum period tied to the original qualifying event, which is typically 18 months from termination and up to 36 months for certain other qualifying events. The usual early termination rules still apply and many COBRA implications in various states should also be taken into account.

**Taryn E. Cannataro**: How do you determine whether the cessation is in connection with the sale?

**Zachary Bocian**: That's a facts and circumstances analysis, including looking at the timing and reasons for cessation, what coverage the selling group provides after closing and how closely the cessation is tied to the transaction at issue.

**Taryn E. Cannataro**: Could you give us a quick example?

**Zachary Bocian**: Sure. Take a seller that sells a division but continues to maintain a medical plan for employees in its remaining operations. A former employee tied to that division is already on COBRA. Under the general rule, a selling group plan has the obligation to provide COBRA coverage for that M&A-qualified beneficiary, because the selling group still maintains a group health plan.

Now let's change the facts a little. The seller sells, substantially all of its assets, ceases to provide any group health plan to any employee in connection with that sale, and the buyer continues the business without interruption or substantial change. In that example, the buyer is a successor employer, and a buying group plan picks up the regulatory obligation for the M&A qualified beneficiaries for the duration of each person's remaining COBRA period. Same people, different answer depending on what the seller does with its remaining health coverage and the structure of the deal at issue.

**Taryn E. Cannataro**: Let's close with some key takeaways. Zach?

**Zachary Bocian**: First, let's make sure that we confirm the relevant plan is subject to federal COBRA and flag any state continuation overlay. Second, classify the transaction as a stock sale or asset sale and flag the open characterization questions. Third, analyze and determine the selling group, buying group and acquired organization, or purchase assets, using the controlled group and common control rules. Fourth, identify the M&A-qualified beneficiaries by tracing each qualified beneficiary's first qualifying event back to the acquired organization or the purchase assets. And fifth, determine whether the selling group will maintain any group health plan after the sale. If it will, the general rule applies and a selling group plan has the COBRA obligation.

**Megan Monson**: Continuing on the list, sixth, if the selling group ceases to provide any group health plan in connection with the sale, determine whether the buying group has the obligation in an asset sale whether the buying group qualifies as a successor employer by continuing the acquired operations without interruption or substantial change.

Seventh, draft the responsible allocation provisions for the transaction or purchase agreement carefully, recognizing that if the assigned party fails to perform, the regulatory obligor continues to have that obligation.

Eighth, plan for timely data transfer and notice administration well before closing, including the 60-day election period, and 45-day initial payment period.

And lastly, remember that an M&A transaction does not restart the applicable continuation period, and the buying group's obligations, if it arises, extends only to M&A-qualified beneficiaries, not to all of the selling group's COBRA population.

**Taryn E. Cannataro**: Thank you both. Today, we discussed the responsibility for providing the federal COBRA coverage in business reorganization, including the differences between stock and asset sales, the general rule and exceptions for allocating the responsibility of COBRA coverage, notice requirements, and practical deal planning opportunities. These are technical rules with real compliance consequences, so getting them right early in the deal process can save significant headaches later.

As always, the episode is a high-level discussion and not legal or tax advice. Please consult your own advisors for guidance on your specific facts.

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