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Health Care Reform's No-rescission Rule And COBRA — Do They Conflict?

Paul M. Hamburger

July 24, 2010 — As a part of its health care reform provisions, the Patient Protection and Affordable Care Act (known simply as the "Affordable Care Act") enacted a rule that prohibits group health plans from rescinding group health plan coverage. This no-rescission rule applies to all group health plans, including so-called grandfathered group health plans (that is, plans in existence on March 23, 2010, the date of the Act's enactment). On June 28, 2010, the federal agencies that interpret the Act's mandates issued an interim final rule (IFR) explaining how the norescission rule works. This guidance raises the possibility that the no-rescission rule overrides certain fundamental COBRA principles. Plan administrators need to consider the implications of this no-rescission rule in planning for COBRA administration in light of health care reform.

Understanding How COBRA Works

To understand the conflict between the IFR and COBRA, let's first review the basics of how COBRA works. The right to COBRA coverage is generally measured from the date of the qualifying event and continues for the relevant 18, 29 or 36-month period. (See ¶1260 of the *Guide*.)

Example. If an employee's hours are reduced from full-time to part-time and that reduction in hours causes a loss of coverage under the plan terms, the affected employee's COBRA right is to elect to continue up to 18 months of continued coverage measured from the date of the switch from full-time to part-time. To do so, the employee must elect coverage on a timely basis and pay the full COBRA premium for that coverage (up to 102 percent of the full cost, including the employer and employee portion of the premium).

One exception to this rule is that a plan, by its terms, may elect to measure COBRA coverage from the date coverage is lost due to the qualifying event rather than from the event date itself.

Example. An employee terminates employment on Aug. 20. In many plans, this means that coverage is not lost until Aug. 31 — the end of the month. These plans will then measure COBRA coverage from Sept. 1 forward, rather than from the Aug. 20 qualifying event date.

Once a qualifying event occurs and a qualified beneficiary has been provided with a proper and timely COBRA notice, he or she has a 60-day election period within which to elect COBRA coverage. According to the final IRS COBRA regulations, a plan has two choices of how to deal with coverage during this COBRA election period:

1. the plan can automatically provide the coverage during the election period; or
2. if the plan allows retroactive reinstatement, the plan can terminate the qualified beneficiary's coverage and reinstate her or him when the election (and, if applicable, payment for the coverage) is made. Claims incurred by a qualified beneficiary during the election period do not have to be paid before the election (and, if applicable, payment) is made. Moreover, the regulations specifically provide that if the plan provides coverage during the election period, it is allowed to cancel the coverage retroactively if COBRA coverage is not elected or the premium is not paid on time.

Understanding the No-rescission Rule

Now let's understand how the new no-rescission rule works. Under the IFR, the agencies first defined the term "rescission" as a retroactive termination of coverage.

Example. If a group health plan finds out that a particular individual is not entitled to coverage, and the plan would like to retroactively terminate that coverage back to the date of improper coverage, that termination of coverage will qualify as a rescission under the new rules.

On the other hand, if the group health plan decided that the coverage would terminate prospectively only, that prospective termination of coverage would not be classified as a "rescission."

Under the Affordable Care Act, effective for plan years beginning on or after Sept. 23, 2010 (Jan. 1, 2011 in the case of a calendar year group health plan), a group health plan may not rescind a participant's coverage (that is, terminate that coverage retroactively) except in the case of fraud or the individual's intentional representation of a material fact, as prohibited by the plan terms. In addition, a group health plan must provide at least 30 days advance written notice to each participant who would be affected before any coverage may be rescinded (due to fraud or an intentional misrepresentation of material fact). Separately, a group health plan may cancel coverage, even retroactively, if the termination of coverage is due to a failure to timely pay required premiums or contributions toward the cost of coverage. Finally, the IFR includes an ominous and unexplained warning that "Other requirements of Federal or State law may apply in connection with a rescission of coverage."

The IFR provides the following example of how the no-rescission rule works:

Facts. An employer sponsors a group health plan that provides coverage for employees who work at least 30 hours per week. Individual B has coverage under the plan as a full-time employee. The employer reassigns B to a part-time position. Under the plan terms, B is no longer eligible for coverage. The plan mistakenly continues to provide health coverage, collecting premiums from B and paying claims submitted by B. After a routine audit, the plan discovers that B no longer works at least 30 hours per week. The plan rescinds B's coverage effective as of the date that B changed from a full-time to a part-time employee.

Conclusion. In this example, the plan cannot rescind B's coverage because there was no fraud or an intentional misrepresentation of material fact. The plan may cancel coverage for B prospectively, subject to other applicable federal and state laws.

Is There a Conflict Between The No-rescission Rule and COBRA?

What is interesting about this example is that the IFR did not address any of the COBRA considerations that would otherwise be involved. Under COBRA, if Individual B in the above example was transferred from full-time to part-time employment and lost group health coverage under the plan terms, that loss of coverage would constitute a COBRA qualifying event. As explained above, the plan would technically be within its rights under COBRA to continue coverage during the COBRA election period and retroactively terminate that coverage back to the qualifying event date (that is, the switch from full-time to part-time employment) if Individual B never elected or paid for COBRA coverage.

The question is whether the IFR intended to override this basic COBRA rule. In COBRA's normal operation, where the administrator does not make mistakes, two rules in the IFR would seem to support the view that COBRA rules continue to apply.

(1) *The IFR specifically states that coverage may be terminated retroactively notwithstanding the norescission rule, if the required premium is not paid on time.* Although the IFR did not specifically so state, presumably this rule would mean that the failure to pay the COBRA premium on time would allow for retroactive termination of coverage in the normal COBRA qualifying event situation.

In support of this view, one would argue that the plan is simply being administered in accordance with its terms (terminating coverage upon the occurrence of a qualifying event) and then applying

COBRA's rules and regulations (allowing for termination of coverage, including retroactively to the qualifying event date, for a failure to elect and/or pay for COBRA coverage).

(2) *There is that unexplained statement that other requirements of federal or state law may apply in connection with a rescission of coverage.* Perhaps this statement is referring to COBRA coverage, whether federal COBRA or a state mini-COBRA law. However, it seems more likely that this statement was intended to be a regulatory threat of sorts that other laws may also prohibit a retroactive rescission of coverage and not as a reference to the permissibility of terminating coverage retroactively under COBRA.

In any case, although it is not entirely clear, where a plan administrator identifies a qualifying event and provides proper COBRA notices on a timely basis, presumably the ability to terminate coverage retroactively under COBRA survives the IFR and health care reform's no-rescission rule.

When Someone Is Inadvertently on Coverage Longer Than Permitted

However, the IFR also raises a slightly different point. What happens when a plan inadvertently keeps someone on coverage longer than otherwise permitted under the plan terms? Group health plans often find that individuals are provided with coverage inadvertently when they are not otherwise entitled to it.

For example, a plan administrator might overlook an employee's change in status. Or a plan administrator might not have realized that a spouse was divorced or a dependent child ceased to be eligible for coverage under the plan terms. In cases where a plan inadvertently keeps someone on coverage for an extended period and this error is discovered, is the plan administrator allowed to terminate coverage retroactively, subject to a COBRA election and premium payment?

This is less clear. Before health care reform, COBRA case law provided a few examples of what to do in these situations. Here are two of those cases.

Consider first the case of *Coker v. Trans World Airlines, Inc.* (see ¶1900, Case Nos. 277 and 346). Susan Coker was a covered dependent (spouse) under the Trans World Airlines (TWA) group health plan. TWA's collective bargaining agreement provided that certain furloughed employees would receive continued health coverage until the earlier of 12 months after the furlough date or the date they got a new job.

On Sept. 30, 1992, Coker's husband was furloughed and was offered the right to up to 12 months of post-furlough coverage paid for by TWA. The Cokers were told they would have to pay for the next six months of COBRA coverage. After 12 months had passed, the Cokers did not exercise their COBRA option. However, due to an administrative error, TWA kept them on the plan and sent them new insurance cards in 1993 and 1994. Had they elected COBRA coverage, the Cokers' 18 months of coverage would have expired on March 30, 1994. In early 1995, the company found out about this inadvertent coverage and the plan stopped paying claims, leaving the Cokers with more than $45,000 in unpaid medical expenses.

The Cokers sued TWA and the TWA plan, alleging that the company should be estopped — or prevented — from denying coverage. In upholding the lower court's decision in TWA's favor, the 7th U.S. Circuit Court of Appeals stated that:

It defies common sense to think that a company for which one was not presently working, that was not paying a current wage or salary, and that had (as of then) made no promise of reinstatement, would continue indefinitely to afford health coverage for the spouse of a former employee.

At worst, [TWA] was guilty of bureaucratic sloppiness when it did not delete the Cokers from the rolls of active health plan participants after 12 months had elapsed and instead sent them new prescription and insurance benefits cards. TWA paid for its mistakes, insofar as it provided free health insurance for her for a substantially longer period of time than it was required to do, and we understand that it is not trying to recoup

anything for that period. It just wanted to turn off the spigot when it learned of the mistake, and we hold that it was entitled to do so.

Now, consider *Kost v. United Parcel Service, Inc*. (see ¶1900, Case No. 259). In that case, a qualified beneficiary fell through the cracks of an otherwise compliant COBRA system and was never offered COBRA coverage. By the time the error was discovered, 17 months had elapsed from the qualifying event date. The employer offered the qualified beneficiary the opportunity to obtain free COBRA coverage retroactively to the qualifying event date, as long as the qualified beneficiary paid for one month of COBRA coverage. The qualified beneficiary rejected the offer and sued the administrator for COBRA notice penalties.

The court flatly rejected the qualified beneficiary's claim, even though it was clear that a COBRA notice was not provided by the administrator on a timely basis. As the court noted, "this is an unabashed effort to exploit inadvertent error by defendants into a windfall award of discretionary penalties and costs. The court will not be a party to such an unscrupulous cause." So the employer was, presumably, allowed to terminate the coverage retroactively in this case.

Looking just at these two cases, then, it seems that when someone is inadvertently kept on coverage beyond a qualifying event date, plan administrators are clearly allowed to "turn off the spigot" and terminate coverage prospectively (as in *Coker*). However, in the right case, they are also allowed to terminate the coverage retroactively to the qualifying event date (as in *Kost*).

What about after health care reform and the effective date of the no-rescission rule? Are plans' options more limited in cases where coverage is maintained inadvertently after what would otherwise be a qualifying event?

In the example of inadvertent extended coverage under the no-rescission rule, the IFR indicated that the plan cannot rescind coverage retroactively to the change from full-time to part-time status because the continued coverage was inadvertent. The question that arises is whether this example is intended to override the COBRA rules just discussed. That is, if the group health plan is not allowed to rescind the coverage (that is, terminate the coverage retroactively) then is the plan's only option to "turn off the spigot" prospectively?

If so, then is the plan at least allowed to credit the period of inadvertent coverage toward satisfying its COBRA obligations to provide up to 18, 29 or 36 months of coverage from the date of a qualifying event (depending on the specific qualifying event involved)? Presumably, this is permissible. If plans had to measure COBRA coverage prospectively from the date the plans identify the inadvertent extension of coverage, the no-rescission rule would override both the plan terms and COBRA.

If the IFR was not intended to override the general COBRA rules, and retroactive termination of coverage is still allowed under circumstances where COBRA coverage otherwise applies, then the IFR example is very misleading in that it does not indicate how the rule prohibiting retroactive termination of an inadvertent extension of coverage is to be integrated with the existing COBRA rules. Instead, it simply provides an example where COBRA coverage would otherwise apply and indicate that retroactive termination of coverage violates the norescission rule.

What Should Employers and Plan Administrators Do at This Point?

Given the lack of clarity in the IFR, what should employers and plan administrators do at this point?

First, consider filing a comment with the agencies. The IFR is effective on Aug. 27, 2010. Comments on the IFR are due on or before that date; however, the agencies will often consider valid comments even after the due date in considering future guidance. In response to comments, the agencies will likely clarify their views on the interplay between the no-rescission rule and COBRA.

Second, consider changing the plan's administration and documentation in certain respects. Under the norescission rule, retroactive termination of coverage is allowed in cases of fraud or where an individual makes an intentional misrepresentation of material fact, as prohibited by the plan terms. Plan administrators

should review their documents carefully with the assistance of benefits counsel to determine whether their documents allow for retroactive termination in the event of fraud or intentional misrepresentation of material fact. Moreover, it may be advisable to change enrollment forms (or other plan documentation) to make it clear that when participants enroll specific dependents, they are affirmatively representing that they reviewed the plan's eligibility terms and their dependents are eligible for coverage. It may also make sense to have them affirmatively represent that they will advise the plan of any change in circumstances affecting their coverage. This may help a plan later make the argument that an individual made an intentional misrepresentation of material fact in a case where an individual kept a dependent on coverage by failing to advise the plan of changed circumstances.

In the final analysis, the no-rescission rule as interpreted by the IFR is simply not clear on how plans are allowed to terminate coverage retroactively in cases that would otherwise constitute COBRA qualifying events. Absent further clarification, plan administrators will have to work through their particular facts with the assistance of benefits counsel to determine how best to integrate the no-rescission rule with COBRA's existing requirements.

Paul M. Hamburger, Esq., is a partner in the Washington, D.C., office of the law firm Proskauer Rose LLP. He is a member of Thompson's Health Plan Advisory Board, and is author and contributing editor of the COBRA Guide, *the* Pension Plan Fix-It Handbook *and the* Guide to Assigning and Loaning Benefit Plan Money, *all published by Thompson Publishing Group.*
