



## Promises, Promises — Dealing With Misstatements, Misrepresentations and Other Mistakes

Paul M. Hamburger

April 23, 2012 — “People make mistakes. Even administrators of ERISA plans,” according to the U.S. Supreme Court (in *Conkright v. Frommert*). The Court went on to point out that these mistakes happen in part because ERISA is “an enormously complex and detailed statute.” COBRA administrators can readily relate to those words. They understand very well the difficulty of administering just a little sub-part of ERISA known as COBRA — a statute that one court described as follows:

In their rush to get out of town with a bundle of seasonal goodies for their constituents, the Members of Congress neglected such details as [commas and] cross references. ... the statute is the product of scissors, tape, and handwritten interlineations by Members rushing to make their planes. *Hermann v. Cencom Cable Associates, Inc.*

So it is only natural that mistakes will happen. But the real issues for COBRA administrators are how to deal with mistakes when they happen, and how to prevent them from happening again. In this column, we will focus on one type of problem — misrepresentations. In the COBRA context, misrepresentations generally fall into three categories: (1) the complete misrepresentation; (2) the ambiguous promise; and (3) the inadvertent misrepresentation.

### Complete Misrepresentation

Here is how the complete misrepresentation happens:

*Qualified beneficiary to Human Resources (HR) Specialist: “COBRA is really expensive and I’m out of work. Can the company pay for my COBRA coverage for me until I get another job?”*

*HR Specialist to qualified beneficiary: “Sure. No problem. We have a policy to take care of that for people in your situation.”*

The issue is elevated up the chain at the company and it turns out (usually three months later) that there is no such policy. The HR specialist so informs the qualified beneficiary of the fact that COBRA premiums must be paid and that, since the qualified beneficiary had not paid for coverage, COBRA coverage was terminated. The qualified beneficiary is not pleased and sues the plan administrator and the company.

This case raises a clear claim by the qualified beneficiary for material misrepresentation. Although judicial results can vary on the outcome in these types of cases, if the goal is to avoid litigation over this matter, the plan administrator should consider a solution that would allow the qualified beneficiary some time to re-join the plan and make up the missed premiums. If not, the administrator could be exposed for liability for lost COBRA coverage and attorney’s fees.

### The Importance of Training

Interestingly, in a similar reported court decision involving portability of life insurance, one court found that the plan administrator breached its fiduciary duties under ERISA by improperly training the HR specialist. This raises another aspect of addressing administrative issues up front. With proper training, HR specialists or

those who answer calls from qualified beneficiaries should know what the requirements are for payment of COBRA coverage. They should also know the health plan rules and requirements and how to apply them to qualified beneficiaries.

Training is also important to justify a waiver of the excise tax for COBRA violations. Under COBRA, there is an excise tax for COBRA violations. This excise tax can be lowered or even entirely abated through showing that the error was due to reasonable cause and not willful neglect. To show reasonable cause, a plan administrator must be prepared to explain the training process for its HR and COBRA administrative personnel. (See the related story on IRS audit guidelines for excise tax assessment and the type of documents the IRS will want to see to justify a full or partial waiver of the excise tax.)

### **Ambiguous Promise**

The ambiguous promise works this way (based on the facts in *Smith v. Rogers Galvanizing Co.*, see ¶1900 of *Mandated Health Benefits -- the COBRA Guide*):

*Qualified beneficiary to HR Specialist: "COBRA is really expensive and I'm out of work. Can the company pay for my COBRA coverage for me until I get another job?"*

*HR Specialist to qualified beneficiary: "I don't know. Let me get back to you on that."*

The HR specialist never gets back to the qualified beneficiary until several months later. In the meantime, through a glitch in the system, the qualified beneficiary was not billed for COBRA coverage but should have been billed. The HR specialist finally gets back to the qualified beneficiary with the bad news: (1) there is no free coverage; and (2) the qualified beneficiary owes the company back premiums for several months (or, perhaps, since he or she did not pay, the qualified beneficiary loses COBRA coverage).

This scenario is different from the complete misrepresentation case in that there never was an overt promise to the qualified beneficiary of free COBRA coverage. The HR specialist promised nothing. On the other hand, the HR specialist did say that he or she would look into the policy to see if there was free coverage. Then, when the plan never billed the qualified beneficiary, it was not unreasonable for the qualified beneficiary to assume that the HR specialist found a way to provide free coverage. Again, no one ever told the qualified beneficiary that COBRA coverage was free; it was an implication of the actions and events that took place after the initial conversation.

Fixing this type of misrepresentation is very difficult and depends entirely on the facts. The biggest problem is figuring out who said what to whom and when. The ambiguous misrepresentation case typically involves a misunderstanding between the qualified beneficiary, who thought he or she heard one thing, and an administrator who is pretty sure he or she said something else entirely.

### **Sort Out the Facts**

So the first step in an ambiguous promise case is to sort out the facts as best as you can. Were COBRA notices provided? Did the notices explain all the COBRA rules clearly and accurately? Did the administrator refer the qualified beneficiary to those notices? Did the administrator say anything that contradicted the notices? Was there any follow up discussion? All of the facts need to come out.

If it looks like the COBRA notices were accurate and that the administrative personnel did everything right, then it might just be a case where the qualified beneficiary is just confused. In that case, the administrator can likely hold to the terms of the COBRA notices.

On the other hand, if it looks like there really were misleading statements or ambiguous information provided to the qualified beneficiary, the administrator should consider trying to settle with the qualified beneficiary and find some type of reasonable accommodation. In the end, it might be cheaper to settle the ambiguous promise case than incur the costs and lost time involved in litigation.

## Inadvertent Misrepresentation

The inadvertent misrepresentation situation generally involves simply a mistake. For example, in *Coker v. TWA, Inc.* (see ¶1900), the employer had a layoff policy under which affected laid-off employees would be provided with 12 months of continued health coverage at employee rates, followed by six months of continued coverage at COBRA rates. So the policy would provide for the full 18 months of COBRA coverage following the layoff; however, the first 12 months would be at subsidized premiums and the last six months would be at full COBRA premiums.

The problem was that, due to an inadvertent error, the administrator left some employees on coverage at subsidized rates longer than the 12 months. Indeed, some employees even benefited from coverage beyond the 18 months promised by COBRA. When this was discovered, the employer simply wanted to stop the coverage at that point. To quote the opinion, it wanted to “turn off the spigot.”

The qualified beneficiaries felt that they were misled into believing that they had extended coverage available. However, the court sided with the employer and found that the coverage could be terminated and that the qualified beneficiaries had received their COBRA entitlement.

This type of situation is a classic “mistakes happen” situation. When mistakes happen, plan administrators who act reasonably under the circumstances tend to prevail in litigation. In the *Coker* case, had the employer sought retroactive premiums or retroactive coverage termination, and this retroactive action caused significant harm to the qualified beneficiaries, the court might have viewed the case differently. Of course, much depends on the facts (as always); nevertheless, it likely helped the employer’s case to argue that it was willing to allow the qualified beneficiaries to keep the coverage they got (albeit incorrectly). When all that was sought was a way to stop the future provision of coverage, that seemed like a reasonable approach to solving what was an inadvertent error.

## Mistakes Happen, so the Key Is How You React

As all of these cases show, people make mistakes; even COBRA administrators. The real challenge is how people react to mistakes. The sidebar provides some basic correction rules that can help sort out the specific issue presented and prevent them from happening again in the future.

### *Basic Correction Rules for COBRA Mistakes*

1. **Do not panic.** Just because a mistake was made, it does not mean that you are going to be in court in front of a judge or that there will be serious tax or fiduciary consequences. Often, when a mistake is made, it can be easily corrected.
2. **Find out the facts.** Do not overreact to what you think the facts are. It is really important to know the accurate facts and all the accurate facts.
3. **Consider all possible solutions.** Do not just jump to the first possible solution to the problem. Sometimes there could be multiple options (for example, provide some free coverage, a longer time to pay for coverage or an alternative to COBRA coverage, etc.).
4. **Select the best option for correction.** At times, one of the options will be a clear great solution to the problem. However, some problems are just really serious (for example, failure to provide notices to hundreds of employees over multiple years). When that happens, the available solutions might all look pretty bad. So solving the problem could involve selecting the “least bad” option instead of the best option.
5. **Implement the solution.** Once a decision is made to implement a solution to a problem, follow-through is important. This means the steps should be taken as soon as possible to fix the error. Also, you should document the steps taken. This will help support the reasonableness of the actions taken in any future audit or litigation.
6. **Fix things going forward.** Fixing COBRA errors involves more than just correcting past errors. Administrators must also take steps to make sure the error does not happen again in the future. This

*means that administrators might need to be retrained. Administrative rules, manuals, policies and other guidelines might need to be rewritten. Plan documents might need to be amended. The bottom line here is that administrators should not be so focused on the immediate problem at hand that they ignore how to prevent errors from happening in the future.*

7. ***Again, do not panic.*** *At the end of the day, all the possible legal consequences (such as COBRA excise taxes, court-imposed notice penalties, court-imposed legal fees, etc.) can be mitigated, if not avoided, when an employer and plan administrator demonstrate that they acted reasonably under the circumstances. So when mistakes happen, don't panic. There is always something that can be done.*

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