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Supreme Court of Canada Speaks on the Deductibility of Income Replacement Benefits from Wrongful Dismissal Damages

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The Supreme Court of Canada has provided some much needed clarity to the issue of the deductibility of income replacement benefits from wrongful dismissal damages in its long-awaited decision, [IBM Canada Ltd. v. Waterman](#) (“*Waterman*”). Justice Cromwell, writing for the majority of the Court, dealt with the deductibility of pension benefit payments in particular. Ultimately, he concluded that unless the pension plan text or employment contract expressly require otherwise, receipt of such payments does not generally reduce damages otherwise payable to an employee for wrongful dismissal. The Court confirmed that this principle applies regardless of the type of pension plan in question, and regardless of whether the plan is fully funded by the employer.

In this *FTR Now*, we discuss the *Waterman* decision, and its potential impact.

BACKGROUND

In *Waterman*, IBM Canada Ltd. (“IBM”) dismissed a long-term employee, Mr. Waterman, as a result of corporate restructuring. At the time of his termination, Mr. Waterman was 65 years old and had 42 years of service. During his employment with IBM, Mr. Waterman was a member of IBM’s defined benefit pension plan, which was fully funded by IBM. Upon his termination date, Mr. Waterman began receiving a full, unreduced pension under this plan. Mr. Waterman decided not to accept the severance package offered by IBM, and pursued a claim for wrongful dismissal. He was successful in this claim, and the Supreme Court of British Columbia awarded him damages based on a 20-month reasonable notice period.

IBM took the position that Mr. Waterman’s pension payments should be deducted from the salary and benefits otherwise payable to him during this 20-month reasonable notice period. IBM relied on the 1997 decision of the Supreme Court of Canada, *Sylvester v. British Columbia* (“*Sylvester*”), where the Court found that disability benefits under an employer-funded plan were deductible from wrongful dismissal damages, based on the premise that “it makes no sense to pay damages based on the assumption that [the employee] would have worked in addition to disability benefits which arose solely because he could not work” (para. 17). Both the Supreme Court of British Columbia and the British Columbia Court of Appeal, however, found that the pension benefits Mr. Waterman received during the reasonable noticed period were not deductible from the wrongful dismissal damages.

THE SUPREME COURT’S DECISION

A majority of the Supreme Court of Canada agreed. In coming to this conclusion, Justice Cromwell revisited first principles in the law of damages. As a starting point, the compensation principle provides that contract damages should place the plaintiff in the position that he or she would have been in “but for” the defendant’s breach. In the present case, IBM owed Mr. Waterman reasonable notice of dismissal or pay in lieu thereof. This means he would have received only his regular salary and benefits during the reasonable notice period; however, Mr. Waterman instead received *both* his regular salary and his pension for that period. As IBM argued, this amounted to a “collateral benefit” or “compensating advantage” and if the general rule was applied, the pension benefits would be deductible from the wrongful dismissal damages.

As Justice Cromwell noted, whether or not a collateral benefit is deductible requires more careful scrutiny, and the general rule will not apply in every case. Generally, a collateral benefit problem arises where the “compensation of the plaintiff is beyond his or her actual loss and either (a) the plaintiff would not have received the benefit but for the defendant’s breach, or

(b) the benefit is intended to be an indemnity for the sort of loss resulting from the defendant's breach" (at para. 32). In these cases, the collateral benefit should be deductible. However, an important exception relates to private insurance or other analogous types of benefits, including pension payments. In determining whether the exception should apply to the collateral benefit in this case, Justice Cromwell reviewed the authorities, and provided the following general guidance with respect to the deductibility of a collateral benefit (at para. 76):

- a. There is no single marker to sort which benefits fall within the private insurance exception.
- b. One widely accepted factor relates to the nature and purpose of the benefit. The more closely the benefit is, in nature and purpose, an indemnity against the type of loss caused by the defendant's breach, the stronger the case for deduction. The converse is also true.
- c. Whether the plaintiff has contributed to the benefit remains a relevant consideration, although the basis for this is debatable.
- d. In general, a benefit will not be deducted if it is *not an indemnity* for the loss caused by the breach and the plaintiff *has contributed* in order to obtain entitlement to it.
- e. There is room in the analysis of the deduction issue for broader policy considerations such as the desirability of equal treatment of those in similar situations, the possibility of providing incentives for socially desirable conduct, and the need for clear rules that are easy to apply.

Justice Cromwell then applied these general principles to the facts of the case before the Court. First, he looked at the nature and purpose of the pension benefit in question, distinguishing this case from the disability benefits at issue in *Sylvester*. In *Sylvester*, non-contributory disability benefits received during the notice period were deducted from wrongful dismissal damages in part because the benefits were intended to be indemnity for lost wages while the employee was unable to work. In *Waterman*, however, the pension benefit in question was not an indemnity for wage loss, but rather a form of retirement savings to which an employee earns an absolute entitlement to over time. Justice Cromwell likened vested pension benefits to property, over which the plan member has specific and enforceable rights, rather than a form of indemnity against wage loss.

Second, Justice Cromwell found that the parties' intention disclosed that pension benefits should not be deducted from wrongful dismissal damages, again distinguishing this case from the disability benefits at issue in *Sylvester*. In *Sylvester*, not only was it impossible in all circumstances to receive salary and disability benefits at the same time, it was clear that the amount of disability benefits would be reduced by other income received by the employee. This was not the case with pension entitlements, which Justice Cromwell characterized as free-standing entitlements to which an employee earns entitlement over time that are not generally reduced by other income or benefits received by the employee.

Finally, Justice Cromwell considered broader policy considerations regarding the deductibility of pension benefits from wrongful dismissal damages. In *Sylvester*, the Court held that failure to deduct disability benefits in that case might discourage employers from funding wage replacement benefits. This concern did not arise in *Waterman*, given that pension benefits are not intended to be an indemnity for wage loss and that employees contribute to the cost of the pension benefits through their employment with the employer. Further, to allow deductibility of pension benefits in this case could provide an incentive for employers to dismiss pensionable employees rather than other non-pensionable employees, given that they could potentially deduct the amount of pension entitlement from any wrongful dismissal damages.

CONCLUSION

The *Waterman* decision is consistent with prior cases that have found that a terminated employee is entitled to both pension benefits as well as wrongful dismissal damages during the reasonable notice period. Further, this decision confirms prior cases, including *Sylvester*, regarding the deductibility of other income replacement benefits from wrongful dismissal damages. Ultimately, the Court has made clear that, in both instances, the deductibility of any payments from wrongful dismissal damages will be a matter of contractual interpretation. This suggests the parties may be able to agree in the employment contract, or a pension plan could provide, that certain payments can be deducted from amounts owing to employees upon the termination of their employment.



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