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Understanding How Termination and Severance Pay will be Offset Against Disability Benefits**

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The relationship between disability claims and employment terminations is a complex and often challenging one to navigate. Determining eligibility for a disability claim for a terminated employee involves an analysis of many different factors. Further, there are questions that arise with regard to offsets against disability payments from terminated employees who receive notice and severance packages.

Where an employee receives both disability benefits and wrongful dismissal damages concurrently, the question arises as to whether disability benefits received during the notice period should offset damages for wrongful dismissal, or whether an employee is entitled to receive both. Moreover, most disability insurance policies will provide as an offset against disability benefits, any income earned during the claim period, including any pay in lieu of notice which effectively represents income replacement.

The leading Supreme Court decision of *Sylvester v. British Columbia*[1] found that the issue of deductibility is decided based on the terms of the employment contract and the parties' intention. In the circumstances, the Court found that disability benefits should be deducted. Mr. Sylvester had received disability payments during the notice period from a benefit plan established solely by the employer. In finding that the short-term and long-term policies formed an integral part of the employment contract, the Court concluded that the employment contract did not provide that both disability benefits and damages for wrongful dismissal could be received. The Court reasoned that the disability policies made clear that such benefits were a substitute for an employee's regular salary. Moreover, disability benefits and wrongful dismissal damages are based on opposite assumptions about an employee's ability to work and it would be incompatible with the employment contract for the employee to receive both. The suggestion was that the parties did not intend for the employee to receive both damages and disability benefits.

The Court also significantly noted that there may be circumstances where the employee is entitled to both disability benefits and notice on the basis that the disability benefits are akin to benefits from a private insurance plan for which the employee has provided

[1] *Sylvester v. British Columbia*, 1997 CanLII 353 (SCC) [*Sylvester*]

consideration. Further, parties to an employment contract can agree that the employee is to receive both disability benefits and damages for wrongful dismissal. As such, while the Court made clear that benefits are deductible when the employee has made no contributions to the plan and where the plan is sponsored solely by the employer; it left open the question as to what would happen where the employee made some contribution or where the benefits were provided by a third party insurer. The courts have interpreted these issues in a number of ways.

In *Sills v. Children's Aid Society of the City of Belleville*[2], the Ontario Court of Appeal found that there was both a direct and indirect contribution by the employee to the disability insurance policies. The Court stated that *Sylvester* stands for the proposition that disability benefits are deductible from wrongful dismissal damages in certain circumstances.[3] Here, the Court found that Ms. Sills earned the disability benefits as part of her compensation and as part of her trade-off in arriving at benefits and salary.[4] The Court referred to *Sylvester* and concluded that Ms. Sills had provided consideration for her disability benefits and accordingly that such benefits were akin to benefits from a private insurance plan. The Court further relied on *Sylvester* and considered the employment contract and whether any intention could be inferred as to the parties' agreement to entitle employees to both disability payments and damages for wrongful dismissal. The Court in *Sills* stated:

> Absent an express provision precluding double recovery, in my view, the principles enunciated in *Cooper* assist in determining whether an intention that there would be double recovery in the event of a wrongful dismissal can be inferred. I consider it reasonable to assume that an employee would not willingly negotiate and pay for a benefit that would allow her employer to avoid responsibility for a wrongful act. I consider it reasonable to infer that parties would agree that an employee should retain disability benefits in addition to damages for wrongful dismissal where the employee has effectively paid for the benefits in question.[5]

In *McKendrick v. Open Learning Agency*[6], the court also considered whether disability benefits received by the plaintiff during the reasonable notice period were deductible from the award of damages for wrongful dismissal. The plaintiff received two months of short-term disability benefits which benefits were completely funded by the defendant employer. The plaintiff thereafter applied for long-term disability benefits. Her request was denied by the employer's insurer. While her appeal of the denial was pending, the employer terminated her employment. Shortly thereafter, the insurer reversed its decision and granted the plaintiff benefits during the reasonable notice period. The court turned to *Sylvester* in its analysis and reiterated the principle that deductibility is

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[2] *Sills v. Children's Aid Society of the City of Belleville*, 2001 CanLII 8524 (ON CA) [*Sills*]
[3] *Sills* at para. 26
[4] *Sills* at para. 41.
[5] *Sills* at para. 45
[6] *McKendrick v. Open Learning Agency*, 1997 CanLII 2172 (BC SC) [*McKendrick*]

determined in reference to the employment contract and the parties' intentions. It is significant to note that while the short-term benefits were funded entirely by the employer, the plaintiff funded the long-term disability benefits with bi-monthly payroll deductions for the premiums.

The court considered the terms of the employment contract and the parties' intentions and determined that both the short-term and long-term disability policies were integral parts of the employment contract, and accordingly that despite the plaintiff's premium payments, the long-term disability plan was not akin to private insurance. The court stated:

> Although the "insured" under the policy is defined as meaning an employee, unlike a private contract of insurance solely between an employee and an insurer the employer under this contract has rights and obligations and is an integral part of the scheme of coverage. Thus the employer is obliged to provide the insurer with information relative to employees at regular intervals and permit inspection of its records which have a bearing on the insurance. The employer, for all purposes of the policy, acts on its own behalf or "as agent of the employee" and not as agent of the insurer. Most fundamentally, however, although the employer deducts an amount for the premiums from the employees' pay, under the policy "All premiums due under this policy ... are payable by the employer on or before their respective due dates" at the insurer's head office. The policy provides that the employer will be liable to the insurer for all premiums due and unpaid for the full period for which the policy is in force, and if the employer fails to pay any premium within the grace period the policy automatically terminates.
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> It is also apparent that the policy provides benefits which are intended to be a substitute for an employee's regular salary. The contract provides that disability benefits cease on the happening of certain events including:
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> > 4. the date the insured's current earnings exceed 80% of his indexed pre-disability earnings.[7]

The Court also noted that the participation in the long-term disability plan was a mandatory component of the plaintiff's employment contract. Further, under the terms of the contract, the employee had to be engaged in "active employment" with an "employer" who is in turn defined as the "policyholder". The court concluded:

> These factors lead me to conclude that the long-term disability plan is an integral part of the employment contract,

[7] *Ibid* at paras. 34 & 35

> and that it cannot be considered a private insurance arrangement between the employee and the insurer. The fact that the employee has paid for the disability benefits coverage here does not, given the provisions of the plan, serve to make inapplicable the reasoning of the Supreme Court of Canada in *Sylvester*. That reasoning clearly does apply in my judgment. I conclude that there is no basis on the evidence before the Court to infer that the parties agreed or intended that the plaintiff would receive both disability benefits and damages for wrongful dismissal.
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> In the result disability payments received by the plaintiff during the notice period are deductible from the award of damages for wrongful dismissal.[8]

In *McNamara v. Alexander Centre Industries Ltd.*[9], the plaintiff's employment was terminated after he advised his employer that he would require an indefinite leave for medical reasons. Subsequent to his termination, the plaintiff was awarded long-term disability benefits. The plaintiff was also awarded damages for wrongful dismissal. The Ontario Court of Appeal noted that in *Sylvester*, the employer paid both salary and disability benefits and concluded that this case was distinguishable since the long-term disability payments were provided by a third party insurer:

> The trial judge in the present action recognized that in *Sylvester* both salary and disability payments came directly from the employer's pocket whereas in this case ACI was responsible for McNamara's salary but London Life would pay the disability benefits. In my view, she was right to think that this was an important difference. It is one thing to be concerned, as the court was in *Sylvester*, with double recovery when all the money comes from a single source, the employer. The concern should be significantly diminished when the double recovery flows from clear entitlement to two different and legitimate recoveries (damages for wrongful dismissal and disability benefits) *and* neither payor would be responsible for paying even a penny more than it should pay pursuant to its individual obligation.[10]

Further, the Court considered whether the plaintiff had provided consideration for the disability benefits and concluded that he had. The evidence demonstrated that the question of benefits was integral to the plaintiff's discussions on salary at the time of hire and that he would not have accepted the salary but for the benefit package as part of the overall compensation plan.

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[8] *Ibid* at para. 37
[9] *McNamara v. Alexander Centre Industries Ltd.*, 2001 CanLII 3871 (ON CA) [*McNamara*]
[10] *Ibid* at para. 22.

The Court then considered whether the parties intended that disability benefits be deducted from damages for wrongful dismissal. The Court found that there was nothing in the employment contract which would suggest an answer either way. The Court then considered the consequences of deducting the disability benefits and concluded that while McNamara would receive his full salary for the entire notice period, that salary would be less than it might have been if he had not bargained a trade-off between salary and benefits. Moreover, the employer would derive a significant benefit from firing a long-term employee during a time of disability. The Court inferred that in considering such a result, a reasonable employee and a reasonable employer would have agreed to provide the employee with both disability benefits and wrongful dismissal damages.

Courts have generally interpreted *Sylvester* to determine that where an employee contributes either directly or indirectly to payment for the benefits, such policy is akin to private insurance and indicates an intention to entitle employees to both. That being said, an employee's contribution to payment for benefits will not automatically ensure their entitlement to both. As in *McKendrick,* courts will consider all the terms of the employment contract to determine whether the insurance policy is integral to the employment contract and accordingly unlikely to express an intention that employees receive both disability benefits and wrongful dismissal damages concurrently. However, where the employment contract is silent as to the parties' intentions and where offsetting disability benefits would lead to an unfair result, a court may infer that a reasonable employee and employer would have intended a just result, and accordingly that an employee receive both. As such, it seems that, excepting decisions with similar facts to *Sylvester,* like *Alcatel*, courts have easily distinguished their facts from *Sylvester* and have determined their cases in accordance with the caveats espoused in *Sylvester* entitling employees to both disability benefits and wrongful dismissal damages.

Another question arises as to whether the treatment of pay in lieu of notice which represents income replacement should be considered differently than severance payments which are not paid for the purpose of income replacement. A strong argument can be made that severance ought not to be deductible from a disability benefit payment absent clear language within the insurance policy that expressly provides for such an offset.

Conclusion

Navigating the terrain of the termination of disabled employees often raises complex employment, human rights and disability benefit considerations. These cases often involve situations that go beyond mere employment law. A comprehensive understanding of the human rights considerations that apply to the termination of disabled employees, the entitlements of such employees during employment and throughout the notice period, and the relationship between disability benefits, notice and severance entitlements, requires a thorough knowledge of the inter-relationship of contract principles that apply in both the employment and insurance context. These principles will apply differently in the unionised and non-unionised work environment.

In order to avoid landmines in navigating what some consider to be a minefield, it is imperative to seek out expert advice in order to ensure that proper principles are applied and sensible decisions are taken that will protect the rights and interests of employers and employees alike.

**** For more information on this topic, please refer back to the OBA Labour and Employment Law Section Newsletter, Volume 14, No. 3, published in May 2013.**

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