

Don't Deduct The "Nest Egg": The Supreme Court Of Canada Upholds No Deduction Of Pension Benefits From Wrongful Dismissal Awards

It is well established that employees in Canada who are terminated without cause are entitled to reasonable notice or severance in lieu. With respect to the latter, severance is an attempt to put the employee in the same economic position that would have resulted had the individual received reasonable notice. Under this principle, courts have generally deducted from the severance amount any salary earned during the notice period, including, in certain circumstances, disability benefits.

On December 13, 2013, a long anticipated decision from the Supreme Court of Canada (the "SCC") was published dealing with whether the employer is able to deduct from wrongful dismissal damages amounts paid to the dismissed employee as pension benefits. In *IBM Canada Limited v Richard Waterman*, 2013 SCC 70, the majority of the Court confirmed the principle that employee pension payments are a type of benefit that should not reduce the wrongful dismissal damages otherwise payable.

Background

Richard Waterman was employed by IBM Canada Limited ("IBM") for 42 years. When he was terminated without cause, he was 65 years old and was a long-standing member of IBM's defined benefit plan (the "Plan"). Pursuant to the Plan, he was not entitled to receive both his full pension and employment income until he reached age 71. As a result, when Mr. Waterman was terminated

without cause, he started receiving his full pension and the termination of his employment had no impact on receipt of full benefits under the Plan.

IBM provided Mr. Waterman with two months' notice and he sued for wrongful dismissal, asking the court for 24 months of reasonable notice.

At the Supreme Court of British Columbia, IBM argued that all of Mr. Waterman's pension benefits should be deducted from any amount of notice awarded. The basis for IBM's argument was that if pension payments were not deducted, Mr. Waterman would be receiving pension benefits in addition to his employment salary, which conflicts with the compensatory goal of damages for wrongful dismissal. IBM relied on the decision of *Sylvester v British Columbia*, [1997] 2 SCR 315 where it had been decided that disability benefits received during the notice period were deductible from the severance in lieu of notice, at least when the plan was established and funded solely by the employer.

Mr. Justice Goepel of the BC Supreme Court disagreed with IBM and held that Mr. Waterman was entitled to 20 months' notice, without any deduction for pension benefits paid during this period.

IBM's appeal of this decision was dismissed by the British Columbia Court of Appeal. Prowse J.A. writing for the Court relied on *Sylvester*, but concluded that it could be distinguished due to differences in the actual benefits and intentions of the parties, which ultimately led to different results.

The SCC upheld the Court of Appeal decision. Two dissenting judges would have allowed the IBM appeal. The majority decision of the Court set out three matters that needed to be considered in order to decide the appeal:

1. Why is there a "collateral benefit" problem in this case?

The collateral benefit in this case is the advantage to Mr. Waterman in the form of receipt of pension benefits that was directly connected to IBM's breach of the employment contract.

The question the Court grappled with is whether those collateral benefits should be deducted from the damages owed to the plaintiff. Cromwell J. for the majority wrote at para. 15 that:

The problem raised by collateral benefits is the question of whether they should be deducted from the damages otherwise payable by the defendant on account of the breach. This case raises a collateral benefit problem because there is a "but for" causal link between the IBM's breach of contract and Mr. Waterman's receipt of the benefit. He would not have received the pension benefits and full salary in lieu of working notice "but for" the dismissal.

The Court noted that not all benefits received by a plaintiff will give rise to this issue. Collateral benefit concerns will be relevant if the receipt of benefits is directly connected to the defendant's breach, which either subsequently causes a recovery for the plaintiff in excess of his or her economic loss, or alternatively, the benefit is intended to be an indemnity for the loss from the breach.

2. Is the compensation principle the answer to the problem?

The Court examined whether the compensation principle (i.e. that Mr. Waterman should be in the same economic position had he received working notice) should be strictly applied. The majority held that it should not.

Cromwell J. wrote that there are many exceptions to the compensation principle when benefits to a plaintiff are not deducted and result in the plaintiff being economically better off. The Court continued the analysis of this principle specifically in the areas of charitable gifts and private insurance. With respect to whether the benefit was intended to be an indemnity for wage loss, the Court held at para. 62 that:

"Reliance on the distinction between indemnity and non-indemnity benefits is sound in principle. As McLachlin J. pointed out in her dissenting reasons in *Cunningham*, if the benefit "is not paid to indemnify the plaintiff for a pecuniary

loss, but simply as a matter of contract on a contingency", the benefit cannot be seen as having compensated the plaintiff for that pecuniary loss: pp. 371-72. If that is the case, the arguments in favour of deducting the benefit are weaker in the sense that IBM is asking to deduct apples from oranges."

With respect to pension benefits, the Court held that these are in place as a form of retirement savings and not as an indemnity for wage loss. Despite the fact that only IBM had contributed money to the Plan, Mr. Waterman was considered to have contributed to the acquisition of his pension through his years of service.

3. Does the Court's decision in Sylvester support IBM's position that the pension benefits must be deducted?

The SCC held that when the factors such as nature of the benefit (i.e. an indemnity), intentions of the parties based on the employment contract and policy considerations, the Court will arrive at an opposite conclusion as was decided in *Sylvester*. A pension plan is based on years of service and salary and is a method for retirement savings. As a result, Cromwell, J. concluded that parties would not have intended that an employee's vested pension plan should subsidize wrongful dismissal damages.

In addition, in *Sylvester* it was impossible for the employee to receive disability benefits and employment income at the same time. Whereas, in *IBM*, it would have been possible for Mr. Waterman to receive both pension payments and employment income in specific circumstances.

Further, the Court reviewed policy considerations and concluded at paragraph 93 that "non-deduction in this case promotes equal treatment of employees." For example, if an employer was facing economic hardship, they might be more inclined to terminate senior employees who have vested pension rights in order to avoid the payment of lengthy notice periods. The SCC noted at paragraph 93, "this is not an incentive the law should provide."

Takeaway for Employers

Employers should pay close attention to this judgment, in particular, because it was held that pension benefits are not an indemnity for loss of earnings and as such, pension benefits should not be deducted from wrongful dismissal damages. This result will apply uniformly to both defined benefit pensions (such as Mr. Waterman's) and defined contribution, or money purchase, pensions.

Further and of particular interest to employers and pension plan sponsors, is the Court's suggestion that an employer could reduce wrongful dismissal damages by the amount of pension payments made during the reasonable notice period if the reduction was expressly stated in the employment contract, offer letter or pension plan. Such a provision should only be introduced after consultation with legal counsel.

While this decision imposes a bright-line rule that prohibits the deduction of pension payments of any type from wrongful dismissal damages, it does not affect the law allowing deduction of wage loss indemnity payments such as disability insurance.

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[a cautionary note](#)

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