

# Supreme Court rules disability benefits must be deducted from wrongful dismissal damages

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Employees dismissed without cause or reasonable working notice are entitled to money damages equal to their salary during the notice period. Where the employee is disabled at the time of termination, should any disability benefits to which the employee is entitled during the notice period be deducted from damages? Until recently, appeal courts in Canada had been divided on this question. While courts in New Brunswick have held that disability payments must be deducted, the view in Ontario and more recently, British Columbia, was that the employee was entitled to both disability benefits and wrongful dismissal damages.

## **ONTARIO COURT OF APPEAL: DISABILITY BENEFITS NOT DEDUCTIBLE**

In *McKay v. Camco Inc.* (January 13, 1986) the Ontario Court of Appeal had reasoned that the benefits and damages arose from two separate and independent rights under the employment contract: the first from the explicit terms of the contract providing for benefits in the event of disability, the second from the implied term that an employee will be given reasonable notice where dismissal is without cause. Further, the Court added, these rights had different purposes:

"The right to disability payments is intended to provide income to the [employee] when he is unable to work. The purpose of requiring reasonable notice is to give the dismissed employee an opportunity to find other employment. ...

If disability payments were deductible from damages for the wrongful dismissal, the right of the [employee] to reasonable notice would be completely frustrated because he could not have exercised it to search for employment while he was disabled."

Based on this view of the distinction between the two rights, the Court ruled the employee was entitled to both the benefits and damages. It also held that the disabled employee's notice period had been "interrupted" by the period of his disability, and resumed following his recovery. While disability payments were not deductible from notice damages, the two forms of compensation could not be made in relation to the same time period.

## **B.C. COURT OF APPEAL: TWO CONTRACTS, TWO SETS OF OBLIGATIONS**

Sylvester v. British Columbia

, decided by the B.C. Court of Appeal on June 2, 1995, concerned a managerial employee dismissed due to restructuring after 19 years of service. Shortly before his dismissal, he had fallen ill. The employer offered him severance of 12.5 months' salary, with any disability benefits to be deducted. The employee sued, and the judge increased his notice to 15 months, with benefits still to be deducted.

The Court of Appeal increased the notice period to 20 months, and ordered that the employee's damages should not be reduced by any disability payments he had received. The Court held that the employee was entitled to both forms of compensation as there were, in effect, two contracts to be honoured: the basic employment contract, with its implied term of reasonable notice, and the disability plan. Both these contracts formed part of the "total employment package".

It was true, the Court noted, that employees who are able to work do not receive disability benefits, and those on disability are not paid their wages or salary. Under the usual circumstances, therefore, either the employment contract or the disability plan control the parties' obligations, but not both at the same time. However, this is not the case once a decision to terminate the employee has been made:

"[T]he interrelationship of those two distinct contractual obligations changes when notice of

termination is given. In my opinion both contracts then operate together and both must be complied with. And if the employer breaks the obligations under one or other of those contracts, or both, then damages can be assessed under the broken contract or the broken contracts."

To adopt the view that disability benefits were deductible from the notice period would defeat the purpose of notice, which was to enable the employee to seek other employment. The Court added that, while it adopted the approach to deductibility expressed in *McKay*, it differed from the Ontario Court in that it held that both notice damages and disability payments could be made in relation to the same period.

## **SUPREME COURT OF CANADA: NO INTENTION TO PAY EMPLOYEE TWICE**

The employer in *Sylvester* appealed on the sole issue of deductibility and was vindicated in a unanimous decision, issued on May 29, 1997 by the Supreme Court of Canada. The Court held that, as this was a contractual matter, the question of deductibility was to be resolved by examining the terms of the employment contract and the intention of the parties to the contract.

In contrast to the view of the Appeal Court, the Supreme Court held that the benefit plans were not contracts distinct from the employment contract, but rather integral components of it. An examination of the terms of the employment contract revealed that it did not provide for the employee to receive both forms of compensation, nor could the Court imply an intention to that effect.

The Court based its conclusion on the facts that the benefits plan was designed to provide a substitute for the employee's salary, and that those benefits were to be reduced by income from other sources. Further, the Court held, simultaneous payment of disability benefits and notice damages was inconsistent with the terms of the employment contract, as the two forms of entitlement were based on opposite assumptions:

"The [employee's] contractual right to damages for wrongful dismissal and his contractual right to

disability benefits are based on opposite assumptions about his ability to work... The damages are based on the premise that he would have worked during the notice period. The disability payments are only payable because he could not work. It makes no sense to pay damages based on the assumption that he would have worked in addition to disability benefits which arose solely because he could not work. This suggests that the parties did not intend the [employee] to receive both damages and disability benefits."

The Court stated that it was reinforced in its conclusion by the fact that the employee would not have received both salary and benefits during the notice period if the employer had provided adequate working notice. Further, deducting benefits ensured equal treatment of all dismissed employees:

"If disability benefits are paid in addition to damages for wrongful dismissal, the employee collecting disability benefits receives more compensation than the employee who is dismissed while working. Deducting disability benefits ensures that all affected employees receive equal damages, i.e., the salary the employee would have earned had the employee worked during the notice period."

As well, the Court observed, allowing employees to keep both types of compensation would create an undesirable incentive for employers:

"If disability benefits are not deductible, employers who set up disability benefit plans will be required to pay more to employees upon termination than employers who do not set up plans. This deterrent to establishing disability benefit plans is not desirable."

The Court concluded by noting that the result might be different in cases where the employee has contributed to the plan. However, in this case, the employer had paid the full cost of the plan, and the question of the deductibility of benefits where the employee had contributed was not in issue. (See also ["Finishing touches -- wrapping up the termination process"](#) on our Publications page.)

In Our View

This decision has been seen by observers as a clear win for employers, who will be spared the burden of compensating terminated disabled employees twice. It has also been assailed as unfair by counsel representing employees, who claim it ignores the distinct purposes of notice and disability payments, as outlined by the Court in *McKay*.

As noted in the Supreme Court's reasons, the decision applies only to cases where the cost of benefits is fully paid by the employer, and leaves in question the outcome where the employee has contributed to the disability benefits plan.

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