

COLLATERAL DAMAGE: HOW TO MAXIMIZE YOUR CLIENT'S LONG-TERM DISABILITY CLAIM BY MINIMIZING COLLATERAL DEDUCTIONS

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I. INTRODUCTION

Collateral deduction clauses are like termites. They are easily overlooked, and if left unchecked, can cause significant damage to the foundation of your client's claim. Most disability insurance policies allow the insurer to deduct a broad range of disability-related benefits received by the insured from other sources, including CPP disability, WCB benefits, Section B WI benefits, pensions, and disability insurance on mortgages. When the insurer applies one or more of these deductions against the monthly benefit, it can result in the insured receiving half or less of the monthly benefit stated in the policy. Your goal should be to identify, and then minimize or exterminate all collateral deductions. This will enable your client to get the maximum benefits, whether in the context of a reinstatement of benefits or in negotiating a lump-sum settlement of the entire claim. Failure to properly consider collateral deductions can cost your client thousands of dollars. Unfortunately, there are no hard-and-fast rules. Given the variability among disability policies, you must consider collateral deductions on a case-by-case basis. The nature and extent of any collateral deductions will turn on the wording of the policy in question. When reviewing your client's policy, keep in mind the principles of interpretation, and the case law that has considered the collateral deductions in question. This paper provides a basic overview of the principles of interpretation, and reviews the cases that have considered the most common collateral deductions.

II. COLLATERAL BENEFIT DEDUCTION CLAUSES

Collateral benefit deduction clauses are a standard part of most policies for long-term disability insurance. A person who has become disabled may qualify for income benefits (i.e., collateral benefits) from a number of sources, in addition to his or her disability insurance policy. Common examples include Section B weekly indemnity payments, workers compensation benefits, Canada Pension Plan disability benefits, pensions and other salary continuation plans. Collateral deduction clauses permit the insurer to off-set these collateral benefits against the

monthly benefit owing under the disability policy. The disability benefit is reduced in direct proportion to any collateral benefit the insured is receiving, *or is entitled to receive*.

Collateral benefit deductions are rooted in theories of indemnity and the rule against double recovery. Insurers say collateral deductions are necessary to discourage fraud: The rationale being that if collateral benefits were not deducted, then in some cases a person's total disability-related benefits from all sources may equal or exceed his or her employment income. Such a result would be invitation to fraud, as people could earn greater income by being disabled. Accordingly, insurers now design disability policies such that the insured will receive a maximum income from all sources, usually 60-80% of his or her employment income.

III. PRINCIPLES OF INTERPRETATION

A comprehensive review of the principles of interpretation of insurance contracts is beyond the scope of this paper; however, Craig Brown provide a succinct statement of the law at Chapter 8 of his text Insurance Law in Canada 2002 (Toronto: Carswell, Looseleaf):

The "rules" of insurance contract interpretation are easy enough to state. A court should give effect to the intention of the parties – the insurer and the consumer. If the words used are not clear enough to disclose what this joint intention is, the words are given a meaning which, if reasonable, favours the consumer. This is considered fair either because the language was chosen by the insurer or because the meaning adopted by the court achieves a result which the parties could reasonably expect.

The sources of these principles are as follows:

- Coverage provisions are to be interpreted broadly, while exclusion clauses are to be interpreted narrowly: Canadian National Railway v. Royal & SunAlliance Insurance Co. of Canada (2008), 68 C.C.L.I. (4th) 1 (S.C.C.); Sansalone v. Wawanesa Mutual Insurance Co., [2000] 1 S.C.R. 551 (S.C.C.); Pictou County Farmers' Mutual Fire Insurance Co. v. Williams, [2001] N.S.J. No. 59 (C.A.); and Wawanesa Mutual insurance Co. v. Neary (2003), 50 C.C.L.I. (3d) 176 (N.S.C.A.).
- Ambiguities with particular words or phrases are to be resolved in favor of the insured, based on the doctrines of *contra proferentem* or reasonable expectation: Consolidated Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co., [1980] 1 S.C.R. 888; McClelland & Stewart Ltd. v. Manulife Assurance Co., [1981] 2 S.C.R. 6 (S.C.C.); and Arnoldin Construction & Forms Ltd v. Alta Surety Co., [1995] CarswellINS 31 (N.S.C.A.)

[*contra proferentem*] and Wigle v. Allstate Insurance Co. of Canada, [1984] CarswellOnt 26 (Ont. C.A.) [**reasonable expectation**].

IV. CANADA PENSION PLAN (CPP) BENEFITS

Canada Pension Plan (CPP) disability benefits are a common collateral deduction. The CPP benefit off-set is usually explicitly stated in most policies; however, even if not explicitly named, the CPP benefit off-set has been found to fall under general clauses such as “amounts received under the legislation of any government”, “income from all sources”, or “wage or salary continuation plans available to a person by reason of his employment”:Paese v. Fidelity & Guaranty Co. (1985), 17 C.C.L.I. 1 (Ont. Dis. Ct.).

On the other hand, courts have held that catch-all phrases such as “benefits payable on account of disability”, “benefits for loss of time under any other contract”, or “any retirement pension”, did not include CPP disability benefits: Coombe v. Constitution Insurance Co., [1978] I.L.R. 1-1034 (Ont. H.C.). It would be unusual for any modern disability policy to include such vague wording, but if your client has an older policy it will be important for you to pay close attention to this issue.

If you determine your client’s policy contains a CPP disability off-set clause, then you should turn your mind to two further issues: 1) Does the policy allow for deduction of gross CPP benefits or net CPP benefits and 2) does the CPP off-set include the right to deduct the children’s portion of the CPP benefit?

A. What to Deduct: Gross Payment or Net Payment?

Canada Pension Plan benefits are subject to income tax. The CPP administration deducts income tax at source, so the payment *received* by the recipient is a lesser net payment. A common issue is whether the insurer is entitled to deduct the gross or net monthly CPP benefit. There is no general rule on this issue; rather, it will depend on the wording of the disability policy in question. I was unable to find any case on point; however, the Ontario Court of Appeal did consider the gross vs. net deduction of the CPP disability benefit in the context of Ontario’s No-Fault Automobile Income Replacement Benefits (IRBs). The statutory wording did not specify if the net or gross amount of CPP was to be deducted from the IRB. In a 2-1 decision, the majority acknowledged that two interpretations were available, but chose to interpret the word “received” to mean the net CPP amount: Bapoo v. Co-operators General Insurance Co. (1997), 36 O.R. (3d) 616 (C.A.). We can rely on Bapoo, supra, as persuasive authority that net CPP should be deducted, if net vs. gross amount is not specified in the policy.

B. Is the Children's Portion of CPP deductible?

When a parent qualifies for CPP benefits, often his or her dependent children will also qualify for CPP payments. As a matter of practice, if the CPP claimant is the legal guardian of the children, then the two payments are added together and paid as one monthly lump sum to the parent. A common issue is whether the long-term disability insurer is also entitled to offset the children's portion of the CPP benefit from the insured's monthly disability benefit. Whether the insurer is entitled to this deduction will depend on the wording of the policy. Many policies now state that the CPP benefit offset includes any portion paid to the insured's children. Other policies explicitly exclude the children's portion of CPP.

There are conflicting cases on what to do if the policy is silent on how to treat the children's portion of the CPP. In Mugford v. Canadian Industries Ltd., [1980] CarswellNfld 129 (S.C.), Justice Noel interpreted the following clause to not allow deduction of children's CPP benefits:

13. The amount of long term disability insurance benefits which may be paid to any eligible employee under the Plan shall be reduced by the total of such amounts as may from time to time become payable to him under Workmen's Compensation legislation, the Canada Pension Plan, the Quebec Pension Plan or under similar legislation under which any disability income or pension benefits are or may be provided in respect of the same period of disability for which the employee has qualified under this Plan.

On the other hand, in Ormonde v. London Life Insurance Co., [1991] I.L.R. 1-2696 (O.C.J.), Justice Steele held that CPP child benefits were deductible under the clause "any benefit payable on account of the disability of the employee."

In Dubasoff v. Mutual Life Assurance Company (1995), 123 D.L.R. (4th) 577 (Sask CA), the Court of Appeal held that the following "other income" clause did not allow for deduction of CPP Benefits paid to the children:

"Other sources" include but are not limited to

4. any government plan providing disability income that becomes payable only after the member became totally disabled.

In Hennig v. Clarica Life Insurance Co., [2003] A.B.C.A. 70, the Alberta Court of Appeal held that the children's portion of CPP was not deductible, even though the policy contained an "other sources" clause that seemed to allow for deduction of children's benefits:

"Other sources" are benefits or payments resulting from the member's disability...these include by are not limited to:

...

4. any government plan providing disability income including benefits for dependent children that becomes payable only after the member became disabled.

The Court noted that there were two off-set clauses: There was a specific clause stating CPP benefits were deductible. This clause was silent on the matter of children's CPP benefits. There was a second clause that allowed deduction for "other sources"(see above). The court declined to use the "other sources" clause to interpret the CPP clause. The Court held these two clauses created ambiguity. Applying the principles of insurance policy interpretation, the Court chose to resolve the ambiguity in favor of the insured.

In Ruffolo v. Sun Life Assurance Co. of Canada, [2007] 56 C.C.L.I (4th) 116 (Ont. S.C.J.), affirmed [2009] ONCA 274, Justice Perell distinguished Hennig, supra, and held that the children's portion of the CPP was deductible, notwithstanding that such wording was not expressly included in the policy. The court relied on a proposal the insurer had submitted to the insured's employer during the negotiations of the group benefits plan. The proposal included options for the employer to choose an LTD plan that expressly stated that children's CPP benefits were not deductible. The employer did not choose that option, and the court held this was determinative of the issue. This case was unique in that the court delved into the negotiations between the employer and the insurer to determine the intentions of the parties.

In summary, there is no general principle that can be applied to say CPP child benefits are or are not deductible. Rather, this issue must be resolved on a case-by-case basis paying particular attention to the wording of the policy. Based on the Ruffolo case, you should be wary of cases where the disability policy was negotiated by the employer as part of a group benefits scheme. In such cases, you should insist the insurer's affidavit of documents include all documents related to the negotiation of the disability insurance plan, including any proposal put to the employer. In cases of individual disability policies, it may be important to review what information was provided by the insurance broker during the sale of the policy.

V. WORKERS COMPENSATION BENEFITS

Most policies name worker's compensation benefits as a deduction. If your client receives monthly WCB benefits then these would be deducted. The real issue you have to watch for happens in the context of motor vehicle litigation, where the plaintiff has "opted out" of worker's compensation coverage in favor of pursuing a tort claim. If the plaintiff is also covered under a disability insurance policy, then in most cases, the disability insurer will be entitled to

deduct what the plaintiff was entitled to receive from WCB, even though he or she has opted-out and will not actually receive WCB benefits.

In Madill v. Chu, [1977] 2 SCR 400, the Supreme Court of Canada held that a long-term disability insurer was allowed to deduct WCB benefits, even though the insured had neither applied for, nor received any WCB benefits. The Court held it was sufficient that the insured was “entitled to receive” WCB benefits to trigger the insurer’s right to deduction.

In Abdulrahim v. Manufacturers Life Insurance Co. (2003), 252 O.R. (3d) 543 (Ont. S.C.J.), Justice Himel distinguished Madill, supra, and held that insurer not entitled to deduct WCB from LTD payments because policy had a subrogation clause, which would eliminate the potential for double recovery. He noted the insured was not “immediately entitled to WCB”, therefore cannot be deducted from LTD.

While Abdulrahim, supra, appeared to open to the door to eliminating deduction of WCB benefits, the Ontario Court of Appeal appears to have closed the door in Richer v. Manulife, [2007] CarswellOnt 1713 (C.A.). The Court of Appeal followed Madill, supra and held that LTD insurer was entitled to deduct what the insured was entitled to receive from WCB, even though there was a subrogation clause in the policy.

VI. OTHER LONG-TERM DISABILITY POLICIES

In some cases, your client may have two or more long-term disability insurance policies, which all contain collateral deduction clauses. This is now fairly common given the proliferation of disability coverage on credit cards, lines of credit, mortgages, and car loans. The existence of competing collateral deduction clauses creates a paradox where each insurer tries to reduce what the other is paying, resulting in no one making payment to the insured. The Nova Scotia Court of Appeal was faced with this situation in Evans v. Maritime Medical Care Inc. (1991) NSCA. The Court rejected the argument that the insurers should share equally in the deduction, and held that the policies had to be read closely to determine which one was the primary policy, and which one was the collateral policy. The primary policy was entitled to deduct the collateral policy, but not vice-versa.

VII. SECTION B WEEKLY INDEMNITY PAYMENTS

You will need to determine the deductibility of Section B Weekly Indemnity benefits on a case-by-case basis. While most disability insurance policies will purport to be able to deduct weekly indemnity benefits, their right to do so will depend on whether the Section B Insurer has a

corresponding right to deduct the disability insurance benefit (see also discussed in Section VI of this paper). If the Section B insurer has a right to deduct the disability insurance benefit, then it will be deemed the primary insurance, and the disability insurer will not be able to deduct the weekly indemnity payments.

The SFF 1 Standard Automobile Policy, Section, Part II, states as follows:

Amount of Weekly Payment – The amount of a weekly payment shall be the lesser of,

(a) \$140 per week; or

(b) 80 per cent of the insured person's gross weekly income from employment, less any payments for loss of income from employment received by or available to such person under,

(i) the laws of any jurisdiction,

(ii) **wage or salary continuation plans available to the person by reason of his employment**, and

In Graham v. Hill, [2003] N.B.C.A. 24, the Court of Appeal held that benefits paid through private disability insurance plans, or union sponsored plans, are not deductible by the Section B insurer when determining the amount of the weekly indemnity payment; however, long-term disability benefits provided through employment, or partially paid for by the employer, will constitute a wage or salary continuation plan....by reason of employment” and therefore, are deductible from the weekly indemnity benefit. Graham v. Hill, supra, affirmed the Court of Appeal’s earlier decision in Sweet v. Co-operative Fire & Casualty Co. (1983), 46 N.B.R. (2d) 189 (C.A.), which held that a Section B insurer cannot deduct disability insurance benefits when the disability insurance premium was paid for by the union, not the employer.

In summary, the long-term disability insurer will be able to deduct Section B weekly indemnity benefits if the policy is paid for entirely the insured, or his or her union. In this situation, the Section B insurer has no corresponding right to deduct disability insurance payments from the weekly indemnity payments; however, where the policy is paid for entirely or partially by the insured’s employer, then the disability insurer cannot deduct weekly indemnity payments, because in these circumstances the Section B insurer has the right to deduct the disability insurance benefit. As noted in Evans v. Martime Medical Care Inc, supra, courts will not allow two disability insurers to deduct each other’s payments, as this would result in a paradoxical situation leaving the insured with no benefits from either insurer.

VIII. SUPERANNUATION / PENSION INCOME

Most disability policies will include a clause allowing deduction of “income under any retirement plan of the employer”. Insurers are entitled to deduct monthly pension benefits based on this and similar clauses: Gameau v. Industrial Alliance ; however, there may be some exceptions, where some portion of the money is paid as a lump sum, in the context of an retirement incentive package: Hetland Estate v. Sun Life Assurance Co. of Canada (1990), 47 C.C.L.I. 169 (Alta. CA).

IX. SEVERENCE PAY

Courts have consistently held that severence pay does not constitute “earnings from employment” or “income” for the purposes of an LTD policy. Rather it is considered capital at common law, notwithstanding that it is taxed as income by the Canada Revenue Agency. Therefore, severence pay will generally not be included under the “other sources” of income clauses common in most policies: see Harvey v. Ultramar, [2000] CarswellOnt 25 and Henderson v. Canadian General Life Insurance Co., [1994] I.L.R. 1-3066 (Ont. Gen Div.).

X. STRUCTURED SETTLEMENTS

Sometimes personal injury actions will be settled using a combination of lump sum and structured settlement purchased by the defendant for the benefit of the plaintiff. This will result in a monthly income to the plaintiff going forward. If the plaintiff also receives ongoing long-term disability benefits, is the disability insurer entitled to set-off the monthly amount received from the structured settlement? In Stitzinger v. Imperial Life Assurance Company of Canada (1998), 39 O.R. (3d) 566 (O.C.J.), the court held that monthly payments received from a structured settlement were not “total monthly income...from all sources”. The money was period payment of damages (not deductible), even though it was structured in a way that resembled monthly income.

XI. CONCLUSION

It is important to carefully analyze the issue of collateral benefits deductions in all long-term disability cases. This can only be accomplished by careful review of the entire master policy. Therefore, it is important that you get a copy of the master policy as early as possible. Understanding the impact of collateral deductions is necessary to maximize your client’s benefits during any settlement negotiations. Seemingly small changes in monthly payments (e.g., deduct net or gross CPP) can result in significant sums of money when factored over a number of years, or when calculating present values for lump-sum settlements. You will need

to analyze collateral deductions on a case-by-case basis, as the issue will be determined by the particular wording of the disability policy in question. While there are no hard-and-fast rules, you can rely on the principles of contract interpretation and a growing number of cases that have interpreted the most common collateral deductions.