Posted on: January 31, 2014

IBM PENSION DEDUCTIBILITY

January 31, 2014

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A recent majority decision from the Supreme Court of Canada has determined that certain pension benefits are not deductible from the amount an employer pays as severance.

Facts

Richard Waterman worked for IBM Canada for 42 years and was 65 years old when his employment was terminated. A percentage of Mr. Waterman's past salary was contributed to a defined benefit pension plan. IBM required Mr. Waterman to begin receiving his monthly pension benefits immediately following the termination of his employment. IBM's plan included two important terms:

- an employee could begin to receive the pension benefits upon retiring and after the age of 65; and
- an employee could not receive both employment income and their pension from IBM at the same time until age 71 – at which time they had to begin taking their pension even if they were still an IBM employee.

No term in the plan prevented an employee over age 65 from receiving their IBM pension and income from another employer.

The British Columbia Supreme Court awarded Mr. Waterman a period of 20 months' notice for the termination of his employment and did not deduct the value of the pension benefits he had received from the amount awarded. The Court of Appeal agreed with the trial judge.

The Supreme Court of Canada Decision

A number of legal principles are analyzed in the decision.

The first important principle was that, as a general rule, when one party breaches a contract, the other party should be placed in the position they would have been in if the contract had been performed. On this issue

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IBM argued that, by not deducting the benefits, Mr. Waterman was in a better position than he would have been because he could not have continued to work for IBM and collect his pension.

The majority of the court concluded, however, that it would be both unjust and beyond the intention of the parties if retirement funds were used to subsidize the severance paid for a wrongful dismissal. The pension issue did not relate to "mitigation" of damages. Mitigation principles require a dismissed employee to act reasonably and try to reduce their losses by finding a new source of income. Instead, the majority decision characterized the problem as a "collateral benefit". This concept addresses benefits a person may receive that were negotiated before the breach of contract occurred. For example, if a person pays into EI and then loses their job they may have a right to collect the EI benefits. If they do, the question arises whether the compensation from a source the person paid into, or arranged to have available, should be used to reduce the severance pay owed by the employer.

The majority concluded that, in some cases, the exact loss suffered by a person is not the only way to measure what is "lost" and "reasonableness" must also be considered. The purpose of the pension was retirement savings – not income for circumstances where an employee lost their job. Although the pension terms did not permit earning both a pension and IBM employment income between ages 65-71, the majority decided it was unreasonable to interpret the employment contract in a way that allowed pension funds to be used to reduce the company's termination obligations. Two other factors were key: first, the pension entitlement was like a property right belonging to the employee; and second, deducting the pension would create different "classes" of IBM employees when termination was being considered. Those employees age 71 and over could be entitled to both pension payments and severance pay, while those under 65 would get full severance pay and could also apply for their pension at a later date. It was only employees between age 65 and 71 who would have pension amounts deducted from severance pay.

All members of the court addressed the prior Supreme Court of Canada decision of *Sylvester* v. *British Columbia*, [1997] 2 S.C.R. 315. *Sylvester* permits an employer, in some instances, to deduct disability benefits from severance pay because both are designed to compensate for lost wages. Failing to deduct these amounts provides an employee with more than if they had continued working. Both disability benefits and severance pay are designed to provide compensation for the reality that a person is not working but for different reasons. The majority concluded that, under the contracts in that case, it was impossible to collect the benefit and other wages. This could be contrasted with the IBM case where Mr. Waterman could earn both the pension and income from another company.

A strong dissent was also written by two of the nine court judges which shows how difficult these issues can be. Influential in their decision was the fact that the pension amounts would continue at the same amount

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and same rate on an ongoing basis. Their conclusion would likely have been different if a fixed value of funds was available which was being eroded by the forced scenario of having to collect the benefits after being terminated.

Considerations for Employers and Employees

The court decisions involving Mr. Waterman and IBM illustrate that multiple legal principles may apply when determining whether a "benefit" should be deducted from severance pay. For employers and employees faced with these issues here are some key points to remember:

- The language and terms contained in a benefit plan and employment contract are important in assessing what amounts can be deducted from severance pay.
- It is unlikely that the issue which arose in this case would arise if the pension plan had been a defined contribution pension plan. Under those plans, permitting a deduction would reduce a fixed amount of pension funds so an employee would not be put in the same position as if they had not been terminated.
- Characterizing a "benefit" and whether it is designed to compensate for a person's inability to work is an important factor. For example, disability benefits are generally deductible from severance pay amounts yet these pension amounts were not.

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