COORDINATING BENEFITS AND THE PURSUIT OF SUBROGATION RIGHTS: NOW YOU SEE THEM; NOW YOU DON'T - HAVING YOUR CAKE AND EATING IT TOO

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INTRODUCTION

It is common for disability insurance contracts to include integration of benefits or offset provisions to reduce the disability benefit payment in situations where the disabled claimant has access to multiple benefit sources. There are as many different integration or offset provisions as there are insurers but most of these provisions share common characteristics.

First of all, in most provisions, the monthly disability benefit is reduced by other disability benefits which are either payable or which would have been payable had the disabled claimant made an appropriate application. Secondly, most provisions set out a non-exhaustive list of other disability benefit sources which usually include the Canada/Quebec Pension Plans (but usually exclude benefits payable on behalf of dependent children), Worker's Compensation Acts and Provincial Auto Insurance laws and any other Government Plan. Additionally, most provisions include an all source total income limit (usually 85%) measured against the employee's pre-disability earnings. A non-exclusive list of income sources is usually specified which is usually more comprehensive than the earlier list of other disability benefits (CPP, WSIB, NFB). The monthly disability benefit is reduced by the all source provision so that the combination of all other monthly income and the monthly disability benefit does not exceed 85% of the pre-disability earnings. Most provisions do not further reduce monthly disability benefits

on the basis of subsequent cost of living adjustments to the other disability benefits but most also do allow the insurer to estimate and deduct other benefits payable even though the disabled claimant may not yet (or ever) be in receipt of such benefits.

It is also common for disability insurance contracts to include third party claim recovery or subrogation provisions whereby the insurer attempts to provide for the right to recover disability benefit payments made in circumstances where the disabled claimant has a claim to pursue against a third party Defendant. Again, there are as many different third party recovery or subrogation provisions as there are insurers. However, most of these provisions provide that where the insurer has made payment and the disabled claimant brings an action, the insurer has the right to recover the amount it paid from the third party Defendant. The insurer is often given the right to initiate legal action in the disabled claimant's name and to take steps to enforce the right that are not otherwise prohibited by law. Some provisions also provide that where the amount recovered does not completely reimburse the loss or damage, the amount will be divided pro rata between the insurer and the disabled claimant to the extent that each has suffered the loss or damage.

Integration of Benefits Provisions

For illustrative purposes, two integration of benefits provisions are set out below. The first provision is taken from a Policy which covers employees of a law firm and the second from a Policy which covered employees of a social service agency:

1. Integration of Benefits

   Monthly benefits are coordinated with other income payments to which you become entitled as a result of your current Total Disability or Residual Disability. The benefit coordination is applied as follows:

   A. The amount of monthly benefit from the Long Term Disability Coverage is reduced by any disability benefits available from the

Canada or Quebec Pension Plan (Employee benefits only), income replacement benefits payable under any workers' compensation act or similar legislation, and "income from all other sources."

"Income from all other sources" includes the following:

- Disability benefits available under any other Government Plan, excluding dependent benefits payable to you under the Canada or Quebec Pension Plan;

- Retirement benefits provided by any employer or Government Plan;

- Income or benefits payable under any group program provided by or through the Employer;

- Income or benefits payable under a plan sponsored by an association, union or fraternal organization of which you are a member;

- Income replacement benefits payable under any plan of automobile insurance, where such reduction is not prohibited by law; and

- Wages or remuneration payable from any employer but excluding earnings received under an approved Residual Disability program.

B. The amount determined in A. above is further reduced, if necessary, so that the amount of monthly benefit, together with all amounts of income described in A. above plus dependent benefits payable to you under the Canada or Quebec Pension Plan, does not exceed 85% of gross earnings on taxable plans, or 85% of net earnings on non-taxable plans.

The amount of the Long Term Disability benefit payable will not be affected by subsequent cost of living adjustments to the Canada or Quebec Pension Plan payments.

Your insurer reserves the right to estimate the benefits payable under the Canada or Quebec Pension Plan pending receipt of information concerning the actual benefits payable."

2. Integration of Benefits

The monthly income payable under this benefit will be reduced by any disability benefit which is payable or which would have been payable to the participant had a satisfactory application been made under:

a) The Canada/Quebec Pension Plans excluding benefits payable on behalf of his dependent children;

b) A Workmen's/Workers' Compensation Act;

c) A provincial auto insurance law;

d) Any other government plan.

Moreover, the amount of disability income paid by the insurer is reduced so that the sum of all income, compensation, indemnity and benefits for which a participant would be eligible on account of disability, from the policyholder, a government body, or under any group insurance or pension plan to which the policy holder contributes, may at no time exceed eighty five percent of the participant's monthly income determined at the onset of disability.

However, future cost of living adjustments made to amounts received from any of the above-mentioned sources will not bring about further reductions.

Nothing in this policy shall prevent the insurer from recovering any overpayment of benefits under the policy which may arise as a result of a lump sum payment from any disability income which, if it had been paid in installments, would have resulted in a reduction or cessation of benefits hereunder."

The purpose behind integration or offset of benefit provisions is to prevent the perceived hazard of over-insurance. Simply put, if a disabled claimant can recover as much (or even more) in disability benefits than he can by working then there will be no incentive for a disabled claimant to overcome his disability and return to work. In fact, there may be an incentive for the disabled claimant not to work. While this rationale makes some sense if we presume all disabled claimants are malingerers, frauds and charlatans it

results in terrible under-compensation in the case of a worker who is catastrophically disabled early in his career. When reviewing Canadian cases interpreting integration and offset provisions, one finds that Canadian courts are not uniform in their interpretations and are often willing to interpret offset provisions in manners which pay more heed to the equities of the disabled claimant's situation than the strict language of the contract or policy.

Third Party Recovery/Subrogation Provisions

For illustrative purposes, two third party recovery/subrogation provisions are set out below. The first provision is taken from a Policy which covers employees of a law firm and the second from a Policy which covered employees of a computer company:

1. Third Party Claim Recovery

   "If you have a legal claim against a third party for causing your sickness or injury and if we provide payments or benefits under this Contract as a result of that sickness or injury, we will have the right to recover the amount we paid from that third party. We may also initiate legal action in your name in order to enforce that right.

   When the amount recovered, after deducting the cost of recovery, does not cover complete reimbursement of the loss or damages, the amount recovered will be divided between us and you according to the portion of the loss which each party has assumed."

2. Subrogation and Right of Recovery

   "Where permitted by law, the plan administrator has full rights of subrogation with respect to damages for loss of income when responsibility for a person's disability may be attributable to another party. The plan administrator also has the right to recover from the person any benefits paid under this plan for loss of income for which he has been indemnified by the other party".

GENERAL RULES OF INTERPRETING INSURANCE POLICIES/CONTRACTS

Whenever Canadian courts attempt to interpret insurance policies, they tend to apply the same several basic rules. First of all, courts look at the plain meaning of the words used. However, words rarely have a plain meaning, especially when written, or spoken by lawyers. Secondly, courts search for an interpretation based on the whole of the contract which promotes the true intent of the parties at the time they entered into the contract. If there are words in the contract which are capable of two or more meanings, the meaning that is more reasonable in promoting the true intent of the parties should be selected. However, ambiguities will be construed against the insurer. This is justified because it was the insurer that prepared the contract and had the opportunity to use precise (not ambiguous) language. Also, coverage provisions in policies are construed broadly and exclusion (or limiting) clauses narrowly. Finally, any interpretation which would result in either a windfall to the insurer or an unanticipated recovery to the insured should be avoided (see Consolidated - Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co., [1980] 1 S.C.R. 888, Brissette v. Westbury Life Insurance Co., [1992] 3 S.C.R. 87, and Reid Crowther and Partners Ltd. v. Simcoe & Erie General Insurance Co., [1993] 1 S.C.R. 252).

PARTICULAR BENEFIT OFFSETS

Canada Pension Plan Disability Benefits and Workers' Compensation Benefits

Generally speaking, Canadian courts have allowed disability insurers to deduct CPP disability benefits and Workers' Compensation benefits from monthly disability payments where appropriate language has been used in the policy.

An exception is the case of Fowler v. North American Life Assurance Co. [1999] N.J. No. 216. In this case, the policy provided for deduction of "benefits for loss of time under another contract" but not specifically CPP disability benefits. The Judge of the Newfoundland Supreme Court – Trial Division deciding the case (after noting that the insurer could have specifically provided for the deduction of CPP disability benefits – and was doing so in more recent policies) held that CPP disability benefits are not provided under "contracts of insurance" but rather are provided pursuant to compulsory legislation which lacked normal contractual ear-marks such as offer, acceptance and consideration.

In the recent case of McGill v. Worthing [2005] B.C.J. No. 1759, the Court ordered that only one half of Workers' Compensation benefits received should be repaid to the insurer. The disabled claimant was paid long term disability benefits beginning in 1988 up to October of 2001. He was a truck driver who had originally become disabled due to a knee injury. He made a claim for Workers' Compensation benefits and those were paid for a short period of time and then further payments were refused and lengthy litigation ensued with the Workers' Compensation Board. Eventually an award was made in October of 2001 against the Board requiring the Board to pay benefits over the same period.

To complicate matters, while undergoing therapy on his knee in January of 1992, the disabled claimant sustained a back injury which eventually required surgery in May of 1997. The Workers' Compensation held that the back injury was non-compensable and the Workers' Compensation benefits which were paid only related to the knee injury. The disabled claimant did not receive all of his Workers' Compensation benefits in pocket as he paid his lawyer 50% of the retroactive benefits through a contingency fee agreement.

The integration of benefits provision in the plan allowed a deduction for any benefits received "for the same Disability" from the Workers' Compensation Board. The presiding Judge held that the disabled claimant was initially disabled by his knee injury and was paid long term disability benefits for that knee injury, only. However, in August of 1993 the disabled claimant's doctor filled out a Statement indicating a primary diagnosis of knee injury and a secondary diagnosis of back injury. The Judge held that after that point, the insurer was paying for a knee disability and a back disability. The back disability was not the "same Disability" as the knee disability and, therefore, one half of the long term disability plan payment was for the knee disability and one half was for the back disability. Therefore, the Workers' Compensation benefits paid for the knee disability would only offset one half of the long term disability benefits paid. The disabled claimant was therefore obligated to repay the insurer only one half of the Workers' Compensation benefits received. The disabled claimant was also entitled to receive further long term disability benefits on the same basis from October of 2001 to September 30 of 2005 when he reached age 65.

In several cases, where disabled claimants were receiving CPP disability benefits, but had failed to advise the disability insurer, the courts were quick to order a repayment of

a sum equal to the CPP disability benefits received (see Kobzey v. Sun Life of Canada [2001] B.C.J. No. 1840 and Baxter v. Constellation Assurance Co. [1997] O.J. No. 1812).

Controversy arises, however, with the timing of the receipt of CPP disability benefits and the timing of the offset from the monthly disability payments. In the case of Ballem v. Prudential Group Assurance Co. of England [1993] B.C.J. No. 2122, the British Columbia Court of Appeal had to rule in a situation where a disabled claimant had purposefully delayed his application for CPP disability benefits, had then applied for and was denied those benefits, but then appealed the denial and was successful on appeal. Had the disabled claimant applied for and received CPP disability benefits as soon as possible, he would have received $373.90 per month in CPP disability benefits. Ultimately, when his appeal was successful, he began to receive $568.25 per month. In the long run, it was to the disabled claimant's advantage to have the lower deduction applied earlier than the larger deduction applied later. The court held that only once the disabled claimant was "determined in the prescribed manner" to be eligible for CPP disability benefits was the CPP disability benefit payable and therefore the court applied the larger deduction commencing later in time (to the disabled claimant's ultimate detriment). In doing so, the court noted that it "empathized" with the disabled claimant (a litigation lawyer) but noted that;

> " . . . it must be recognized that the end result is attributable to his conscious choice not to apply for CPP benefits until February of 1989. Only he could apply. The Freeze Clause constitutes an incentive to apply. He was not moved by the incentive. He must abide by the result which flows from the combination of the terms of the contract and the provisions of the Canada Pension Plan Act."

In the case of Wachal v. Crown Life Insurance Co. [1999] M.J. No. 366, the disabled claimant was a head cashier with Grade 12 education. She applied for CPP disability benefits four years after she became disabled. This was as soon as her treating doctor told her that CPP disability benefits might be available to her. Her insurer had discontinued benefits after two years of payment. The disabled claimant was successful at trial and the defendant insurer was ordered to pay disability benefits from the date of termination to the date of trial. Counsel for the insurer argued that had the disabled claimant applied for CPP disability benefits as soon as possible, and had she been accepted, she would have begun receiving CPP disability benefits two years earlier and the insurer should therefore receive an earlier offset. After noting that the insurer knew that the disabled claimant might be eligible for such benefits, but failed to advise her to apply (either in the benefit booklet or in correspondence to her regarding her benefits) the Trial Judge denied the earlier offset. Additionally, the insurer did not establish that CPP would have approved the disabled claimant's eligibility had she applied earlier.

Disabled claimants have attempted to argue that a retroactive lump sum disability benefit payment from CPP is not offset under integration provisions. Arguments have been made that the lump sum payment is not a "periodic payment" (see Mahn v. Canada Life Assurance Co. [1999] O.J. No. 4834) and also, as a lump sum payment is received in one month, it only reduces that month's benefit but not the months of benefits dating back to the retroactive entitlement date (see Sun Life Assurance Co. of Canada v. Halla [1994] I.L.R. 1-3012). In both cases, the court determined that the lump sum retroactive CPP

disability benefit should be set off on a monthly basis from the date of initial entitlement to the date of its receipt.

Similarly, in Confederation Life Insurance Co. v. Waselenak [1997] A.J. No. 1204, the Court ordered a disabled claimant to repay benefits when he received a retroactive award from the Workers' Compensation Board. In this case, the disabled claimant failed to inform the insurer of the retroactive award and, when the insurer discovered the retroactive award had been made, the disabled claimant did not pay the monies "because he did not think that [the insurer] deserved it."

In another case, the combination of temporary Worker's Compensation benefits and CPP disability benefits offset the disability benefit entirely. In fact, those other benefits exceeded the amount of the disability benefit each month for 24 months in a total amount of slightly under $4,000.00. In that case, the insurer sought to apply the excess to subsequent disability benefit payments to delay the payment of those benefits for a further period of nine to ten months (after the temporary Worker's Compensation benefits had ceased). In this case (Neves v. Mutual Life Assurance Company of Canada, [2002] N.S.J. No. 3), the Nova Scotia Court of Appeal held that the offset should be calculated on a monthly basis and any excess offset could not be applied to other months. Essentially, the Court of Appeal offset "apples to apples and oranges to oranges" holding that as the benefit was calculated on a monthly basis so too should the reductions be calculated on a monthly basis.

Canada Pension Plan Children's Benefits

Although it appears that most disability insurers do not attempt to include CPP children's benefits in their integration or offset provisions, some do and some have even attempted (with mixed success) to take advantage of the all source offset to make such a deduction.

In the case of Ormonde v. London Life Insurance Co. [1991] O.J. No. 51, the court held that the CPP children's benefit was deductible from the disabled claimant's disability benefit. The policy contained an 85% all source deduction which included "any other benefits payable on account of the disability of the employee". After noting that the CPP children's benefit is for the maintenance and support of children, and not a windfall payment, the court held that the benefits were received for no other reason than that they were children of a disabled contributor and therefore they were "other benefits payable on account of the disability of the employee".

In more recent cases, where the benefit integration provisions of the policy required benefits to be "received" by the disabled contributor, courts in Saskatchewan and Alberta have both declined to make a deduction for CPP children's benefits paid even where the benefit integration provisions provided that other sources, including "benefits for dependant children that become payable only after the member became disabled", are to be deducted.

In the case of Dubasoff v. Mutual Life Assurance Co. of Canada [1995] S.J. No. 171, the Saskatchewan Court of Appeal held that the CPP children's benefit is first and foremost payable to the child. If the child is under the age of 18 years, the payment is made to the person having custody and control of the child. As the all source integration

provision only took account of income the disabled claimant was "receiving" the court held that even thought the disabled claimant was being paid the money, the money was actually being paid to the child and not to the disabled claimant. In this case, the court considered (but distinguished) the Ormonde v. London Life case.

Similarly, in the case of Hennig v. Clarica Life Insurance Co. [2003] A.J. No. 243, the Alberta Court of Appeal held that the CPP children's benefit, although paid to the disabled claimant, was not to be considered "disability income" which the disabled claimant was "receiving". The court cited the Dubasoff v. Mutual Life case with approval. It is also interesting to note that in this case, the disabled claimant had paid a disability insurance premium of $16.45 per month. If the insurer was allowed to deduct the CPP children's benefit from the monthly disability payment, the disabled claimant would have received a monthly disability benefit of only $9.38.

Severance Pay

When disabled claimants are terminated from employment in some circumstances the severance pay they receive will be deducted from disability benefits they are receiving.

The Supreme Court of Canada, in the case of Sylvester v. British Columbia [1997] 2 S.C.R. 315, considered the case of a British Columbia government employee who was terminated during a period when he was receiving disability benefits. The employer offered a severance package of 12½ months salary less any disability benefits received during that time. The employee sued for wrongful dismissal and claimed damages equal to 24 months of pay without any deduction for disability benefits received. It is important to note that in this case the employer was also responsible to pay the disability benefits.

The court held that the disability benefits were intended as a substitute for the employee's regular salary. The employee would receive either his regular salary or his disability benefits. It would be incompatible with the employment contract for the employee to receive both amounts simultaneously. Wrongful dismissal damages are based on the premise that the employee would have worked during the notice period and disability payments are premised on him not being able to work. It would make no sense to pay damages based on the assumption that he would have worked in addition to disability benefits which were paid only because he could not work.

The Supreme Court noted that if it found that the employee in this case was entitled to both severance pay and disability benefits, then employers who set up disability benefit plans would be required to pay more to employees upon termination than employers who did not set up such plans. The court believed that this would deter employers from establishing disability plans for employees. The Supreme Court also noted that had the employer simply provided adequate notice, and not breached the contract, the employee would not have received both disability benefits and salary during the notice period. The Supreme Court left it open, in appropriate cases, for an employee to receive disability benefits in addition to damages for wrongful dismissal "on the basis that the disability benefits are akin to benefits from a private insurance plan for which the employee has provided consideration".

This situation arose in the cases of Canada Life Assurance Co. v. Donohue [1999] O.J. No. 3549 and McNamara v. Alexander Centre Industries Ltd. [2000] O.J. No. 1891, both decisions of the Ontario Superior Court of Justice.

In Canada Life v. Donohue, the employee's disability commenced three days before he received his termination notice. He received a lump sum payment for termination of his employment in an amount equivalent to 24 months of salary. The disability policy had an 85% all source integration provision which listed sources including "any continuation of salary from his employer" and "income from any employment".

The court held that as the integration provision did not specifically mention severance pay, it was an ambiguous provision and the Judge proceeded to resolve the ambiguity against Canada Life. After reviewing numerous cases, the Judge held that the severance pay paid to the employee in this case was in the nature of cash consideration for the termination of a contract and, therefore, it was "income from the termination of employment" and not "income from any employment" or "continuation of salary". Canada Life appealed this decision and the Ontario Court of Appeal upheld the lower court's decision (Donohue v. Canada Life Assurance Co. [2000] O.J. No. 2217).

In the McNamara v. Alexander Centre case, the employee was terminated shortly after providing a sick leave note and the employer sought to deduct disability payments received from wrongful dismissal damages it was required to pay. The court considered and distinguished the Sylvester v. British Columbia case on the basis that Mr. McNamara was receiving benefits from a private third party insurer. Also, the Judge held that Mr. McNamara had accepted a lower salary when he commenced his employment because of the benefit package which was included in his overall compensation package.

This decision was also upheld by the Ontario Court of Appeal (McNamara v. Alexander Centre Industries Ltd. [2001] O.J. No. 1534) and an Application for Leave to

Appeal to the Supreme Court of Canada was dismissed. Writing for the Court of Appeal, Justice McPherson found it significant that the employer:

> " . . . will derive a huge benefit from the deductibility scenario, solely because it chose an employee's new disability, after 24 years of loyal service, as the moment and reason to fire him. [The employer's] windfall for acting abominably will be $163,000.00".

These cases illustrate that Canadian Courts are often involved in the exercise of choosing between the "lesser of two evils". In Sylvester, the greater evil would have been to require the employer to pay the employee twice. In McNamara, the greater evil would have been to allow the employer to avoid paying compensation where the employer acted abominably and fired a loyal employee thereby exacerbating his new disability.

Deductions for Benefits Not Being Received

In a number of cases, disability insurers have attempted to deduct other disability benefits from disability payments where the disabled claimant is not yet in receipt of those benefits on the grounds that the disabled claimant should be receiving those benefits. Most disability policies contain within their integration provisions wording which allows not only a deduction where benefits are being received but also where they "would have been payable had application been made" or "if an employee does not apply for a benefit for which he is eligible, the amount of such benefit will be estimated by the insurer and assumed to be paid". It is submitted that only in the most clear cases of employee dereliction will insurers be allowed to make these "assumed deductions".

In the case of Ballem v. Prudential Group (see CPP and WCB Benefits, above) the insurer advised the disabled claimant to apply for a CPP benefit and indicated that it would make an assumed deduction in several months even if the benefit was not paid. The

disabled claimant made the application to CPP and the insurer commenced making the deduction. When the disabled claimant was denied CPP benefits, the insurer paid the total of the assumed deductions to the disabled claimant. In considering these events, the Judge noted that:

> " . . . the insurance benefits will be reduced either by CPP benefits actually received or which the insurer "reasonably considers" would have been received if there had been timely application and approval. The focus is upon actual or deemed receipt. The clause recognizes that there should not be a deduction if there was no payment and no eligibility for CPP benefits . . . . It would have been a grave injustice to a disabled claimant to countenance reduction from the insurance payments for benefits not being received by him and for which he was not eligible."

It must be remembered that in this case, the disability definitions in the disability policy and the CPP legislation were different and the Judge considered that it was:

> "quite possible for a person in the disabled claimant's position to be totally disabled for purposes of the insurance benefits but not disabled for purposes of CPP benefits."

The recent Ontario case of Abdulrahim v. Manufacturers' Life Insurance Co. [2003] O.J. No. 2592 considered the situation where a disabled claimant was in receipt of Worker's Compensation disability benefits but then "de-elected" to receive those benefits to pursue a tort claim. Although the Worker's Compensation benefits ended at that point, the disability insurer continued to offset those benefits arguing that the disabled claimant was "entitled to receive" the Worker's Compensation benefits.

In reviewing the policy, the Judge held that the phrase "receives, or is entitled to receive" was ambiguous and interpreted it in a way not favourable to the insurer. The Judge emphasized that the disabled claimant had exercised a statutory right to make a choice between claiming Worker's Compensation benefits and suing in tort and, once he

had exercised the right to sue in tort, he was no longer either in receipt of the benefits nor entitled to receive them. The Judge noted that if the Plaintiff won his tort case, or even if he lost and was forced to return to the Worker's Compensation scheme to top up his damages, the insurer retained subrogation rights under the disability policy and might, in the end, receive repayment of benefits paid.

As often happens in these cases where the insurer is denied an offset, the Judge noted that the insurer;

> ". . . has complete control over the wording of the contract, and it could have used more specific wording in constructing the exclusion clause if it wished to limit the benefits payable to the insured in these circumstances".

No-Fault Automobile Insurance Benefits

Most disability policies include integration or offset provisions which refer to no-fault automobile insurance benefits. In Ontario, by virtue of Ontario Regulation 403/96-Statutory Accident Benefits Schedule and Section 267.8 (17) of the Insurance Act, disability benefits are paid first in priority to no-fault automobile insurance benefits and a disability insurer who makes disability benefit payments does not have a right of subrogation. However, in other provinces, the situation may be different.

In Manitoba, for example, in the case of Shannon v. The Great-West Life Assurance Company [1996] I.L.R. 1-3317, a disabled claimant argued that his disability benefits were not to be reduced by the automobile insurance benefits he was receiving. The disability policy allowed a deduction for benefits paid under "any automobile accident insurance plan". The disabled claimant argued that payments received from the Manitoba Public Insurance Corporation pursuant to insurance legislation were not paid pursuant to a "plan" but were paid pursuant to "legislation". The disability policy referred to Worker's

Compensation benefits or "similar legislation" but did not use such wording with respect to "automobile accident insurance plans" and, therefore, it was argued there was ambiguity and that ambiguity should be resolved in favour of the disabled claimant. Also, the disabled claimant argued that the insurer could simply have inserted a reference to the automobile insurance legislation into the policy.

The court found that the phrase "any automobile accident insurance plan" was clear and unambiguous and referred to any type of plan which could arise either under a private contract of insurance or as a scheme of automobile insurance legislation.

THIRD PARTY RECOVERY/SUBROGATION AND THE OFFSET OF TORT DAMAGES

The issue of whether tort damages for loss of income can be offset against disability benefit payments is interrelated with the issue of whether those same tort damages can be claimed from a disabled claimant pursuant to an insurer's right of subrogation.

The leading case on subrogation is that of Gibson v. Sun Life Assurance Co. of Canada (1984) 45 O.R. (2nd) 326. In this case, the court held that where the disability policy is a "contract of indemnity" (one in which the insurer binds itself to pay money to the insured upon proof of an uncertain event occurring, and upon further proof that as a result of that event, the insured has suffered a loss) the disabled claimant is required to account to the subrogated insurer for money received from third parties on account of the loss. This accounting is made only to the extent that the money received exceeds the amount required for full indemnity. The insurer cannot assert a claim to recover money

that is paid to the insured, or withhold future payments on the policy, until such time as the insured has received full indemnity from the tortfeasor. These principles do not apply in cases where the contract is not one of indemnity (where proof of loss suffered by the insured is not a condition of payment – a fixed sum is paid solely on the occurrence of the event insured against irrespective of any pecuniary loss resulting from the event).

The Gibson v. Sun Life case was considered in the case of Confederation Life Insurance Co. v. Causton [1989] B.C.J. No. 1172, a decision of the British Columbia Court of Appeal. In this case, the disabled claimant had been paid approximately $18,000.00 in disability benefits and at the trial of her automobile accident claim, she received judgment for her full wage loss. However, she incurred legal fees equal to 25% of that sum. The court held that, as a result, the disabled claimant had not received full indemnification for her loss. The insurer, as a result, was not repaid any money out of the disabled claimant's tort recovery.

The case of Budnark v. Sun Life Assurance Co. of Canada [1994] B.C.J. No. 1960 reviewed both the Gibson v. Sun Life and Confederation Life v. Causton cases. In this case, Sun Life had paid approximately $41,000.00 in disability benefits over a certain period. At trial, the disabled claimant was awarded 100% of his past loss of income for a period which included the period for which Sun Life had paid the $41,000.00 in benefits. The disabled claimant was also awarded damages for future loss of income which, by the time the disability action was heard, turned out not to be enough to compensate the disabled claimant for full income loss from the date of the tort trial until the date of the disability claim trial.

The Judge in the Budnark case estimated the amount of legal fees paid by the disabled claimant in recovering his past loss of income claim and when the net past loss of income claim recovery and the disability benefits were added together they exceeded 100% of the disabled claimant's loss over the relevant time period. Therefore, Sun Life was entitled to a repayment in the amount of $25,000.00.

With respect to the future loss of income award, the Judge held:

> ". . . a tort award for future loss of income cannot be used by a disability insurer as the basis on which to call upon a beneficiary to account. This is because it ordinarily will never be known how the award will compare with the actual future loss. I see no way in which, at any point in time, it can be said that the moment has arrived in which an insurer's right of subrogation may be determined.
>
> The possible exception I see to this is where a tort award for future loss of income is premised on complete future unemployability, so that the award is calculated to compensate the Plaintiff for all of the income he or she would have earned up to the termination date of the benefits under the disability policy".

The Judge further noted that in subrogation cases, the insurer is in a "subordinate position":

> "There must be a surplus before an insurer can call on an insured to account and the surplus must be calculable for the same period of time to which the tort award applies."

In essence, the Judge in Budnark required that an "apples to apples and oranges to oranges" comparison be made. With respect to the past, an accurate comparison can be made but with respect to the future, in the vast majority of the cases, no accurate comparison can be made because of the uncertainties implicit in a tort award for future loss of income.

In the case of Nash v. Mutual Life of Canada [1999] N.J. No. 204, the insurer sought repayment of disability benefits paid over a nine month period. Referring to and relying upon Budnark, the Judge held that

> "even after an allowance for legal fees, the sum recovered for past loss of income far exceeded [the insurers'] payment and was paid with respect to the same time period during which the disability benefits were paid and the insurer was therefore entitled to recover the disability payments paid under the terms of the subrogation clause."

In the case of Stitzinger v. Imperial Life Assurance Company of Canada (1998) 39 O.R. (3rd) 566, the Ontario Court was asked to consider whether payments being received by a disabled claimant pursuant to a Judgment which incorporated a structured settlement could be offset against disability benefits in the context of a disability policy which provided for an 85% all source "total monthly income" maximum.

Before the accident, the disabled claimant was earning approximately $2,600.00 per month and at the time the case was argued, the tort structured settlement was paying approximately $3,900.00 per month. The disabled claimant conceded that this payment was being made for future income loss. The Judge deciding the case considered whether the periodic payment of damages pursuant to the structured settlement was "income" within the meaning of the policy. He determined that income is the product of one's work, business or investments while, on the other hand, damages remedy the loss of an ability or an asset. Damages replace a lost ability or asset, they are not the product of an existing ability or asset. Therefore, the periodic payment of damages pursuant to the structured settlement could not be offset against the disability payments.

It was also argued that the principle of subrogation applied to prevent the disabled claimant from recovering both the periodic structure payments from the Judgment and

payments under the disability policy. The Judge held that there was not sufficient evidence to show that the disabled claimant had been fully compensated for his losses and, in any event pursuant to the structured settlement, damages were being withheld from him and were to be paid in the future and therefore he had not yet received them. Furthermore, there was nothing before the Judge to establish that the structured settlement was intended from the outset to award full compensation in the long term. The Judge concluded his Judgment by noting that:

> "An award of damages for a loss of future earning capacity requires proof of matters which have not yet occurred, unlike damages or disability benefits for past or continuing losses of earnings, which require proof of what has transpired, or is transpiring. For this reason the determination of an amount of damages to compensate for future loss of earning capacity is subject to uncertainty . . . this uncertainly in the assessment or settlement of compensation for future losses is relevant in considering whether the Plaintiff has been fully compensated".

In the case of Kobzey v. Sun Life of Canada [2001] B.C.J. No. 1840, the British Columbia Court of Appeal overturned a lower court decision which awarded Sun Life full repayment (approximately $46,500.00) of disability benefits paid to a disabled claimant for a period slightly in excess of three years. The disabled claimant had settled her tort claim after the period and included in the settlement was approximately $200,000.00 for past loss of income and future earning capacity. In overturning the award, the court noted that it was "not yet known whether the settlement covered all the Plaintiff's wages or only a portion" and further commented that:

> "for the future component, there is an inherent difficulty in relating subrogation to loss of future earning capacity. An entitlement under this head is not wage replacement in the ordinary sense but compensation for a loss of an asset . . ."

CONCLUSIONS

Despite the fact that most disability policies contain very similar integration or offset provisions what is striking is that for every case that allows an offset there seems to be another case that disallows a similar offset. Therefore, when an insurer is deciding to make an offset, and when a claimant is deciding whether to accept an offset that has been made, both should keep the general principles of interpretation firmly in mind and pay heed to the equities of the case.

It should be remembered that disability policies are purchased to provide protection to insureds and courts often attempt to provide protection where, on a "plain reading" of the policy, none may exist. Courts broadly interpret coverage provisions and narrowly interpret exclusion (or limiting) provisions to provide the insured with what was bargained for. No insured actually "negotiates" the terms of a disability policy with an insurer. The insurer drafts the policy and sets a price and the insured pays the price for the coverage. The courts later look askance at an insurer who attempts to severely restrict the benefit paid for the price received. The courts have told insurers in many decisions that plain and precise wording is the solution if an insurer feels aggrieved. Insurers have re-worked and re-re-worked policies with this in mind but still policies are found to be ambiguous and ambiguities are resolved in favour of the insured. It appears that often the Courts pay heed to the equities of the disabled claimants' claim rather than the strict contractual terms of the policy.

With respect to the insurers' subrogation rights, the same trend appears to hold true. It is a very rare case indeed where a disabled claimant prevails perfectly and completely in

a lawsuit to recover damages for illness or injury disability caused by a third party. Damages are supposed to (as much as money can) put the disabled claimant back into the same position he or she would have been in had the wrong not occurred. However, our system is not one that awards perfect, complete compensation even to the most innocent victim. General damages are capped, negative contingencies eat away at both past and future claims, contributory negligence and the risks of proving negligence moderate claims and, in the end, even "substantial indemnity" costs awarded to a disabled claimant leave the disabled claimant less than perfectly compensated. In this context, it is not surprising that insurers can rarely persuade judges to enforce their subrogation rights. It will therefore be the exceptional case in which an insurer recovers its subrogated interest.

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