

Ex-employees leave money on table



**MERRICK
WEALTH**

**By
Peter
Merrick**

Last year, lawyer Ian Wright told me he believed the way employee benefits had been valued by legal counsel across Canada through the decades was inadequate.

He intuitively knew that the method used when an employee was let go, or left, had not fully represented the true monetary value of the lost group employee benefit coverage provided by the former employer.

The traditional method used to value lost benefits was to find out what the employer had paid for those employee benefits per month, and then multiply that amount by the number of months of severance the employee was awarded. This would be tacked onto the salary portion of the severance package.

For example, if an employer

had paid a total of \$2,000 per month for a former executive's benefit package and the former executive was awarded 20 months of severance, he might be offered an additional \$40,000 to compensate for the loss of benefits, in addition to a salary severance. This additional compensation would usually be taxed at the former employee's marginal rate.

The issue Wright had is it did not represent what it would cost for the former employee to purchase those same benefits privately. That would provide the former employee with the same coverage and place him in the same financial position as before his employment ended.

Some of the issues that the traditional method neglected to address are:

- Employers are able to deduct their employee benefit contributions as a business expense, and their employees receive these same benefits either tax-free or tax-deferred. If these same employee benefits were purchased by the former employee on his own, the individual would have to buy similar benefits with his after-tax dollars at his marginal tax rate.

- Employers are able to buy employee benefits at a reduced cost from insurance companies or other benefit providers because the cost of administration and

claim risk for these benefit providers is spread out over a number of employees who form the group. The former employee would not benefit from such economies of scale. He would be insured only on an individual basis.

For individual coverage the risk of loss to an insurance company or other benefit provider, and the greater cost of administration, would not be spread out so the former employee would pay a substantially greater amount per benefit than if he could buy those same benefits at his former employer's group benefit plan rates.

- For the vast majority of employee group benefits, plans do not discriminate between whether someone is healthy or not, or a smoker or not. However, this does not apply when someone applies for individual medical and dental, critical illness, short and long-term disability, long-term care or life insurance coverage.

For example, smokers will pay substantially more for individual insurance coverage than if they were a part of group coverage. And for former employees who have health issues, there is the very real prospect that they will be denied coverage.

Wright felt that the following

court decisions were applicable:

- The Ontario Court of Appeal in *Davidson v. Allelix Inc.* confirmed that a wrongfully dismissed employee may claim, in addition to lost salary, the pecuniary value of lost benefits flowing from such dismissal.

- *Alpert v. Les Carreaux Ramca Ltee* concluded that the dismissed employee was entitled to compensation for the loss of coverage under the employee medical plan "... calculated by reference to the cost to the defendant (employer) of maintaining the plan in favour" of the former employee.

- In *Connolly v. General Motors of Canada Ltd.*, the judge, although dismissing the claim of the dismissed employee because the employer had cause to terminate the worker, nevertheless went on to conclude that on the issue of compensation (had the employee been wrongfully dismissed), "... the measure of the 'pecuniary value' was the amount the employer would have had to pay to maintain the benefits for the benefit of the employee during the notice period."

- In *Habraken v. MacMillan Bathurst Inc.*, the court was again faced with the issue of valuing the dismissed employee's benefits for a reasonable notice period. The court noted that, "No specific evi-

dence was offered as to the value of these benefits to the employee or the cost to the employer." Note that both employer and employee requested the court "to calculate these damages according to a percentage of the plaintiff's annual salary of \$46,500."

The current reality is not good. Very few in the legal or accounting professions acknowledge that the old lost benefit compensation matrix is obsolete.

Nor do they fully understand how to evaluate the true value of lost benefits when they have been directed by their client to negotiate the best possible severance package.

This money is being left on the table by former employees. That reality may present future liabilities for former employees' legal counsel or other advisors, who have failed to investigate the real value of losing employee benefits.

Peter J. Merrick, BA, FMA, CFP, FCSI, is the president of Merrick-Wealth.com, a fee-for-service financial planning and executive benefit consulting firm in Toronto. He is the author of "The Essential Individual Pension Plan Handbook" (Lexis-Nexis Canada, 2007). He can be contacted at: (416) 854-1776 or peter@merrickwealth.com.