COLLATERAL BENEFITS REVISITED: A CASE COMMENT ON *IBM CANADA LIMITED V. WATERMAN*

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I. INTRODUCTION

In late 2013, *IBM Canada Limited v. Waterman* joined the list of divided decisions by the Supreme Court of Canada on the problem of collateral benefits.[1] In a 7-2 split, the majority of the Court held that pension benefits received by the plaintiff during the notice period would not be deducted from damages payable by the employer for wrongful dismissal. The Court reasoned that the pension benefits were analogous to non-indemnity insurance proceeds and so were not properly deductible from the damages owing — even though the plaintiff was, as a result, overcompensated under the contract.[2] The dissenting justices would have held that, because the plaintiff's losses and entitlements arose under a single contract, the pension benefits were not at all "collateral" and ought to be analyzed under the rubric of expectation damages.[3]

The *Waterman* Court has issued a confusing judgment. Part I of this comment argues that this confusion arises from the Court's unsatisfactory engagement with the rationales for deducting only indemnifying collateral benefits, and not non-indemnifying collateral benefits, from a plaintiff's compensable loss. The *Waterman* Court relied expressly but only superficially on the reasoning set out in the dissenting judgment of *Cunningham v. Wheeler*,[4] and so provided an analysis that was inconsistent: according to the *Cunningham* dissent, an indemnifying collateral benefit prevents the plaintiff's loss from arising, while a non-indemnifying collateral benefit is irrelevant to the plaintiff's loss. In neither of these instances does the Court correct a situation of "excess compensation," as the *Waterman* Court explicitly did.[5] As a consequence, the *Waterman* Court was forced to set out an exception to the compensation principle instead of focusing on the conditions that cause a compensable loss to arise. Part of the analytical confusion in *Waterman* arose from the Court's desire to reconcile its reasoning with the result reached in *Sylvester v. British Columbia* — a case dealing strictly with expectation damages, and not collateral benefits.[6] It is argued in this comment, alongside the *Waterman* dissent, that where the losses and gains at issue are governed by a single contract, collateral benefits do not arise and the plaintiff's expectation interest ought to be determined according to ordinary contract principles.

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1 2013 SCC 70, [2013] 3 SCR 985 [*Waterman*].

2 *Ibid* at paras 34–35.

3 *Ibid* at paras 137–38, Rothstein JA, dissenting (relying on the earlier decision *Sylvester v British Columbia*, [1997] 2 SCR 315, [*Sylvester*]).

4 *Cunningham v Wheeler*; *Cooper v Miller*; *Shanks v McNee*, [1994] 1 SCR 359 [*Cunningham*].

5 *Waterman*, *supra* note 1 at para 33.

6 *Sylvester*, *supra* note 3.

In Part II, it is suggested that the *Waterman* Court missed an opportunity to connect the analysis of collateral benefits to those benefits that arise, or ought to arise, from a plaintiff's reasonable efforts to mitigate losses following breach. There is a meaningful overlap between these two areas of contract law, which both operate as limiting factors on a plaintiff's compensable loss. This comment seeks to show that analyzing this overlap would have helped the Court to better articulate a basis for the limiting effects of indemnifying benefits without resorting to what is the unpersuasive argument that the compensatory principle is not absolute.

II. *IBM CANADA LIMITED v. WATERMAN*

The issue at the core of *Waterman* is known by several names. The *Waterman* Court preferred the term "compensating advantage," but "collateral source" and "collateral benefit" are among those terms more conventionally used.[7] In the interest of consistency with the majority of analysis in this area, the term "collateral benefit" will be used, despite observations by the *Waterman* Court and others that the word "collateral" unhelpfully suggests some predecision of the very thing at issue.[8]

A party who suffers a loss may receive compensation for that loss from a number of sources. Where an injured party is able to bring a successful action in tort or contract, his or her loss will ordinarily be compensated by the defendant to that action. But the defendant is just one possible source of recovery.[9] For example, a party who suffers a loss may be protected by social welfare arrangements, such as unemployment or disability benefits; she may be entitled to the proceeds of private insurance or to the benefits of insurance-like structures arising from her employment; or she may be the beneficiary of a private gift intended to assist with her recovery.[10] Thus, basically construed, a collateral benefit, is any benefit received by the plaintiff, from a source other than the defendant, in connection to the loss occasioned by the defendant's private wrong. Often a further temporal quality is present, insofar as collateral benefits frequently arise from contractual arrangements made prior to the injury, such as agreements for insurance, disability, or pension benefits; but this is not necessarily the case, as where the plaintiff receives a gift of money or services following injury. Thus, the essential quality of collateral benefits is that such benefits do not come from the defendant, but do benefit the plaintiff, and are connected to the loss before the court. The issue, then, is determining in what cases, if at all, such benefits, if any, should affect the amount of damages owed by the defendant to the plaintiff. This is often framed in terms of the collateral benefit's "deductibility" from the amount owed by the defendant — a benefit is deducted from the loss caused by the defendant, thereby reducing or eliminating the damages payable by the defendant in reparation of her wrong.

The question of whether collateral benefits are deductible was first considered in the context of tort law with respect to private insurance in the English case *Bradburn v. Great Western Railway Co.*,[11] where it was answered in the negative. The collateral benefits rule

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7 *Waterman*, *supra* note 1 at para 3.
8 *Ibid* at para 26.
9 KD Cooper, "A Collateral Benefits Principle" (1971) 49:4 Can Bar Rev 501 at 501.
10 *Parry v Cleaver* (1969), [1970] AC 1 at 38 (HL) [*Parry*], cited in Cooper, *ibid* at 501.
11 (1874), [1865] 10 LR Ex 1, [1874-1880] All ER Rep 195 [*Bradburn* cited to LR Ex].

that developed from early cases like *Bradburn* has come to have both substantive and evidentiary functions, understood as the rule that precludes a defendant from showing that the plaintiff has received benefits from other sources in connection to the loss that she, the defendant, has caused. Of the many rules relating to collateral benefits that have arisen since *Bradburn*, the rule that a plaintiff's private insurance proceeds have no bearing on that plaintiff's loss (the "private insurance exception") has been the most persistent.

Significant precedent supports the non-deductibility of collateral benefits arising from private insurance or its analogues.[12] As such, the question of whether a benefit is or approximates private insurance has usually been central to the issue of the benefit's deductibility, often without any examination of the exception itself. However, one of the charges of the common law is to ensure that legal rules remain supportable when examined in light of societal and jurisprudential progress. The private insurance exception presents just such a challenge, as has been made clear by the severe academic criticism levied against it. Early rationales for excluding collateral benefits when determining an injured party's loss were premised on conceptions of causation and fault that are now considered less persuasive by both judges and legal commentators, particularly in the contractual context.[13] Thus, as in *Waterman*, where a modern court discredits the historical rationales for the private insurance exception but is unable articulate, or articulates inconsistently, any alternative principles, such a court runs the risk of maintaining a rule that no longer has any defensible basis. This was the concern of Beverly McLachlin (as she then was), when she wrote in 1981 that "[n]o issue in the law of damages reflects the absence of underlying principle so clearly as the question of whether benefits accruing to the plaintiff because of his injury are to be offset against his award."[14]

The following section analyzes the *Waterman* decision with respect to its treatment of some of the arguments commonly advanced in favour of and against the deduction of collateral benefits: causation, punishment, and behavior modification. It demonstrates that although the Court clearly rejects the judicial arguments that have historically supported the non-deductibility of private insurance proceeds, the Court goes on to support the non-deductibility of the plaintiff's pension benefits by appealing to rationales contradicted elsewhere in its own analysis. We are thus left with a judgment that affirms the exception for private insurance as a matter of precedent but takes a confusing position on the rationale for this exception.

A. CAUSATION

Causation has often been an important concept in deciding that collateral benefits ought to have no bearing on calculating the damages owed by the defendant. The *Bradburn* Court in particular justified its decision primarily on the basis of causation. In *Bradburn*, the plaintiff, who had been injured in a railway accident, had taken out private insurance from the Railway Accident Insurance Office, and had received compensation pursuant to that

12 *Cunningham*, *supra* note 4 at 370–71.
13 Hillel David, "Case Comment – Collateral Benefits: Raytch v. Bloomer" (1990) 12:1 Adv Q 124 at 127.
14 Beverley M McLachlin, "What Price Disability? A Perspective on the Law of Damages for Personal Injury" (1981) 59:1 Can Bar Rev 1 at 44.

agreement following his accident. In deciding that this benefit would not be deducted from the plaintiff's overall assessment of loss, the Court argued:

> He does not receive that sum of money because of the accident, but because he has made a contract providing for the contingency; an accident must occur to entitle him to it, but it is not the accident, but his contract, which is the cause of his receiving it.[15]

The Supreme Court of Canada has cited this passage when giving a historical overview of the collateral benefit problem,[16] but did not cite causation as the rationale for excluding some benefits and not others in *Waterman*. Neither has legal causation proven to be a persuasive factor in academic attempts to understand whether and when collateral benefits ought to be deductible. It has been pointed out that the Court's causal language in *Bradburn* is a legal conclusion and not a rational argument, and that the language of legal causality, while occasionally still favoured by judges, has tended to obscure rather than illuminate the issue.[17]

The Court in *Waterman* was careful not to overemphasize legal causation as a factor, explaining that reliance on "strict principles of causation" could conceal "unarticulated policy concerns."[18] The reasoning in *Bradburn* was specifically rejected as artificial to the extent that it purported to determine whether a particular benefit should or should not be deducted.[19] However, the Court in *Waterman* confirmed the importance of causation-like considerations as a threshold issue in determining whether a benefit even engaged the collateral benefit problem.[20] The relevant concept was that of "sufficient connection" — the Court wrote that a benefit must be sufficiently connected to the breach in order to be considered even potentially deductible, a requirement that serves similar purposes as considerations of causation and remoteness in assessing damages.[21]

In the view of the Court in *Waterman*, a benefit was sufficiently connected to the breach to constitute a collateral benefit problem where either the plaintiff would not have received the benefit but for the breach, or the benefit was intended to indemnify the plaintiff for the sort of loss resulting from the breach.[22] The "but for" requirement is a matter of factual causation and is relatively uncontroversial. It has been noted that cause in fact is a necessary, but not sufficient, aspect of whether a collateral benefit ought to be deducted.[23] This requirement is what prevents anyone from arguing that collateral benefits such as lottery winnings[24] and personal savings[25] ought to be deductible from damages owing, because such benefits are wholly unconnected to the injury at issue, whatever their capacity to repair it. It is probably more accurate, however, to require that the benefit would not have arisen but for

15 *Bradburn*, *supra* note 11 at 3.
16 *Cunningham*, *supra* note 4 at 370.
17 Richard Lewis, "Deducting collateral benefits from damages: Principle and policy" (1998) 18:1 LS 15 at 19.
18 *Waterman*, *supra* note 1 at para 31.
19 *Ibid* at para 54.
20 *Ibid* at para 23.
21 *Ibid* at para 25.
22 *Ibid* at para 28.
23 Lewis, *supra* note 17 at 19.
24 *Waterman*, *supra* note 1 at para 29.
25 Lewis, *supra* note 17 at 19.

the loss suffered as a result of the breach, since collateral benefits are ordinarily not triggered by contractual breaches per se, but rather the losses they occasion. "Breach" is a convenient shorthand for such losses, but the two are not interchangeable.

More problematic is the Court's second "sufficient connection" criterion, which seems to only confuse matters without adding analytical purchase by simply presupposing the centrality of indemnity. Any benefit triggered by the breach — whether intended to indemnify the plaintiff or not — will satisfy the requirement of factual causation. This captures private benefactions as well as benefits arising from social welfare programs and contractual insurance or insurance-like arrangements. In adding a separate indemnity criterion, the Court was likely attempting to account for its holding in *Sylvester*, a case in which the plaintiff was receiving disability benefits prior to wrongful dismissal.[26] The issue was whether the receipt of disability benefits precluded the plaintiff from then receiving damages equivalent to the salary the plaintiff would have received during the notice period, had he worked. Clearly the disability benefits were not triggered by the plaintiff's wrongful dismissal, as he had been in receipt of them well in advance of the breach. However, the Court in *Waterman* argued that the disability benefits nevertheless raised a compensating advantage problem because they were intended to be a substitute for the employee's salary.[27]

In my view, the Court accomplished little more than analytical confusion by introducing this consideration. The Court's reasoning raises the question of whether it is possible for one party to cause a particular loss to another party when the other party is already being compensated for that same particular loss. The answer to this must be no, but it is not a matter of indemnity. It is rather a matter of the fact that the loss indemnified against has already occurred. At most, one party may then cause the other party to lose the benefit of the compensation for the preceding loss. But in such a case this would constitute a loss distinct from that loss for which the plaintiff was already being compensated. For example, if a person has lost his wages under an employment contract, and is then being compensated for that loss by virtue of social welfare benefits, one cannot cause that person again to lose those same wages under that employment contract — at least until their receipt is resumed. The Court in *Waterman* thus makes little sense on this point: if a benefit was intended to indemnify for the type of loss caused by the breach,[28] but was not triggered by the breach because it was already in operation (as in *Sylvester)*, then the Court is dealing with two similar but factually distinct losses. *Sylvester* was, in other words, not a collateral benefits case. The collateral benefits problem concerns the management of multiple sources compensating for a single loss.[29] A benefit that precedes the injury at issue necessarily compensates some loss other than the one before the Court. The disability benefits in *Sylvester* were not factually triggered by any loss occasioned by the breach, but rather by the loss occasioned by the plaintiff's illness, which preceded the breach and was unconnected to the defendant's wrong. It was the illness that caused the plaintiff to no longer receive his salary and to instead receive disability benefits. Thus, the plaintiff did not have a salary to lose when the breach occurred, and for a portion of the notice period thereafter, until his recovery. For that time period, the plaintiff only had his receipt of disability benefits, which

26 *Sylvester*, *supra* note 3.
27 *Waterman*, *supra* note 1 at para 30.
28 *Ibid*.
29 *Ratych v Bloomer*, [1990] 1 SCR 940 [*Ratych*].

continued unaffected by the breach. The plaintiff reacquired his salary — and the ability to lose it — after his recovery from illness, and the end of his disability benefits.

Considerations in *Sylvester* as to the extent to which the disability benefits constituted a "replacement salary" were not directed at answering the question of whether or not the plaintiff was compensated by the disability benefits for the loss of salary arising from the breach (since no salary had been in fact lost in that time period). Rather, the benefits were considered in determining whether or not the parties had intended that the plaintiff (under the terms of the employment contract and as a matter of contractual interpretation) would ever be in receipt of both salary and disability benefits such that receipt of one did not necessarily preclude receipt of the other. In other words, *Sylvester* was not a case about whether or not the defendant ought to compensate the plaintiff for lost salary occasioned by wrongful termination when that same loss was also compensated by a collateral source. Rather, *Sylvester* was about determining the scope of the plaintiff's expectation interest under the employment contract, and, more precisely, whether it included both disability benefits and salary. The Court in *Sylvester* made this clear when it wrote that parties could "obviously agree that the employee [was] to receive both disability benefits and damages for wrongful dismissal."[30] The Court in *Waterman* mischaracterized *Sylvester* and gave undue primacy to the concept of indemnity as a result. The dissent in *Waterman* supports this interpretation, arguing also that *Sylvester*, properly construed, did not engage the issue of collateral benefits.[31] This suggests that, contrary to the majority in *Waterman*, the question of factual causation is essential to the collateral benefits problem and that a sufficient connection between the loss and the benefit cannot be established by the quality of indemnity alone.

B. PUNISHMENT

The collateral benefit problem is often thought to engage the issue of an unexpected windfall.[32] Where a source other than the defendant is willing or obliged to repair the plaintiff for the loss caused by the defendant, it is sometimes said that this creates an issue of overcompensation that must then be fairly allocated either to the plaintiff's or the defendant's credit. The Court in *Waterman* used the language of "excess recovery," and wrote that overcompensation was a threshold issue for the collateral benefit problem.[33]

When collateral benefits are construed as overcompensating the plaintiff, the argument to credit the plaintiff with the windfall has often been defended on the relative moral position of both parties. Where the benefit is one that the plaintiff secured as a result of her own actions, she is characterized as possessing prudence and foresight, for which she deserves the reward of the windfall.[34] The defendant, as the wrongdoer, is thought to either deserve to pay for the full extent of the loss caused, or to be not fairly entitled to the benefit of the plaintiff's prudence.[35] Courts have taken a divided view to such rationales in the context of tort law. The concept of tortious conduct as a wrong was relied upon as recently as the

30 *Sylvester*, *supra* note 3 at para 20.
31 *Waterman*, *supra* note 1 at para 136–38.
32 Albert Averbach, "The Collateral Source Rule" (1960) 21:2 Ohio St LJ 231 at 240.
33 *Waterman*, *supra* note 1 at para 23.
34 *Parry*, *supra* note 10 at 14.
35 *Cunningham*, *supra* note 4.

majority judgment in *Cunningham*, in which Justice Cory wrote "[t]ort recovery is based on some wrongdoing. It makes little sense for a wrongdoer to benefit from the private act of forethought and sacrifice of the plaintiff."[36] Litigants have continued to rely upon such reasoning in recent cases.[37]

In writing for the majority in *Ratych v. Bloomer*, Justice McLachlin (as she then was) emphasized the compensatory (and not punitive) focus of private law damages:

> [T]he modern trend in the law of damages [is] away from a punitive approach which emphasizes the wrong the tortfeasor has committed. The link between the moral culpability of the tortfeasor and his obligation to pay damages to the person he injures is frequently tenuous in our technological and mechanical era.… In this context, the maxim that compensation must be fair to both the plaintiff and the defendant seems eminently reasonable.… That fairness is best achieved by avoiding both undercompensation and overcompensation.
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> The trend away from a moralistic view of tort suggests that the process of assessing damages should focus not on how the tortfeasor may be appropriately punished, but rather on what the injured person requires to restore him to his pre-accident state. To focus on the alleged "benefit" to the tortfeasor resulting from bringing collateral payments into account is to misconstrue the essential goal of the tort system. The law of tort is intended to restore the injured person to the position he enjoyed prior to the injury, rather than to punish the tortfeasor.[38]

The view taken by Justice McLachlin in *Ratych* is superior to one that confuses compensatory damages with those that have a clearly defined punitive function. Modern scholars have tended to support Justice McLachlin's approach, particularly in the context of contract law, where to construe contractual breach as a wrong is even less appropriate than in tort law, given the Supreme Court of Canada's endorsement of efficient breach.[39] Thus, the Court in *Waterman* rightly rejected punitive rationales for the collateral benefits problem on the basis that fault is not ordinarily an operative concept in remedial contract law.[40]

C. BEHAVIOUR MODIFICATION

Related to the concept of punishment is the policy argument that deducting collateral benefits from damages owed by a defendant will negatively impact the deterrent effect of private law damages.[41] Deterrence is not generally perceived to be a function of ordinary contract damages because contractual breach, although compensable as a matter of right, is not necessarily discouraged. This observation aside, it is commonly noted that a defendant will often pay substantial damages to restore the plaintiff even where some collateral benefits are deducted, and that the precise impact of deduction on deterrence will often be negligible.[42]

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36 *Ibid* at 401.
37 See e.g. *Boyle v Prentice*, 2010 BCSC 1212, [2010] BCJ No 1694 (QL).
38 *Supra* note 29 at 963–64 [citations omitted].
39 *Bank of America Canada v Mutual Trust Co*, 2002 SCC 43, [2002] 2 SCR 601.
40 *Waterman*, *supra* note 1 at para 71.
41 John G Fleming, "The Collateral Source Rule and Contract Damages" (1983) 71:1 Cal L Rev 56 at 58.
42 *Cunningham*, *supra* note 4 at 383–84.

Commentators have also argued that the deduction of collateral benefits disincentivizes the purchase of insurance, but courts in recent decades have not laid much stock in such concerns. The issue of collateral benefits is frequently raised even where the plaintiff is in receipt of the benefit involuntarily. Moreover, a person's desire to purchase the security provided by insurance is unlikely to be outweighed by the fear that such proceeds will be deducted following a successful action for damages, not least because the insurance proceeds may be triggered by non-actionable events, or cover types or degrees of losses that are for other reasons not compensable under private law.[43] Again, the Court in *Waterman* rightly argued that the actual effect of deducting collateral benefits on the behaviour of parties was probably minimal.[44]

D. COMPENSATION FOR ACTUAL LOSS

Thus far this comment has outlined common rationales for and against the deduction of collateral benefits generally,[45] without distinguishing between different kinds of collateral benefits, addressing whether or not only certain collateral benefits ought to be deducted, or on what basis such distinctions might be drawn. I now turn to the Court's actual analysis in *Waterman*, as it pertains to the concepts of indemnity and non-indemnity, and the rationales offered in favour of these distinctions.

It should be noted at the outset that *Waterman* engaged minimally with the concept of subrogation, which ought to be critical if the quality of indemnity forms the primary basis for deduction. A right of subrogation ordinarily vests in the insurer when the contract is one of indemnity, and can be further set out by the parties to a contract.[46] Subrogation is the process by which an insurer may recover monies it has paid to the insured, either from the party who caused the loss (sometimes called reimbursement), or from an insured that has received both insurance proceeds and an award of damages arising out of the same loss.[47] The Court in *Waterman* correctly identified that subrogation offers a solution to the collateral benefits problem by ensuring that the receipt of damages is allocated to the party that, properly speaking, has borne the loss. However, it is critical that where a party receives, under a test such as that articulated in *Waterman*, less than the full amount of damages owed by virtue of the operation of an indemnity benefit, the court must be satisfied that no right of subrogation or reimbursement exists that will be frustrated by the party's reduced compensation. Insurance premiums are frequently set at a price that reflects the insurer's intention to recoup the costs of indemnity; if such recoupment is frustrated, the insurer has lost the benefit of its contract.

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43 Christopher A Taylor, "When is a Loss not a Loss?: The Deductability of Collateral Benefits After Ratych v. Bloomer" (1990) 12:2 Adv Q 231 at 244.

44 *Waterman*, *supra* note 1 at para 71.

45 An important rationale for excluding benefits arising from insurance and insurance-like arrangements is the argument that the plaintiff will lose the benefit of something for which she has paid (see e.g. *Ratych*, *supra* note 29). However, this is an argument that pertains only to benefits that the plaintiff has financed. I have focused on rationales that pertain to collateral benefits generally. The Court in *Waterman* argued that little can be said to turn on whether the plaintiff paid for the benefit or whether it arose out of some other arrangement (*Waterman*, *supra* note 1 at para 76).

46 Brendan S Maher & Radha A Pathak, "Understanding and Problematizing Contractual Tort Subrogation" (2008) 40:1 Loy U Chicago LJ 49 at 51.

47 *Ibid* at 50.

In its analysis, the Court in *Waterman* began by asserting that the compensation principle did not provide a "full answer to the issue."[48] In other words, the Court reasoned that the benefits at issue, if not deducted, would result in overcompensation to the plaintiff, but that such overcompensation was nevertheless justified if the benefits fell into an exception to the principle of full compensation. The Court emphasized that the compensation principle was not a principle of strict application, and was subject to well-established exceptions.[49] It cited in support of this proposition the English case *Attorney General v. Blake*, which had held that disgorgement of profits for contractual breach was exceptionally appropriate where compensatory remedies were inadequate.[50] The Court also noted that principles of mitigation and remoteness further affected the compensation principle by adjusting the plaintiff's loss in terms of what was reasonable.[51] Thus, the Court was very clear that the plaintiff's actual loss was not at issue. The Court explicitly stated that, to fully compensate the plaintiff, and no more, the pension benefits would need to be deducted from the damages owing, or else the plaintiff would be in a better position than if the contract had been performed.[52] However, an exception could allow for overcompensation: in this case, it was the private insurance exception established in *Bradburn*.[53] In other words, if the pension benefits were analogous to private insurance, the plaintiff's overcompensation was justifiable by virtue of the rationales supporting the exception. In *Waterman*, the Court found that the plaintiff's retirement pension fell within the exception as it had "always been applied: the benefit is not an indemnity and the employee contributed to the benefit."[54] Thus the non-deduction of the pension benefits, although resulting in overcompensation, was justifiable on the basis of the "justice, reasonableness, and policy" presupposed by the private insurance exception.[55]

The problem with the *Waterman* analysis is that it provides an internally inconsistent account for the result reached. As shown above, the Court rejected the common rationales in favour of and against excluding collateral benefits — causation, punishment and reward, and behaviour modification, were, in my view, rightfully reduced to threshold issues or policy rationales holding little weight. Instead, the Court relied on the distinction between indemnity and non-indemnity benefits, and held as a matter of observable precedent that indemnity benefits generally do not fall within the insurance exception and so have tended to be deductible from damages owing. However, in support of emphasizing the distinction between indemnity and non-indemnity, the Court adopted the rationale proposed in the dissenting judgment in *Cunningham* and the majority judgment in *Ratych*, calling such a distinction "sound in principle":

> The nature and purpose of the benefit was central to the minority's reasoning in *Cunningham*.… [T]he minority refocused the analysis on the nature of the benefit, distinguishing between "indemnity" and "non-indemnity" insurance. The former should be deductible, while the latter should not:

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48 *Waterman*, *supra* note 1 at para 13.
49 *Ibid* at para 36.
50 [2000] UKHL 45, [2001] 1 AC 268.
51 *Waterman*, *supra* note 1 at para 36.
52 *Ibid*.
53 *Supra* note 11.
54 *Waterman*, *supra* note 1 at para 77.
55 *Ibid* at para 38.

> This distinction is critical to a discussion of collateral benefits. If the insurance money is not paid to indemnify the plaintiff for a pecuniary loss, but simply as a matter of contract on a contingency, then the plaintiff has not been compensated for any loss. He may claim his entire loss from the negligent defendant without violating the rule against double recovery.[56]

If the rationale for the non-deductibility of non-indemnity benefits is, as articulated in *Cunningham*, that such benefits do not in fact compensate the plaintiff for *any* loss, including the loss at issue, then the *Waterman* Court's preliminary analysis on the necessity of "excess compensation" to the collateral benefits problem makes little sense. A non-indemnity benefit, construed as it was in the *Cunningham* dissent, does not produce "excess compensation." A non-indemnity benefit is not compensatory at all; rather the payment of a predetermined amount is simply triggered by the occasion of a contingency. The receipt of such benefits is simply not relevant to the quantification of the loss at issue because the receipt does not respond to the loss at issue.[57] The private insurance exception to the compensation principle, construed as it was in the *Cunningham* dissent, is thus not an exception to the principle of compensation, because non-indemnity benefits do not compensate for loss, and so cannot result in overcompensation.[58]

Indemnity benefits, conversely, are (in the view of the *Cunningham* minority) in a sense compensatory.[59] Such benefits prevent a loss from ever arising, and so must be taken into account. But this has less to do with avoiding after-the-fact overcompensation, in the sense of setting off gains against an actual loss, than with determining the plaintiff's compensable loss as a preliminary issue.[60] This was made clear in *Ratych*, where the plaintiff in a tort action could not claim the value of lost wages from the tortfeasor because she had not, in fact, suffered any such loss: she was indemnified against such loss by her receipt of sick-pay benefits.[61] Again, the reasoning of the dissent in *Cunningham* (and *Ratych*), purportedly relied on in *Waterman*, conflicts with *Waterman*'s overall analysis. If the reasoning of the *Cunningham* dissent is accepted, then indemnity benefits must be accounted for in determining the plaintiff's actual loss, which is then compensated by the defendant. In other words, the analysis articulated by the *Cunningham* minority does not correct excess compensation based on rationales conflicting with the compensation principle, but rather properly determines compensable loss at the outset. The Court in *Waterman* did not mirror the *Cunningham* dissent's overall analysis, and so reliance on the *Cunningham* dissent makes for an analysis that is supported by inconsistent rationales.

Why did the Court in *Waterman* construe the plaintiff's pension benefits as essentially compensatory, and so as resulting in excess compensation, despite their non-indemnifying quality, and despite its reliance on the *Cunningham* dissent? One could suggest that the *Waterman* Court did not clearly set out the legal nature of its analysis. To reiterate, the *Waterman* Court began by arguing that, should the plaintiff receive both pension benefits and

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56 *Ibid* at para 59, citing *Cunningham*, *supra* note 4 at 371–72.

57 Notably, non-indemnity benefits so construed may not even satisfy the threshold requirement of causation, insofar as they are not, under this view, triggered by the *loss* arising from the defendant's breach.

58 *Cunningham*, *supra* note 4 at 371–72.

59 *Ibid* at 392–93.

60 *Ibid* at 376–77.

61 *Ratych*, *supra* note 29.

compensation for wages lost, the plaintiff would be overcompensated. The Court then had to account for this overcompensation by virtue of an exception to the compensation principle. However, the plaintiff was only overcompensated by the receipt of both pension and wages if his compensable loss was determined according to his expectation interest under the employment contract. This was the central argument made by the *Waterman* dissent, which would have held that the "collateral issue problem" was not even engaged where a plaintiff's entitlements flowed from a single contract.[62] In the view of the dissent, *Waterman* ought to have been strictly a matter of putting the plaintiff in the position he would have occupied had the contract been performed. This would have precluded, as the *Waterman* majority conceded, simultaneous receipt of pension and wages. Thus, because the *Waterman* majority began by framing the plaintiff's actual loss in terms of his expectation interest, it encountered analytical difficulty by then departing from the fulfillment of that expectation interest.

Further, the *Waterman* majority only reconciled its reasoning with that of *Sylvester* by characterizing the contractual issue in *Sylvester* as follows:

> Contrary to the view of my colleague Rothstein J., the relevant question was *not* what Mr. Sylvester was entitled to under his contract in the event that his employer had not breached it. The question was whether the contract expressly or impliedly provided for him to receive both disability benefits and damages for wrongful dismissal.[63]

In so characterizing the question at the heart of *Sylvester*, the *Waterman* majority attempted to transform a straightforward issue of contractual interpretation into one supposedly concerning collateral benefits. In fact, and to the contrary, the Court in *Sylvester* stated at the outset of its judgment that whether or not the plaintiff's damages properly included disability pay turned on the "intention of the parties to the employment contract."[64] The collateral benefits doctrine does not turn on the intentions of the parties to a dispute, but rather on the abstract determinations of a party's loss and compensation. In *Sylvester*, the Court's subsequent inquiry into whether disability benefits were a replacement for wages was intended to determine what the plaintiff was entitled to under the employment contract. The indemnifying quality of the disability benefits was a fact that spoke to the intentions of the parties to the contract, which could have chosen a structure in which the plaintiff could have received both disability pay and wages. This inquiry went, in other words, directly to the question of "what Mr. Sylvester was entitled to under his contract in the event that his employer had not breached it."[65]

As already stated, the doctrine of collateral benefits manages a plaintiff's entitlement to damages when benefits have been received or are due from multiple sources. The introduction of a collateral benefits analysis (turning on the fact of indemnity) when the benefits at issue are governed by a single contract, distorts the intentions of the contracting parties, who are presumed to have bargained for the rights and responsibilities as set out in the contract. The quality of indemnity may be important in determining intention, but it is not

62 *Waterman*, *supra* note 1 at para 138.
63 *Ibid* at para 87 [emphasis in original], citing *Sylvester*, *supra* note 3 at para 13.
64 *Sylvester*, *ibid* at para 2.
65 *Waterman*, *supra* note 1 at para 87.

determinative in and of itself. This distinguishes single contract scenarios from other cases where a plaintiff receives benefits from parties other than the defendant.[66]

It has usually been asserted that the collateral benefits problem has equal and similar application in both contract and tort.[67] However, the *Waterman* majority judgment illustrates that, where the receipt of the multiple benefits at issue for one loss are governed by a single contract, attempting to combine analyses that perform separate functions (namely, the analysis that determines the scope of expectation damages and the analysis that determines the deductibility of collateral benefits) may prove very problematic. It could be suggested that the better approach is to determine the plaintiff's expectation interest according to ordinary contract principles where all the benefits concerned arise from and are governed by the contractual relationship between the parties. The alternative is to effectively enforce a policy that the intentions of contracting parties necessarily turn on whether the contract benefits perform indemnifying functions.

III. MITIGATORY BENEFITS AND COLLATERAL BENEFITS

Part II discussed how the *Waterman* judgment dealt with some of the ordinary arguments in favour of and against deducting collateral benefits. It also explained why *Waterman* did not articulate an internally coherent position on the issue of the private insurance exception. Thus, in terms of the rationales articulated for and against deducting private insurance proceeds, *Waterman* is an apparently confusing judgment. However, the *Waterman* judgment is helpful in the following sense, at least insofar as the Canadian treatment of the issue is concerned: in *Waterman*, the Court explicitly referenced, in providing the definition of collateral benefits, the "considerable overlap" between the collateral benefits question and the plaintiff's duty to mitigate her loss following breach.[68] Although this overlap did not meaningfully inform any part of the Court's later analysis, it is the first time that the Supreme Court of Canada has acknowledged the conceptual mirroring that exists between collateral benefits and a plaintiff's so-called duty to prevent the accrual of avoidable losses.

John Fleming has suggested that a collateral benefit can be negatively identified by applying a sort of temporal criterion.[69] This is also the basis for the distinction as drawn in *Waterman*: where a plaintiff benefits by reason of action taken after the breach, this is mitigatory and not collateral, but if the action is taken before the breach the benefit is collateral and not mitigatory.[70] Fleming's comment observes a distinction in the law as practiced, but it does not look at the justifications for the distinction beyond suggesting that this perhaps has to do with the existence of a duty to mitigate that only arises after breach.[71] The implications of the word "duty" in this context, although in common use, are misleading. Properly construed, the duty to mitigate loss in fact engages no positive duty at all. Rather, where an injured party fails to take reasonable steps to mitigate her loss, she will merely be precluded from claiming any part of her loss that could have been reasonably avoided.[72] As

66 *Ibid* at paras 137-38.
67 Fleming, *supra* note 41 at 56–57.
68 *Waterman*, *supra* note 1 at para 22.
69 Fleming, *supra* note 41 at 78.
70 *Waterman*, *supra* note 1 at para 22.
71 Fleming, *supra* note 41 at 78.
72 *Asamera Oil Corp Ltd v Seal Oil & General Corp*, [1979] 1 SCR 633.

such, this article employs the following terminology: "principle of avoidable loss" instead of "duty to mitigate," and "mitigatory benefits" when referring to the benefits arising from mitigation, whether actual or deemed.[73] Fixation on the misnomer "duty" obscures the relationship between mitigatory and collateral benefits:

> Certainly the plaintiff has no duty to anticipatorily mitigate any damages a later unknown tortfeasor defendant may cause him. This is so because no one contests his right to "full damages" in the absence of his having acquired the insurance policy. Absent such a duty by the plaintiff where does the defendant get the correlative right to have the proceeds of the policy, if purchased, used in mitigation of the legal damages as between him and the plaintiff?[74]

Such comments are affected by the misconception of duty in limiting a plaintiff's compensable loss. The principle of avoidable loss is often construed as involving duty — but in fact, similar to the comment made above, no corresponding right to the mitigatory benefit exists.[75] Thus the rationale for limiting the plaintiff's compensable loss must be based on other grounds. An argument could be made that the temporal distinction that apparently distinguishes collateral benefits from mitigatory benefits detracts from the significant overlap between these two doctrines. In the context of contract law, each doctrine sets out what portion of a plaintiff's expectation interest, if any, remains to be compensated by the defendant where that interest has been satisfied (or ought to have been satisfied) by some other source. In other words, each operates as a limitation on the plaintiff's recovery as between the plaintiff and the defendant.[76] Further, each must rationalize the limitation of damages owing without engaging concepts of duty and right.

The relationship between collateral benefits and the principle of avoidable loss has received some academic treatment. Occasionally, the principle of avoidable loss is cursorily referenced when the writer is of the view that collateral benefits ought to be deducted from damages owed. The argument is generally one of analogy. Collateral benefits that arise following breach as a result of the breach are required as a matter of law to be deducted from the plaintiff's claimable loss — so why should the treatment of other collateral benefits dependent on pre-breach arrangements be any different? For example:

> In a case where the defendant admittedly breached a lease by vacating premises before the end of the term, no one today would think of arguing that he is liable for the full rental to the end of the term, where the fact is that the plaintiff released the premises to another party at the same rental for the balance of the term. Should mitigation be denied in such a case on the theory that to allow it would bestow a "benefit" on the wrongdoer defendant? Yet this is precisely the situation which exists in most collateral source situations in personal injury actions where the collateral source rule is applied with impunity.[77]

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73 Caprice L Roberts, "Restitutionary Disgorgement for Opportunistic Breach of Contract and Mitigation of Damages" (2008) 42:1 Loy LA L Rev 131 at 140, citing Doug Rendleman, *Remedies: Cases and Materials*, 7th ed (Thompson West, 2006) at 101.

74 Walter H Beckham, "The Collateral Source Rule is Sound, is Firmly Embedded in the Rubric of our Law, and should not be Changed" (1965) American Bar Association Section of Insurance, Negligence & Compensation L Proc 310 at 312.

75 Roberts, *supra* note 73 at 159.

76 *Ibid* at 151.

77 Charles W Peckinpaugh, "An Analysis of the Collateral Source Rule" (1966) 1966:9 Insurance LJ 545 at 551.

Although this analogy does not provide a complete basis for the deductibility of all collateral benefits, it does illustrate that the punitive rationale for requiring a defendant to compensate for the full extent of the injury caused is simply not operative in other areas of contract law. To the contrary, a plaintiff who has suffered loss is precluded from claiming that the defendant ought to carry the cost of repairing injuries that could have been avoided by the plaintiff's reasonable action. A proponent of the collateral benefits rule who argues that a defendant should not benefit from a plaintiff's prudence forgets that the mitigation principle requires that the defendant benefit from the plaintiff's mitigatory conduct as a matter of law by deducting from the damages owed any loss which could have been recouped or avoided. These observations lend further support to the *Waterman* Court's rightful rejection of any rationales for the non-deductibility of collateral benefits that view the breaching party as wrongdoer. Fairness to both parties in assessing the amount of damages owing is a well-established aspect of remedial contract law, as the principle of avoidable loss illustrates.

It is sometimes argued that the principle of avoidable loss flows from the reasonable expectations of the contracting parties, although this has not been very persuasive.[78] Causation has also been thought to play a part, the idea being that losses arising from avoidable circumstances are not attributable to the defendant's wrong.[79] However, it is often argued that the most persuasive rationale for the mitigation principle arises from considerations of economic efficiency and the avoidance of waste, because "[t]he nonbreacher's successful mitigation ideally results in a better allocation of resources and services for broader economic welfare."[80] Efficiency analyses of the collateral benefit problem have come to similar conclusions: where a collateral benefit is not properly accounted for, the defendant's transfer of resources is not an efficient allocation of societal wealth.[81]

Why is fairness to the defendant accepted for the purposes of mitigation that occurs after injury, but very problematic when assessing benefits arising from arrangements made before injury? It appears that too much of a distinction has been drawn here. The principle of avoidable loss requires that plaintiffs seek substitute performance where it is reasonably available or deems them to have done so in assessing their compensable loss. But mitigatory benefits are still, strictly speaking, collateral benefits that have been supported by persuasive policy rationales. In the contractual context, moreover, collateral indemnity benefits arranged before injury could be viewed as a kind of pre-secured substitute performance. As in the mitigation context, then, a defendant may be liable for the costs the plaintiff has incurred in securing substitute performance, such as the payment of insurance premiums.

Although it is reasonable to impose a requirement to mitigate avoidable losses on plaintiffs who have notice of breach, it would require too much of plaintiffs to demand as a matter of law that they secure substitute performance in advance of breach. In other words, a plaintiff should not be precluded from claiming losses that could have been insured against. A perfect

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78 Roberts, *supra* note 73 at 162.

79 SM Waddams, *The Law of Contracts*, 6th ed (Aurora: Canada Law Book, 2010) at para 753.

80 Roberts, *supra* note 73 at 165. See also Waddams, *ibid*.

81 Lawrence P Wilkins, "A Multi-Perspective Critique of Indiana's Legislative Abrogation of the Collateral Source Rule" (1987) 20:1 Ind L Rev 399 at 423.

mirror between collateral benefits and mitigatory benefits therefore does not exist. However, the comparison of the two doctrines shows that the extreme jurisprudential agitation toward openly accounting for collateral benefits is likely unfounded given the doctrinal acceptance and the requirement of mitigatory benefits following breach.

IV. CONCLUSION

This article is not intended to provide a full account of the many and varied arguments in favour of and against deducting collateral benefits from damages owed. However, it does seek to explain that, by failing to adequately engage with the *Cunningham* dissent's rationale for deducting indemnity benefits, and by injecting the issue of contractual interpretation with that of collateral benefits, the *Waterman* judgment has taken us in a very confusing direction. There are some solutions. A future court could further clarify the desirability of determining a plaintiff's expectation interest according to contractual principles where the sources of the benefits are governed by a single contractual relationship, giving effect to the reasoning in the *Waterman* dissent. But a future court would also need to confirm the *Cunningham* dissent's rationale for excluding or including collateral benefits, and not simply rely on the concept of indemnity.

It has been argued in this comment that insufficient attention has been paid to the connection between mitigatory and collateral benefits, and that the deduction of such benefits might, with further study, even be construed as merely variations of a single limiting principle. At the very least, the wide acceptance of mitigatory benefits should cast doubt on lingering notions that the deduction of collateral benefits from damages owed by the defendant is an inherently suspect idea.

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