

# THE Litigator



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## LONG TERM DISABILITY

### Special Features:

- Subrogation in LTD Actions
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# Settling the Long Term Disability Claim

by Russell J. Howe

## Introduction

With the expansion of Long Term Disability insurance into all available markets throughout the 1970's and 1980's, we are seeing many more of these claims in our practices than ever before. People have private policies they have purchased on their own through brokers. People are insured through unions and employers, and through other types of fraternal organizations. Behind all of these types of protections are some of the largest insurers in Canada, operating in the life and health industry. With the development of previously unforeseen illnesses, and other difficulties financially for certain types of policies, we are seeing much more litigation over long term disability denials than ever before. In one regard, long term disability litigation is not unlike other types of litigation in that the vast majority of claims settle before trial. However settling a long term disability claim is often not as simple as it might seem, and practitioners have to be careful that their clients' rights are at least fully understood and protected, before they advise their clients on what rational compromises ought to be made to resolve their claims.

## Types of Policies

Fundamentally there are three types of Long Term Disability insurance "Policies" available to people in Ontario:

1. **Group Policies** where all the employees of a certain company or other organization pay into a particular plan, and the risk is spread amongst the group – thus hopefully reducing premiums for each individual enrolled in the group. The payment of premiums involved in a group policy can come about in three ways, which can add headaches to the settlement analysis. These ways are a) all paid by the individual insured, b) all paid by the employer, or c) partially paid by the individual insured and partially paid by the employer.
2. **Individual policies** are often sold to employed/self employed Canadians via brokers in the same fashion that other insurance is sold. In these situations the insured

usually pays all of the premiums for the policy and thus the benefit is non-taxable. These types of policies run the gamut, from Ladas to Cadillacs, with a significant portion of the most lucrative insurance sales markets being high income or professional individuals who now place policies.

3. **ASO Plans.** ASO plans (or "Administrative Services Only" plans) aren't really insurance policies in the true sense even though they may have the outward appearance of such policies. An ASO plan is put together by a large corporation when it has decided that it is financially better to be self-insured, but to hire an insurance company to administer the plan. In this case it may appear to the individuals insured that they are in fact dealing with a normal insurance policy, when in fact the insurer is only evaluating the claims, and issuing the payments, while the actual source for the payments is a fund within the self-insured company. Financial reasons have made these types of plans more attractive to various large corporations, and thus we are seeing more litigation in which the actual employer must be added as a party due to the fact that it will be the true payer in the plan.

## Types of Settlements

There are two ways to settle a Long Term Disability action. These are reinstatement, and lump sum settlements. Both have their advantages and disadvantages and

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should be considered carefully in the particular context.

In a reinstatement the insurer will usually pay some or all of the arrears, prejudgment interest and costs, and will then put the person back on claim, making either full payments or reduced payments on a going-forward basis, subject to all the normal terms of the policy, with the potential for being cut off in the future.

In a lump sum settlement the insurer will pay some or all of the arrears, prejudgment interest and an agreed amount for the future risk of the insured remaining disabled, in exchange for a Full and Final Release of all obligations under the policy. In explaining these two different options to clients I often utilize family law terms (which they seem to find easier to understand) and I describe these two mechanisms of settlement as either "an insurance reconciliation" or "an insurance divorce".

### The Pro's and Con's of Reinstating

Many times reinstatement is the only viable option for settling a Long Term Disability case. When the claimant is young or there are too many medical variables to make an accurate prediction about the future, or the benefit is very large, the case may well best be settled by way of reinstatement. In the case of reinstatement, the risk is actually fairly balanced – that is, if the insured's health improves and he or she can return to work, the claimant has not been under- or over-compensated; rather the level of compensation has been appropriate. A reinstatement is indeed the closest thing possible to putting the plaintiff in the position he or she would have been in "but for" the contract having been breached by the insurer. Plaintiffs who have trouble handling large sums of money, or prefer to have a regular

monthly income rather than having to plan based on a large sum of money, are often better served by reinstatements or structures. In cases where the reinstatement means pensions will continue to be topped up, seniority accumulated or other benefits moved forward which have a high value, the reinstatement will obviously be the optimum choice.

However, many of our clients have no wish to be reinstated due to the fact that their relationship with the insurance company has been quite poisoned. They are often emotionally damaged and personally affected when their claim for disability has been rejected or terminated by the insurer, particularly where the rejection or termination of benefits was clearly unmeritorious. These individuals are afraid of further claims handling, the stress and fear of being cut off in the future, and in cases where surveillance has been extensively conducted, are often traumatized by the possibility of other individuals coming to spy on them after they have been put back on claim. These clients may be better served via a lump sum settlement, and some of them will in fact direct you to take a fairly significant discount so they can be rid of the unhealthy impact of the insurer on their life once and for all.

### Actuarial Foundations for Lump Sum Settlements

For productive negotiations to occur with respect to lump sum settlements, the two parties involved really have to have some sort of meeting of the minds as to what the future exposure for the insurer is. This can be challenging as disagreements arise on how the present value of the future stream of payments potentially forthcoming from a long-term disability policy should be calculated. The insurer will want more aggressive discount rates while the plaintiff may seek something more in

line with the *Courts of Justice Act*. A great deal of time and money can be spent fighting over this issue. However, when one takes an objective approach to the setting of rates for both types of common policies, it is actually quite easy. In the case of a policy that is indexed to inflation in a somewhat normal fashion, the discount rate should be exactly in accordance with the *Court of Justice Act*. In a case where the payments out of the policy are not indexed in any way to inflation, the discount rate should be approximately 5 to 5.5 percent.

In cases where there exists a clause like the following, there is no substitute for having an actuary do the work:

#### *Cost of Living Adjustment*

*After each successive 12 month period of Disability but not beyond the month in which you attain age 65, we will increase your Disability Income Benefit by an amount equal to the following:*

- a) *While you are receiving a Total Disability Income Benefit, the increase is equal to 0.08 times the Total Disability Income Benefit amount as shown in the Policy Specifications.*
- b) *If you are receiving a Residual Disability Income Benefit, the increase is equal to 0.08 times the Loss of Monthly Earning times the Total Disability Income Benefit amount as shown in the Policy Specifications.*

Trying to work this out on your own will lead to a long night of work, as well as potential errors that may come

back to haunt you later. In almost all cases in our office, we like to have an actuary calculate the future benefits before we give our clients advice on a lump sum settlement, despite the fact that insurers are often reluctant to pay this entirely reasonable actuarial disbursement.

Individual policies in particular should be examined to determine when the stream of payments end. In some policies this will be at age 65; some, however, have shorter periods such as 10, 12 or 15 years of benefits payable; while others depend upon circumstances including how the disability came about, and will make the payments for the life of the individual. In these cases there is no substitute for hard work and attention to the details of the policy provisions to ensure that your assumptions about a long-term disability policy do not end up costing your client.

### **Lump Sum Settlements of Individual Policies**

As lump sum settlements go, these are actually the simplest. The present value of the future stream of payments is calculated and a negotiation takes place, hopefully based on rationally-analyzed medical evidence as to the possibility of the policy holder recovering, litigation risk and the value of ending the relationship with an insurer, with a discount applied against the 100% value of the future stream of payments. Once the present value of the future benefits has been calculated, this negotiation and finalization can be carried out with a great deal of confidence and some expediency. However, when one is settling an individual policy be it either on a reinstatement or lump sum basis, one should keep in mind that a waiver of premiums takes place when an individual is found disabled under this type of policy. Therefore, if your client

has paid premiums to keep the policy in place despite a denial of benefits, he or she will be entitled to a repayment of those premiums as well and prejudgment interest on them. This frequently overlooked detail can have a significant value for your client.

### **Lump Sum Settlements of the Group Policy – Tricks and Traps**

Lumping out a group disability policy for a client is not an exercise for the faint of heart. There are multiple factors to be considered and many places where a mistake by counsel could lead to significant shortfall in their client's recovery.

The first step is very similar to that taken with respect to the individual policy, namely calculating the arrears and prejudgment interest. Once this is done, the work for plaintiff's counsel is just beginning, even before negotiations with the insurer begin.

Group policies often have many types of collateral benefits that follow along with them. These may include pensions, accumulating seniority, dental/medical plans and other types of enhancements that are continued while the individual is in receipt of benefits. Some of these benefits may be provided directly by the employer, some by outside bodies such as a pension fund, and some may be provided by the defendant's insurer or a different insurer. Your client's employment status may well also be affected by the termination of the litigation. In many cases the employer is just waiting to see what happens with respect to the disability dispute before making a decision as to terminate your client's employment or to leave your client on the books with the attendant benefits. Settling via lump sum without the reinstatement or a clear indication from the insurer may cause the employer to terminate your

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client's employment with negative consequences flowing from that.

The only way that one does not stick ones foot in a bear trap when lumping out a group policy is through lengthy preparation before the negotiations begin. A complete employment file must be obtained, and a lengthy interview must be conducted with your client to ensure you understand all of the benefits he or she receives from the employment and the policy before making any decisions. If there is pension plan, complete information from the plan administrators must be obtained as to what impact the termination of the benefits will have on that plan as these can be of significant value to plaintiffs. If another insurance policy is involved, or the same insurance policy providing collateral benefits is involved, the precise terms of when these benefits start and stop when a client is on an LTD claim, must be fully understood before the negotiations can take place.

In the case where benefits are complex and significantly valuable, such as for a teacher or civil servant, the collateral issues will often make it impossible to settle on a lump sum basis. For instance, in the case of some teachers pension plans, there is a loss of the value of the pension by terminating benefits, and thus terminating pension credits can have an impact on the eventual pension of hundreds of thousands of dollars. In cases where an individual has taken a pension early due to termination of Long Term Disability benefits, a calculation must be made and recovery sought for the shortfall of the pension due to the client's early retirement.

Where the value of collateral

benefits is extremely high, and/or the calculation is extremely complex or virtually impossible to carry out, a reinstatement of benefits is simply the safest option for both counsel and client. While it may take significant amounts of time to explain these complexities and every single ramification of the group lump-out to your client, there is no substitute for spending that time so that both you and your client understand exactly what is occurring.

### **Tax Issues**

One must also advise clients on the tax implications of settling the LTD claim. The first and most important step is to get the insurer to confirm in writing whether or not the disability payments that were either paid, or should have been paid, were taxable or nontaxable. This is normally determined by whether or not your client made a contribution to paying for these benefits as distinct from the premiums having been paid by the employer. If they were paid by the employer, they are a taxable employment benefit. If paid by the client, they are nontaxable. However, there is no substitute for written confirmation from the insurer as to the tax status.

If the original benefit was non-taxable, the amounts recovered via reinstatement or lump sum settlement will follow that character and remain non-taxable. In these types of cases a structured settlement can be used to settle an LTD case, and although this practice is rare, in a few cases it has provided exactly the incentive the

parties have needed to get the deal finalized.

In the case where the original benefit was taxable, all of the arrears paid as part of a reinstatement will also be taxable. The plaintiff and insurer should work together in these circumstances to fill out a T-1198 tax form to allow the plaintiff to amortize the taxable benefits over the years they *would have been received* so that they are not all taxable in the year in which they are in fact received. All of the major life and health insurers in Canada do this on a regular basis, and plaintiffs' counsel should assist their clients in completing this form so their tax liabilities arising out of the settlement are thus minimized.

The case where a taxable benefit is lumped out is perhaps the most complex but potentially rewarding scenario tax-wise. Based on the current state of the case law it appears that the portion of the settlement that is attributed to arrears remains taxable (and should be dealt with via a T-1198), while the portion of the settlement relating to the future stream of payments is not taxable. This presents a slight win-win situation for the insurer and the plaintiff who are negotiating a lump sum on the taxable policy. The plaintiff can concede some amount of discount on the present value of future benefits, a savings to the insurer, simply based on the fact that they will not have to pay tax on those funds, and thus the net to the plaintiff will be similar arising out of the lump sum settlement after a discount as the future stream of payments would have been if they were ongoing and taxed.

If one is in doubt in these situations, seeking the opinion of a well-informed accountant or tax law specialist is obviously a necessity.

### **Helping Your Client Decide**

This is the most important role a lawyer plays in resolving an LTD

claim. There are many features, factors, advantages and disadvantages to the different types of settlements available for this type of claim. This is where counsel must really be at their best and do their highest work for clients. Counsel must become a guide and mentor to clients to help them decide which options are best. One usually should just start out by explaining the broad differences, and the pros and cons, relative to the different types of available settlements. Then comes the really important part which is often hard for counsel to do. Counsel must be quiet and really listen to what clients have to say about their needs, desires, abilities, hopes, fears, plans and so on. One really has to give the client a significant opportunity to talk in this context so that an understanding can be had as to just how badly their relationship with the insurance company had gotten before they were terminated, their level of sophistication and ability to manage funds, the reliance or nonreliance on the collateral benefits in the policy, and in many cases what replacement benefits are available to them through their spouses' coverage or in the marketplace.


After one has achieved a full and fair assessment of the client's position and needs, the conversation with the client can become more directed and

specific on various items. Counsel should take the information provided by the client about his or her personal position in life and match it with the various types of considerations (including risk tolerance) and explain to the client how each of them is impacted by the various types of settlement options that are available to them. This will likely provoke further questions and more discussion with the client who is now becoming more knowledgeable on each issue as you help them in doing self-analysis of where they really should be on these types of claims.

While this may seem like a long and complex exercise to undertake, I would suggest that it is really lawyering at its best. We should become guides, mentors and trusted advisors to our clients, all of which require truly understanding who they are before we can help them choose which path of settlement to take.

### Conclusions

Long Term Disability litigation is becoming more prevalent. The issues involved are becoming more complex, and more money than ever is at stake. One must make a special effort to ensure that we are properly versed in the issues surrounding Long Term

Disability settlements to serve our clients properly. When we do so we can improve their lives, and help them find the financial security they were seeking when they initially sought out the insurance policy in the first place. This type of litigation, and resolving it, allows us to engage in lawyering at its highest, and we should all be proud and privileged of this opportunity. In each of these cases we need to roll up our sleeves, do a great deal of hard work, pay attention to detail, and check and double check all the direct, collateral and tax implications of our clients settlement before we offer them guidance and most importantly before they set their signatures on the dotted line. While some aspects of Long Term Disability settlements can be quite complex and, at times may even seem overwhelming, there are always resources available from other counsel practicing in the field who's generosity I have benefited from over the years. It seems like senior OTLA counsel are always willing to drop what they are doing to help you untangle one of these Gordian Knots in ways that you may have never thought possible. 

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*Russell J. Howe is a Past President of OTLA, a practices with with Boland Howe Barristers LLP in Aurora, Ontario.*

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## OTLA NEWS

# OTLA Member Appointed

The Honourable David Price was recently appointed a Judge of the Superior Court of Justice. Mr. Justice Price was admitted to the Bar of Ontario in 1976 and has been a sole practitioner since 1987.