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Compensation preclusion periods and special circumstances: some recent issues

A significant proportion of appeals before the SSAT and the AAT relate to the inability of claimants to gain access to a social security payment as a result of the imposition of a compensation preclusion period. Where a person receives a compensation lump sum payment, and this includes a component for lost earnings or loss of capacity to earn, entitlement to a social security payment will be affected. Where a Court or Tribunal makes an award specifying the heads of damage, that award will be looked at to determine the component of economic loss or the 'compensation part' of the lump sum. However, where a compensation claim is settled or there is a consent judgement, s.17(3) of the *Social Security Act 1991* (the Act) deems 50% of the payment to be the compensation part of the lump sum.

The preclusion period, during which a person is precluded from receiving certain social security entitlements, is then calculated by dividing that part of the lump sum deemed to be for economic loss by the amount above which no social security pension would be payable to a single person under the income test (see Part 3.14 of the Act).

The Act does, however, contain a potential exemption from the general rule. Section 1184 provides that the Secretary may treat all or part of the compensation payment as not having been made or not liable to be made, if the Secretary thinks it appropriate to do so, in the special circumstances of the case.

The extent of the economic loss and special circumstances

Difficulties can arise where settlements purport to include no component for economic loss. More often, however, the issue of the extent of the component for economic loss is put forward as a special circumstance, which would justify treating a significant part of a compensation payment as not having been made. In an early decision of the AAT, *Fowles and Secretary to the DSS* (1995) 38 ALD 152, 86 *SSR* 1257, it was argued that special circumstances should apply, because the economic loss component was significantly less than the amount so deemed by the 50% rule. The

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AAT Decisions

Federal Court

AAT referred to the decision of Secretary to the DSS v *Banks* (1990) 23 FCR 416, 56 *SSR* 762, where Von Doussa J examined the rationale for the introduction of the 50% rule. Von Doussa J said:

> Prior to the amendments the Secretary was required to form an opinion in respect of every lump sum payment as to what proportion or part of that payment was referable to an incapacity for work. Thus in practical terms the delegate was required to go behind the settlement sum and try to work out the extent of the economic loss component. The problem which arose with the effluxion of time in the course of the operation of that legislation was that it was not a difficult matter for people to inflate various heads of damage and deflate other heads, namely economic loss heads, achieve the same overall result but defeat the intent of the Social Security legislation.

The issue in *Banks* case was whether in a lump sum settlement of $35,000 an amount of $1000, representing redemption of the employee's liability to pay future medical expenses, should be excised from the total lump sum. His Honour rejected this argument pointing out that the definition of the 'compensation part' of a lump sum simply required that part of the payment being considered be made in respect of lost earnings or lost capacity to earn. So long as part of the total amount had that character, then the whole of it was brought into account.

The AAT in *Fowles* also noted the decision of O'Loughlin J in *Secretary, Department of Social Security v Hulls* 22 ALD 570. In *Hulls* the AAT had effectively determined that it was possible to excise the component of the global settlement sum that might have been referable to legal costs. Referring to the analysis of the legislative scheme in *Banks*, O'Loughlin J came to the view that the AAT had erred and concluded:

> Once the mischief at which the amending legislation was aimed has been so clearly identified, it becomes apparent that the legislation prevents any dissection of the 'lump sum'.

The AAT in *Fowles* adopted this approach and said:

> ... if one acceded to Mr Jeffery's argument on 'special circumstances' ... one would in a back door fashion be giving credence to the sort of approach the amending legislation sought to prevent. That approach of seeking to dissect the lump sum into components by disguising it under the phrase 'special circumstances' pursuant to s.1184 should not be countenanced in the circumstances.

(See also Secretary to the *DSS and McFetrish* (1998) unreported, to similar effect.)

A series of decisions, however, have taken an alternative approach. In *Secretary to the DSS and Beel* (1995) 38 ALD 736, the AAT disregarded a substantial part of a lump sum payment of $60,000 because it was clear from the terms of the consent order that only $10,000 was in respect of incapacity for work. The AAT concluded that it would be 'unfair, unjust and quite inappropriate' to leave the 50% formula figure of $30,000 in place.

In *Secretary to the DSS and Caruso* (1996) unreported, the AAT said:

> In Mrs Caruso's case I accept that very little of the lump sum payment of $95,000 related to economic loss. During the course of her civil trial she was forced to abandon those parts of her claim which related to lost earnings or lost capacity to earn and future care and assistance. Mrs Caruso received $70,142.06, the major proportion of which was compensation for pain, suffering and loss of amenities of life (originally estimated by Mr White to be $55,000). This leaves approximately $15,000 for other damages, including economic loss. In my view it would be an injustice in Mrs Caruso's case to attribute $47,500 to the compensation part of the lump sum payment when it could not be greater than $15,000.

In *Jones and Secretary to the DFaCS* (1998) 3(9) *SSR* 138, the damages claim was for $4,560,665 with a claim for loss of earnings amounting to $361,000. The settlement of $1,000,000 gave no breakdown indicating how the settlement figure was arrived at, but the AAT noted that the lump sum settlement was approximately 21% of the original amount claimed, and accepted that the economic component was also 21% of the amount claimed for loss of earnings.

In *Harmat and Secretary to the DFaCS* (2000) 4(6) *SSR* 73 the AAT considered that while dissection of a lump sum amount should not be encouraged, such dissection was possible where there was a clear designation in the terms of the settlement of an amount for economic loss, and s.1184 could accordingly apply where the economic loss component was less than half of the settlement figure.

Two more recent decisions seem, however, to considerably restrict the potential application of special circumstances in these kinds of situations and to be somewhat at odds with the line of cases where special circumstances have been found, as discussed above. In *Secretary to the DFaCs and Woolrich* (2000) 4(7) *SSR* 87 the AAT was of the view that such cases were not consistent with the statutory intent of the legislation. Advocates for such a position were:

> placing a significant emphasis on the proper construction of a consent order, while at the same time jeopardising the integrity of a statutory process which balances both individual social need and a community's responsibility to ensure equity and probity of resource distribution to meet those needs.

The AAT distinguished cases such as *Beel and Caruso* on the basis that the consent order in *Woolrich's* case was silent as to the elements making up the lump sum. It said that even if the application of the 50% rule was unfair in *Woolrich's* case this had to be looked at in the light of her other circumstances to decide whether special circumstances existed.

To similar effect is *Secretary to the DFaCS and Keighley* (2001) reported this issue, where the Tribunal concluded that "regardless of whether heads of damage have been identified, a lump sum is indivisible for the purposes of Part 3.14 of the Act (the Tribunal having considered and followed the decision in the matter of *Cunnaan*".

In the Federal Court decision of *Secretary to the DSS v Cunnaan* (1997) 3(3) *SSR* 36, however, Cunaan had received a settlement amount of over $58,000 including $2500 for arrears of weekly payments. The rest was for non-economic loss. The AAT excluded the sum of $2500 on the basis that it was not a lump sum compensation payment. The Federal Court concluded that the lump sum amount was not divisible and included a component of economic loss. Importantly, however, the Federal Court noted that the AAT had not considered special circumstances, and that if the application of the law in Cunaan's case resulted in genuine hardship then the provisions of s.1184 gave a discretion to alleviate that hardship.

Thus, the decision of *Cunnaan* would appear rather to support the exercise of the discretion under s.1184 in appropriate circumstances, which may well include situations in which the component for economic loss is at significant variance with the deemed figure of 50%. Certainly some of the earlier AAT cases support the application of s.1184 where it is clear from the terms of the consent order that this is the case. Further the words of s.1184 are 'wide words intended ... to allow the decision-maker the fullest opportunity to consider the particular circumstances of each case' (*Secretary to the DSS v Smith* (1991) 30 FCR 36, 62 *SSR* 277).

On the other hand, the decisions of the AAT in *Fowles, Woolrich* and *Keighley* appropriately recognise the inherent danger of using s.1184 to circumvent the legislative scheme, in circumstances where it is possible to 'manipulate the various heads of

damage' and have these reflected in a release or consent order. It is contended that it is incumbent upon a decision maker to satisfy him or herself that any loss of earnings component set out in a release or consent order is a true and proper reflection of the compensation attributable to that loss. This may well occur where, as in *Caruso*, the AAT was satisfied that the compensation recipient had to abandon parts of her claim relating to lost earnings or capacity to earn. Arguably, it could also apply where a person is nearing retirement age and their compensation for loss of earnings is considerably reduced to reflect this fact (see for example the approach taken by the AAT in *Hooper* (2001), reported in this issue).

There is also a need to ensure the situation does not arise where the applicant in effect has a 'windfall' or there is an element of 'double dipping'. In the case of *Secretary to be DFaCS v Edwards* (reported this issue) the Federal Court found that it was inappropriate for the AAT to have used the discretion set out in s.1184 to disregard the whole of a lump sum compensation payment because the likelihood of the applicant incurring economic loss was remote and this was reflected in the settlement amount. The Federal Court said that such an approach ignored the fact that if this was true, Edwards had in reality gained a 'windfall', as it was clear that $5000 had been included in the lump sum settlement of $27,500 to cover the potential for future economic loss.

The compensation divisor

Another issue which has recently come under scrutiny is the application of the compensation divisor used to determine the length of a preclusion period. *Stephens and Secretary to the DFaCS* (2001) unreported, is the first of a line of decisions which examines this issue. Those decisions firstly note the terms of s.1168 which provides:

> **1165(8)** If a compensation lump sum is received on or after 20 March 1997, the number of weeks in the preclusion period is the number worked out under the following formula:
>
> $$\frac{\text{Compensation part of lump sum}}{\text{Income cut out amount.}}$$

The terms used in the formula are then defined in s.17. However, the legislation does not specify the date at which the formula is to applied. This is relevant because the compensation divisor changes periodically. On 27 February 1997 it stood at a figure of $571.90 (at that time based on average weekly earnings). Following legislative amendment and the insertion of the definition of 'Income cut-out amount' which relates to the amount above which no social security pension would be payable to a single person under the income test, the divisor dropped to $403.20 per week from 20 March 1889, and rose steadily to a figure of $428.40 as at 20 March 2000. However, on 1 July 2000 it increased to $543.63.

Departmental policy is to apply the compensation divisor in effect on the last day on which the person receives periodic compensation payments. In *Stephens* and *Giannekas and Secretary to the DFaCS* (2001) unreported, the AAT questioned whether this was correct or whether it was more appropriate to use the compensation divisor in effect on the day the person claims a compensation affected payment [s.1165(1) and (1A) begin 'Where/If (a) a person receives or claims a compensation affected payment']. However, in both cases the AAT chose to deal with the issue under s.1184 instead and decided that special circumstances applied.

In *Stephens* the AAT said:

> It is indeed unfortunate for Mr Stephens that his solicitors did not settle his compensation claim before 20 March 1997... There has been a gradual increase in the divisor figure, no doubt reflecting cost of living adjustments until 1 July 2000 when the divisor jumped to $552.63 [sic] to compensate those on low incomes for the introduction of the goods and services tax ('GST') and the effect of the introduction of that tax on their cost of living.

The AAT went on to note that those who received their lump sum compensation before 20 March 1997 were still subject to an average weekly earnings divisor. Stephens did not have a partner to take advantage of the amending provisions that meant the new lump sum preclusion period would only apply to the compensation recipient and not his or her partner, although it continued to apply to those whose partners received a lump sum compensation payment before 20 March 1997. The Tribunal included the effect of the GST on Stephen's cost of living as one of the special circumstances which led it to treat part of his compensation payment as not having been made. See also *Allan and Secretary to the DFaCS* (2001) reported this issue, where again the AAT determined the amount of compensation to be disregarded by reference to the length of the preclusion period which would result if the divisor in effect at the time Allan claimed a compensation affected payment had been used.

The issue was again canvassed in *Coxon and Secretary to the DFaCS* (2001) but the AAT in that case determined that special circumstances did not apply because there was insufficient evidence that Coxon was unduly affected by the increase in the cost of living as a result of the introduction of the GST, or that he was in dire financial circumstances. However the AAT said in that case:

> If it is the Department's policy to apply the compensation divisor in effect on the last day of the periodic payment period ... that policy should be applied so that there is consistency of decision-making. However, if a degree of unfairness arises because of changes in rates of pensions which leaves behind those customers, locked into a lengthy preclusion period, that fact may add its measure to other circumstances such that it may be appropriate to treat part of a compensation payment as not having been made.

[A.T.]

Note: It is understood that the DFaCS have lodged an appeal to the Federal Court in the matter of *Stephens*.

Erratum

We regret that the April 2001 issue of the Social Security Reporter carried the wrong date and volume number at the foot of each page. It was in fact Vol 4, No 8, April 2001.