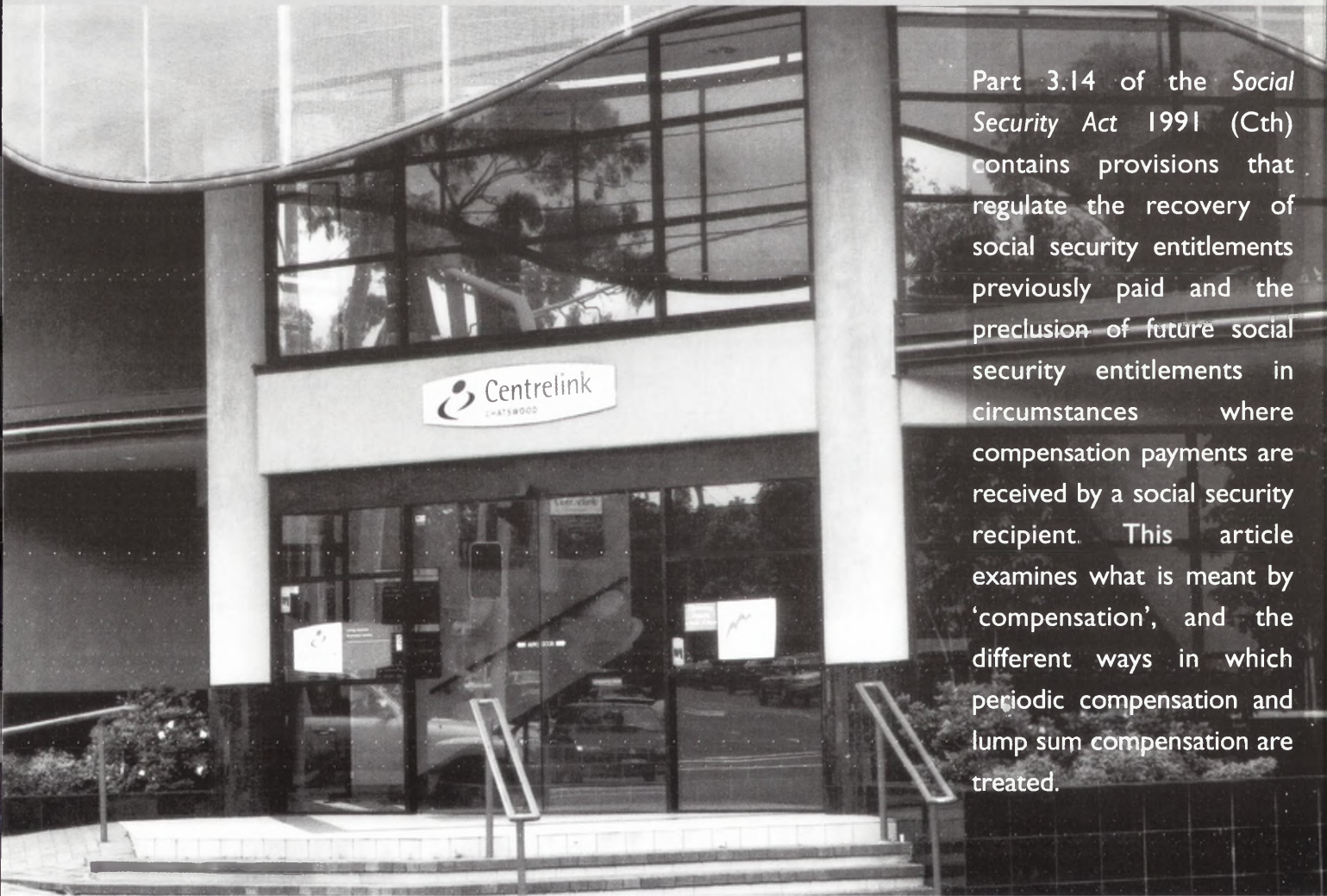


Compensation recovery provisions in the Social Security Act 1991 (Cth)¹



Part 3.14 of the *Social Security Act 1991 (Cth)* contains provisions that regulate the recovery of social security entitlements previously paid and the preclusion of future social security entitlements in circumstances where compensation payments are received by a social security recipient. This article examines what is meant by 'compensation', and the different ways in which periodic compensation and lump sum compensation are treated.

Allan Anforth is a Barrister at the National Press Club and **Lucy Gibson** a student at law at the Australian National University **PHONE:** 02 6273 7370
EMAIL: allananforth@primus.com.au

COMPENSATION

The definition of 'compensation affected payments' in section 17(1) of the *Social Security Act 1991 (Cth)* ('the Act') limits the range of current social security payments to which the compensation recovery provisions apply. It

now covers almost all categories of payments although some dependency payments such as wife (age) pension are still exempt.

Because of the historical development of the Act, different categories of pensions and benefits are caught in the

compensation recovery provisions from different dates.²

The definition of 'compensation' in section 17(2) is broad and catches payments at common law as well as under statutory insurance and compensation schemes. However, it does not catch:

- insurance payments made pursuant to contributory insurance schemes such as income protection policies or superannuation invalidity payments, provided those policies do not contain income-shifting provisions which purport to reduce the payments by the amount of social security payable;³ and
- payments made under victims' compensation type schemes.⁴

The compensation recovery provisions in relation to lump sums apply whether the compensation payment was received before or after the commencement of the social security payment.⁵ However, in relation to periodic compensation, there is a distinction drawn in section 1173 between cases where the person only commenced receiving social security payments after the injury which gave rise to the periodic compensation, and those where the person was receiving social security before the injury.

In the former case, the compensation recovery provisions apply, whereas in the latter case, the periodic compensation is treated only as ordinary income. The ordinary income test is less severe than the compensation recovery test.

This does not mean that the subsequent receipt of social security after the injury is only caught in the definition of compensation if the social security entitlement and compensation arise from the same injury. The compensation recovery provisions apply to 'compensation' received whether or not there is any connection between the event that gave rise to the payment of the social security payments and the event that gave rise to the compensation payment. Thus they catch circumstances where a person may be in receipt of a disability support pension for a disability that is totally unrelated to the circumstances

for which the compensation is paid.⁶

Compensation is taken to have been 'received' whether it is received directly or whether another person receives it, on behalf of, or at the direction of, the first person.⁷

If the compensation payment is paid under a state or territory statutory scheme which provides for the amount payable to be reduced by reason of the existence of a potential social security entitlement, then section 1165 provides that the amount of the 'compensation' for the purposes of part 3.14 is the amount which would have been payable but for the cost-shifting provision.

The secretary's powers to compel a person (or their partner) to pursue their rights to compensation payments are found in sections 1166 and 1167. A failure to comply with the secretary's request permits the secretary to withhold payment of the social security entitlement. However, the secretary will not force a person into litigation where the insurer has denied liability.⁸

ECONOMIC LOSS

The definition of 'compensation' catches both periodic payments of compensation and lump sum payments of compensation whether made inside Australia or not, although these two types of payments are assessed differently. The definition of 'compensation' in its application to both types of payments does require that the payment 'is made wholly or partly in respect of lost earnings or lost capacity to earn resulting from personal injury'. This is an important proviso as it is the basis upon which compensation payments made wholly for general damages, permanent impairments or the like are exempt from the compensation recovery provisions.⁹

Importantly, the proviso catches both lost earnings and lost capacity to earn. Whilst lost earnings in a past sense have always been treated as a form of economic loss, lost earning capacity, in the future sense, has traditionally been treated as a loss of a capital asset.¹⁰ For the purposes of the compensation recovery provisions, there is no distinction

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drawn between these two concepts and the generic term 'economic loss' is used to embrace both. The departmental guidelines include compensation for lost superannuation rights as economic loss.¹¹

Even if only 'part' of a lump sum is paid in respect of economic loss, then the whole of the payment falls within the definition of 'compensation'. This will be the case even if the element of economic loss is small compared to the total sum.¹² It is doubtful that the *de minimis* principle even applies.¹³

The compensation payment only has to include an element paid 'in respect of' economic loss. The term 'in respect of' has been the subject of some judicial debate as to the degree of directness of the relationship that must exist between the compensation payment and the economic loss sustained. In *Secretary Department of Family and Community Services v Mourilyan*¹⁴, the Full Federal Court held that the award of interest on economic loss in a common law settlement was paid 'in respect of' economic loss. The court concluded that the phrase was one of broad scope to be ascertained from its particular statutory context.

Examples of payments held to be 'in respect of' economic loss include:

- an *ex gratia* payment made by an employer to the applicant on

the condition that he desist with a workers' compensation claim;¹⁵

- a payment of \$1,000 made to release the insurer from an obligation to redeem a right to periodic payment;¹⁶ and
- payments made to a person on a rehabilitation graduated return to work.¹⁷

Examples of cases where payments were not held to be in respect of economic loss include:

- where the insurer's solicitors conceded that there was no element of economic loss and the respondent had been advised on barrister's advice to settle a claim of \$1.17 million for \$80,000 because of 'insurmountable difficulties in relation to liability'.¹⁸
- where a settlement payment was made in relation to a fall in a Woolworths supermarket and the applicant was in receipt of a disability support pension at the time of the accident and other evidence of the arbitration process showed that the parties had dismissed any component for economic loss as unrealistic.¹⁹

Whether a component of a lump sum was paid 'in respect of' economic

loss can be difficult to determine in some consent orders and settlements. Generally, the secretary looks to the objective evidence of the pleadings filed, the particulars supplied to the insurer and the terms of the settlement. Where economic loss features in the pleadings and particulars, the secretary will generally assume that the settlement includes an element of economic loss even if there is no mention of any economic loss in the terms of settlement.²⁰ There is a range of decisions at the tribunal level going both ways on the secretary's inherent power to look behind settlement and consent awards to ascertain its true nature. The reality is that there is nothing an applicant can practically do to prevent this course of action.

If legal practitioners wish to settle claims without subjecting the client to a social security preclusion then the statement of claim should be amended to delete any claim for economic loss and any particulars filed in the matter. However, in *SDFaCS v Sammut*²¹, Branson J was critical of any attempt by solicitors to misrepresent the true nature of a settlement amount and suggested that it may constitute unethical behaviour. She further said that the tribunal could not simply assume that a settlement amount had the character of being wholly for non-economic loss because the solicitors concerned asserted it to be so.²²

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PERIODIC COMPENSATION

'Periodic compensation' is not defined in the Act. In *SDSS v Hulls*²³ the Federal Court rejected the notion that there had to be any periodic nature about the payments, rather the term simply stood in contradistinction to lump sum payments.²⁴

In *Re SDSS and Jackson*²⁵, the tribunal held that the series of compensation payments continued over a three-year period and encompassed a 21-month break when the respondent was working and not in receipt of compensation payments. However, on appeal²⁶, the court held that the tribunal had erred in law in describing the whole period as 'a series of periodic payment periods'. Rather, there were several discrete 'series of periodic payment periods'²⁷.

A payment wholly composed of arrears of periodic compensation in the form of a lump sum is not treated as a 'lump sum' payment under the Act but rather is treated as a periodic payment.²⁸ It is treated as if it had been received over the 'periodic payment period'²⁹ which is simply the period to which the payments are referable. However, if the payment of lump sum arrears of periodic compensation is part of a larger lump sum including other heads of compensation, then the whole is treated as a lump sum and not periodic compensation.³⁰

The treatment of redemptions or commutations of periodic payments depend on whether the person 'chose' to receive them as a lump sum in a settlement or consent judgment, or whether the redemption was at employer/insurer choice or otherwise compelled by law. In the former situation, section 17(3)(ab) treats the payment as a lump sum, whereas in the latter case section 1164 treats them as a periodic payment over the period to which the redemption is referable.³¹ If the redemption is not specifically referable to any identifiable period then it is treated as a lump sum.³²

Where a person receives periodic payments of compensation, and later receives a lump sum payment predicat-

ed on the basis of the repayment of the periodic payments previously received, then the person is treated as having received a lump sum payment, where the lump sum has subtracted from it the amount of the repaid periodic payments. This most commonly occurs where a person has been in receipt of workers' compensation for a period of time after which a lump sum common law settlement or award is received.³³

The treatment of periodic compensation under section 1173 depends on whether the person was receiving a social security payment before the injury which gave rise to the compensation payment or not. In the former case, the compensation recovery provisions do not apply and the compensation is treated as ordinary income.

The periodic compensation test is a simple dollar for dollar reduction from the social security entitlement. It is applied using the gross fortnightly periodic compensation figure and not the net figure.³⁴

Periodic compensation can impact on the social security entitlements of a spouse. If the amount of periodic compensation is not wholly exhausted by reason of the dollar for dollar reduction of the social security entitlement of the recipient of the compensation, then the balance of the periodic compensation for the fortnight is treated as ordinary income in the hands of the spouse and can result in a reduction of the spouse's social security entitlement.³⁵

LUMP SUM COMPENSATION

The term 'lump sum compensation' is not defined in the Act, but the term 'the compensation part of a lump sum compensation payment' is defined in section 17(3). The term 'lump sum' has been considered by the Federal Court in a series of cases that are of historical



value, although the effect of some decisions has been reversed by statutory amendment. In *SDSS v Banks*³⁶, Von Doussa J said that a lump sum 'is simply one which includes a number of items' and consisted of the aggregate amount paid. The decision of the Federal Court in *Cunneen* is an example of where a single lump sum consisting of arrears of periodic compensation plus

other heads of compensation was treated as a single lump sum payment.

The definition of the 'compensation part of a lump sum compensation payment' has two parts:

1. lump sum awards which contain an element of economic loss, including redemptions or commutations of periodic payments, which are the product of a settlement or a consent judgment; and
2. lump sum awards which contain an element of economic loss which are the outcome of a judgment by the court after a hearing of the matter on the merits.

In the case of lump sums arising from settlements or consent judgment, the 50 per cent deeming rule set out in the definition of the 'compensation part of the lump sum compensation payments' applies, and 50 per cent of the total amount received is treated as being for economic loss and is included in the compensation recovery. In the case of lump sum awards following contested hearings, the component of the lump sum included in the compensation recovery is the part of the lump sum the secretary believes to have been paid for economic loss. If the court gives judgment in terms that specifically identifies this sum then the secretary has no discretion to adopt any other figure.

The other key concept in section 17 ►

relevant to the operation of the compensation recovery provisions for lump sums is the 'income cut-out amount' that forms the so-called 'divisor' in section 1170. The income cut-out amount is the maximum weekly income a single person can earn before the whole of their pension is lost in the income test. The figure varies with indexation and can be obtained direct from Centrelink or the Department of Social Security. It is approximately \$400 per week. Prior to 20 March 1997, the divisor was the 'average weekly earnings' which was considerably more than the income cut out amount, so that the substitution of the new, lower, divisor caused an increase in the length of preclusion periods. In *Re Stephens and SDFaCS*³⁷, the tribunal held that the appropriate divisor to use is that which was in force at the time the applicant claimed the social security entitlement.

In the case of lump sum compensation, the key provisions are sections 1169 and 1170. The former provides that social security payments are not payable during the 'lump sum preclusion period' and the latter defines this period. Where only a lump sum is received then the lump sum preclusion period dates from the date of the commencement of the lost earnings, which will generally be the date of the injury but not necessarily so.³⁸ Where periodic compensation has been received prior to the receipt of the lump sum then the preclusion period runs from the date of last periodic payment regardless of any breaks that may have occurred in the

receipt of those payments. If there has been more than one previous period of periodic payments then the preclusion period runs from the date of the last payment in the last periodic payment period.

The preclusion period is a number of weeks, and is calculated by dividing half the total lump sum payment by the income cut-out amount. It will operate from a date preceding receipt of the compensation and may operate into the future past the date of receipt of the compensation.

Where older applicants are concerned, consideration should be given to the fact that the preclusion period remains in force after the applicant reaches the age at which he or she would otherwise become eligible for an aged pension.

The lump sum compensation recovery periods only affect the social security entitlements of the recipient and not the partner of the recipient. Periodic compensation can affect both as described above.

In the past, it became practice for solicitors to divide settlements from the same action into two or more parts in which one part contained the whole of the economic loss and the other part contained all of the non-economic loss. This resulted in only half the true economic loss being taken into account and none of the non-economic loss being taken into account. This practice was aimed at circumventing the 50 per cent deeming rule. Section 1171 now provides that in such cases the two or more

components of the settlement will be considered as one lump sum settlement.

The rationale for the 50 per cent deeming rule was considered by Von Doussa J in *SDSS v Banks*. His Honour referred to the difficulty that the secretary had experienced in determining the true nature of settlements, which on their face contained little if any component for economic loss. His Honour referred to the relevant explanatory memorandum and indicated what he considered to be the purpose of the 1947 Act equivalent of section 17(3), which introduced the 50 per cent deeming rule:

...a broad attempt to balance the interests of the recipient of the payment with the competing interests of others in the community whose needs must be met as far as possible from a finite budget allocation for social security measures. The paragraph seeks to eliminate double dipping in a practical way which operates effectively in a straight forward manner.³⁹

Once some element of economic loss is found in a lump sum then the whole of the lump sum is caught in the compensation preclusion, including:

- the legal costs component of settlements;⁴⁰
- the medical costs component;⁴¹ and
- interest on the damages awarded by the court.⁴²

The 'Departmental Guidelines'⁴³ provide that if a settlement includes quantified legal costs then these are included as part of the lump sum, but if the settlement is on the basis of costs to

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be determined at a later time, then the preclusion period is worked out only on the basis of the lump sum and no account is taken of later determined costs. Clearly there is an advantage to the client in leaving costs to be agreed or taxed in any settlement.

Some of the obvious unfairness of the above cases has been ameliorated by the secretary's adoption of policies in which some or all of these three heads of compensation are excised from the lump sum. The tribunal has further ameliorated the unfairness by allowing an excision of some or all of these heads of compensation under the special circumstances provisions.

Section 1178 provides for the secretary to serve a notice on the person liable to make a payment of lump sum compensation requiring the payment to the secretary of the lesser of the amount of social security payments having been paid in the compensation preclusion period or the lump sum compensation payable to the person.⁴⁴ There is similarly provision for recovering the balance of unpaid periodic payments relating to periods in which social security payments have been made. The 'Departmental Guidelines'⁴⁵ provide that compensation recovery is not to be made from an estate of a deceased person.

Sometimes there is a clear disadvantage to a plaintiff in receiving a small sum for economic loss as part of a larger claim containing other heads of compensation in that the amount lost in social security preclusion exceeds the small amount awarded for economic loss. For example, a small buffer of \$10,000 for economic loss paid as part of a total settlement of \$200,000 will result in a preclusion of about five years social security. The single rate of social security is about \$10,000 so that preclusion for five years will result in a loss of about \$50,000. Thus the inclusion of the \$10,000 buffer results in a \$40,000 net loss to the client.

A CAVEAT FOR PRACTITIONERS

Whilst it may be stating the obvious to say that practitioners should consider

these matters before negotiating settlements inclusive of small economic loss buffers, the reality is that such mistakes are commonplace.

The tribunal has on a number of occasions adverted to the desirability of clients suing solicitors for such obvious mistakes.⁴⁶

'I am not satisfied that the Australian community should undertake the financial responsibility of supporting the applicants when they might properly recover damages from their solicitor as a result of the negligent legal advice thereby reinstating some financial security.'

And in *Re SDSS and VXY*⁴⁷, the tribunal said:

'... in these days of severe limits on the availability of legal aid, it may be unrealistic to expect applicants for disability support pensions or similar payments from the Department, to commence proceedings against their solicitors. Perhaps it might be a good idea if more did so. That might encourage those practicing in compensation and personal injury area to ensure that they keep up with amendments to the social security legislation.' **PL**

ENDNOTES:

¹ This article is an edited version of a paper originally presented at the 2002 APLA National Conference and draws significantly on P. Sutherland and A. Anforth, 'Social Security and Family Assistance Law', Federation Press, 2001. In the next edition of *Plaintiff*, the authors will explore the circumstances in which compensation payments may be disregarded by reason of special circumstances.

² s1161.

³ s17(2A).

⁴ s17(2B).

⁵ s1168.

⁶ s1160(2).

⁷ s17(5).

⁸ *Re Najdovska and SDSS* 54 ALD 184.

⁹ *SDSS v Silveira* 68 ALR 147; *Re SDSS and Kirwan* [1990] 22 AD 280.

¹⁰ *Re Barnett and Federal Commissioner for Tax* [1999] AATA 950; *Coward v Federal Commissioner of Taxation* 99 ATC 2166.

¹¹ at 4.13.2.40.

¹² *SDSS v Hulls* [1991] 22 ALD 570.

¹³ *SDSS and Pilgrim* 21 ALD 340.

¹⁴ [2002] FCAFC 207.

¹⁵ *Re Baker and SDSS* 20 ALD 505; aff'd on appeal in *Baker v SDSS* [1991] 23 ALD 305.

¹⁶ *Re SDSS and Graham* 30 ALD 909.

¹⁷ *Re Martin and SDSS* [1993] 30 ALD 637.

¹⁸ Note that this concession did not bind the Secretary and does not detract from the principle cited above: *In Re SDSS and Philpott* [1998] unreported 3/10/98; see also *Re Lawlor and SDFaCS* [1999] 57 ALD 509.

¹⁹ *Re Stern and SDFaCS*.

²⁰ *Re Sammut and SDFaCS* unreported 6/10/99.

²¹ 58 AD 691.

²² *ibid*, paras 26-27.

²³ *Supra*.

²⁴ at 575.

²⁵ unreported 12/8/96.

²⁶ *Jackson v SDSS* [1997] 48 ALD 241.

²⁷ *ibid*, at 248-249.

²⁸ s17(4A).

²⁹ s17(1).

³⁰ 'Departmental Guidelines', 4.13.2.20: *SDSS v Cunneen* [1997] 48 ALD 251.

³¹ *SDFaCS v Reid* 2000 FCA 1874.

³² 'Departmental Guidelines', 4.13.2.20.

³³ s17(4).

³⁴ *Re Gutierrez and SDSS* 35 ALD 353.

³⁵ s1174.

³⁶ [1990] 20 ALD 19.

³⁷ [2001] AATA 108.

³⁸ *Re Nixon and SDSS* 52 ALD 129; *Re Robinson and SDFaCS* 29 AAR 272.

³⁹ *supra* at 424. See *SDSS v a'Beckett* per Von Doussa J at 359 for a broader comment on the perceived legislative intent of the 1947 equivalent to s 17(3).

⁴⁰ *SDSS v Hulls*; *Re SDSS and Lane*; Departmental Guidelines, 4.13.2.30.

⁴¹ *SDSS v a'Beckett*; *Re SDSS and Lane*.

⁴² *Re SDSS and Grycevicz*; cf. *Re Mourilyan and SDFaCS* unreported 23/11/00.

⁴³ 4.13.2.30.

⁴⁴ s1179.

⁴⁵ 6.4.1.

⁴⁶ See, for example, *Re Mosarevski and SDSS* unreported 2/2/96.

⁴⁷ 40 ALD 745.