SOCIAL SECURITY PRECLUSION PERIODS AND LUMP SUM COMPENSTION PAYOUTS: **THE NEED FOR REFORM**

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The recent Administrative Appeal Tribunal decision in the case of *Lind and SDSS* (2014) AATA 680 again demonstrates the difficulty an applicant faces when trying to establish the existence of 'special circumstances' to obtain relief from a preclusion period preventing access to social welfare benefits. This article discusses the need for reform in this area and sets out some issues solicitors should consider when their clients receive a lump sum compensation payout.

Facts

In December 2009, Ms Lind, a 62-year-old nurse, was injured when a car crashed into the rear of her car as she was driving to work. Her injuries were such that she was unable to continue working on a full-time basis and had to scale back to a part-time role. Ultimately, her condition worsened and she became unable to work at all. She received workers compensation payments until she became ineligible upon reaching 65 years of age, at which time she began receiving the age pension. Ms Lind then later settled her CTP claim and received a lump sum payment (including legal costs) of around $275,000. This was the second lump sum she had received in relation to her injury and included an amount for future economic loss. An earlier lump sum payment of around $7,000 was also paid, which did not include any component of future economic loss.

Ms Lind used the lump sum to make payments for workers compensation payback, legal fees, outstanding mortgage payments on her home, outstanding Medicare payments, refunds to Centrelink and outstanding council rates (including interest).

This left her with a very modest amount of money, which she spent in a very short period of time by paying for basic repairs to her home, a second hand car, and repaying loans to friends and family. .

Snapshot

- The case of *Lind and SDSS* (2014) AATA 680 demonstrates the difficulty an applicant faces when trying to establish the existence of 'special circumstances' to obtain relief from a preclusion period preventing access to social welfare benefits
- While the policy direction of Part 3.14 of the *Social Security Act 1991* (Cth) may be a sensible one, i.e. to prevent double dipping, the legislation goes too far and has the capacity to produce surprisingly harsh outcomes, particularly for vulnerable clients inexperienced in managing a lump sum
- Solicitors should advise clients who have received a lump sum compensation payout that the current legislation will impose a preclusion period, the extent of the period, and that it can apply prospectively and retrospectively

Application of the legislative scheme

The compensation recovery provisions contained in Part 3.14 of the Social *Security Act 1991* (Cth) (the Act) operate when a person receives a compensation payment that includes some element of economic loss.

The policy approach behind the imposition of preclusion periods is to avoid what is known as double dipping, i.e. receiving money by way of compensation and receipt of a welfare benefit.

In Ms Lind's case, ss 17(3), 1169, 1170 and 1171 of the Act operated to preclude her from the age pension. The preclusion period was calculated by dividing the lump sum compensation amount of $282,000 ($275,000.00 plus $7,000) by 50 per cent (the 50 per cent rule) and then dividing that amount by a compensation divisor, calculated by reference to the pension rate, which resulted in a preclusion period from the age pension of around three years.

As a result, Ms Lind found herself, at the age of 65, with a mortgage on her modest home, unable to work, very limited assets, no income stream, no income support from family, in relatively poor health and unable to receive the age pension.

Ms Lind now has no option but to sell her home, use the proceeds of the sale to pay out her mortgage and try to live on what is left over for the next three years.

Special circumstances

Section 1184K provides a mechanism for shortening the preclusion period if special circumstances exit.

In *Beadle and Director-General of Social Security* [1984] AATA 176 – the case most relied upon by Centrelink when arguing against a finding of special circumstances – the tribunal considered that special circumstances meant circumstances that were 'unusual, uncommon or exceptional' (at [12]).

Each case will turn on its own facts, but the cases generally show that the requirement for special circumstances is a very high and difficult threshold to meet.

The basis of the claim in the AAT was that pursuant to s 1184K of the Act, the tribunal should reduce the preclusion period in the special circumstances of Ms Lind's case. She first appealed the decision to an Authorised Review Officer, then to the Social Security Appeals Tribunal and finally to the AAT. All of these appeals were unsuccessful

Financial hardship

Ms Lind's financial hardship was not considered by Member Denovan to be severe enough to satisfy the test of special circumstances.

Financial hardship must go beyond 'straitened circumstances' (*Martin v SDSS* [1990] AATA 6482 (14 November 1990)). It must be severe hardship, although the applicant is not required to take a one way ticket to poverty (*SDSS v VYS* [1995]

AATA 371 (15 December 1995)) and it is assessed at the rate a pensioner would be paid such that if a person has income at that level then there could be no financial hardship (*Napolitano and SDSS* [1992] AATA 388).

The 50 per cent rule over estimates economic loss

The 50 per cent rule can cause excessive sums to be deemed as economic loss, e.g. the inclusion of substantial medical costs in the lump sum can cause the deemed economic loss to be artificially inflated and therefore the preclusion period to be artificially extended.

In *SDSS v Smith* [1991] FCA 280, Von Dousa J noted that it was wrong to conclude that there could be no special circumstances when 'the 50 per cent rule produces a clearly unjust result' (at [17]).

In *Kirkbright v SDFaCS* [2000] FCA 1876, Mansfield J noted that a strict application of the Act and the 50 per cent rule could result in an unfairness which could comprise special circumstances (at [22]).

However, a different view was adopted in *Chamberlain v SDDaCS* [2002] FCA 67 *Chamberlain* (2002) where Kiefel J noted that special circumstances cannot be made out where the amount of economic loss payment is less than the 50 per cent assumed by the statute (at [27]–[35]).

Ms Lind was 65 years of age at the time she received her lump sum compensation. Consequently, only a small portion of her lump sum payout related to her loss of capacity to earn beyond 65 years of age.

However, the 50 per cent rule deemed half of the lump sum to be the amount on which to determine the preclusion period.

Member Denovan considered herself to be bound to follow *Chamberlain* and concluded that the apparent unfairness of the 50 per cent rule did not constitute special circumstances.

Application of the preclusion period to the age pension

However, Member Denovan considered that *Chamberlain* addressed the issue of the application of preclusion periods to the age pension and declined to find special circumstances.

Legal costs were included in the determination of the preclusion period

In *Fuller and SDFaCS* [2004] AATA 615, Downes J noted that when a settlement is reached inclusive of costs, the practice is for the total figure to be treated as the lump sum compensation payment but where a matter is settled on the basis that costs are to be paid after being assessed then the preclusion period is calculated without reference to the costs and that this was unfair (at [27]).

Member Denovan agreed with Downes J that this practice amounted to unfairness. However, because legal costs are included in the lump sum used in the calculation of the preclusion period in many if not the majority of cases, Member Denovan found that there were no special circumstances in Ms Lind's case.

However, Member Denovan concluded that Ms Lind's circumstances, taken as a whole (including her poor health and that she was not wasteful of the expenditure of the lump sum), were neither unusual nor exceptional to qualify as special circumstances.

The need for reform

It is submitted that while the policy direction of the legislation may be a sensible one, i.e. to prevent double dipping, the legislation goes too far and has the capacity to produce some surprisingly harsh outcomes.

The legislation establishes a scheme for the determination of preclusion periods which is arbitrary in nature, i.e. it is based on the 50 per cent rule.

In order to provide relief in cases where the scheme produces results that are harsh and unfair, the scheme provides a mechanism to reduce the preclusion period, i.e. s 1184K special circumstances. However, the bar is set very high for applicants seeking to obtain that relief.

It is submitted that the legislation can be particularly problematic for clients that are vulnerable, e.g. if suffering from any mental health issues, or even for clients who are simply unskilled or inexperienced in managing a lump sum.

The legislation as it currently operates produced a result whereby Ms Lind must sell her home, and possibly her car, just to get by until the preclusion period concludes. One of the concerning aspects of this case is that Member Donovan noted that Ms Lind's circumstances were the rule rather than the exception. Given these outcomes are the norm, this would suggest there is a need for reform in this area.

Issues for solicitors to consider

If a client receives a lump sum compensation payout, the solicitor should, where applicable, advise the client that the current legislation will impose a preclusion period, and the extent of the period of preclusion.

Importantly, preclusion periods can operate both prospectively and retrospectively, i.e. they can result in an overpayment of a Centerlink benefit to a client, which will need to be paid back, typically from the lump sum compensation payment received by the client.

Section 1171 of the Act requires solicitors to take into account all lump sum payments made to the client when determining the length of the preclusion period, even if some of the lump sum payments contain no element of economic loss.

The client should be advised to be very careful with the lump sum payout and be encouraged to see a financial advisor with a view to ensuring that the lump sum will cover the client's living expenses during the preclusion period.

The client should also be advised that if the compensation money is spent before completion of the preclusion period, the chances of having the preclusion period reduced are extremely low and will typically require the client to be effectively homeless with no assets at all on which to live.

This may be a more difficult task than expected, given that some clients may feel they are entitled to a particular social security benefit such as the age pension when they reach 65 years of age.

When negotiating the settlement for a lump sum compensation payout, solicitors are advised to garner evidence of the breakdown of the lump sum because this may be of some use to avoid any potential harsh application of the 50 per cent rule (*Glenville and SDFHCSIA* [2012] AATA 35).

Finally, solicitors should consider negotiating an outcome that excludes legal fees otherwise the legal fees will be factored into the determination of the preclusion period. **LSJ**