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Update

Entitlement to damages for fees for managing the investment of compensation payments

As a general rule, the courts have no concern with the manner in which a claimant uses damages recovered for personal injury caused by a defendant's negligence. Therefore, expenses incurred by the investment decisions that a claimant makes on the investment of a judgment sum are not considered to be a consequence of a claimant's injury and are not recoverable as damages. When a claimant's intellectual capacity has been so impaired by the defendant's negligence, a need may arise for assistance with future management of a lump sum compensation award. As a consequence, the general rule has been refined by the courts such that the expenses associated with managing the award in such circumstances are compensable.

In *Gray v Richards*, the High Court of Australia considered two issues relating to the recoverability of compensation for expenses incurred for the future management of a compensation award. They were:

1. Is an incapacitated claimant entitled to recover expenses associated with managing a component of damages that was awarded to meet the cost of managing a lump sum recovered as damages?
2. Is an incapacitated claimant entitled to recover costs associated with managing the predicted future income of the managed fund?

Background

Gray sustained a traumatic brain injury in a motor vehicle accident as a result of Richard's negligence. This injury left Gray with a significant intellectual impairment for which she required constant care.

Proceedings were initiated in the District Court of New South Wales in which Gray, by her next friend, claimed damages. The proceedings were compromised on terms which entitled Gray to compensation in a lump sum of AUD 10 million (the **Compromise Monies**) plus an amount to cover expenses associated with managing the compromise monies to be determined by the Court (the **Fund Management Charges**).

Richards conceded that Gray was incapable of managing her own affairs and that the Compromise Monies and Fund Management Charges would be paid to a fund manager. It was not in issue that the fund manager would charge fees for managing the Compromise Monies to be calculated as a percentage of the total funds under management, which would include the Compromise Monies and compensation for the Fund Management Charges.

The trial judge accepted that:

- The income derived from the management of the fund and reinvested by the manager would itself become part of the fund, and accordingly, would incur its own management fees
- If the future income earned by the fund was excluded from the calculation of management costs, there would be a shortfall in the damages, and consequently, insufficient money to manage the damages
- The statutory discount rate of 5% prescribed by section 127 of the *Motor Accidents Compensation Act* 1999 (NSW) for the assessment of damages of future economic loss represented the net earning capacity of the fund over time. Accordingly, the trial judge concluded that an award of damages reflecting the cost of managing fund income was therefore necessary to preserve the longevity of the fund

The trial judge decided both issues in favour of Gray and allowed compensation for expenses incurred in managing the Compromise Monies and the Fund Management Charges. On the second issue she allowed recovery for the cost of managing predicted income earned on the reinvestment of the funds under management.

A compensation component of approximately AUD 2.151 million was made for the Fund Management Charges in the judgment sum.

Decision of the Court of Appeal

The Court of Appeal overturned the primary judge's decision on both issues. In deciding the first issue, the Court of Appeal applied the general rule that a court has no concern with the manner in which a claimant uses the sum of damages awarded.

As to the second issue, the Court of Appeal disallowed the compensation for the management cost of managing the fund's income on the basis that the discount rate prescribed by the *Motor Accidents Compensation Act* did not require the maintenance of a 5% return on investment over the life of the fund or the adjustment of the damages awarded so as to achieve that result.

Factors taken into account by the judges of the Court of Appeal included:

- It was open to those who represented Gray to choose a fund manager and negotiate the terms of the fund manager's remuneration
- It should not be assumed that fees would be paid on the amount set aside for fund management costs or on the basis that a particular fund manager may levy fees in such a way as to require the amount to be set aside for fund management to itself be managed
- That the calculation of the amount to cover the cost of managing the fund was unacceptably uncertain and involved speculation as to the performance of the fund or assumptions as to the rate of dissipation of the fund management award which as a matter of probability would bear little relation to reality and lead to over compensation

The Court of Appeal reduced the compensation amount for the Fund Management Charges to AUD 1.49 million.

Decision of the High Court of Australia

Issue 1: Fund management on fund management

The High Court unanimously overturned the Court of Appeal's ruling in regard to the first issue, and instead held that Gray was entitled to fund management costs on the Fund Management Charges. The High Court held that in truth, ascertaining the cost of managing the Fund Management Charges:

> "is not an exercise separate and distinct from assessing the present value of fund management expenses as part of the appellant's future outgoings … the expenses in question are not incurred separately … they are an integral part of that cost".

The High Court observed that there was no issue that the appointment of the proposed fund manager was not a reasonable response by Gray and there was no evidence that the fund manager's fees were not in accordance with the practices of the market or that the proposed rates were greater than market rates or were contrary to any statutory regulation.

In addition, the High Court rejected the Court of Appeal's concern that the "*multiple iterations*" of fund management damages upon fund management damages would involve undue speculation or would be too difficult to calculate. The High Court observed that "*the common law does not permit difficulties of estimating the loss in money to defeat an award of damages*" nor was there any element of "*double counting*" involved – fund management costs were considered to be one component of the loss consequent upon the appellant's injury.

Issue 2: Fund management expense on fund income

Gray argued that the Court of Appeal erred in finding that the discount rate under section 127 of the Motor Accidents Compensation Act covered the potential costs of managing fund income.

The High Court upheld the Court of Appeal's ruling in regard to the second issue, finding that the discount rate prescribed by the *Motor Accidents Compensation Act* assumed that the return from the fund takes into account the cost of generating that return. The High Court observed that the discount rate is merely a conceptual tool utilised to determine what sum represents the present value of anticipated losses or expenses. It held that the discount rate does not imply a statutory requirement that the fund should achieve a net future earnings rate of 5%, nor does it imply that the award of damages must be supplemented in order to sustain such an income.

The High Court also rejected the appellant's entitlement to these damages on the basis that the cost of managing the income generated is not an integral part of the appellant's loss flowing from the injury. The High Court observed that it could only be considered so if it were assumed that income will always be greater than the drawings, and that the income of the fund will always be reinvested back into itself.

The appeal was therefore allowed in part, with the High Court increasing the sum of damages which the Court of Appeal awarded by approximately AUD 600,000 plus interest.

Comment

The object of compensation for personal injury is to put the injured party in the same position as if he or she had not sustained injury, insofar as it is possible to do so by way of the payment of a sum of money. The Court is concerned to give fair compensation, but is not required to give perfect compensation. Accordingly the calculation of damages may involve an element of estimation and does not require precise proof of loss.

In an appropriate case, compensable damages may include a component of damages to compensate the injured party for the future costs of investing and managing judgment sum, including a sum representing the estimated expenses incurred in managing the judgment sum invested.

Defendants may be able to reduce the amount recovered for management fees, if evidence can adduced that the claimant's proposed investment is unreasonable or that the proposed fund manager's fees are not in accordance with the practices of the market or are greater than market rates or were contrary to any statutory regulation.

Statutory discount rates used to calculate the present value of future losses do not imply a statutory requirement for courts to supplement award damages to achieve future earnings consistent with the prescribed discount rate. Such rates do not assume that awards that are invested will produce annual income at an equivalent rate or imply that the award should be adjusted to achieve the same result.

There are statutory equivalents to section 127 of the Motor Accidents Compensation Act throughout Australia that apply to future loss that relates to personal injury or death. The High Court's observations concerning the operation of statutory discount rate in the present case is relevant to all state jurisdictions.

Further information

If you would like further information on any issue raised in this update please contact:

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