



FERRIER HODGSON CORPORATE ADVISORY

TELECOMMUNICATIONS INDUSTRY OMBUDSMAN

- FAST TRACK ARBITRATION

SMITH - CAPE BRIDGEWATER HOLIDAY CAMP

ANALYSIS OF FINANCIAL CLAIM

Dated: 3 May 1995

L69451

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PART A - EXECUTIVE SUMMARY

Mr Alan Smith ("Smith"), the proprietor of Cape Bridgewater Holiday Camp has made a claim of \$3,459,091 against Telstra Corporation Ltd (trading as Telecom Australia) ("Telecom") in respect of costs, losses and damages suffered due to alleged telecommunications problems for the period between February 1988 and January 1995.

This report has been prepared by Ferrier Hodgson Corporate Advisory (Vic) Pty Ltd ("FHCA") on the instructions of Dr Gordon Hughes, the Arbitrator of the "Fast Track Arbitration" and is strictly limited to a financial analysis of Smith's claim.

The following is a summary of Smith's financial claim and Telecom's defence.

	Smith Claim \$	Telecom Defence \$	Reply/Revised Claim \$
Loss of occupancy	1,596,000	130,799	1,596,000
Loss of rates	307,000	-	409,550 NB1
Loss of Restaurant/tea room revenue	154,000	-	154,000
Additional Cost of acquiring facilities	91,000	-	172,000 NB2
Loss of capital value in the Business	447,000	29,452	447,000
Interest and borrowing costs	153,790	-	153,790
Loss of capital gains on assets sold	15,060	-	15,060
Capital costs of a new telephone system	25,000	-	25,000
Advertising costs	72,300	-	72,300
Damage for personal injury and suffering	300,000	NB3	300,000
Claim for preparation costs	81,650	-	114,391 NB4
	<u>3,242,800</u>	<u>160,251</u>	<u>3,459,091</u>
Less Previous Settlement		<u>80,000</u>	
		<u>80,251</u>	

NOTES

- NB1: Adjusted after Deloitte Touche Tohmatsu reported that the increased tariff is profit and should not be reduced by variable expenses.
- NB2: Grossed up because of taxation, therefore \$172,000 less tax = \$91,000 which is the additional cost of acquiring facilities.
- NB3: Deloitte Touche Tohmatsu are unable to comment on that part of the claim.
- NB4: Increased for ongoing costs incurred in the preparation of the claim.

This report should in no way fetter the Arbitrator's discretion in determining the merits of Smith's claim and the amount of compensation (if any) which should be awarded to the claimant.

This analysis of Smith's claim by FHCA is based upon reasonable financial assumptions and accounting principles and determined by reference to that material which has been made available to the Resource Unit from the Arbitrator. When necessary, FHCA have obtained industry data to investigate certain comments and calculations in the claim and defence. Further, FHCA have reviewed the technical report dated 30 April 1995 prepared by DMR Group Inc and Lane Telecommunications Pty Ltd.

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The Arbitrator has specifically requested that in making any calculations we provide a range of figures to act as a guide only, to assist him in his determinations and calculations. FHCA appreciates that the Arbitrator may well have his own reasons for making a determination outside the ranges outlined in this report.

At the request of the Arbitrator, we have calculated the mid point between the amount claimed by Smith and that calculated by Telecom. This is to provide a guide only to the Arbitrator and does not represent FHCA's recommendations.

Having concluded our review, we estimate that the losses suffered by Smith to be in the following range:

	Low \$	Medium \$	High \$	Mid Point Smith-Telecom \$
Loss of profits - occupancy	27,051	98,632	177,490	863,400
Loss of interest on profits - occupancy	8,796	25,181	43,797	--
Loss of profits - rates	64,432	74,128	84,915	--
Loss of interest on rates	9,146	10,420	11,902	--
Loss of Restaurant/team room revenue	--	--	--	--
Additional cost of acquiring facilities	--	--	--	--
Loss of capital value in the business	43,000	81,000	123,000	238,226
Interest and borrowing costs	--	--	--	--
Loss of capital gains on assets sold	--	--	--	--
Capital costs of a new telephone system	--	--	--	--
Advertising costs	--	--	--	--
Damage for personal injury and suffering	NB1	NB1	NB1	--
Claim for preparation costs	NB1	NB1	NB1	--
Total	\$152,425	\$289,361	\$441,104	\$1,101,626

NOTES

NB 1: FHCA is unable to comment on this part of the claim.

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PART B - BACKGROUND ON CAPE BRIDGEWATER HOLIDAY CAMP

Cape Bridgewater is located 420km west of Melbourne and 20km from Portland and is situated on the south western coast of Victoria. Portland is a town of 11,000 people and has an airport serviced by Kendall Airlines. The Portland area is well serviced by coaches from both Melbourne and Adelaide.

Cape Bridgewater boasts many attractions, including The Blowholes, Petrified Forest, a seal colony, the Bridgewater Lakes, the spectacular Bridgewater Bay and Shelly Beach. Cape Bridgewater is a small community and comprises holiday houses, homes, farms, kiosk, Snuggles Tearoom and Cape Bridgewater Holiday Camp ("CBHC"). CBHC is positioned close to the main cluster of housing and has some views of Bridgewater Bay.

The CBHC was purchased in December 1987 by Smith and his wife, from a Mrs Crouch. Smith and his wife paid \$280,000, comprised of \$140,000 in cash and \$140,000 of borrowings from Moore's solicitors secured by a registered first mortgage.

The purchase price was apportioned as follows:

Chattels	\$25,000
Goodwill	\$35,000
Freehold	<u>\$220,000</u>
	<u>\$280,000</u>

In Smith's claim document, he states that in December 1987 he conducted a market survey and after reviewing the bookings of the previous owner, he concluded:

- With proper advertising he could, within 12 months, turn over approximately \$120,000
- The CBHC revenue would be able to grow by up to 40% per year.

Smith has stated that he had made enquiries and was told by the Victorian Tourism Commission that:

- Tourism in the area had been escalating for the last four years.
- The level of tourism was increasing from 8% to 15% per year.

At the time of the purchase, CBHC catered predominantly for school camps. Smith states that he set out to increase this market to social, Probus and singles clubs and he intended to run tours and total package holidays.

Smith states that in January and February 1988, 2,000 brochures were printed to advertise CBHC in Melbourne and the brochure was sent to 600 establishments. A response of less than 1% was received from this advertising. Smith claims that approximately two months after he and his wife arrived at Cape Bridgewater, they noticed that they were not getting phone calls.

After several years of complaining about telecommunications faults, Smith agreed to enter into the Fast Track Arbitration process in an attempt to resolve his dispute with Telecom.



PART C - INSTRUCTIONS

We were instructed by the Arbitrator, Dr Gordon Hughes on 21 February 1995, to provide an analysis of the financial claim of Smith for costs, losses and damages suffered due to telecommunications problems while Smith traded the Cape Bridgewater Holiday Camp. The analysis includes a review of the financial assumptions utilised by Smith in his claim and by Telecom in their defence.

1.0 Approach

To assist the Arbitrator with his deliberations, where FHCA have concluded that a loss incurred by Smith can be primarily attributed to telecommunications faults and problems, three scenarios of loss have been estimated, a low, medium and high range.

In adopting this approach, FHCA in no way seeks to pre-empt the findings of the Arbitrator as to whether telecommunications faults did in fact exist and if they did exist, that these faults should give rise to a liability.

2.0 Sources of Information

A detailed list of the information considered by FHCA in the preparation of our report is contained in Appendix A, but comprises primarily:

- Smith's claim dated 15 June 1994
- DM Ryan Corporate Pty Ltd Report ("DM Ryan") dated 21 June 1994
- Telecom's Principal Submission dated 12 December 1994 ("the defence") including a report of Peter Neil Crofts of Deloitte Touche Tohmatsu ("DTT") dated 12 December 1994.
- Smith's reply to Telecom's defence dated 18 January 1995
- DM Ryan's reply to Telecom's defence dated 21 January and 23 January 1995.

Staff of FHCA also attended CBHC on 28 February 1995.

3.0 Technical Findings

FHCA have also reviewed the report of DMR Group Inc of Montreal Canada and Lane Telecommunications Pty Ltd dated 30 April 1995 and have been advised of the following:

- Faults did exist for which Telecom should be held accountable.
- These faults existed over a substantial period of the claim.

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PART D - FINANCIAL CLAIM BY SMITH

Smith has claimed \$3,459,091 for costs, losses and damages from February 1988 to approximately January 1995 due to telecommunications faults and problems.

Telecom in their Principal Submission adopt the DTT Report which states Smith may be entitled to \$160,251 (less \$80,000 previously paid in settlement), although this amount is dependent upon a number of assumptions including the following assumptions in particular being decided in favour of the claimant:

- "(a) That there was a fault(s) for which Telecom was liable;*
- (b) That there was sufficient nexus between the fault for which Telecom was liable and the economic loss complained of;*
- (c) That other causes of economic loss or change in financial performance had been properly considered; and*
- (d) That the effect of any fault for which Telecom was liable and its consequential economic loss were constant over time." [DTT para 82]*

To assess Smith's claim, FHCA have reviewed the actual trading results of CBHC and the industry data relied upon by DM Ryan in his calculation of the potential trading performance that CBHC could have achieved.

DTT have provided their own analysis of industry data and certain areas of contention between DM Ryan and DTT have been analysed in Part E of this report.

Part F of this report analyses specific heads of claim by Smith and details DTT's opinion as to Smith's assumptions.

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PART E - ANALYSIS OF FINANCIAL RESEARCH AND DATA

This section of the report provides an analysis of certain key assumptions and the industry data relied upon by both DM Ryan and DTT. Details of assumptions utilised by DM Ryan and DTT can be found in Part F of this report.

1.0 Camping Association of Victoria ("CAV") Prices and Occupancy Surveys

DTT have utilised industry data to question assumptions in the DM Ryan calculations. In particular, DTT have utilised surveys prepared by CAV and an IBIS report on caravan parks. DM Ryan disputes the use of CAV surveys, stating the surveys concentrate on camps where schools are the primary customers and that schools only contributed to 53% of the clientele of CBHC from 1988 to 1994. Further, DM Ryan points out that the caravan park survey by IBIS is not relevant because 45% of caravan park residents are permanent and further that they do not provide fully catered holidays.

Given that schools did account for at least 53% of CBHC clientele, FHCA consider it reasonable to utilise the information provided in CAV surveys. However, we agree with DM Ryan that there appears to be limited relevance in comparing the results of the IBIS caravan park survey to CBHC trading results.

2.0 Bed Numbers

One of the main heads of claim of Smith was that he wanted to increase bed numbers from 114 to 166 in 1991 by the construction and purchase of additional facilities. Smith states that by upgrading the quantity and quality of accommodation, he could lift the profile of CBHC, expand the extent of fully catered accommodation and target more "profitable" groups i.e. executives.

DTT describe the main customers for fixed accommodation recreation camp sites as schools and other special groups and go on to state that the main use of the camp sites is school groups.

DTT dispute the economic viability of increasing bed numbers and outlaying funds in construction. DTT believe that as the current beds at CBHC were under-utilised, it would not be consistent with prudent commercial practice to increase bed numbers. DTT's conclusions were based on numerous factors including:

- The CAV "School Needs survey" highlights 75% of respondents stated that the average size of groups was 20 to 60.
- 96% of CBHC groups have less than 100 attendees.
- Average actual occupancy from February 1988 to June 1991 was only 12.7%.
- Building costs to increase the bed levels to 166 were estimated at \$208,000 and DTT believe that this could be a gross over capitalisation of the business.



Smith has provided numerous examples where large groups have attended CBHC to support the rationale for increasing bed numbers to 166. An analysis of the information provided by Smith in fact shows that the average size of groups is still substantially less than 100 and there is insufficient information to suggest that Smith would have been successful in getting a large number of groups in excess of 100 people to Cape Bridgewater.

From the information provided, FHCA consider that Smith may not have been able to attract large fully catered groups in sufficient quantity to pay for the funding of the additional facilities.



3.0 Three Hour Travel Distance

DTT state that the School Needs survey found that schools generally preferred to travel less than three hours to camp sites. As CBHC was more than three hours from the main metropolitan area of Melbourne, its target market (schools, as assumed by DTT) was reduced accordingly. DTT believe that this reduced market continues to effect CBHC's profitability. DTT calculated the percentage of Victorian schools within three hours of Portland to be as follows:

	% of Victorian Schools	Schools
Government	15.7%	304
Independent	15.0%	102
		406

FHCA believe the School Needs survey (as quoted by DTT) provides limited information. The survey was sent out to 2,651 Victorian primary and secondary schools and only 10% were returned. There are obvious limitations in utilising a survey when only 10% of those surveyed respond. Details of the schools that replied to the survey are as follows:

	% of Victorian Schools
State Schools	74%
Church Schools	20%
Private Schools	6%

An analysis of the clientele of CBHC shows that only 53% were in fact schools. Further, the clientele of CBHC from 1988 to 1994 shows that there are a considerable number of attendees that have travelled more than three hours. FHCA also note that DTT's analysis of schools within three hours excludes those schools from South Australia and particularly schools close to the South Australian/Victorian border, which means that the potential market for CBHC is in fact bigger than the number of Victorian schools mentioned above.



4.0 Tourism Monitors

DTT utilised Domestic Tourism Statistics from IBIS to gauge the use of Portland by other groups (including tourists). The statistics as reported by DTT show a decline in visitors from 1990 to 1993.

DM Ryan states the Bureau of Statistics ("BoS") information supplied by DTT gives an incorrect impression of the tourist market. DM Ryan quotes from the Victorian Tourism Domestic Monitor indicating 122,000 tourists visited Portland in 1992/1993.

FHCA have contacted the BoS who stated the Victorian Tourism Domestic Monitor as supplied by DM Ryan should not be used because it had a very high sampling error. FHCA have obtained information on the Great Ocean Road region (including Cape Bridgewater) from the BoS which states the following:

	No. of Guests 000's	% Change
1991/1992	1,396	—
1992/1993	1,490	6.7%
1993/1994	1,565	5.0%

FHCA have concluded that the level of tourists and other guests to the general Great Ocean Road region has in fact increased from 1992 to 1994.

5.0 Level of Occupancy

There is considerable difference between DM Ryan's stated achievable level of 60% occupancy at CBHC and DTT's recommended level of 20% occupancy, based upon industry data and research. DTT have stated that various CAV surveys shows reported average annual bed occupancy in the range of 10% to 34% and that only 1 out of 55 respondents to the December 1993 survey reported actual occupancy of 60% (highest reported). DTT goes on to state that the factors impacting the level of occupancy include:

- Location
- Travel Distance
- Size of Group
- Marketing
- Availability of Services

FHCA have reviewed the CAV surveys, in particular the average bed occupancy levels which are summarised as follows:

Year Ending	Average Bed Occupancy
December 1992	26%
December 1993	27%
December 1994	25%



FHCA's analysis of CBHC's actual bed occupancy (whilst adversely impacted by telecommunications faults) are as follows:

Year Ending	Average Bed Occupancy
30 June 1988	4.15%
30 June 1989	9.88%
30 June 1990	14.70%
30 June 1991	10.73%
30 June 1992	12.47%
30 June 1993	10.17%
30 June 1994	13.83%

For the periods where the CAV surveys were conducted (1992 to 1994), FHCA believe CBHC had an average occupancy percentage of at least 50% less than the average recorded by the industry.

In determining appropriate ranges of bed occupancy that Smith may have achieved, FHCA have taken the following information into account:

- Actual average bed occupancy.
- Industry data and CAV Prices and Occupancy surveys.
- Telecommunications faults and problems existed over a substantial period of the claim.
- Smith made substantial efforts to market the camp to schools and other groups. In particular, Smith advertised for "singles group" weekends.
- On occasions, Smith visited schools and other groups on marketing exercises.
- Smith maintained CBHC to the best standard his finances would allow.
- Where possible, Smith attempted to combine groups to obtain greater occupancy levels.

FHCA have adopted the following average bed occupancy scenarios in our calculation of the potential loss suffered by CBHC:

	Average Bed Occupancy
Low	Maximum to 30%
Medium	Maximum to 40%
High	Maximum to 50%

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PART F - REVIEW OF FINANCIAL CLAIM BY SMITH

This part of the report details Smith's claim and DTT comments on each part of Smith's claim. When FHCA conclude that a loss has been suffered, the range of the loss according to low, medium and high scenarios has been detailed.

1.0 Loss of Occupancy

Smith - Claim	Telecom - Defence
\$1,596,000	\$130,799

1.1 Overview

Smith has stated that, due to telecommunications faults and problems, customers/clients were unable to contact CBHC to enquire about accommodation and make bookings. Accordingly, Smith has claimed for loss of occupancy (bookings).

Smith's calculations for loss of occupancy are based on:

- CBHC increasing bed numbers from 114 to 166 in 1991 [refer para 1.3].
- Bed occupancy ("utilisation") peaking at 60% by the year ended 30 June 1991 refer para 1.4].
- Night occupancy based on excluding "certain Sundays" (which gives an effective night occupancy of 89%) [refer para 1.5].
- Average bed rate based on actuals [refer para 1.6].
- Variable operating costs (expenses) calculated as 25% of gross revenue [refer para 1.7].

DTT believe that an increase in the bed numbers was not "*consistent with prudent commercial practise*," [DTT para 103] given that the average actual occupancy of CBHC from 1988 to 1991 was 12.7%. DTT adopted 114 beds in their calculations and estimated a reasonable occupancy level to be 20%, based on information including CAV Surveys and an IBIS report on Caravan Parks.

FHCA have reviewed the information provided by Smith and Telecom concerning loss of occupancy and conclude that Smith has suffered losses within the range of :

	Loss of Occupancy
Low	\$27,051
Medium	\$98,632
High	\$177,490

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1.2 FHCA - Source of Financial Information

FHCA's calculations for loss of occupancy incorporates the statistical data of the clientele of CBHC from February 1988 to June 1994. This information was sourced primarily from tax returns of Smith and CBHC, bookings summaries, Smith's diaries and docket book of CBHC.

1.3 Bed Numbers

Smith states "that they were losing large groups as there was insufficient accommodation to cater for large groups" [DM Ryan Reply para 20]. Smith saw the need to upgrade and increase capacity to make CBHC more profitable. Accordingly, Smith's calculations include an increase of beds from 114 to 166. DTT conclude that of CBHC clientele, "96% of groups have less than 100 attendees" [DTT para 103] and it was therefore not logical to increase the amount of accommodation.

FHCA have recalculated the average size of the groups attending CBHC from the information supplied as follows:

Period Ending	People
30.6.88	30
30.6.89	37
30.6.90	45
30.6.91	52
30.6.92	50
30.6.93	39
30.6.94	41

It does not appear to be financially beneficial for Smith to increase capacity, since the current beds were substantially under-utilised. Even if we assume Smith had no telecommunications faults over this period, there is no significant evidence that there would be a demand for greater than 114 beds at any one time at CBHC. Further, we are not convinced that in all the circumstances, including the recession and the documented reluctance of financiers (such as banks) to provide new funding for such ventures, Smith could have secured the necessary finance to fund the capital costs.

Based on our comments in Part D of this report, information provided and our analysis of current trading levels, FHCA have adopted 114 beds as the maximum number of beds for the period of the claim.

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1.4 Bed Occupancy ("Utilisation")

Smith expected bed occupancy to gradually increase to 60% by the year ended 30 June 1991. DTT reviewed Smith's expectations and concluded that "this significantly exceeds a reasonable occupancy level for a camp of this nature which I [Peter Crofts] believe would be 20% based upon the industry research" [DTT para 107]. DTT also conclude that the average occupancy of CBHC from 1988 to 1991 was 12.7%.

FHCA have calculated actual bed occupancy (utilisation) from the information supplied as follows:

Period Ending	Bed Occupancy %
30.6.88	4.15%
30.6.89	9.88%
30.6.90	14.70%
30.6.91	10.73%
30.6.92	12.47%
30.6.93	10.17%
30.6.94	13.83%

Based upon the information provided, FHCA consider the following ranges of occupancy levels to be reasonable for each year:

Occupancy Levels at CBHC							
	30.6.1988	30.6.1989	30.6.1990	30.6.1991	30.6.1992	30.6.1993	30.6.1994
Low	20%	25%	30%	30%	30%	30%	30%
Medium	20%	30%	40%	40%	40%	40%	40%
High	20%	35%	50%	50%	50%	50%	50%

1.5 Night Occupancy

Night occupancy relates to the number of days in the year the camp is occupied.

DTT have calculated from CBHC's guest summaries that the majority of bookings are for a period of only three to five days. In addition, DTT state that the camp would commonly be restricted in its ability to sell excess rooms on the basis of sharing facilities with another customer group. This inability to sell the excess capacity would adversely impact occupancy rates.

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Smith has provided examples in his claim where schools and groups have shared the accommodation of CBHC at the same time.

DM Ryan and DTT have deducted only certain Sundays from their calculations for available bed nights which equates to the camp being occupied for 89% of the days in the year.

FHCA have calculated the average night occupancy of CBHC from the sources of information provided by Smith:

Period Ending	Night Occupancy %
30.6.88	15.2%
30.6.89	29.9%
30.6.90	33.2%
30.6.91	23.8%
30.6.92	28.8%
30.6.93	27.1%
30.6.94	35.3%

The percentage of night occupancy that FHCA believe reasonable is 48% and this is based upon available CAV surveys.

1.6 Average Bed Rate

DTT have adopted the average bed rate as stated in the DM Ryan report (except for utilising the 1993 rate for 1994). FHCA have recalculated this rate based on the trading results of CBHC provided by Smith as follows:

Period Ending	Average Bed Rate \$
30.6.88	13.90
30.6.89	16.97
30.6.90	13.82
30.6.91	18.08
30.6.92	21.55
30.6.93	18.77
30.6.94	15.41

These actual average bed rates have been used in our calculations.

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1.7 Variable Costs

In various calculations, DM Ryan has assumed CBHC's variable costs on average are 25% of gross revenue. DTT have recalculated variable costs to be 53% of gross revenue.

FHCA have calculated variable costs as a percentage of revenue after reviewing the information provided. This calculation involved re-allocating expenses between fixed and variable.

FHCA's re-calculation of variable costs as a percentage of revenue for the period of the claim is as follows:

Period Ending	Variable Costs %
30.6.88	54
30.6.89	51
30.6.90	60
30.6.91	50
30.6.92	52
30.6.93	59
30.6.94	Unavailable
Average	54

We have used the above variable costs percentages in our calculations.

1.8 Summary of Assumptions and Findings of FHCA - Review of Loss of Occupancy

In summary, FHCA have adopted the following assumptions:

- Number of Beds 114
- Night Occupancy 48%
- Expected Bed Occupancy (utilisation) max 30% to 50%
- Actual Bed Occupancy - taken from actual records
- Average Bed Rate - taken from actual rates
- Variable Costs - average 54% of gross revenue

The total loss of profits relating to loss of occupancy that FHCA has calculated based on the above assumptions are as follows:

	Loss of Occupancy	Bed Occupancy
Low	\$27,051	max 30%
Medium	\$98,632	max 40%
High	\$177,490	max 50%

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2.0 Loss of Interest on Profits - Occupancy

Smith - Claim	Telecom - Defence
Nil	Nil

FHCA, having concluded that Smith has suffered losses due to reduced occupancy, consider it only reasonable that Smith should also be paid interest on this lost profit.

FHCA have calculated interest on a simple interest basis (as opposed to an alternative such as compound interest) using the 90 day Bank Bill Rates on the three loss of occupancy scenarios from February 1988 to June 1994 as follows:

	Loss of Interest - Occupancy
Low	\$8,796
Medium	\$25,181
High	\$43,797

3.0 Loss of Rates

Smith - Claim	Telecom - Defence
\$409,550	Nil

Smith has made a claim for loss of rates (tariffs) stating that "rates applicable to Cape Bridgewater have fallen from a premium of 23% over industry averages to a discount on industry averages" [DM Ryan Report page 7], because, due to his telecommunications faults, he has had to discount to attract customers.

DM Ryan states that "Cape Bridgewater had plans to improve the quality of accommodation (as well as capacity), the general maintenance program and the occupancy of special interest groups for weekends" [DM Ryan page 6], but then "as a result of the general rundown in the standard of buildings and facilities, Cape Bridgewater has had to reduce its rates (or not increase them), and it has been unable to attract regular weekend patrons who would normally pay a higher rate" [DM Ryan page 6]. DM Ryan considers that the projected revenue should be increased by 15% to compensate the business for this loss from 1990 to 1993 and further increased by 25% in 1994.

DTT state that the industry tariff extracted by DM Ryan from the CAV survey for 1988 to 1990 has been incorrectly transposed. Accordingly, DTT have utilised different figures for their industry averages and conclude that: "the suggestion that CBHC rates have fallen from a significant premium to below industry average is not correct (i.e. in respect of fully catered accommodation CBHC was already 7% lower than the industry average in 1988/89)". [DTT Report para 121]

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FHCA believe this discrepancy has arisen because DM Ryan has in places utilised December year end surveys of the CAV for financial years ending 30 June. FHCA have applied the industry data over the appropriate time periods and concluded that CBHC rates were on average at a discount of 15% below reported industry rates from 1990 to 1994.

FHCA have reviewed the reported industry rates and after incorporating the loss of occupancy calculation in Part F 1.1. of this report, conclude the value of the loss of rates suffered by Smith would be in the range of:

	Loss of Rates
Low	\$64,432
Medium	\$74,128
High	\$84,915

4.0 Loss of Interest on Rates

Smith - Claim	Telecom - Defence
Nil	Nil

FHCA, having concluded that Smith has lost revenue due to CBHC rates being at a discount, we consider it is only reasonable that Smith should be paid interest on the value of the loss of rates.

FHCA have calculated interest on a simple interest basis (as opposed to an alternative such as compound interest) using the 90 day Bank Bill Rate on the three the loss of rates scenarios from 1990 to 1994 as follows:

	Loss of Interest on Rates
Low	\$9,146
Medium	\$10,420
High	\$11,902

5.0 Loss of Restaurant/Tea Room Income

Smith - Claim	Telecom - Defence
\$154,000	Nil

Smith has claimed loss of profits for a Restaurant/Tea Room he had planned to construct but did not proceed with because he could not get funding. DM Ryan's reply dated 23 January 1995, paragraph 132, states "the restaurant/tea room was unable to be built as the CBHC could not find a financier due to the poor financial position it found itself in due to telecommunications problems".



DTT disputes Smith's belief that the Restaurant/Tea Room would be as profitable as suggested and disputes Smith's calculations of the level of passing traffic on the Blowholes Road. DTT concludes that the "profitability of the Restaurant/Tea Room is based upon passing traffic, a matter unrelated to the telephone" [DTT para 132].

FHCA have reviewed the available documentation and concluded the following:

- The Restaurant/Tea Room did not proceed due to lack of finance available to fund the construction.
- No costings for the construction have been supplied.
- Plans were drawn up for the Restaurant/Tea Room but no planning permit was granted.
- There is disagreement between Smith and DTT on the extent of passing traffic on the Blowholes Road. FHCA investigations (including discussions with the Glenelg Shire) as to the level of traffic, support the level indicated in the DTT calculations (i.e. 120 cars per day).
- During a site visit on 28 February 1995, FHCA staff identified a tea room (Snuggles Tea Room) at Cape Bridgewater which supports the suggestion that there may be a market for this type of business. The tea room was closed on the day of inspection.
- The success of the Restaurant/Tea Room would have been dependent upon factors including, obtaining suitable finance for the construction, minimal overheads, quality of product, and passing traffic.

From the investigations FHCA have conducted, we conclude that Smith would have been unable to obtain any substantial finance to fund such construction given his base debt levels and anticipated trading performance.

6.0 Additional Costs of Acquiring Facilities

Smith - Claim	Telecom - Defence
\$172,000	Nil

Smith has claimed \$172,000, being the additional costs (plus tax effect) he would now incur to construct and purchase additional facilities at CBHC.

These new facilities would increase bed numbers to 166, and the claim provides for repairs to existing structures including the manager's house, toilets, showers and the Church block.

L69470



DTT state that "there is no evidence that Smith could have funded such work and every reason that he could not" [DTT para 136]. DTT also state that an investment of \$208,000 (1991 cost) to provide further accommodation when the existing accommodation was not being utilised would not be good commercial practice. DTT believed that the outlay would have been a significant over capitalisation given that existing land and buildings were purchased for only \$280,000. DTT conclude that CBHC was heavily geared with limited working capital and that there was never any realistic expectation of the project being completed.

FHCA have reviewed the available documentation and concluded the following:

- Plans were drawn up for certain additional facilities, and a planning permit was received for a mobile structure.
- The construction and purchase of additional facilities at CBHC did not proceed primarily due to lack of finance.
- Smith did not have the funds available to construct or purchase the additional facilities and would have had to borrow the entire amount to complete the project.
- Smith has provided external quotes and estimates where possible to support his claim.
- DTT report that the Building Price Index "indicates that from 30 June 1991 to 31 December 1993 average costs of building fell by 6.55%" [DTT para 136].
- After taking into account our estimate of the extent of loss of profits from occupancy and rates, detailed in Part F 1.1 and 3.0 of this report, Smith would not, in our opinion have been able to service any increased debt level.
- FHCA consider an outlay of funds as suggested by Smith may be a significant overcapitalisation of the existing business.

7.0 Loss of Capital Value in the Business

Smith - Claim	Telecom - Defence
\$477,000	\$29,452

DM Ryan has prepared an analysis of the expected income and expenses over the next two years (1995 and 1996) and the future profits (losses) which would be earned (incurred) as the business of CBHC is rebuilt. DM Ryan has assumed that the business will be rebuilt over two years based upon 45% and 60% occupancy levels respectively. DM Ryan have calculated capital losses as follows:

L 69471



Losses to 30.6.95	(\$38,089)
Profit to 30.6.96	\$308,486
Other costs 1996	<u>\$100,000</u>
	<u>\$446,575*</u>

* DM Ryan have added losses to profits in this calculation.

DTT state that in DM Ryan's calculations, the "difference between this 'expected or anticipated' performance and actual performance is seen as entirely due to the alleged telephone faults" [DTT para 138].

DTT have recalculated the maximum future profitability based on the following assumptions:

Bed numbers	114
Occupancy	20%
Tariff - weighted average	\$17.20
Variable costs to gross revenue	53%

DTT conclude that "CBHC may at best realistically achieve the following operating results in 1995 and 1996 provide economic conditions improve and the business is well managed" [DTT para 143].

Losses to 30.6.95	(\$5,395)
Profit to 30.6.96	<u>\$24,057</u>
	<u>\$29,452*</u>

* DTT have added losses to profits in this calculation.

DTT state that the additional claim for other costs of \$100,000 cannot be supported.

FHCA has calculated the loss of profits from reduced occupancy and rates, and according to normal business practice, believe that this would result in a corresponding loss of capital value in the CBHC business.

FHCA have calculated the loss of profits and rates based on the three scenarios detailed in Part F 1.1 and 3.0 of this report. The loss of profits and rates have been averaged over the period (1988 to 1994) and based upon a pre-tax earnings multiple of three times (as is the normal practice in such circumstances), the lost capital value of the business is calculated as follows:

	Low \$	Medium \$	High \$
Total Loss of Profits and Rates 1988-1994 Due to Telecommunications Faults	91,483	172,760	262,405
Average Loss of Profit and Rates Per Year	14,294	26,994	41,000
Three Times Lost Profits & Rates	42,882	80,982	123,000
Loss of Capital Value - Say	\$43,000	\$81,000	\$123,000

L 69472



8.0 Interest and Borrowing Costs

Smith - Claim	Telecom - Defence
\$153,790	Nil

Smith has claimed additional interest and re-finance costs of \$153,790. Smith states that he has incurred higher interest costs and late payment interest costs due to his financial position which was caused by telecommunications faults.

The additional interest and borrowing costs claimed are based on the following:

- Original borrowing's of \$160,000 in 1988.
- The business should have had sufficient profit to repay the loan at \$20,000 per annum from 30 June 1991 onwards.
- Interest costs should have been incurred at the level of the 90 day bank bill rate plus 1% and not the penalty rates incurred by Smith.

DTT state that "CBHC would not have generated sufficient profits to repay loan principal at a rate of \$20,000 per annum" [DTT para 150]. DTT have (by way of demonstration) recalculated the trading results of CBHC from July 1989 to June 1994 based on a 50% increase in reported revenues. DTT calculations provide:

Average Net profit per year	\$36,398
Less Taxation (estimate 30%)	(\$10,919)
	\$25,479
Less drawings - A Smith	(\$25,000)
Surplus to Repay Loan	<u>\$ 479</u>

DTT have nominated drawings of \$25,000 per annum for Mr Smith for personal expenses. DM Ryan in his reply stated that DTT's comments and calculations are incorrect as they are based on incorrect assumptions.

FHCA have recalculated CBHC's trading performance, taking into account the telecommunications faults [Refer Part F 1.1. and 3.0 of this report]. The calculations show that even if the "high" scenario was adopted, the average increase in profits (pre-tax) per year would be only \$41,000. Given the effect of taxation and also allowing for drawings by Smith of say, \$25,000, FHCA concluded that Smith would not have been able to repay the loan at \$20,000 per annum as suggested in his claim.

In any event, FHCA have recommended that interest be paid on the lost profits arising from reduced occupancy and rates (see Part F 1.2 and 4.0) and any further allowances for interest may be seen as double counting.

L69473



9.0 Loss of Capital Gains on Assets Sold

Smith - Claim	Telecom - Defence
\$15,060	Nil

9.1 2,000 Woodside Shares

Smith states that he was forced to sell the Woodside shares at a loss to fund the ongoing business operations of CBHC. Smith further states, CBHC's financial position had deteriorated and the poor cashflow was due to various telecommunications faults.

DTT state "if money raised on the sale of an asset were used in the business to make up for a shortfall in profits, then provided that any shortfall in profits are subsequently compensated, the loss of assets has also been compensated" [DTT para 154].

FHCA have previously calculated the loss of earnings and loss of capital value CBHC incurred due to telecommunications faults. FHCA believe that the sale of the shares was probably due to normal funding requirements of CBHC.

9.2 22 Seater Bus

Smith has supplied various documents concerning the bus and, in summary, the transaction appears to have been as follows:

- 22 seater bus purchased for \$10,000
- Traded in for Mazda - Nov. 1989 \$6,376
- Smith states that the bus was worth \$18,000 at the time of purchase.

DM Ryan states that "losses have been incurred on these sales or alternatively a capital gain has been forgone and, we consider that the losses represent part of the claim for damages". [DM Ryan page 12]

Peter Crofts in the DTT Report [para 157] states "in my opinion there can be little doubt that a vehicle which had depreciated from \$18,000 or \$10,000 to approximately \$6,000 could not substantially be sold for a capital gain".

FHCA conclude, based upon the information provided, that the bus depreciated in the normal course from \$10,000 (or \$18,000) down to \$6,376 (trade in value).

L69474



9.3 Ride On Mower, Video, TV and Horse

The information provided by Smith states the following:

- Lawn Mower

Cost	\$1,300
Sold	<u>\$ 300</u>
Loss	\$1,000

- Video

Cost - 1986	\$840
Sold	<u>\$250</u>
Loss	\$590

- TV

No detailed information was provided and therefore, FHCA is unable to comment.

- Horse

Smith informed FHCA that he did not want to proceed with this claim.

In relation to all these items, FHCA did not sight any information which would directly link the sale of these items to telecommunications faults.

10.0 Capital Cost for New Telephone System

Smith - Claim	Telecom - Defence
\$25,000	Nil

Smith has claimed \$25,000 for a new UHF receiver to be installed at CBHC to overcome the existing difficulties and faults in the telecommunications system.

DTT's state that no information has been provided to support or explain how the receiver would resolve the telecommunications problems.

Lane Telecommunications Pty Ltd, who have investigated Smith's technical claim, have informed FHCA that the UHF receiver would not, in itself solve Smith's reported faults. In addition, Smith has informed FHCA that Telecom are laying Optic Fibre to Cape Bridgewater and that he believes that this may overcome the need for a UHF receiver.

L69475



11.0 Advertising Costs

Smith - Claim	Telecom - Defence
\$72,300	Nil

Smith claims "that Cape Bridgewater has gained a bad reputation in the eyes of the public and it is going to take a concerted effort to remarket the camp and convention centre once the rebuilding and refurbishment have been completed" [DM Ryan page 13].

DTT state that to outlay 136% of last year's sales revenue on advertising is not a commercial strategy for a properly managed business.

By restoring the revenue of CBHC by say advertising, the capital value of the business would likewise be restored. Smith has already made a claim for loss in capital value in the business of CBHC and this has been considered by FHCA (see Part F 7.0). It may be double counting to consider further compensation for advertising to restore the "reputation" of CBHC.

12.0 Damages for Personal Injury and Suffering

Smith - Claim	Telecom - Defence
\$300,000	Unable to comment

Smith has claimed \$300,000 for stress and suffering over the last six years. DM Ryan [para 14] states "Telecom difficulties have resulted in the run down of his [Smith's] business, the breakdown of a 20 year marriage and an incredible strain on his own mind and body. He has been diagnosed as suffering from post traumatic stress syndrome".

DTT were not in a position to form any opinion on this element of the claim.

FHCA are also not in a position to form any opinion on this part of Smith's claim.

13.0 Claim Preparation Costs

Smith - Claim	Telecom - Defence
\$114,391	-

Smith has claimed costs of travel, accountants, technical adviser and loss adjusters in preparing his claim in this Fast Track Arbitration procedure.

DTT were unable to comment on certain parts of this claim due to invoices and other support documents not being provided.

Whether claim preparation costs are recoverable in these proceedings is a matter for the Arbitrator to determine and outside the scope of FHCA's review.

L 69476



14.0 Previous Settlement.

On 11 December 1992, Telecom and Smith agreed to a settlement to compromise claims against Telecom by Smith.

Telecom state two payments were made:

- \$1,329.00 which was paid prior to 11 December 1992
- \$80,000 paid on 11 December 1992.

In addition, Telecom state that they provided Smith with a 008 telephone service on or about 11 December 1992 and a \$5,000 credit towards 008 charges.

DTT recommended Smith's claim should be reduced as follows:

Loss of Occupancy	\$130,799
Loss of Capital Value in the Business	<u>\$ 29,452</u>
	\$160,251
Previous Settlement	<u>\$(80,000)</u>
Total	<u>\$ 80,251</u>

DTT have not deducted the \$1,329.00.

It is not necessary for FHCA to comment further on the previous settlement payments.

L69477



PART G - SUMMARY

This analysis of Smith's claim by FHCA is based upon reasonable financial assumptions and accounting principles and determined by reference to that material which has been made available to the Resource Unit from the Arbitrator. When necessary, FHCA have obtained industry data to investigate certain comments and calculations in the claim and defence. Further, FHCA have reviewed the technical report dated 30 April 1995 prepared by DMR Group Inc and Lane Telecommunications Pty Ltd.

In accordance with the Arbitrators specific instructions, we have provided a range of figures to act as a guide only, to assist him in his determinations and calculations.

This report should in no way fetter the Arbitrator's discretion in determining the merits of Smith's claim and the amount of compensation (if any) which should be awarded to the claimant.

Yours faithfully,
FERRIER HODGSON CORPORATE ADVISORY

A handwritten signature in black ink, appearing to read 'J. Selak'.

JOHN SELAK
Executive Director

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DMR CORPORATE

DMR

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6 December 1995

Senator R Alston
Level 2, Suite 3
424 St Kilda Road
Melbourne
Vic

Dear Senator Alston,

Re: Casualties of Telecom ("COT") - A Smith

Over the last 2 years I have acted as an independent accountant for Alan Smith and I prepared the independent assessment of his losses and damages which formed part of his submission to the arbitrator, Dr G Hughes.

In response to accounting documents and evidence submitted to the arbitrator, he appointed Ferrier Hodgson Corporate Advisory (Vic) Pty Ltd ("FHCA") to support him in assessing the losses and damages.

The FHCA report was inaccurate and incomplete. I have since been advised by a staff member of FHCA that a large amount of information was excluded from their final report at the request of the arbitrator. This has left the report in an incomplete state and it is impossible for anyone to re-calculate or understand how the FHCA loss figures were determined. This effectively meant that it was impossible to challenge the assumptions, calculations and the time periods used in the FHCA report.

After receiving a copy of the FHCA report I responded with a letter dated 9 May 1995 and a copy of that letter is attached for your information. I have never been provided with a response or any further details in respect of this letter.

I consider that a grave miscarriage of justice has occurred in relation to the A Smith arbitration and that without a full and open inquiry it may be impossible to ever determine how the arbitrators award was calculated.

Yours sincerely

Derek Ryan

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22 December 1995

Mr J Pinnock
Telecommunications Industry Ombudsman
321 Exhibition Street
Melbourne
VIC 3000

Dear Mr Pinnock,

Re: Alan Smith

Further to your letter dated 20 December 1995 I respond to your request as follows:

1. The Ferrier Hodgson Corporate Advisory (Vic) Pty Ltd ("FHCA") report was dated 3 May 1995 and I received a copy of the report on 5 May. After discussions with Alan Smith it was decided that I should reply to the report as soon as possible.

I worked all day Saturday and Sunday with Alan Smith trying to interpret the FHCA report. After this work I considered that the report was incomplete as the calculations of the FHCA loss figures were not included in their report.

2. On 8 May 1995 I telephoned FHCA and spoke to John Rundell and requested a meeting to discuss how the FHCA loss figures were determined. He was reluctant to talk to me at that time however we set a tentative date of 17 May 1995 for us to discuss this matter again. I have a note in my diary for the 17 May 1995 - John Rundle - Ferriers -604 5188.

My response to the FHCA report was lodged on 9 May 1995.

On 17 May I telephoned John Rundell and he stated that he was unable to discuss anything with me until the appeal period had expired. During that telephone conversation I told him that I was unable to recalculate the FHCA figures and that I felt that the report was deficient in that regard. He then stated that he understood my problems and that FHCA had excluded a large amount of information from their final report at the request of the arbitrator.

To the best of my recollection the above facts are exactly as they occurred.

Yours faithfully

Derek Ryan