

**PRIVATE &
CONFIDENTIAL**

MEMORANDUM

DRAFT

TO : Warwick Smith

FROM : Susan Hodgkinson

DATE : 30 March 1995

SUBJECT : Telecom - Points of Interest

You have asked for an overview of Telecom's approach to the COT claims. I have used Alan Smith's claim as an example and if you require a similar review done of the Garms and Gillan/Valkobi claim, I can complete one.

ALAN SMITH, CAPE BRIDGEWATER HOLIDAY CAMP ("CBHC")

Documents Provided

Alan Smith's claim has been presented in a fairly haphazard manner. He has included volumes of documents and the direct relevance of all this information is difficult to ascertain. Nonetheless, Smith has gone to a lot of trouble to assemble his FOI information which, as you may be aware, was not provided in full by Telecom until 23 December 1994. To support his claim, Smith has engaged experts, including George Close and Associates (technical) and DM Ryan Accountants (financial). Smith has provided a detailed, well set out reply to Telecom's defence.

Telecom has provided a very detailed submission with the main documents including:

- Principal submission
- Legal submission (one volume of appendices)
- Technical Report (five volumes of appendices)
- Deloitte Touche Thomatsu Report (Financial Report)
- Overview document - providing background information of Telecom Australia
- Telecom Australia's Networking and Management Philosophy

Progress of Fast Track Arbitration Process

- On 21 April 1994 Smith signed his Request for Arbitration.
- On 25 July 1994, Smith lodged his claim documents.
- Delays from July 1995 to December 1994 include:
 - detailed request for further particulars by Telecom
 - an oral hearing to settle request procedures

Smith continued to "drip feed" lodgement of his claim documents based on the fact that Telecom "drip fed" his FOI request (this culminated in a complaint to the Commonwealth Ombudsman and subsequent FOI review by Telecom).

- Smiths claim was formally certified as complete in November 1994.
- On 25 November 1994, Telecom requested a two week extension to deliver their defence and this was granted.
- On 13 December 1994, Telecom delivered its defence to the Arbitrator.
- Smith has stated verbally to myself, that on 23 December 1994, he received 90 kilograms of FOI material. As his claim was "finalised" he did not have the ability to examine these documents and add to his claim.
- On 25 January 1995 Smith lodged his reply to the Telecom defence.

EXTRACTS OF TELECOM'S DEFENCE

Principle Submission

(A) Opening submission

- The total amount claimed by Smith of \$3.24 million is 11.5 times the 1988 purchase price of \$280,000 and represents 30 years of profit based upon a generous 30% return on investment.
- Claim documents submitted are in no apparent sequence or order.
- No where in the claim documents is there a statement, allegation or claim setting out the basis of any alleged legal responsibility which Telecom may have to the claimant in respect of provision of telecommunications service.
- Most of the allegations are unsubstantiated and many are not verified by statutory declaration.
- Smith has relied upon records kept in his diaries as his primary record of complaints.
- The magnitude of faults complaints reported is unsubstantiated and appears overstated.
- Of the few faults which occurred, most were trivial or short lived due to prompt rectification by Telecom.
- Those faults that did occur, many were due to misuse of telephone and associated equipment by the claimant or customers of CBHC.
- Of the 58 customers (66 by August 1991) connected to the Cape Bridgewater telephone exchange, only Smith has had a significant level of fault complaints. Is it virtually impossible that faults at this exchange can effect the claimant only.

- The actual level of faults was very much less than asserted by Smith.
- On 11 December 1992, Telecom settled all claims with Smith for the following:
 - (i) Payment - \$1,329 (paid prior to 11 December 1992)
 - (ii) Payment - \$80,000
 - (iii) 008 telephone service and \$5,000 credit towards 008 charge.
- The settlement was made ex-gratia by Telecom with express denial of liability and was reached in full and final resolution and satisfaction of all claims for compensation made against Telecom prior to 11 December 1992.
- Telecom submit that the settlement was more than adequate to compensate for the period prior to 11 December 1992 and Telecom is legally released from all the claims made by the claimant that relate to that period. Telecom therefore does not propose to comment in detail as to the claims in the pre-settlement period.
- Telecom state that the Arbitrator should exclude from consideration any of the fault complaints alleged by the claimant as having occurred prior to 11 December 1992.
- The level of service provided to the claimant was a far higher level than normally provided to Telecom customers.
- Each complaint made by the claimant was handled diligently by Telecom. Many of the Telecom's investigations lead to the conclusion that fault complaints made by the claimant were attributable by his (Smith's) mis-operation of his telephone, cordless telephone, telephone answering machine and facsimile equipment.
- The burden of proof of liability and quantum lies on the claimant. The claimant has not established liability on the part of Telecom. The claimant has not established that Telecom's relevant acts caused loss and damage.
- There are currently three other Fast Track Arbitrations presently on foot. Each claim must be considered separately from the other. Evidence in one claim is not evidence in the other.

(B) Telecom

Telecom provides an analysis of the number of services and operations, it also discusses generic relationships between customer and Telecom service obligations including the following:

- Telecom does not and has never had a duty to provide a specified level of service to an individual customer.

- There is no legal obligation or duty for Telecom to ensure that telephone services are supplied at performance standards which reasonably meet the social, industrial and commercial needs of the Australian Community (Section 3 (a) (iii) of the Telecommunications Act 1991 make this an objective only).
- Telecom does not and cannot have regard to the individual characteristics or requirements of customers unless they have an express agreement to do so. No such agreement was ever entered into between Telecom and Smith.

(C) Pre Settlement Period (prior 11 December 1992)

The network upgrade program was brought forward in the Cape Bridgewater areas in light of the volume of complaints received from the claimant.

Legal Submission

A copy of the legal submission and appendices has been provided to Mr Peter Bartlett, Counsel, Telecommunications Industry Ombudsman.

(A) Introduction

Telecom state that, at no place in the claim document does the claimant articulate, even in general terms, the nature or basis for attributing legal liability to Telecom in respect of alleged service difficulties problems and fault in the provision of Telecommunications. **No cause of action is suggested and no particulars are advanced of any such a cause.**

In the absence of the above, Telecom outlined its defence to **possible causes** of an action that may be raised by the particular allegations made by the claimant.

(B) Legal relationship between the claimant and Telecom

- These are imposed by statute (cases cited).

(C) Possible causes of action

(C.1) Breach of terms and conditions for the supply of telecommunications.

- Scrutiny of the claimants claim document does not disclose any allegation of this breach.

(C.2) Breach of statutory duty.

- Claimants claim documents do not disclose any allegation of breach of any statutory duties imposed upon Telecom.
- Various obligations were imposed upon Telecom during the relevant period including:
 - A duty to supply telecommunications services within Australia
 - Between July 1975 and June 1991, Community service obligations (see Section 6 of the 1975 Act and Section 27 of the ATC Act 1989). The 1975 Act however, provides that these obligations do not impose on Telecom a duty that is enforceable by proceedings in court. The nature of discretion conferred by S.27 of the Act 1989 will mean that it too is not legally enforceable.
 - Since July 1991, various conditions have been incorporated in Telecom's licence as a carrier which reflect its function to provide national telecommunications services and community service obligations.
- Telecom does not undertake to provide or guarantee telecommunications services will be continuously provided or be fault free (reference 3.1 (b) (i) of the BCS Tariff).
- The result is that the claimant, as with all customers, has no claim against Telecom merely by reason of the occurrence of faults in the provision of telecommunications services, or the failure to continuously provide those services.
- The obligations outlined above impose a statutory duty for which Telecom submits they are not enforceable by an individual user and do not sound in an award for damages (Section 101 of the 1975 Act, Section 30 of the ATC Act 1989 Clause 1.2.26 (b) of the SCACs or Clause 8.1 of the BCS tariff).
- Nothing in the statutory duties outlined above indicates a legislative intention that breach by Telecom can give rise to a private action for damages by the claimant (various cases cited).
- Even if the Arbitrator were to find that the duties of the type detailed above do exist, it is submitted that none of these duties have been breached by Telecom.

(C.3) Negligence

- A review of the claimants claim documents show no claim made for negligence. If negligence were to be alleged, it would be essential to specifically identify the acts or omissions said to be negligent and provide full particulars and details of the negligence including expert evidence.
- The claimant does not claim damages for loss arising out of property damage.
- Damages are claimed for pure economic loss and for what the claimant has termed "personal injury and suffering". What the claimant appears to have claimed is some form of mental stress (eg. disappointment, anxiety, grief and annoyance). This is not regarded by the law as personal injury nor is it recognised as a compensable form of psychological injury (unlike nervous shock).
- Telecom submits it does not owe a duty of care to the claimant not to cause economic loss in the provision of telecommunication services.
- Telecom is constrained by statutory obligations and the limited availability of allocatable resources where such obligations can be met. If the Arbitrator were to find Telecom can owe a duty of care to the claimant not cause economic loss, it is submitted that the nature of the damages which are claimed (ie. pure economic loss) such duty could only exist if the relationship between Telecom and the claimant were sufficiently approximate (refer various cases cited for concept of proximity)
- Even if special circumstances were found to exist sufficient to establish a duty of care by Telecom not to cause economic loss, it will still be necessary for the claimant to establish that Telecom has breach the duty of care.
- It is necessary to determine what a reasonable person would have done in response to identify risks. The necessitates consideration of the magnitude of the risk and the degree of probability of its occurrence and the difficulty and inconvenience of taking alleviating action and other conflicting responsibilities (cases cited).

(D) Immunity

- Any exposure to Telecom in respect of events which occurred between 1 July 1975 and 1 July 1989 was governed by Section 101 of the 1975 Act. It operates to prevent a person proceeding against Telecom in respect of any loss or damage suffered by reason of default, delay, error or omission whether negligent or otherwise.

- Any exposure of Telecom to liability in respect of events between 1 July 1989 and 1 July 1991 is governed by Section 30 of the ATC Act 1989. Section 30 operates to prevent a person proceeding against Telecom in relation to any loss or damage suffered because of any act or omission (whether negligent or otherwise).
- There is no equivalent provision in the 1991 Act. Accordingly, any exposure to Telecom to liability in respect of events which occurred between 1 July 1991 and 16 December 1991 was governed by Clause 1.2.26 (b) of the SCACs.
- The period between 16 December 1991 to the present is governed by Clause 8.1 of the BCS tariff.
- Clause 8.1 of the BCS tariff operates to limit or exclude Telecom's liability in respect of the provision of basic carriage service.

(E) Causation

- Telecom states the power of the Arbitrator to make a finding as to the causal link between the provision of the telecommunications services and the losses claimed is qualified in that any finding must be made on reasonable grounds. Any inference drawn from the evidence must be reasonable, and such inferences can only be made where appropriate. Telecom state that the evidence is unreasonable and inappropriate to attribute any liability to Telecom for the losses claimed.

(F) Nature of damages claimed

- Damages for mental distress are not recoverable for the kind of claim which is being made in this arbitration (cases cited).

(G) Remoteness of Damage

- The claimant could only recover damages for loss which is not too remote. It is submitted that most of the heads of damage claimed are plainly too remote, particularly, those which relate to projected profits on the proposed extension of facilities.

(H) Settlement

- On 11 December 1992, Telecom and the claimant entered into a settlement.

Deloitte Touche Thomatsu Report ("DTT")(prepared by Peter Neil Crofts)

The DTT has responded to Alan Smith's claim and has used sources of information including the Camping Association of Victoria and the IBIS Caravan Camping Park Survey.

Major differences of opinion between DTT and DM Ryan's (Smith's) Report include:

- DTT: Average occupancy of the camp should be 20%.
Smith: Average occupancy of CBHC should have been between 40% to 60%.
- DTT: The camps predominantly cater for school groups and schools was the main target group for CBHC.
Smith: Schools were not their primary target market. Schools only accounted for 47% (or is it 53%) of CBHC income.
- DTT: Schools generally prefer travelling less than three hours to camp sites and the majority of Victorian schools are within two hours of Melbourne. Cape Bridgewater is outside three hours.
Smith: Schools comparison is not relevant.
- DTT: There are approximately 300 members of the camping association of Victoria which give a broad indication of the competitors with 34 other camps in the West Coast region.
Smith: Not concerned as special purpose groups such as singles clubs, probis clubs and families were his main target market.
- DTT: reports that the operating costs industry benchmark for caravan parks is 47% of income (this would reduce Smith's claim for loss of profits).
Smith: has calculated that his camp's operating costs amount to 25% of income.
- DTT detailed average tariffs for the camping industry and has compared this to the tariffs offered by Smith from 1988 to 1994. DTT's application of the average rates over the relevant period differ to that used by Smith.

History

- CBHC was purchased in February 1988 for \$280,000 of which \$140,000 was borrowed from Moores Solicitors with the balance from the sale of Smith's family home.
- From 1988 to the date of the claim, there does not appear to be any raising of working capital for purposes of rejuvenating the camp.
- The extensions and redevelopment of which the claimant says should have occurred, if he did not have the telephone faults, would appear not to have proceeded because funding could not be obtained.

DTT concluded:

- The claimant maintained poor business records and did not seek to rely on any consistent professional financial advice.
- The CBHC is a business which had limited or no working capital to undertake the rejuvenation apparently required.
- CBHC was a business that was highly geared.
- During the period since the claimant purchased the business, the business was detrimentally affected by the change in schools funding from 1992 and a generally static or declining domestic tourism until 1993. *wrong*

Other factors:

- During the period the claimant operated the business, he also separated from his wife in or about October 1989, and girlfriend in or about 1992.
- Marital and relationship breakdowns is a further factor known to significantly effect the performance of small businesses.
- At page 14 of a document referred to as "Cape Bridgewater Part 1", Smith refers to an attendance to his property by the sheriff and a subsequent assault charge against him. These admissions leave DTT to conclude that Smith had not the ability to provide adequate working capital and proper cashflow management.

DTT'S COMMENT ON THE LOSS AS CLAIMED BY SMITH AND HOW IT WAS CALCULATED

The claim includes a request for \$2.3 million in compensation for lost profit over six years (loss of occupancy, loss of rates, loss of restaurant/tea room, additional costs of acquiring facilities, interest and borrowing costs). This amount of loss relates to approximately \$384,000 per year of operation. The sum is more than four times the average annual turnover of a small business and many times the average annual profit.

The claimant also seeks loss of capital value of \$447,000 from December 1988. This could have only arisen if the business had appreciated in capital value by an excess of 2.5 times for that period. Given that Australia was in a recession, this is unlikely.

Unless the Arbitrator can find that the following assumptions are established, there can be no basis for an award of compensation:

- (a) There was a fault which Telecom was liable.
- (b) There was a sufficient nexus between the fault for which Telecom was liable and the economic loss complained of.

- (c) Other causes of economic loss or change in financial position had been considered.
- (d) That the effect of any fault for which Telecom was liable and its consequential economic loss were constant over time.

OVERALL ASSESSMENT OF CLAIM, DEFENCE AND REPLY

Financial summary of losses and damages claimed by Smith:

	Claimed \$	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	-	300,000	
Claim for preparation costs	<u>81,650</u>	<u>-</u>	<u>114,391</u>	NB3
	<u>3,242,800</u>	<u>160,251</u>	<u>3,459,091</u>	
<u>Less Previous Settlement</u>		<u>80,000</u>		
		<u>80,251</u>		

NB1: Adjusted after Deloitte Ross Thomatsu ("DTT") reported that the increased tariff is profit and should not be reduced by variable expenses.

NB2: Grossed up because tax effect therefore, \$172,000 less tax = \$91,000 which is the cost of acquiring facilities.

NB3: Increased for ongoing costs incurred in the preparation of the claim.

Analysis of DM Ryan Prepared Financial Claim

(A) LOSS OF OCCUPANCY - \$1,596,000

- DM Ryan has tried to claim for loss of profits that would have been achieved had the renovations taken place in 1991 and the Bed numbers increased by 52, from 114 to 166. Actual bed occupancy as reported by DM Ryan ranges from 4.7% in 1988 to 13.5% in 1991.

- DTT do not accept that it is commercial practice to increase bed capacity when the present utilisation was on average 12.7%.
- The renovations were budgeted at \$208,000 which were considered to be a gross overcapitalisation given the initial purchase price was only \$280,000.

(B) REASONABLE LEVEL OF OCCUPANCY - \$1,596,000

- DMR has estimated occupancy should have been up to 60% during the period of the claim. This appears totally unreasonable to DTT given the average occupancy as cited by the Camping Association for Victoria was between 10% and 34% and the IBIS information on caravan parks state average occupancy at 27%.
- CBHC is a substantial distance from Melbourne, which makes it susceptible to increasing costs and less attractive to schools. DTT have determined that 73% of revenue comes from schools located within three hours driving distance from Portland (*this excludes 34% of revenue which DTT could not identify where the school came from*).
- A review of total Victorian schools shows that only 15.5% of schools in Victoria are located within three hours of Portland (*this ignores the South Australian school market*).
- In conclusion, DTT say it is reasonable to expect that CBHC could have an average occupancy of 20%.

(C) VARIABLE OPERATING COSTS (associated with various loss calculations)

- DM Ryan has submitted that the business operated with a variable operating costs of 25% of gross revenue.
- An analysis of the financial information by DTT shows on average, variable expenses were 53% of profit and this is consistent with an IBIS report which reports caravan parks to report variable expenses as high as 47%.

(D) LOSS OF RATES - \$409,550

- DM Ryan are of the view that tariffs charged by the business of CBHC were at a discount to that of the industry average due to telephone faults and has claimed loss of the difference between the Cape Bridgewater rate and the industry rate.
- DTT's analysis shows that the CBHC's tariffs were already 7% lower than the industry average.

- DTT do not agree that if CBHC had additional rooms, it would be more successful and could charge higher tariffs. This is based upon CBHC distance from Melbourne and the general downturn in economic conditions facing schools and other customers over the past four years.

(E) LOSS OF RESTAURANT/TEA ROOM - \$154,000

- DTT find DM Ryan's assessment of 130,000 vehicles as passing Cape Bridgewater each year as totally unrealistic. In DTT's view, the profitability of the restaurant/tea room is based on passing traffic and is unrelated to a telephone.

(F) ADDITIONAL COSTS FOR ACQUIRING FACILITIES - \$172,000

- There is no evidence that Smith could have funded such renovations.
- The renovations would have been gross over capitalisation of the business.

(G) LOSS OF CAPITAL VALUE AND BUSINESS - \$477,000

- DTT submit that it is inappropriate to claim the difference between the expected or anticipated performance and the actual performance as being due entirely to alleged telephone faults. DTT have reworked DM Ryan's claim based upon the following assumptions:

- No increase in bed numbers
- Occupancy level based at a realistic level of 20%
- Tariffs based on industry average
- Variable expenses based on current actuals
- Concluded that the claim of only \$29,452 could be assessed

(H) INTEREST AND BORROWING COSTS - \$153,790

- DTT believe that CBHC could not have generated sufficient profits to repay loan principle at a rate of \$20,000 per annum and thus reduce Smith's interest costs.

(I) LOSS OF CAPITAL GAINS ON ASSETS SOLD - \$15,060

- If there was no potential for capital gain on sale in the first place, then DTT do not believe that there is a compensable loss.

(J) CAPITAL COST OF NEW TELEPHONE SYSTEM - \$25,000

- No information has been provided as how this new telephone system will solve the communications problems.

(K) ADVERTISING COSTS - \$72,300

- In DTT's opinion, a strategy to outlay an amount equal to 136% of the prior year's revenue on advertising is not a good commercial strategy.

(L) DAMAGES FOR PERSONAL INJURY AND SUFFERING - \$300,000

- DTT were not in a position to form any opinion as to the claim for \$300,000.

(M) CLAIM PREPARATION COSTS - \$114,391

- Unable to comment as evidence to support this was not supplied.

Continued -

7 pages attached