

**REDACTED**

**PUBLIC VERSION**

**IN THE MATTER OF AN ARBITRATION UNDER CHAPTER ELEVEN OF  
THE NORTH AMERICAN FREE TRADE AGREEMENT  
AND THE UNCITRAL ARBITRATION RULES**

**BETWEEN:**

**UNITED PARCEL SERVICE OF AMERICA, INC.**

Investor

**AND**

**THE GOVERNMENT OF CANADA**

Party

**INVESTOR'S MEMORIAL  
(MERITS PHASE)**

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**PART ONE: OVERVIEW**

1. This is a case about unfair and discriminatory conduct by the Government of Canada (“Canada”), on its own and through Canada Post Corporation (“Canada Post”). Canada has allowed Canada Post to engage in unfair competition by exploiting its letter mail monopoly and other legal privileges. Canada has exempted Canada Post from ordinary customs requirements, thereby allowing Canada Post to avoid collecting millions of dollars of duties and taxes. Canada has denied basic labour rights to Canada Post’s workers and deprived Canadian publishers of their choice of distributor provider. This preferential treatment has allowed Canada Post to maintain its market share at the expense of its largely foreign-owned competitors.
2. The conduct of Canada and of Canada Post is inconsistent with the objectives of the North American Free Trade Agreement (“NAFTA”) and incompatible with the relationship between the parties which it sought to ensure. This conduct is also inconsistent with the specific obligations of NAFTA Chapters 11 and 15 that may be enforced by Investor-state arbitration.
3. A critical objective of the NAFTA is to promote **“conditions of fair competition in the free trade area”** and **“to increase substantially investment opportunities in the territories of the Parties”**. Its aim is to “present to investors the kind of hospitable climate that would insulate them from political risks or incidents of unfair treatment”.<sup>1</sup> This case will establish that the conduct of Canada and of Canada Post, rather than advancing these objectives, wholly undermines them.
4. There is no question that Canada is responsible for acts inconsistent with its obligations of national treatment, international law standards of treatment and most favored nation treatment which have harmed the Investor or its investments.<sup>2</sup>

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<sup>1</sup> *Pope & Talbot, Inc. and Government of Canada, Award on the Merits of Phase 2*, (April 10, 2001) at para. 116 (Book of Authorities at Tab 7).

<sup>2</sup> The international law of national treatment, international standards of treatment and most favored nation treatment is canvassed in Part Three of this Memorial.

5. In addition, Canada is responsible for the actions taken by Canada Post under the well-established customary international law principles of state responsibility.<sup>3</sup> Canada failed, and is failing, to ensure that Canada Post does not engage in practices that are inconsistent with Canada's obligations of national treatment, international law standards of treatment and most favored nation treatment. That failure in itself constitutes a breach of NAFTA Articles 1102, 1103 and 1105 and also constitutes a violation of Canada's duty to properly supervise and regulate Canada Post pursuant to NAFTA Articles 1502(3)(a) and 1503(2).
6. The national treatment obligation is the cornerstone of international trade and investment law. The obligation ensures that foreign traders and investors are granted an "equality of competitive opportunities" with their domestic competitors. The obligation prohibits all forms of discrimination, be they *de jure* or *de facto*, intentional or not. It also guarantees that foreigners are given the best treatment given to any domestic competitors.<sup>4</sup>
7. A large part of this claim arises out of Canada's violation of its national treatment obligation to investments of US investors in the courier market.<sup>5</sup> Canada has created two separate legal regimes in that market, one applicable to its state owned enterprise, Canada Post, the other applicable to Canada Post's largely foreign owned competitors.<sup>6</sup> As a result, Canada Post enjoys unique competitive advantages and is able to maintain market share that would otherwise have gone to its competitors, including United Parcel Service Canada Ltd. ("UPS Canada"), an investment of United Parcel Service of America, Inc. ("UPS").
8. Canada has granted Canada Post a series of legal privileges and authorized Canada Post to exploit these privileges in any manner that it sees fit. Canada has failed to take

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<sup>3</sup> The international law of state responsibility is canvassed in Chapter III of Part Three of this Memorial.

<sup>4</sup> The international law of national treatment is canvassed in Chapter V of Part Three of this Memorial.

<sup>5</sup> In this Memorial, the term courier market or courier services refers to courier and small package delivery services. See expert report of Professor Melvyn A. Fuss ("Fuss Report") at para. 47.

<sup>6</sup> Canada's two separate legal regimes for the courier market are described in Chapter V of Part Two, Section A of this Memorial.

sufficient steps to ensure that these privileges are employed in accordance with any stated policy objectives. As a result, Canada Post openly boasts that it “leverages” its monopoly and other privileges in order to gain advantages over its competitors.

9. The legal measures implemented by Canada have thus created a Canadian and international anomaly: an unregulated state-owned monopoly, engaged in unrestrained competition with the private sector, that is free to employ unique legal privileges in order to obtain competitive advantages. This system benefits only Canada Post and survives at the expense of consumers who rely on Canada Post’s letter mail monopoly and competitors in the courier market.
10. On several occasions, Canada has initiated review processes to oversee aspects of Canada Post’s operations and its use of its privileges. In all cases, Canada chose to abandon these processes once it became clear that they would not serve as a rubber stamp for maintaining the status quo in which Canada Post retains virtually complete discretion to conduct its operations as it sees fit.
11. At the time of Canada Post’s creation in 1981, Canada recognized the need for third party regulation of Canada Post’s monopoly. Yet, Canada then modified its draft legislation to eliminate such oversight. Later, in 1988, Canada created an independent advisory body, the Postal Services Review Committee (“PSRC”). When the PSRC undertook a serious review of Canada Post’s 1989 rate and service proposals and refused to approve Canada Post’s proposals without attaching conditions, Canada quickly rejected the PSRC’s report and soon thereafter disbanded the PSRC.<sup>7</sup>
12. Next, in 1995, Canada established the Canada Post Mandate Review. The Mandate Review held extensive public consultations and conducted independent research and investigations. In late 1996, the Mandate Review delivered a report which found numerous problems with Canada Post’s business conduct, in particular with the manner in which it used its Monopoly Infrastructure to provide courier services. The Mandate Review recommended that Canada Post should withdraw from competition with the

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<sup>7</sup> The facts relating to the Postal Services Review Committee are canvassed in Chapter IV of Part Two, Section A of this Memorial.

private sector outside of its core public policy responsibilities and divest itself of its subsidiary, Purolator Courier Ltd. (“Purolator”). Canada undertook to consider the findings and recommendations of the Mandate Review.

13. On April 23, 1997, Canada announced that it would ignore the findings and recommendations of its own Mandate Review. It did so, notwithstanding confidential advice that, if Canada chose to allow Canada Post to remain in courier services, it should establish a regulator to ensure fair competition. The Minister’s announcement confirmed that Canada Post was indeed authorized by Canada to exploit its legal privileges without restriction or supervision and to the detriment of its competitors. This authorization violates the provisions of the NAFTA and thus, UPS has pursued its remedies thereunder.<sup>8</sup>

***The Legal Privileges Enjoyed By Canada Post***

14. The legal privileges enjoyed by Canada Post may be classified as follows:
  - a. First, Canada Post enjoys special privileges conferred by the *Canada Post Corporation Act* (the “*CPC Act*”),<sup>9</sup> including the exclusive privilege of collecting, transmitting and delivering first class mail and addressed Ad mail (the “Postal Monopoly”), the power to prescribe rates of postage, the exclusive right to place its mailboxes in any public place without payment of any fee and rights of access to locked apartment mailboxes and post office boxes. These privileges have been accorded to Canada Post without any restriction of their benefits to the supply of services associated with the Postal Monopoly.<sup>10</sup>
  - b. Second, Canada Post has been exempted from the customs procedures applicable to other courier companies. As a result, Canada Post fails to collect duties and

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<sup>8</sup> The facts relating to the Canada Post Mandate Review are canvassed in Chapter IV(B) of Part Two of this Memorial.

<sup>9</sup> R.S.C. 1985, c. C-54.

<sup>10</sup> The Postal Monopoly and other privileges granted by the *CPC Act* are described in Chapter I(c) of Part Two of this Memorial.

- taxes that are collected by its competitors.<sup>11</sup>
- c. Third, Canada Post has been exempted from the operation of general laws relating to basic labour rights. For much of the period covered by this claim, Canada Post's Rural Route Contractors could not be unionized and all of its employees were prevented from negotiating pension benefits.<sup>12</sup>
  - d. Fourth, Canada Post has been granted the exclusive right to act as carrier for magazine publishers that benefit from a program to assist that industry.<sup>13</sup>
15. The Postal Monopoly and other privileges granted by the *CPC Act* are a form of delegated governmental authority over the supply of postal services. These privileges have enabled Canada Post to maintain a vast network for the collection, sorting, transportation and delivery of postal services. While these governmental privileges were granted to Canada Post for the purpose of supplying basic postal services, Canada Post uses this extensive network in order to compete in the courier market without fairly charging the appropriate costs to its courier services and without allowing access to this network by UPS Canada or other competitors. Canada Post provides access to this network solely to its own courier services and those supplied by Purolator without charging these services appropriately. This discriminatory leveraging of its network gives Canada Post and Purolator unfair competitive advantages. It enables them to reduce their costs in a manner that cannot be replicated by their competitors.<sup>14</sup>
16. In order to fulfill its stated policy objective of providing universal basic postal services, Canada Post should allow access to the network developed for its Postal Monopoly to

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<sup>11</sup> A description of Canada Post's exemption from customs procedures applicable to other courier companies can be found in Chapter V of Part Two of this Memorial.

<sup>12</sup> A description of Canada Post's exemption from laws relating to labour matters can be found in Chapter VI of Part Two of this Memorial.

<sup>13</sup> A description of Canada Post's exclusive right to act as a carrier for magazine publishers can be found in Chapter VII of Part Two of this Memorial.

<sup>14</sup> The Postal Monopoly and other privileges granted by the *CPC Act* are described in Chapter I(c) of Part Two of this Memorial.

any courier service supplier who could use it. Such a policy would ensure that the competitive services offered by Canada Post are fully contributing to supporting its basic postal services. Instead, Canada Post chooses to restrict access to its Monopoly Infrastructure to services that it supplies directly or through Purolator. In addition, by not properly allocating the costs of using this network to its courier services, Canada Post is able to offer these services at unfairly low prices and thereby takes business from its competitors. Users of Canada Post's basic services also suffer as a result of these practices, as they pay more for basic services (or enjoy fewer basic services) than if costs were properly allocated to courier services.

17. Examples of Canada Post's discriminatory exploitation of its Postal Monopoly and related privileges without allocation of appropriate costs include:
  - a. allowing courier products to be deposited into Canada Post's 936,000 red letter mail boxes which Canada Post has the exclusive right to place in any public place, including a public roadway, without payment of any fee or charge;
  - b. allowing pick up by Canada Post employees using Canada Post vehicles of courier products deposited in red letter mail boxes;
  - c. use of monopoly mail processing facilities to process courier products;
  - d. use of Canada Post vehicles for the purpose of moving courier products;
  - e. delivery of courier products by Canada Post letter carriers as part of their regular mail delivery function;
  - f. use of Canada Post retail outlets for the sale of courier products, including Purolator's domestic and international courier products, to the exclusion of UPS Canada's products and those of other competitors;
  - g. delivering courier products to locked apartment mail boxes, to post office boxes at retail postal outlets, and to community mail boxes, access to which, Canada Post employees have solely by reason of their delivery of letter mail;

- h. contracting directly with Purolator for the provision of letter mail airlift services so as to reduce the costs incurred by Purolator, while not permitting UPS Canada to bid competitively for such airlift services; and
  - i. allowing Purolator to sell stamps at its retail outlets while at the same time prohibiting the sale of stamps at retail outlets that sell UPS Canada products.<sup>15</sup>
- 18. Canada's preferential treatment of Canada Post with respect to customs matters includes:
  - a. treatment accorded to Canada Post under an agreement dated April 25, 1994, between Canada Post and the Canadian Department of National Revenue (the "*Postal Imports Agreement*"), through which Canada has agreed to perform services for Canada Post which other courier companies are required by law to perform for Canada;
  - b. exemption from customs laws applicable to courier companies, such as the payment of fines, penalties and interest for the improper assessment of duties and taxes or the requirement to post bonds as security; and
  - c. failing or neglecting to ensure that Canada Post charges duties and taxes to Canadian importers on courier packages imported by Canada Post through the postal system for which duties and taxes are payable.
- 19. Canada's failure to enforce its customs laws against Canada Post, while requiring strict compliance from its competitors, is also a violation of Canada's obligations under NAFTA Article 1105 to accord UPS Canada treatment in accordance with international law.
- 20. Canada has also failed to meet its international law obligations through its denial of labour rights to Canada Post's workers and its restrictions on Canadian publishers choice of distributors. These violations of Canada's NAFTA obligations have harmed UPS and its investment, UPS Canada. UPS Canada has lost customers and market share that it

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<sup>15</sup> Canada Post's discriminatory exploitation of its Postal Monopoly and related privileges are canvassed in Chapter III of Part Two of this Memorial.

would otherwise have obtained but for Canada's breaches. While the full valuation of these losses will be left for the damages phase of these proceedings, UPS has suffered harm as a result of them.<sup>16</sup>

***Canada Post's Unlawful Retaliation Against UPS***

21. Following the initiation of this arbitral claim, Canada Post chose to unlawfully retaliate against UPS by denying a contract to its investment, Fritz Starber, Inc. ("Fritz Starber"). In April 2001, before Fritz Starber was acquired by UPS, Canada Post had solicited its bid for certain freight forwarding services. Canada Post later informed Fritz Starber that its bid was competitive. However, on December 5, 2001, Canada Post informed Fritz Starber that its bid would no longer be entertained due to the fact that Fritz Starber had since been acquired by UPS and UPS had commenced this NAFTA claim.<sup>17</sup>
22. Canada Post's retaliation against UPS was a breach of Canada's obligations under NAFTA Article 1105 to accord Fritz Starber treatment in accordance with international law, including fair and equitable treatment, freedom from arbitrary or discriminatory conduct and full protection and security.<sup>18</sup>

***Canada's Self-Contradictory Defences***

23. In its *Award on Jurisdiction*, this Tribunal dismissed Canada's objection to UPS' claim that Canada violated the national treatment obligation in NAFTA Article 1102 by granting Canada Post the benefit of "allowing non monopoly products access to and the benefit of the infrastructure built to service Canada Post's monopoly products without appropriate charges being allocated to the non monopoly product".<sup>19</sup>

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<sup>16</sup> The issue of showing some loss or damage arising out of the NAFTA inconsistent action as required by NAFTA Article 1116 has been considered in the Valuation Report prepared by Howard Rosen of LECG (Rosen Report).

<sup>17</sup> The facts describing Canada Post's unlawful retaliation against UPS are canvassed in Chapter V of Part Two of this Memorial.

<sup>18</sup> Canada's failure to meet international law standards of treatment with respect to UPS Canada and Fritz Starber are described in Chapter VI(F) of Part Three of this Memorial.

<sup>19</sup> Para. 16(f) of the *Revised Amended Statement of Claim*. Canada's objections to this claim were dismissed at para. 135. See also *Award on Jurisdiction* (November 22, 2002) paras. 100-103 (Book of Authorities at Tab 48).

24. Much of Canada's *Statement of Defence* consists of a repetition of the same jurisdictional objection that this Tribunal has already dismissed. Canada essentially claims that, because its discriminatory treatment of Canada Post may also violate Canada's obligations under NAFTA Article 1502(3)(d), it is thereby excluded from obligations under NAFTA Article 1102 or other NAFTA obligations. Canada's position ignores the well-established principle of NAFTA and WTO jurisprudence that obligations under complex international trade and investment agreements are cumulative and overlapping.<sup>20</sup> Previous NAFTA tribunals have confirmed that obligations may violate both the national treatment obligation in Chapter 11 and obligations in other chapters.
25. Canada also repeatedly mischaracterizes UPS' claim. UPS does not seek to prevent Canada from maintaining a state enterprise operating in the courier market nor does it challenge Canada's maintenance of a governmental monopoly over letter mail and other services. UPS merely asks that Canada ensure that its state enterprise competes on a level playing field with other enterprises, including UPS Canada, as required by NAFTA Article 1102.
26. As Canada acknowledges in its *Statement of Defence*, "Canada Post is one of the very few Crown Corporations established by Canada that is a commercial entity operating in a competitive environment".<sup>21</sup> Having chosen to create such a commercial entity, Canada must ensure that this enterprise competes under the same rules that govern other participants in the market place.
27. Canada Post is not exempted from the national treatment provisions of NAFTA merely because it is a state enterprise. NAFTA Article 1102(2) requires Canada to accord "to investments of investors of another Party [in this case, UPS Canada] treatment no less favorable than that it accords, in like circumstances, to investments of its own investors [in this case, Canada Post] with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments". The

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<sup>20</sup> This cumulative principle is described in Part Three of this Memorial.

<sup>21</sup> *Statement of Defence* at para. 34.

definition of “investor of a Party” in NAFTA Article 1139 confirms that foreign investors are entitled to the same treatment as that accorded to state enterprise investments owned by a Party.

28. Nor does Canada’s delegation to Canada Post of governmental authority to provide basic postal services excuse Canada’s preferential treatment of Canada Post. The provision of basic postal services is undermined rather than advanced by Canada Post’s restriction of the use of its network to Canada Post’s own courier services and the granting of access to this network without proper allocation of costs. Canada’s expansion into new courier services has been accompanied by cut backs to basic postal services.
29. In addition, NAFTA Chapter 15 ensures that a delegation of governmental authority to Canada Post remains subject to the requirements of NAFTA Article 1102. Canada’s own position is that the special privileges granted to Canada Post under the *CPC Act* are intended to fulfill a critical public policy objective.<sup>22</sup> The *CPC Act*, therefore, delegates governmental authority to Canada Post. Canada is obligated by NAFTA Articles 1502(3)(a) and 1503(2) to ensure “through regulatory control, administrative supervision or other measures” that Canada Post does not use its governmental authority so as to obtain special competitive advantages.
30. Canada has also failed to provide any valid justification for its exemption of Canada Post from ordinary customs requirements. The dispute does not concern the existence of different postal and courier streams nor Canada’s right to contract for services from Canada Post. Rather, it concerns the waiver of ordinary customs requirements for one courier service provider (Canada Post) that are strictly enforced for others. This practice harms both Canadian taxpayers and UPS Canada, which incurs higher compliance costs and loses customers to Canada Post.
31. Canada could have pursued its stated policy objectives in compliance with its NAFTA obligations. Instead, it chose to ignore the recommendations of its own Mandate Review and to grant Canada Post additional discriminatory preferences and privileges. As a

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<sup>22</sup> *Statement of Defence* at para. 25.

result, it should pay compensation to NAFTA investors such as UPS that have been harmed by Canada's measures.

**PART TWO: STATEMENT OF FACTS**

32. The following statement of facts is based on the documents cited below and the following witness statements and expert reports filed with this Memorial:
- a. the statement of Alan Gershenhorn, formerly President of UPS Canada and currently President of Global Shared Services and Business Process at UPS Supply Chain Solutions, Inc., describing UPS' investment in UPS Canada and UPS Canada's business operations;
  - b. the statement of Lisa Paré, Vice-President of Brokerage at UPS Canada, regarding customs procedures;
  - c. the statement of Leslie Ross, Manager at UPS SCS, Inc., regarding the Fritz Starber incident;
  - d. the expert report of Professor Melvyn Fuss, economist, addressing the competition between Canada Post's services and those of UPS Canada;
  - e. the expert report of Dr. Kevin Neels, economist, addressing the unequal treatment granted to UPS Canada by Canada Post's exclusive and discriminatory use of its Monopoly Infrastructure to compete against UPS Canada without proper allocation of costs;
  - f. the expert report of Kenneth Dye, former Auditor General of Canada, addressing the lack of assurances in the statements by Canada Post's auditors regarding cross-subsidization;
  - g. the expert report of James Nelems, an expert in the design of controlled studies, providing evidence of Canada Post's failure to properly collect duties and taxes; and
  - h. the expert report of Howard Rosen, Chartered Business Valuator, confirming the

existence of harm to UPS as a result of Canada's NAFTA violations.

33. After describing the corporate structures and business operations of UPS and Canada Post, this Memorial will discuss the competition between the services offered by these two enterprises, the unfair advantages available to Canada Post from its ability to leverage its monopoly privileges and Canada's failure to supervise Canada Post's exploitation of its monopoly privileges. Canada's preferential treatment of Canada Post with respect to customs, labour rights and the *Publications Assistance Program* will then be summarized before reviewing Canada Post's retaliation against Fritz Starber.

## **Chapter I. THE PARTIES**

34. This claim arises out of the unfair advantages accorded by Canada to Canada Post in its direct competition with UPS Canada. UPS Canada is an investment of UPS, an investor of the United States of America. Canada Post is an investment of Canada as it is a commercially oriented state enterprise. The corporate structure and business activities of UPS and Canada Post are described below.

### **A. The Investor: UPS**

#### **1. Overview of UPS' Global Business**

35. UPS began operations in the United States of America in 1907. Originally established as a local bicycle and on-foot messenger service, UPS has grown to become the largest express carrier and package delivery company in the world. It is also a leading provider of logistics and distribution services, transportation and freight services, freight forwarding services and customs brokerage services.<sup>23</sup> Through its subsidiary, UPS Canada, UPS supplies courier services between all destinations in Canada, from Canada to the United States, and from Canada to the rest of the world.

36. UPS now operates in more than two hundred countries and territories.<sup>24</sup> It has almost 360,000 employees worldwide and maintains a delivery fleet of 88,000 motor vehicles and over 500 airplanes. On a daily basis, UPS delivers over 14 million packages within the United States, and over one million packages to the rest of the world, to approximately 8 million customers.<sup>25</sup>

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<sup>23</sup> UPS Fact Sheet (17469-17470) (Tab U317); UPS Canada Service Matrix (AA00082-AA00089 at AA00084) (Tab U291). All references to the Investor's Schedule of Documents are referred to below with the prefix U for UPS.

<sup>24</sup> UPS Fact Sheet (17469-17470) (Tab U317). See also description of UPS (Tab U181).

<sup>25</sup> UPS Fact Sheet. (17469-17470) (Tab U317). See also description of UPS (Tab U181).

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37. Yet, notwithstanding UPS' proven track record of success around the world, UPS' ability to gain market share in Canada has been stymied by the actions of the Government of Canada that are the subject of this NAFTA claim. [REDACTED]  
[REDACTED]  
[REDACTED] Canada Post's position is due, at least in part, to its unrestrained ability to leverage its monopoly and to other unfair advantages.

## **2. Corporate Organization**

38. UPS is incorporated under the laws of Delaware in the United States of America.<sup>26</sup> In 1999, UPS became a subsidiary of a publicly traded company, United Parcel Service, Inc., which is also incorporated under the laws of Delaware.<sup>27</sup>
39. UPS has several subsidiaries in the United States that are relevant to this claim because they provide services to UPS Canada, either directly or indirectly through UPS itself. To the extent that UPS Canada loses volume and revenues due to the unfair advantages granted to Canada Post, the UPS subsidiaries that provide services to UPS Canada will also lose revenues. These lost revenues also harm UPS in addition to any harm to UPS suffered through losses by UPS Canada.<sup>28</sup>
40. The relevant US subsidiaries of UPS include UPS Worldwide Forwarding, Inc., United Parcel Service Inc. (New York), United Parcel Service, Inc. (Ohio), UPS Supply Chain Solutions, Inc., and United Parcel Service Co. (collectively, "US subsidiaries").<sup>29</sup> These US subsidiaries provide freight forwarding, air and ground transportation and related

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<sup>26</sup> Certificate of Incorporation of UPS of America, Inc. dated May 9, 1930 (00604-00629) (Tab U41).

<sup>27</sup> UPS Corporate Organization Chart (12867-12885 at 12868) (Tab U18).

<sup>28</sup> See Witness Statement of Alan Gershenhorn at paras. 17 and 18.

<sup>29</sup> See UPS Corporate Structure (12867-12885) (Tab U18); Certificate of Incorporation of UPS Worldwide Forwarding, Inc. dated August 12, 1988 (00635-00639) (Tab U52); Certificate of Incorporation of United Parcel Service of New York Inc. dated June 27, 1930 (00640-00652) (Tab U42); Articles of Incorporation of United Parcel Service of Cincinnati, Inc. dated March 19, 1934; Certificate of Amendment of United Parcel Service of Cincinnati Inc. dated September 30, 1995 (20431-20432) (Tab U179). See also Witness Statement of Alan Gershenhorn at para. 18 and Assistant Secretary's Certificate (00699-00703) (Tab U275).

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services. Further details regarding the role of the US subsidiaries within the UPS network will be left for the damages quantification phase of this claim.

**B. The Investments: UPS Canada and Fritz Starber**

**1. Business Operations of UPS Canada**

41. UPS Canada was UPS' first business operation outside of the United States. It was incorporated under the laws of Ontario on September 19, 1974. The headquarters for UPS Canada are now located in Mississauga, Ontario.<sup>30</sup>
42. UPS Canada is an investment of UPS. [REDACTED] is responsible for appointing the Board of Directors of UPS Canada<sup>32</sup> and is entitled to share in its profits.<sup>33</sup> In 2002, UPS also had an inter-company loan to UPS Canada [REDACTED] [REDACTED]<sup>34</sup>
43. UPS Canada began its operations in Ontario with small package ground delivery services, offering its first pick up and delivery service in 1975.<sup>35</sup> This service consisted

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<sup>30</sup> Witness Statement of Alan Gershenhorn at para. 15. Certificate of Incorporation of United Parcel Service Canada Ltd. dated September 19, 1974 (00630-00632) (Tab U44). UPS Canada was incorporated as UPS, Ltd. before changing its name to UPS Canada. See Certificate of Amendment dated August 26, 1977 (14164-14166) (Tab U45).

<sup>31</sup> See the Response to Question 1(a) in the Investor's Answers to Canada's Reformulated Interrogatories dated October 18, 2004 (AA00285-AA00291) at Tab U 292. See Officer's Certificate of John Ferreira, dated June 16, 2004 with attachments (14285-14303) (Tab U295). See Witness Statement of Alan Gershenhorn at para. 16. . UPS holds 5000 common shares and 1,120,000 Class A preference shares.

<sup>32</sup> UPS Response to Canada's Reformulated Interrogatories (July 6, 2004), question 1(d) (AA00285--AA00291) at Tab U292. See also Witness Statement of Alan Gershenhorn at para. 16.

<sup>33</sup> UPS was entitled to share in UPS Canada's profits both as the sole shareholder and pursuant to a licence agreement. See AA00296-AA00310 (Tab U53). UPS Response to Canada's Reformulated Interrogatories (July 6, 2004), question 1(c) (AA00285-AA00291 at AA00286) (Tab U292). See Witness Statement of Alan Gershenhorn at para. 16.

<sup>34</sup> UPS Response to Canada's Reformulated Interrogatories (July 6, 2004), question 1(b) AA00285-AA0029 and AA00292-AA00295) at Tabs U250 and U292. See Witness Statement of Alan Gershenhorn at para. 16.

<sup>35</sup> See Witness Statement of Alan Gershenhorn at para. 5, 10 and 11.

entirely of scheduled day delivery within Metropolitan Toronto.<sup>36</sup> At the time, Canadian regulations limited competition by private courier companies, forcing UPS Canada to rely on private automobiles with roof racks, checker cabs and U-Hauls. Yet, UPS Canada began to overcome those barriers and, by 1977, UPS Canada had grown to 150 employees and offered services to all of southern Ontario, as well as to Montreal and the United States.<sup>37</sup>

44. Between 1987 and 1990, UPS Canada obtained operating licenses in the remaining Canadian provinces, introduced air services and extended its ground operations. Since 1990, UPS Canada has served every destination in Canada. By 2003, UPS Canada had grown to 6,700 employees in 54 facilities including retail stores and authorized shipping outlets.<sup>38</sup>

## **2. Fritz Starber**

45. Fritz Starber was the Canadian operating company and subsidiary of Fritz Companies, Inc., a global company that provided international freight forwarding services, Canadian and United States customs brokerage services, and Canadian customs consulting services.<sup>39</sup> Fritz Starber was based in Montreal, Canada and had been in operation for almost seventy-five years.
46. Fritz Companies, Inc. was acquired by a UPS affiliate on May 24, 2001. Fritz Starber and other UPS affiliates were later amalgamated to form UPS SCS, Inc. This amalgamated

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<sup>36</sup> UPS Response to Canada's Interrogatories (September 13, 2004), question 5; Schedule 4 (AA00082) (Tab U291). See Witness Statement of Alan Gershenhorn at para. 11.

<sup>37</sup> UPS Canada Story at Tab U300. See also Witness Statement of Alan Gershenhorn at paras. 11 and 12.

<sup>38</sup> UPS Canada Fact Sheet (14310-14311) (Tab U301). See also Witness Statement of Alan Gershenhorn at paras 13-15.

<sup>39</sup> Fritz Overview Presentation, updated July 2000 (02299-02307) (Tab U21). See also Witness Statement of Leslie Ross at para. 2.

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corporation is indirectly owned by UPS [REDACTED] UPS SCS, Inc. now provides the services previously offered by Fritz Starber in Canada.<sup>41</sup>

**C. Canada Post Corporation**

47. Canada Post is a state enterprise competing in the private sector and an investment of Canada. At the same time, Canada Post has also been delegated a broad range of governmental authority relating to the provision of postal services. The corporate structure and business activities of Canada Post are described below, together with a summary of the governmental authority delegated to Canada Post.

**1. Organization and Mandate**

48. Canada Post was established as a Crown Corporation in 1981 by the *CPC Act*.<sup>42</sup> As a Crown Corporation, Canada Post is owned by the Government of Canada and is “an agent of Her Majesty in right of Canada”. However, Canada Post exists outside of the administrative structure of government and is organized and operated on a commercial basis.

49. Section 16(1) of the *CPC Act* grants Canada Post all of the rights, powers, and privileges of a natural person. This section endows Canada Post with the same corporate powers as those provided to other Canadian corporations.<sup>43</sup> In this capacity, Canada Post is

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<sup>40</sup> See Witness Statement of Leslie Ross at para. 2; UPS SCS, Inc. Shareholders’ Register (19462) (Tab U337). Assistant Secretary’s Certificate [REDACTED] 6925-

<sup>41</sup> “Welcome to UPS Supply Chain Solutions in Canada”, available at <www.fritz.ca/about> (14312) (Tab U299).

<sup>42</sup> *CPC Act*, s. 4 (Tab U218).

<sup>43</sup> See e.g. *Canada Business Corporations Act*, R.S. 1985, c. C-44, s. 15 (Tab U43).

empowered to issue debt and is authorized to pay dividends.<sup>44</sup>

50. The structure of Canada Post parallels that of private corporations. Section 6(1) of the *CPC Act* establishes a board of directors appointed by the Minister responsible for Canada Post with the approval of the Governor in Council.<sup>45</sup> Section 10(1) requires the Board to direct and manage the affairs of the corporation.
51. The board of directors, with the approval of the Governor in Council on the recommendation of the Minister, is empowered to establish a share capital structure.<sup>46</sup> The Government of Canada is the sole shareholder of Canada Post.<sup>47</sup>
52. Section 5(1) of the *CPC Act* sets out the objects and mandate of the Corporation. Under its mandate, Canada Post is authorized to:
- a. establish and operate a postal service for the collection, transmission and delivery of messages, information, funds and goods, both within Canada and between Canada and places outside Canada;
  - b. manufacture and provide such products and to provide such services as are, in the opinion of the Corporation, necessary or incidental to the postal service provided by the Corporation; and
  - c. provide to or on behalf of departments and agencies of, and corporations owned, controlled or operated by, the Government of Canada or any provincial, regional or municipal government in Canada or to any person services that, in the opinion of the Corporation, are capable of being conveniently provided in the course of

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<sup>44</sup> *CPC Act*, s. 30, s.28 (Tab U218).

<sup>45</sup> *CPC Act*, s. 6 (Tab U218). The Governor in Council is effectively the Cabinet of Canada's federal government.

<sup>46</sup> *CPC Act*, s. 27(1), (2) (Tab U218); Canada Post, *Annual Report 2003* (16833-16899 at p.65) (Tab U257).

<sup>47</sup> Short term filing under s. 121 of the *Competition Act*, Notifiable Transactions (R248B-19) at Appendix A-6, p.36, 459 (Tab U59).

carrying out the other objects of the Corporation.<sup>48</sup>

53. Section 5(2) directs Canada Post to maintain “basic customary postal service”. The *CPC Act* does not provide a definition for this term. While maintaining this service, Canada Post “shall have regard to” a number of factors including “the desirability of improving and extending its products and services in light of developments in the field of communication” and “the need to conduct its operations on a self-sustaining basis”.<sup>49</sup>
54. In short, Canada Post is required to operate a “basic customary postal service” and is authorized to offer all services “necessary or incidental” to fulfilling that objective as well as any other service capable of being conveniently provided in the course of carrying out this objective. Although only “basic customary postal services” need to be provided, Canada Post is free to provide any other services that are “incidental” or capable of being “conveniently” provided.
55. Canada Post is also governed by the *Financial Administration Act* (“*FAA*”).<sup>50</sup> The *FAA* prescribes the governance framework for Crown Corporations. The *FAA* defines Canada Post as a Schedule III, Part II Crown Corporation. This designation requires Canada Post to conduct its operations on commercial terms. The Governor in Council must be satisfied that the Crown Corporation operates in a competitive environment, operates independently of government appropriations, earns a return on equity, and reasonably expects to pay dividends.<sup>51</sup> Canada Post is one of only three Crown Corporations listed under Schedule III, Part II of the *FAA*.

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<sup>48</sup> *CPC Act*, s. 5 (Tab U218).

<sup>49</sup> *CPC Act*, ss. 5(2)(a) and (b) (Tab U218).

<sup>50</sup> R.S. 1985, c. F-11 (Tab U298).

<sup>51</sup> *FAA*, s. 5(3) (Tab U298).

## 2. Special Powers and Privileges

56. The *CPC Act* also endows Canada Post with special powers and privileges. These include the exclusive privilege to provide letter mail and other special powers not ordinarily available to private corporations. Canada Post, therefore, has a hybrid character. On the one hand, it is a commercial corporation authorized to provide services that compete with the private sector. On the other hand, Canada Post has special privileges ordinarily reserved for the state. This hybrid character enables Canada Post to compete against the private sector with unique governmental powers.

### *a. Exclusive Privilege*

57. Article 14(1) of the *CPC Act* gives Canada Post the “sole and exclusive privilege of collecting, transmitting and delivering letters to the addressee thereof within Canada.”<sup>52</sup>

58. Section 15(1) enumerates nine exceptions to Canada Post’s exclusive privilege. Courier companies operate under one of these exceptions. The exclusive privilege does not apply to “letters of an urgent nature that are transmitted by a messenger for a fee at least equal to an amount that is three times the regular rate of postage payable for delivery in Canada of similarly addressed letters weighing fifty grams”.<sup>53</sup>

### *b. Other Special Powers and Privileges*

59. Pursuant to section 19 of the *CPC Act*, Parliament has also delegated to Canada Post the authority to make regulations with respect to its operations. Accordingly, Canada Post has the power to make regulations prescribing, *inter alia*, rates of postage of “mailable matter” and the definition of “letters”.<sup>54</sup> The definition of “mailable matter” in sections 2 and 19 of the *CPC Act* can be considered so broad as to include all items that can be

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<sup>52</sup> *CPC Act*, s. 14(1) (Tab U218).

<sup>53</sup> *CPC Act*, s. 15(1)(e) (Tab U218).

<sup>54</sup> *CPC Act*, s. 19(1) (Tab U218).

posted, even products outside of the Postal Monopoly.<sup>55</sup>

60. Although regulations under section 19 must be approved by Cabinet, this approval is deemed to be given within sixty days unless Cabinet has previously approved or refused to approve the regulation. This automatic approval is highly unusual for Crown Corporations. Canada Post may also prescribe rates of postage without such regulations for any person who has entered into an agreement with it for:
- a. the variation of rates of postage on the mailable matter of that person in consideration of his mailing in bulk, preparing the mailable matter in a manner that facilitates the processing thereof or receiving additional services in relation thereto; or
  - b. the provision of experimental services for any period not exceeding three years.<sup>56</sup>
61. Over time, Canada Post has sought and received approval to remove numerous rate categories from Cabinet oversight, including any rates for courier services.<sup>57</sup> Moreover, although the Minister responsible for Canada Post may require Canada Post to comply with the Minister's directives, the Minister has never exercised this power.<sup>58</sup>
62. Canada Post has other special powers and privileges. Many of these powers are set out in the *Mail Receptacles Regulations*.<sup>59</sup> For example, it is empowered to control the location and use of red letter mailboxes throughout Canada.<sup>60</sup> Canada Post has custody of keys for

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<sup>55</sup> *CPC Act*, s. 2: "mailable matter" is defined as "any message, information, funds or goods that may be transmitted by post" (Tab U218).

<sup>56</sup> *CPC Act*, ss.20(5) and 21 (Tab U218).

<sup>57</sup> General Accounting Office, *Postal Reform in Canada* (extract) at 10414 - 10415 (Tab U84).

<sup>58</sup> *CPC Act*, s. 22(1) (Tab U218).

<sup>59</sup> *Mail Receptacles Regulations*, [D14138-14151] (Tab U30).

<sup>60</sup> *Mail Receptacles Regulations*, (D14138-14151)] (Tab U30).

access to locked apartment, condominium and office complex mailboxes.<sup>61</sup> It also has custody of keys for access to locked community mailboxes. Canada has also granted Canada Post authority to provide private locked post office boxes on its premises.<sup>62</sup>

### **3. Judicial Consideration of Canada Post's Powers**

63. The scope of Canada Post's powers under the *CPC Act* has been judicially considered in four cases that are germane to this claim.<sup>63</sup> These cases demonstrate that Canada Post's authority to provide services outside of its area of exclusive privilege will be interpreted very broadly, as an exercise of delegated governmental authority. Moreover, Canada Post has substantial discretion with respect to the manner in which it chooses to fulfill its mandate.
64. Pursuant to section 23 and subsection 5(2)(e) of the *CPC Act*, Canada Post is an "agent of Her Majesty in right of Canada" and an "institution of the Government of Canada". Canadian jurisprudence has established that the actions of Canada Post will be attributed to the Government of Canada whenever such actions flow from its delegated authority. This reasoning is consistent with the Canadian law of Crown agency, which stipulates that a public corporation designated by legislation as an agent of the Crown retains this designation so long as it acts within its statutory authority.<sup>64</sup>

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<sup>61</sup> *Mail Receptacles Regulations*, s. 3. (D14138-14151) (Tab U30).

<sup>62</sup> *Mail Receptacle Regulations*, s. 10(h), Schedule IV (Para. 10(c)). (D14138-14151) (Tab U30).

<sup>63</sup> *Canadian Daily Newspaper Assn. v. Canada Post Corp.* [1995] 3 F.C. 131, [1995] F.C.J. No. 945 (T.D.) ("*Canadian Daily Newspaper*") (Book of Authorities at Tab 68); *Canadian Union of Postal Workers v. Canada Post*, [1994] F.C.J. No. 317 (T.D.), upheld on appeal, [1996] F.C.J. No. 544 (C.A.) ("*CUPW*") (Book of Authorities at Tab 69); *Rural Dignity of Canada v. Canada Post Corp.*, [1991] F.C.J. No. 33 (T.D.), upheld on appeal, (1992), 88 D.L.R. (4<sup>th</sup>) 191 (F.C.A.) ("*Rural Dignity*") (Book of Authorities at Tab 75); *Re City of Nepean and Canada Post Corp.* (1986), 57 O.R. (2d) 297 ("*City of Nepean*") (Book of Authorities at Tab 71).

<sup>64</sup> Peter Hogg, *Liability of the Crown* (Toronto: Carswell, 1989) at p. 253 (Book of Authorities at Tab 41).

a. *Canadian Daily Newspaper Assn. v. Canada Post Corp.*

65. In *Canadian Daily Newspaper*, the Federal Court of Canada broadly construed the exercise of Canada Post's delegated governmental authority to include Canada Post's activities in the delivery of non-monopoly postal services, in particular unaddressed Ad mail.<sup>65</sup> The decision demonstrates that Canada Post remains part of the government's "decision making machinery" even when it is engaging in the supply of competitive services.
66. In this case, the Canadian Daily Newspaper Association and others ("CDNA") challenged actions of Canada Post as *ultra vires* the *CPC Act* and Regulations made thereunder.<sup>66</sup> CDNA represented 82 daily newspapers in Canada which distributed unaddressed advertising flyers. Canada Post offered a similar unaddressed Ad mail service, which consisted of unsolicited, unaddressed advertising and promotional materials. Canada Post also had exclusive custody of the keys to locked apartment mailboxes. This allowed it to deliver unaddressed Ad mail directly into locked apartment mailboxes.
67. As a preliminary matter, Justice Cullen of the Federal Court considered the court's jurisdiction. He concluded that Canada Post was part of the government decision-making machinery and that its actions with respect to locked apartment mailboxes represented an exercise of authority conferred by the *Mail Receptacles Regulations*.<sup>67</sup>
68. Justice Cullen then considered whether or not Canada Post's statutory authorization was restricted to the delivery of "letters". He determined that Canada Post's exclusive access

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<sup>65</sup> *Canadian Daily Newspaper* (Book of Authorities at Tab 68).

<sup>66</sup> *Canadian Daily Newspaper* (Book of Authorities at Tab 68).

<sup>67</sup> SOR/83-743. [D14138-14151] (Tab U30) *Canadian Daily Newspaper* at paras. 12 - 16 (Book of Authorities at Tab 68).

to mailboxes could not be restricted to exclusive access for letters only.<sup>68</sup>

69. In *Canadian Daily Newspaper*, Canada Post defended its business activities with respect to Ad mail as entirely consistent with the purposes of the statutory scheme and the history of Canada Post's services.<sup>69</sup> Accordingly, Canada Post relied on the fact that it exercises delegated governmental authority in delivering competitive services in order to demonstrate that it was not acting outside the powers granted by the *CPC Act*.

*b. Canadian Union of Postal Workers v. Canada Post*

70. In *CUPW*, the Federal Court of Canada broadly construed Canada Post's exclusive privilege. Justice Mackay found section 14 of the *CPC Act* to be an empowering provision, one which did not prescribe the manner in which Canada Post's exclusive privilege may be exercised.
71. In that case, the Canadian Union of Postal Workers ("CUPW") sought a declaration that the franchising program of Canada Post was *ultra vires* section 14(1) of the *CPC Act*.<sup>70</sup> In 1986, Canada Post began a program to franchise some of its post offices to private firms. At issue was whether or not these franchising arrangements violated Canada Post's "sole and exclusive privilege to collect, transmit and deliver letters" pursuant to subsection 14(1) of the *CPC Act*.
72. Justice Mackay determined that section 14 of the *CPC Act* does not expressly or implicitly limit the capacity of Canada to contract with others in the performance of its exclusive privilege to collect, transmit, and deliver letters. He held that the *CPC Act* granted Canada Post "broad powers" to exercise its exclusive privilege in the manner that

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<sup>68</sup> *Canadian Daily Newspaper* (Book of Authorities at Tab 68).

<sup>69</sup> *Canadian Daily Newspaper* (Book of Authorities at Tab 68).

<sup>70</sup> *CUPW* (Book of Authorities at Tab 69).

it saw fit.<sup>71</sup> Accordingly, the program to franchise post offices did not violate Canada Post's exclusive privilege under the *CPC Act*.

*c. Re City of Nepean and Canada Post Corp.*

73. In *City of Nepean*, the Ontario High Court of Justice confirmed that Canada Post has broad discretion with respect to the operation of its Postal Monopoly and that Canada Post is free to decide for itself how it will supply basic customary postal services.
74. In that case, the City of Nepean challenged Canada Post's decision to replace door-to-door delivery service with service to community mail boxes as inconsistent with Canada Post's obligations under section 5(2) of the *CPC Act*.<sup>72</sup> In 1985, Canada Post adopted a national delivery policy, which provided that door-to-door delivery would not be extended beyond existing routes. The new communities to which this policy applied would be serviced by community mailboxes.
75. The City of Nepean submitted that Canada Post was mandated to maintain "basic customary postal service", which entailed door-to-door mail delivery. It also contended that Canada Post's obligation to conduct its operations on a self-sustaining financial basis was subject to two positive duties: to provide a standard of service that will meet the needs of the people of Canada and that is similar with respect to communities of the same size.<sup>73</sup>
76. Justice Maloney rejected the argument that Canada Post had a positive duty to perform any of the objectives listed in section 5(2) of the *CPC Act*. He determined that the obligation to maintain "basic customary postal service" in section 5(2)(b) of the *CPC Act*

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<sup>71</sup> *CUPW* (Book of Authorities at Tab 69).

<sup>72</sup> *City of Nepean* at 1 (Book of Authorities at Tab 71).

<sup>73</sup> *City of Nepean* at 3 (Book of Authorities at Tab 71).

did not include a duty to provide door-to-door mail delivery services.<sup>74</sup>

*d. Rural Dignity of Canada v. Canada Post Corp.*

77. The *City of Nepean* decision was followed in *Rural Dignity*. In *Rural Dignity*, Canada Post closed post offices in four rural communities and replaced them with retail outlets. The applicants challenged Canada Post's decision as a violation of section 5(2) of the *CPC Act* and its statutory duty to maintain "basic customary postal service".<sup>75</sup>
78. As a preliminary matter, Martin J. considered the court's jurisdiction. He concluded that Canada Post was part of the government decision-making machinery and, therefore, its actions were reviewable by a federal court. Then, relying on the authority of *City of Nepean*, Martin J. concluded that section 5(2) of the *CPC Act* did not impose a duty to provide a local post office in each community.<sup>76</sup> This decision was affirmed by the Federal Court of Appeal.
79. Both *City of Nepean* and *Rural Dignity* confirm that Canada Post's delegated governmental authority includes a large sphere of discretion, which permits it to determine the manner in which it fulfills its mandate. These cases contradict Canada's extensive reliance in its *Statement of Defence* on the purported burden on Canada Post to maintain basic customary postal services. They demonstrate that Canada Post has been left free to reduce the scope of these services while it pursues its aggressive expansion in the courier market.

**4. The Universal Service Obligation ("USO")**

80. Canada's *Statement of Defence* relies on Canada Post's alleged Universal Service

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<sup>74</sup> *City of Nepean* at 3 (Book of Authorities at Tab 71).

<sup>75</sup> *Rural Dignity* at 14 (Book of Authorities at Tab 75).

<sup>76</sup> *Rural Dignity* at pages 14-17 (Book of Authorities at Tab 75).

Obligation (“USO”) to justify Canada’s special treatment of Canada Post.<sup>77</sup> Yet, the *CPC Act* does not even define Canada Post’s USO and leaves the fulfillment of this purported obligation to Canada Post’s discretion. While Canada claims that the USO is also a treaty obligation, there is no definition of the USO in the treaty upon which Canada relies. The treaty only calls upon member states to adopt their own definitions of the USO, an obligation that Canada has failed to fulfill.

*a. The Universal Postal Union*

81. In 1999, the Universal Postal Union (“UPU”), the United Nations body responsible for postal services, adopted the *Universal Postal Convention*, which came into force for all its member countries on January 1, 2001. The UPU refers to what Canada describes as the Universal Service Obligation as Universal Postal Service. These terms are interchangeable. Article 1(1) of the *Universal Postal Convention* defines Universal Postal Service as “the permanent provision of quality basic postal services at all points in ... [a country’s] territory, at affordable prices.”

82. The UPU does not define the USO further, leaving it to individual members to specifically define their own USO. Article 1(2), therefore, states:

With this aim in view, member countries shall set forth, within the framework of their national postal legislation or by other customary means, the scope of the postal services offered and the requirement for quality and affordable prices, taking into account both the needs of the population and their national conditions.<sup>78</sup>

83. Objective 1 of Part 1 of the UPU’s strategic document for 2000 - 2004 also reflects this understanding of the USO, as does a memorandum issued by the UPU in 2002. The memorandum states that “[t]he concept of a Universal Postal Service should at all times

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<sup>77</sup> *Statement of Defence* at paras. 25-33.

<sup>78</sup> Universal Postal Union, *Memorandum on Universal Postal Service Obligations and Standards*, December 1, 2002, at page 10. (14323-14417) (Tab U185).

be governed by the national regulations.”<sup>79</sup>

84. The only international obligation on UPU member countries is to adopt a definition that satisfies the general requirement of “permanent provision of quality basic postal services at all points in their territory, at affordable prices.” Yet, Canada has failed to fulfill even this simple obligation.

*b. Canada’s Failure to Provide a Definition of the USO*

85. In response to UPS’ request to describe “all treaties, legislative, regulatory or ministerial directive or instrument upon which Canada relies to define” the USO, [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

86. [REDACTED]  
[REDACTED]  
[REDACTED]

87. [REDACTED]  
[REDACTED]  
[REDACTED]

[REDACTED] [REDACTED]

[REDACTED] [REDACTED]

<sup>79</sup> Universal Postal Union, *Memorandum on Universal Postal Service Obligations and Standards*, December 1, 2002, at p. 10 - 15 and 45. (14323-14417) (Tab U185).

<sup>80</sup> Canada’s Interrogatory answers to Investor’s Information Request to Canada, question 257 (AA00404-A00468) (Tab U290).

[REDACTED]

[REDACTED]

88. Canada provides no explanation for how it extracts its definition of the USO from section 5 of the *CPC Act*. The section neither provides the level of obligation nor the content of those obligations that Canada seeks to ascribe to it. Section 5(1) lists Canada Post’s “objects” and section 5(2) lists matters Canada Post “shall have regard to.” Neither “objects” nor “matters to have regard to” are obligations and, therefore, cannot inform a Universal Service Obligation.
89. Section 5, therefore, does not tell Canadians what Canada Post *will* do. The section merely repeats Canada’s obligation in the *Universal Postal Convention* to provide “quality basic postal services at all points in their territory, at affordable prices.” The section fails to fulfill the UPU’s direction to member states to specifically define the obligations they undertake so that people understand the service they can expect from their postal service.
90. Canadian courts have reached the same conclusion. In *City of Nepean*,<sup>81</sup> discussed above, the Ontario High Court accepted Canada Post’s argument that there is nothing in Section 5 of the *CPC Act* that imposes an obligation on Canada Post. The decision was subsequently supported in *Rural Dignity of Canada*,<sup>82</sup> also discussed above.
91. After both Canada Post and Canada’s courts relied on a narrow interpretation of the *CPC Act*’s reference to basic customary postal services to excuse Canada Post’s failure to provide such services, Canada now seeks to rely on a broad interpretation of the same

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<sup>81</sup> *City of Nepean and Canada Post Corporation*, 57 OR (2d) 297, [1986] OJ No. 1301, 32 DLR (4<sup>th</sup>) 765 (Book of Authorities at Tab 71).

<sup>82</sup> *Rural Dignity of Canada v. Canada Post Corporation* [1991] FCJ No. 33, 40 FTR 255, 78 DLR (4<sup>th</sup>) 211, affirmed at [1992] FCJ No. 28 (F.C.A.) (Book of Authorities at Tab 75).

provisions in the *CPC Act* to excuse its breaches of the NAFTA.

## **5. History of Canada Post**

92. Canada Post performs a traditional governmental function and is the successor to a governmental department. The replacement of this department by a Crown Corporation does not change the governmental nature of that corporation's powers. The history of Canada Post confirms that it exercises delegated governmental authority.
93. On December 21, 1867, shortly after Canada's Confederation, the Post Office was created as a department of the federal government.<sup>83</sup> In this capacity, the Post Office Department ("POD") bore the same formal relationship to Parliament as other federal departments, and held the same formal place in Cabinet.<sup>84</sup> The POD was headed by a minister, the postmaster general, who was a member of Cabinet. Its purpose, authority, and responsibilities were set out in the *Post Office Act of 1867*.<sup>85</sup>
94. The *Post Office Act* gave the POD authority to, *inter alia*, open and close post offices, make postal regulations, and set rates of postage. It also established the principle of the POD's exclusive privilege.<sup>86</sup>
95. In 1981, the *CPC Act* transferred to Canada Post power and authority for postal services, which included the responsibilities previously assigned to the POD. The POD's adaptation into a Crown Corporation marked the first time that a government department had been transformed into a Crown Corporation.<sup>87</sup> This transformation did not alter the

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<sup>83</sup> Canada Post Newsroom - Information fillers (16969-16970) (Tab U314).

<sup>84</sup> Robert M. Campbell, *The Politics of the Post* (Peterborough: Broadview Press Ltd., 1994) at 50 (Book of Authorities at Tab 64).

<sup>85</sup> *Post Office Act (The)*, 1867, S.C. 1867, c. 10.

<sup>86</sup> Campbell, *The Politics of the Post* at 50 (Book of Authorities at Tab 64).

<sup>87</sup> Campbell, *The Politics of the Post* at 192, 196 (Book of Authorities at Tab 64).

fact that Canada Post continues the governmental responsibilities of the POD.

96. Canada Post's responsibilities under the *CPC Act* are similar to those of the POD under the *Post Office Act*. The *CPC Act* reproduced the general requirement to collect, process, and deliver the mail under analogous legal conditions and definitions. Canada Post maintained its exclusive privilege over first class mail.<sup>88</sup> Similarly, Canada Post was empowered to open and close post offices, make postal regulations, and set rates of postage.<sup>89</sup>

## **6. Business Operations**

97. At the time of its creation as a Crown Corporation, Canada Post was one of Canada's largest companies. The POD was Canada's largest department and Canada Post became its largest Crown Corporation.<sup>90</sup> In 1981, it had fixed assets of \$1.5 billion, 29 sorting plants, 3,500 vehicles, 22,000 owned properties, 1,100 leased properties and 62,000 employees.<sup>91</sup>
98. Since its designation as a Crown Corporation, Canada Post has expanded significantly. In 2003, Canada Post had revenues of \$6.3 billion and assets worth over \$4.5 billion.<sup>92</sup> Canada Post remains one of Canada's largest corporations.<sup>93</sup>
99. In 2003, Canada Post delivered 10 billion messages and parcels to 32 million individuals and over one million companies and public institutions in Canada. With more than

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<sup>88</sup> Campbell, *The Politics of the Post* at 60 (Book of Authorities at Tab U64).

<sup>89</sup> *CPC Act*, s. 19 (Tab U218).

<sup>90</sup> D. K. Adie, *The Mail Monopoly* (Canada: The Fraser Institute, 1990) at 1.

<sup>91</sup> Campbell, *The Politics of the Post* at 201 (Book of Authorities at Tab 64).

<sup>92</sup> Canada Post, *Annual Report 2003* at p. 59 (16833-16899) (Tab U257).

<sup>93</sup> Canada Post's Submissions to Postal Mandate Review, *Ensuring Universal Service at Affordable Rates*, (February 15, 1996) (D5091-5145 at 5112).(Tab U75).

70,000 full and part-time employees, it is the seventh largest employer in Canada. Canada Post also offers annual procurement contracts for goods and services exceeding \$2.8 billion.<sup>94</sup>

100. Canada Post has the most extensive retail and delivery network in Canada. In 2003, Canada Post had 23,765 retail points of access for its customers.<sup>95</sup> It has twenty-three major processing plants, and approximately 7,000 full-service outlets.<sup>96</sup> Canada Post processed items for delivery to more than 14 million addresses.<sup>97</sup> It is the largest user of transportation services in the country.<sup>98</sup>
101. Canada Post offers and delivers a number of products and services through this network. These services fall into five major categories:
- a. Communications;
  - b. Advertising;
  - c. Physical Distribution;
  - d. Publications; and
  - e. Other.<sup>99</sup>

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<sup>94</sup> Canada Post, *Annual Report 2003* (16833-16899 at 16835) (Tab U257). See also (Tab U277)

<sup>95</sup> Canada Post, *Annual Report 2003* (16833-16899 at 21, 73) (Tab U257).

<sup>96</sup> Canada Post, *Annual Report 2003* (16833-16899 at 21) (Tab U257).

<sup>97</sup> Canada Post, *Annual Report 2003* (16833-16899 at 16835) (Tab U257).

<sup>98</sup> Canada Post's Submissions to Postal Mandate Review, *Ensuring Universal Service at Affordable Rates*, (February 15, 1996) (D5091-5145 at 5112).(Tab U75).

<sup>99</sup> Canada Post, *Annual Report 2003* (16833-16899) (Tab U257).

102. Communications services are comprised of Canada Post's traditional sources of revenue, such as letter mail and Registered mail. Advertising services are primarily made up of Addressed Ad mail, Dimensional Addressed Ad mail, and Unaddressed Ad mail. Physical Distribution services offer delivery of letters and parcels for different rates, depending on the required delivery time. Publications mail services encompass the delivery of newspapers, magazines, and newsletters. Finally, Other services include products such as money orders, postal box rentals, mail redirection services, retail products, and non-postage fees.
103. Only Communications services (letter mail) and Advertising services (Addressed Ad mail) fall under the Postal Monopoly. The other two main categories - namely, Publications and Physical Distribution services - represent services in which Canada Post is in direct competition with private sector corporations.
104. As discussed in greater detail in Chapter II of this Part of the Memorial, Canada Post offers the following Physical Distribution services that compete with UPS Canada:

- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]

105. [Redacted]

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<sup>100</sup> Xpresspost includes Xpresspost - USA and Xpresspost - International.

<sup>101</sup> Expedited Parcel includes Expedited Parcel - USA.

<sup>102</sup> Campbell, *The Politics of the Post* at 141 (Book of Authorities at Tab 64).

[REDACTED]

106. [REDACTED]

107. [REDACTED]

**7. Purolator Courier Ltd.**

108. Canada Post also competes in the courier market through the operations of its subsidiary, Purolator. Canada Post sells courier services through Purolator as well as selling directly the Purolator Overnight and Purolator International brands as a sales agent for Purolator.<sup>109</sup>

109. Canada Post acquired 75 per cent of the shares of Purolator from Onex Corporation in

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<sup>103</sup> Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 71 (AA00404-AA00468 at AA00419) (Tab U290).

<sup>104</sup> Canada Post, *Annual Report 2003* (16833-16899 at 16847) (Tab U257).

<sup>105</sup> Product Specifications for Xpresspost (R69A-1 at page 7) (Tab U81).

<sup>106</sup> Distribution Services Customer Guide dated July 1998 (P69A-3) (Tab U110); Canada Post, *Annual Report 2003* (16833-16899 at 16847) (Tab U257).

<sup>107</sup> Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 97(c) (AA00404-AA00468 at AA00425) (Tab U290).

<sup>108</sup> Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 71 (AA00404-AA00468 at AA00419) (Tab U290).

<sup>109</sup> Sales Agency Agreement for Purolator International (R107-2) (Tab U166); Canada Post began selling Purolator International in June 2000 and Prepaid Purolator Overnight in the fall 2001, see Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 120 (AA00404-AA00468 at AA00430) (Tab U290).

1993.<sup>110</sup> Under the ownership of Canada Post, Purolator has expanded its transportation facilities to include over 5,300 vehicles and over 700 chartered aircraft and aircraft support equipment.<sup>111</sup>

110. In 1998, Canada Post increased its ownership of Purolator to 95.6 per cent. Today, Canada Post, directly and indirectly through a wholly owned subsidiary, owns 94 per cent of Purolator.<sup>112</sup>

111. Purolator is Canada's largest courier service. According to Canada Post's most recent Annual Report, Purolator is Canada's leading overnight courier company, providing delivery to more communities in Canada than any other courier.<sup>113</sup> In 2003, Purolator posted revenues of \$1.08 billion. It delivers approximately 275 million courier packages annually through 143 operations locations, and employs over 13,000 individuals in Canada.<sup>114</sup>

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<sup>110</sup> *Statement of Defence* at para. 41; Decision re: Proposed Acquisition of 75% of Purolator Courier Inc. by Canada Post Corporation dated November 26, 1993 (R248A-1) (Tab U61); Backgrounder Canada Post Corporation/Purolator Courier Inc. dated November 26, 1993 (P248A-3). (Tab U60).

<sup>111</sup> Purolator Facts and Figures (16900-16901) (Tab U313).

<sup>112</sup> *Purolator Facts and Figures* (16900-16901) (Tab U313).

<sup>113</sup> Canada Post, *Annual Report* 2003 (16833-16899) (Tab U257).

<sup>114</sup> *Purolator Facts and Figures* (16900-16901) (Tab U313).

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**Chapter II. CANADA POST'S COMPETITION WITH UPS CANADA**

112. Canada Post, through its own courier services and through its ownership of Purolator, competes directly with UPS Canada. For every UPS Canada courier service, there is at least one competing Canada Post and/or Purolator service. [REDACTED]

[REDACTED]

**A. The Canadian Courier Market**

113. Couriers deliver documents, parcels, and packages to addresses in Canada, the United States, and the rest of the world. The Canadian courier market is characterized by a small number of large companies.<sup>115</sup> The main competitors are the same for most of the market segments: Canada Post (including Purolator), FedEx, UPS Canada, DHL,<sup>116</sup> and Canpar. Only the smallest of these main competitors, Canpar, is owned by Canadian investors.<sup>117</sup>

114. In Canada, couriers generated delivery revenues of approximately \$3.7 billion in 2002.<sup>118</sup>

[REDACTED]

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<sup>115</sup> Fuss Report at para. 50.

<sup>116</sup> See Deutsche Post *World Net Annual Report 2003* at 20 and 53; DHL acquired Loomis in 2003. (Tab U374).

<sup>117</sup> FedEx, UPS, and DHL are all foreign-owned companies. See Certificate of Incorporation of UPS of America, Inc. dated May 9, 1930 (00604-00629) (Tab U41); See also FedEx *Annual Report 2003* at 5 and 30 (Tab 48); See also Deutsche Post *World Net Annual Report 2003* at 12, 17 and 116 (Tab 374).

<sup>118</sup> Fuss Report at para. 47. Since 1998, the annual revenue and volume shares for all major competitors have been within one or two percentage points of their 2002 values. See Fuss Report at para. 55.

<sup>119</sup> [REDACTED]

[REDACTED]

115. In contrast, the total market share for each of the main competitors, by revenues or by volume, was a fraction of Canada Post's. [REDACTED]

[REDACTED]

116. Courier services in Canada fall into three geographical categories: Domestic, United States and International. Domestic deliveries are the largest segment of the courier market. [REDACTED]

[REDACTED]

117. As was the case with the total courier market, the market share for each of the main competitors with respect to the domestic delivery segment was a fraction of Canada Post's. [REDACTED]

[REDACTED]

118. The other two delivery categories - United States and International - represent a smaller market share for Canada Post, but a larger one for its competitors. [REDACTED]

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<sup>120</sup> Fuss Report at para. 51.

<sup>121</sup> Fuss Report, Table 4: [REDACTED] at 23.

<sup>122</sup> Fuss Report at para 52.

<sup>123</sup> [REDACTED]

<sup>124</sup> Fuss Report at footnote 32.

<sup>125</sup> Fuss Report, Table 4: [REDACTED] at 23.

[REDACTED]

**B. Economic Analysis of Competitive Services**

119. UPS has provided an expert report with respect to whether UPS Canada and Canada Post are in the same economic sector. Professor Melvyn A. Fuss, a Professor of Economics at the University of Toronto, authored this expert report. Professor Fuss has extensive consulting experience in the areas of postal services and competition matters.

120. In order to assess whether or not UPS Canada and Canada Post are in the same economic sector, Professor Fuss considered whether they provide directly competing services and whether they are sufficiently close competitors that any benefits enjoyed by Canada Post could harm UPS Canada. Professor Fuss concluded that UPS Canada and Canada Post are direct and close competitors.<sup>127</sup>

121. Professor Fuss employed two criteria to determine whether or not UPS Canada and Canada Post are direct competitors. First, he considered whether the services of UPS Canada and Canada Post are functionally interchangeable. Functional interchangeability takes into account the properties, nature, and quality of the services, their end uses, and consumers' tastes and habits. Accordingly, he considered the service features and attributes of the services, the internal strategic and marketing documents of each company, and third party reports and analyses.<sup>128</sup> [REDACTED]

<sup>126</sup> Fuss Report, Table 4: [REDACTED] at 23 - 24.

<sup>127</sup> Fuss Report at para 10.

<sup>128</sup> Fuss Report at paras 11 -12.

122. Professor Fuss used his functional interchangeability analysis and his review of company documents to infer substitutability of services.<sup>129</sup> The criteria he used to assess substitutability are similar to those adopted by Canadian, American and European competition authorities. They are also consistent with the approach employed by GATT/WTO panels, which examines factors such as physical characteristics and common end uses.<sup>130</sup>

123. Many of the service features of products offered by UPS Canada, Canada Post's Physical Distribution division and Purolator are identical or very similar<sup>131</sup>. [REDACTED]

[REDACTED]

[REDACTED]

As a result, Professor Fuss considers that UPS Canada and Canada Post are in the same economic sector and that advantages accorded to Canada Post may harm UPS Canada.

**C. Canada Post Services Which Compete Against UPS Canada**

124. Canada Post and Purolator compete directly with UPS Canada in the Canadian courier market. Professor Fuss found a competing Canada Post or Purolator service for every UPS Canada service. Canada Post, Purolator, and UPS Canada compete directly with respect to domestic courier services, courier services to the United States and courier services to other countries.

**1. Domestic Courier Services**

125. UPS Expedited and UPS Standard provide delivery between Canadian addresses by the second day or later. [REDACTED]

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<sup>129</sup> Fuss Report at paras 57 - 60.

<sup>130</sup> Fuss Report at para 63. *Japan - Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, October 4, 1996 (Book of Authorities at Tab 79).

<sup>131</sup> These service features are discussed in this Part of the Memorial.

[REDACTED]

[REDACTED]

127. UPS Express Saver and UPS Express provide delivery between Canadian addresses by the next day. [REDACTED]

**2. Courier Services to and from the United States**

128. UPS Standard, and UPS 3-Day Select compete with [REDACTED]. All of these services offer second day or later delivery to the United States. UPS Express, which provides next day delivery to the United States, [REDACTED].

129. UPS Canada, Canada Post and Purolator also compete in deliveries from the United States to Canada (“import services”). Canada Post completes delivery of many courier services offered by the United States Postal Service (“USPS”). These jointly produced USPS/Canada Post services compete with services offered in the United States by UPS/UPS Canada. [REDACTED]

<sup>132</sup> Fuss Report at para. 203.

<sup>133</sup> Fuss Report at Table 2: [REDACTED] at 15.

<sup>134</sup> Fuss Report at para 166.

<sup>135</sup> Fuss Report at para 166.

<sup>136</sup> Fuss Report at para 233 - 234.

[REDACTED]

**3. Courier Services to Other Countries**

130. UPS Worldwide Express competes directly [REDACTED]  
[REDACTED] UPS Worldwide Expedited competes directly  
[REDACTED] These courier services share most  
service features in common and very close delivery times. They provide delivery from  
Canada to countries other than the United States. Table 1 summarizes Professor Fuss'  
conclusions on direct competition.<sup>139</sup>

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<sup>137</sup> *UPS and USPS Product Comparison*, February 2004 (19487 - 19536) (Tab U270).

<sup>138</sup> Fuss Report at para. 244.

<sup>139</sup> Fuss Report at Table 1: Directly Competing Products at 11.

*Table 1 – Directly Competing Products*

UPS Service	UPS Distribution Revenues 1997-2002 <sup>140</sup>		Competing CPC Services	
	(\$000,000)	(%)	Canada Post	Purolator
<b>Domestic</b>				
UPS Standard	[REDACTED]	[REDACTED]	[REDACTED] [REDACTED]	[REDACTED]
UPS Expedited	[REDACTED]	[REDACTED]	[REDACTED]	
UPS Express Saver	[REDACTED]	[REDACTED]	[REDACTED] [REDACTED]	[REDACTED] [REDACTED]
UPS Express	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
UPS Express Early A.M.	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED] [REDACTED]
<b>To the US</b>				
UPS Standard	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
UPS Expedited	[REDACTED]	[REDACTED]		
UPS 3 Day Select			[REDACTED]	[REDACTED]
UPS Express	[REDACTED]	[REDACTED]	[REDACTED] [REDACTED]	[REDACTED]
UPS Express Early A.M.	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
<b>To Other International Locations</b>				
UPS Worldwide Express	[REDACTED]	[REDACTED]	[REDACTED] [REDACTED]	[REDACTED]
UPS Worldwide Express Plus			[REDACTED]	[REDACTED]
UPS Worldwide Expedited	[REDACTED]	[REDACTED]	[REDACTED] [REDACTED]	

\* Purolator Overnight and Purolator International are services provided by Canada Post as agent for Purolator.

\*\* Percentage of UPS Canada revenues not including Brokerage, Document Exchange or Sonic Air.

<sup>140</sup> UPS Response to Interrogatories, Schedule 4, Response to Canada Questions 4, 5, 6 (AA00082-AA00089), (Tab U291).

**4. Service Features**

131. Canada Post, Purolator, and UPS Canada offer shippers a variety of service options. For example, each company provides services that guarantee delivery by noon the next day and offers at least one service that, for a lower rate, guarantees delivery by the second day between many of the same addresses.<sup>141</sup>

132. Delivery time is only one service feature that differentiates competing courier services. Professor Fuss identified several primary service options for his functional interchangeability analysis. These features include: tendering of shipments; delivery guarantee; tracking capability; delivery confirmation; and signature option. He also considered secondary service features such as insurance options, COD availability and Saturday delivery.

133. Professor Fuss concluded that Canada Post, Purolator, and UPS Canada were direct competitors in each market segment. For many major urban centres, the delivery times for Canada Post and Purolator services exactly match the delivery times for UPS Canada services.

134. Canada Post, Purolator, and UPS Canada services have most other important primary features in common. Professor Fuss found that these similarities indicated that Canada Post, Purolator, and UPS Canada services are functionally interchangeable. [REDACTED]

[REDACTED]

**5. Documents Produced by the Parties**

135. [REDACTED]

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<sup>141</sup> Fuss Report at para. 10.

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

136. [Redacted]

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<sup>142</sup> See, for example, *1999/ 2000 Rate Change - Domestic - Management Executive Committee Presentation, May 11, 1999* (R69B-20) (Tab U129); *2000/ 2001 Rate Change - Operations Committee Presentation, February 5, 2000* (R69B-27) (Tab U144).

<sup>143</sup> *2001 2002 Rate Change - Operations Committee Presentation, May 14, 2001* (R69B-38) (Tab U200); *2002/ 2003 Rate Change - Board of Directors Memorandum & Presentation, May 30, 2002* (R69B-63) (Tab U245).

<sup>144</sup> See for example, *2002/ 2003 Rate Change - Board of Directors Memorandum & Presentation, May 30, 2002* (R69B-63) (Tab U245); *2000/ 2001 Rate Change - Board of Directors Memorandum & Presentation, May 14, 2001* (R69B-62) (Tab U206).

<sup>145</sup> *1999/ 2000 Rate Change - Domestic - Management Executive Committee Presentation, May 11, 1999* (R69B-20) (Tab U129); *2000/ 2001 Rate Change - Operations Committee Presentation, February 5, 2000* (R69B-27) (Tab U144).

<sup>146</sup> *2002 Business Plan* ( 13187) (Tab U235).

<sup>147</sup> *1997 Business Plan - Market Section - Competitive Analysis, 1997,*( 11432-11540) (Tab U83). See, for example, *UPS Marketing* (06719-06739) (Tab U381); *UPS Business Plan 1997, Market Section* (11432-11540); *Analysis by Market Sector 1997* (17005-17015) (Tab U385); *UPS Business Plan 2000* (13185) (Tab U388).

**Chapter III. CANADA POST'S DISCRIMINATORY USE OF ITS MONOPOLY  
INFRASTRUCTURE**

137. Canada Post has developed a network to enable it to perform its monopoly letter mail service as well as to supply competitive services. As explained in the expert report of Dr. Kevin Neels, “the extent and density” of this “complex network of offices, retail outlets, processing centres, and transportation routes and services ... largely result from the substantial volumes of monopoly letter mail that Canada Post alone is permitted to process and deliver.”<sup>148</sup> Thus, the extensive network that Canada Post’s privileges have enabled it to develop and maintain is referred to below as Canada Post’s “Monopoly Infrastructure.”
138. Canada has delegated to Canada Post complete discretion to control access to the Monopoly Infrastructure and the terms on which it gives that access. Canada Post has used that discretion to give exclusive access to its own courier services, including those supplied by Purolator. Canada Post provides this access to its courier services on terms that do not reflect the prices that competitors would be willing to pay. As a result, Canada Post uses its Monopoly Infrastructure to provide its own courier services with an unfair competitive advantage.
139. Canada has sought to justify Canada Post’s decision to give exclusive access to the Monopoly Infrastructure to its courier services as necessary to the pursuit of Canada Post’s Universal Service Obligation (“USO”). Although Canada has failed to precisely define the nature and the scope of the USO, UPS accepts that Canada Post is authorized by Canada to pursue some form of universal service for “basic customary postal services”. However, Canada Post’s exclusive use of its Monopoly Infrastructure undermines rather than advances the fulfillment of the USO. If Canada Post took this objective seriously, it would seek to maximize the contribution of any courier services to the maintenance of its Monopoly Infrastructure, including services offered by others. Instead, Canada Post makes this infrastructure available to its Physical Distribution

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<sup>148</sup> Neels Report at para 29.

services and to Purolator at costs that are below what competitors would pay for these benefits.

140.

[REDACTED]

By performing this Annual Cost Study, Canada Post is able to declare that it is not “cross-subsidizing”. Furthermore, this Annual Cost Study is not subjected to any outside scrutiny and suffers from serious flaws.

**A. Canada Post’s Monopoly Infrastructure**

141. Canada Post’s Monopoly Infrastructure supports the “four basic functions or stages of processing required for mail and courier services:”<sup>149</sup>

a. Collection

- i. Canada Post has regulatory authority to install mail boxes in any public place.<sup>150</sup> There are approximately 950,000 such boxes across Canada.<sup>151</sup>
- ii. Canada Post has approximately 7,000 full-service retail outlets and approximately 17,000 stamp shops (often located in pharmacies) in Canada.<sup>152</sup>

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<sup>149</sup> Neels Report at para. 34.

<sup>150</sup> *Mail Receptacles Regulations* s. 3 [SOR 83-743] says Canada Post has the authority to “install, erect or relocate or cause to be installed, erected or relocated in any public place, including a public roadway, any receptacle or device to be used for the collection, delivery or storage of mail.” D14138-14151 (Tab U30).

<sup>151</sup> *Statement of Defence* at para. 19.

<sup>152</sup> *Canada Post Annual Report, 2003*, Financials Section at page 22, 16833-16899 (Tab U257).

iii. The *CPC Act* gives Canada Post a monopoly over the sale of postage stamps<sup>153</sup> and the *Postage Meter Regulations* gives Canada Post a monopoly over the use of postal meters.<sup>154</sup> Postal meters are machines that print impressions equivalent to stamps and are used instead of stamps by companies that produce large volumes of mail.

b. Processing

i. Canada Post has 25 “major” processing plants across Canada.<sup>155</sup>

c. Transportation

i. -----

d. Delivery

i. In addition to delivering to private letter boxes, Canada Post delivers to Post Office (“PO”) boxes, apartment mail boxes and community mail boxes. PO boxes are private boxes that Canadians access at the post office. Apartment mail boxes are boxes in apartment buildings which cannot be accessed without a key and community mail boxes receive mail for an entire community and are often built instead of individual post boxes in new residential areas. -----

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<sup>153</sup> *CPC Act*, s. 57 states: “Every person commits an offence who, without the consent of the Corporation, engages in the business of selling postage stamps to the public for the purpose of payment of postage” (Tab U218).

<sup>154</sup> SOR/83-748. Available at (D14153-14160) (Tab U37).

<sup>155</sup> *Canada Post Annual Report, 2003*, (16833-16899) (Tab U257).

<sup>156</sup> Canada’s Interrogatory answers to Investor’s Information Request to Canada dated April 25, 2003, question 218 (AA00404-AA00468 at AA00459) (Tab U290).

[REDACTED]<sup>157</sup> Canada refused to divulge the number of PO or apartment mail boxes in Canada in response to an interrogatory from UPS.<sup>158</sup>

142. Canada Post's infrastructure also supports the management, administration and marketing of its services. This infrastructure includes call centres,<sup>159</sup> control centres<sup>160</sup> and management teams.<sup>161</sup>
143. Although UPS Canada maintains its own network for the collection, processing, transportation and delivery of its courier services, UPS Canada is prohibited by the *CPC Act* from even attempting to obtain the volumes necessary to maintain a network as vast as Canada Post's.<sup>162</sup> The *CPC Act* gives Canada Post access to economies of scale and scope that no competitor can hope to replicate. Canada Post allows its Physical Distribution services and Purolator to benefit from these economies while denying such benefits to its competitors.

**B. Canada Post's Courier Services' Use of Canada Post's Monopoly Infrastructure**

144. Canada Post openly admits giving its courier services access to its Monopoly Infrastructure. With regard to the access they give to Priority Courier, Canada Post has

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<sup>157</sup> Canada Post, *Corporate Plan (1995-96 to 1999-2000)*, Capital Budget at 2. Submission of the Director of Investigation and Research, Competition Bureau, to Canada Post Corporation Mandate Review Committee, February 15, 1996 at 15 (R249-1) (Tab U76).

<sup>158</sup> Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 227(b) (AA404-AA00468 at AA00464) and question 228(b) (AA00404-AA00468 at AA00465).

<sup>159</sup> Catherine McCoy, "'Smart' Technology Improves Customer Service," *Performance Magazine*, October 1997 at page 21 (D6147) (Tab U99).

<sup>160</sup> See Canada Post National Control Centre Brochure [D21102-21107] (Tab U38).

<sup>161</sup> Francois Legault, "The Buck Stops in the Local Area Now," *Performance Magazine*, June/July 2000 at 14 [2445] (Tab U163).

<sup>162</sup> See Witness Statement of A. Gershenhorn at para. 8.

said:

The network has been designed primarily to process letters, parcels, advertising and publications and it also processes Priority Courier services through shared and dedicated facilities. ... In economic terms, it would be wasteful for CPC to fail to utilize its network fully.<sup>163</sup>

145.

[REDACTED]

[REDACTED]

146. In commenting on the decision to purchase Purolator, John Caines, Canada Post Media Spokesperson, said: “We have a legislated obligation to operate in a businesslike fashion and part of that is the effective use of our infrastructure ...”<sup>165</sup>

147. UPS agrees that Canada Post should fully utilize its network. However, this is not what Canada Post does. Instead, Canada Post allows only its own courier services to utilize the network while excluding any competitors. These courier services enjoy the benefits of exclusive access without being allocated the true costs of this access.

148. Examining the different elements of Canada Post’s Monopoly Infrastructure highlights the access its competitive services enjoy and how this access is denied to UPS Canada or other competitors.

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<sup>163</sup> Canada Post’s Submissions to Postal Mandate Review, *Ensuring Universal Service at Affordable Rates*, (February 15, 1996) at page 34 D5091-5145. (Tab U75).

<sup>164</sup> [REDACTED] 45)] the Resources and Government Operations (where Ouellet admits as much), February 16, 2000.

<sup>165</sup> Transcript, John Caines Interview on CBO-FM, 31 August 2000 (D854) (Tab U170).

**1. Collection**

*a. Mail Boxes*

149. Canada Post allows consumers to deposit courier products, including products destined for the US,<sup>166</sup> in its mail boxes.<sup>167</sup> Canada Post does not pay rent to use the mail boxes. [---]

[-----]  
[-----]  
[-----]  
[-----]

150. Unlike Canada Post, UPS Canada cannot put letter boxes in any public place. Canada Post does not allow consumers to deposit UPS Canada products in Canada Post's mail boxes. Instead, UPS Canada must pay to install its own drop boxes and must pay rent to use some of the sites on which it keeps these boxes.<sup>170</sup> Consequently, [-----]  
[-----] where consumers can drop off its products to be collected, compared to Canada Post's 950,000. Most UPS Canada products must, therefore, be directly

<sup>166</sup> See Xpresspost advertisement at 21489 (Tab U310).

<sup>167</sup> In its *Statement of Defence*, Canada acknowledged that "Mail receptacles are not, and have never been, limited to monopoly services" [*Statement of Defence*, February 7, 2003, at para. 52]. Indeed, most mail boxes have a sign announcing that competitive service products may be deposited in them [see photograph of mailbox with sticker at [D21119]] Tab U14). See also clauses 1.4, 1.5 and 2.1 of the Product and Service Specifications for Xpresspost and Priority Courier (22 April 2003 and 5 May 2003, respectively) (R127B.1-1 (Tab U269) and R127B.2-1) (Tab U271) See also page 3 of the Xpresspost brochure (D2281) (Tab U10) and Xpresspost advertisements (D3567)(Tab U20). The Canada Postal Guide advises customers against depositing Purolator Overnight items in mail boxes. However, if a Purolator Overnight item is deposited in a mailbox, Canada Post will deliver it although the service guarantee does not apply. See Canada Postal Guide 2005, Section C, Chapter 7 (Tab U309).

<sup>168</sup> See Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, questions 128 and 133 (AA00404-00468 at AA00441) (Tab U290).

<sup>169</sup> See Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 132 (AA00404-00468 at AA00441) (Tab U290).

<sup>170</sup> See Memorandum from Doug Appleby to Alan Kaufman, UPS, April 5, 2001, in which he confirms that UPS pays rent on about 20% of its drop box locations (D18905) (Tab U193). See witness statement of Alan Gershenhorn at paras. 28 - 29.

collected from the consumer.<sup>171</sup>

151. Canada Post advertises this difference as an advantage of its Xpresspost product over its competitors:

By using prepaid Xpresspost bubble envelopes and boxes, customers don't have to hang around until a private courier picks up their items. They can just drop them off in a street letter box or at their nearest retail outlet, and get on with their day.<sup>172</sup>

Indeed, some consumers choose Xpresspost because of this advantage.<sup>173</sup>

*b. Post Offices and Retail Outlets*

152. Canada Post requires its post offices and retail outlets to carry Canada Post courier products.<sup>174</sup> For example, Canada Post began selling Purolator International courier products and pre-paid Purolator Overnight products from Canada Post retail outlets in June 2000 and autumn 2001, respectively. [REDACTED] [REDACTED] Indeed, Purolator advertises its broad availability at Canada Post offices and outlets.<sup>176</sup>

<sup>171</sup> Statement of Alan Gershenhorn at para. 24.

<sup>172</sup> Canada Post *Performance Magazine*, "Xtra Tips for Selling Xpresspost", March / April 1997 at 27 (3559-3562 at 3561) (Tab U410).

<sup>173</sup> ACTA announced it was exclusively using Canada Post for its delivery requirements because it "provides pick-ups 'in any postal box'": "Three Companies Chosen for ACTA/CATO Fulfillment," *Travelweek*, August 26, 1999 (D801) (Tab U134).

<sup>174</sup> See, for example, clause 10.1.1 of Canada Post's Type B Dealership Agreement, January 1999: "The Dealer agrees to sell, merchandise, promote or otherwise deal in all Products and Services which are deemed mandatory from time to time by the Corporation, and only in Products and Services ..." (R102.7-1 (Tab U120); description of Priority Courier on Canada Post website, stating that Priority Courier can be purchased "at any Canada Post retail postal outlet" (D18868) (Tab U6); Letter of Intent between Canada Post Corporation and Purolator regarding the retail sale of Purolator services, October 9, 2001 (R107.1-1 (Tab U224)); and clause 4 of the Sales Agency Agreement for Purolator International between Purolator and Canada Post, 26 June 2000 (R107.2-1).

<sup>175</sup> See Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, questions 120(a) and 121(b) (AA00404-00468 at AA00441) (Tab U290).

<sup>176</sup> Canada Post: International Distribution Services. 13193 - 13198 at 13193 (Tab U188).

153. Canada Post allows customers to deposit courier products, including Purolator, at any office or outlet after they have paid for them,<sup>177</sup> where they will be stored before they are picked up at the end of the day.

154. Canada Post does not offer these facilities to UPS Canada. [REDACTED]  
[REDACTED]  
UPS Canada can, therefore, only sell its services through its own [REDACTED] outlets compared to the 24,000 outlets from which Canada Post sells its courier products.

155. Canada has strengthened this competitive advantage by attracting customers to post offices by offering other government services. Canada offers government forms and information brochures at post offices and also provides public computers, where customers can access government websites.<sup>179</sup> Canada Post office and retail outlets are also passport application receiving agents.<sup>180</sup>

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<sup>177</sup> See page 3 of Canada Post’s Shipping Services brochure: “Priority Courier and Xpresspost prepaids allow you to pick-up postage-included packaging for drop off at any retail outlet when its handy for you” (D2379)(Tab U3).

<sup>178</sup> See Canada’s Interrogatory answers to Investor [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

<sup>179</sup> See “Canada Post and Cybersurf Delivering Free Internet Access - From Postal,” *Canada Newswire*, October 13, 2000 (D2895) (Tab U175). See also “Connecting Canadians,” from Government of Canada website (D6196) (Tab U5).

<sup>180</sup> See note on Canada Post website entitled “Canada Post becomes passport application receiving agents” (D20987) (Tab U15).

*c. Stamps and Meters*

156. Canada Post allows customers to pay for courier services with stamps or meters.<sup>181</sup> Canada Post also allows customers to buy stamps at Purolator centres.<sup>182</sup>
157. UPS Canada cannot sell stamps and customers cannot pay for UPS Canada services with stamps or meters.<sup>183</sup> Canada Post has sued companies for selling stamps at the same time as courier services that compete with Canada Post.<sup>184</sup> UPS Canada, therefore, cannot attract customers wanting to buy stamps into its stores and loses customers who prefer the convenience of paying with stamps or meters.

**2. Processing**

158. Canada Post processes courier products at its [ ] facilities that are also used for letter mail processing.<sup>185</sup> Canada Post thereby achieves economies of scale in processing that UPS Canada cannot replicate.

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<sup>181</sup> With regard to Purolator, see Canada Post Canada Postal Guide, October 2000, Section D, Chapter 1, Page 1 (D12891) (Tab U172). See also Canada's evasive answer on this issue in Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 258(a) (AA00404-AA00468 at AA00467) (Tab U290).

<sup>182</sup> See receipts for purchase of stamps at Purolator Centre (D13309) (Tab U151).

<sup>183</sup> Section 57 of the *Canada Post Act* provides that no person is entitled to sell postage stamps to the public without the consent of Canada Post. The *Postal Meter Regulations* SOR/83-748 give Canada Post a monopoly over the use of postal meters.

<sup>184</sup> Statement of Claim against Mail Boxes Etc., April 27, 1995 (D4670-4689) (Tab U70).

<sup>185</sup> Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 142 (AA00404-AA00468 at AA00446) (Tab U290) and questions 210, 212, 213, 214 (AA00404-AA00468 at AA00457) (Tab U290). See also Interrogatory question 209 ("Please provide a copy of any documents or internal policies currently in force regarding the use of Canada Post owned or leased buildings and facilities for the processing and shipment of non monopoly "courier or small parcel express market" products, such as: Priority Courier, Xpresspost, Expedited Parcel and Regular Parcel") and note Canada's failure to respond. See also Canada Association of Logistics Management, "Supply Chain e-Merchants," May 28-30, 2000, Conference Brochure, at Page 5 (D3293) (Tab U4). With regard to Purolator items see: "New UMO Cape Breton Hires 10 Employees," *Performance Magazine*, February/March 2002 at page 5 (D23478) (Tab U237), discussing processing of Purolator parcels at Canada Post's centre for non deliverable mail.

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### 3. Transportation

159. Canada Post's employees collect courier products from mail boxes,<sup>186</sup> outlets, homes and businesses with a contract with Canada Post.<sup>187</sup> Businesses with a minimum volume of packages, combining both monopoly and courier services, qualify for a daily pick-up service.<sup>188</sup> After collecting courier products, Canada Post vehicles will deliver them to sorting centres. Those vehicles will then deliver courier packages between sorting centres and to their final destination.<sup>189</sup> For example, the delivery of Xpresspost is performed by letter carriers.<sup>190</sup> [REDACTED]

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<sup>186</sup> See Canada's Interrogatory answers, question 152, 153 at page 44. See clause 2.1 of Canada Post's *Corporate Manual System* (2000.11), "Relay Bundles and Bags" (R127a.1-1) (Tab U177); Clauses 2.8.4 and 2.8.6 of Canada Post's *Corporate Manual System* (September 2002), "Mail Collection Service" (R127a.3-1) (Tab U252); Canada Post's *Corporate Manual System* (March 2003), "COD" [REDACTED]

<sup>187</sup> Canada Post Postal Guide 2001-2002 at page 5 (D20901) (Tab U7).

<sup>188</sup> Xpresspost brochure [2281-2284 at 2283] (Tab U10).

<sup>189</sup> See Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, questions 140(a), 142, 144b, 146, 152, 153, 221(a) and (b) and 222 (AA00404-AA00468 at AA00446) (Tab U290). See also the section on "Integrated Shipping Services" in the Xpresspost brochure: "Integrated Shipping Services Consists of Regular Post, Xpresspost and Priority Courier." (D2281)(TabU10). See "Canada Post Mega Depot Consolidates Non-monopoly and Monopoly Services Together Under One Roof," *Performance Magazine*, February 1997 (D3590) (Tab U86). See also Sara Ferguson, "The Making of Etobicoke Mega Depot: A Venture in Cooperation", *Performance Magazine* (February 1997) at 20-21 (D3590-3592) (Tab U86): "Combining different operations under one roof was just the first step in realizing savings ... routes were restructured to accommodate a mobile (often carrier system in which a driver teams up with one or two partners to deliver mail, relays, oversized Priority Courier items)."

With regard to Purolator products, see page 3 of Canada Post's 22 July 2002 presentation on Purolator Rural [REDACTED]

<sup>190</sup> Krystyna Lagowski, "Trial offer Rockets Xpresspost to Grand Slam," *In the Mail*, October 1999: "Xpresspost generally gets delivered overnight, but does not guarantee an early morning delivery. "The reason is, a lot of it gets delivered by letter carrier. They don't knock off at noon, they do about two-thirds of their route before noon and another third in the afternoon (D3577) (Tab U137)."

<sup>191</sup> See Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 141 (AA00404-00468 at AA00441) (Tab U290).

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160. All Purolator International products and most Purolator Overnight courier products, sold to the public from Canada Post's retail outlets, [REDACTED]

161. Letter mail carriers accept orders from businesses for stamps, Xpresspost prepaid envelopes and Priority Courier envelopes.<sup>193</sup> Letter mail carriers also market courier services<sup>194</sup> and deliver courier services sales brochures.<sup>195</sup> As Georges Clermont, former President and Chief Executive Officer of Canada Post, has declared, Canada Post letter mail carriers are:

not just delivering mail. They're picking up parcels ... and servicing from their trucks regular business customers. In effect, through the MMC's, as we call them, we are bringing the postal outlet to the customer.<sup>196</sup>

162. UPS Canada must build its own transport infrastructure and attributes the costs of building and running this infrastructure to the prices of its products. Compared to Canada

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<sup>192</sup> See Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 122(a) and (b) (AA00404-00468 at AA00441) (Tab U290).

<sup>193</sup> Susan Hirshorn, "Getting Down to Business," *The Costco Connection* 18 (March/April 2001) at 19 [D13861-13863 at 13862] (Tab U187).

<sup>194</sup> See Jane Wilson, "Delivery Model Pilots - A work in progress" *Performance Magazine* 22 (July/August 2002) at 23 [10970 - 10971] (Tab U248): "Kelowna has been the site of an interesting twist on the Venture One customer contact program. Letter carriers use their knowledge of businesses on their routes to make contact with potential customers. To date, more than 100 businesses have been signed up by carriers." Venture One is a program facilitating use of competitive service products.

<sup>195</sup> "Thinking Outside the Box: North Bay Pilot Boosts Business," *Performance Magazine*, December/January 1999 at 20: "Letter carriers and drivers know the small offices and home offices on their routes; they'll be dropping off sales brochures to the customers they believe might use CPC's services such as Xpresspost." [3699] (Tab U116); "CP pushes global e-post, domestic e-commerce," *Par Avion*, April 28, 2000 at 3 [3639] (Tab U152). "The 'buy Canadian' e-commerce program was launched with the mailing of 10 million 'GoShopping' brochures to Canadian households promoting GoShopping.canadapost.ca, a Web site directory featuring more than 250 Canadian online retailers."

<sup>196</sup> Minutes of Proceedings and Evidence of the Standing Committee on Government Operations, March 21, 1995 at 38:6 [3350 - 3399 at 3355] (Tab U69).

Post's [redacted] ground vehicles, UPS Canada owns only [redacted] ground vehicles.<sup>197</sup> UPS Canada does not have access to the volumes that would make a larger ground transportation network viable.

163. Once again, Canada Post trumpets access to this part of its infrastructure as an advantage its courier companies hold over their competitors. Fadi Hayek, Director of Corporate Projects at Canada Post, said:

Courier companies don't have the extensive delivery network of a postal administration. Opportunities exist for Purolator to hand off a package for delivery by Canada Post, and having a common technological platform will facilitate the seamless transfer of pickup and delivery information. It gives both companies a significant competitive advantage.<sup>198</sup>

Some customers choose Canada Post precisely because of this advantage.<sup>199</sup>

164. [redacted]  
[redacted]  
[redacted]  
[redacted]<sup>201</sup> Canada Post often rents the aircraft to use during the day, when the aircraft would otherwise not be used.<sup>202</sup> Renting this space reduces

<sup>197</sup> Statement of Alan Gershenhorn at para. 30.

<sup>198</sup> J.D. Booth, "New Portable Data Units Widen the Technological Highway of the Future," *Performance Magazine*, January 2000, at page 28 (D2709) (Tab U142).

<sup>199</sup> See Brenda Stewart, "Canada Post and Purolator Deliver for Provigo," *Performance Magazine* (December 2003) 25 (15114-15115) (Tab U286), which explained the grocery chain, Provigo, offered their business to a joint Canada Post/Purolator bid because of their combination of "Canada Post's network of remote locations with Purolator's guaranteed pickup and next-day delivery services."

<sup>200</sup> See Board Submission for the Purolator night-time freighter network (R215C-2) (Tab U197) and contracts at (R217-1) (Tab U64), (R217-2) (Tab U67), (R217-3) (Tab U68), (R217-4) (Tab U105), (R217-5) (Tab U131), (R217-6) (Tab U149), (R217-7) (Tab U189), (R217-8) (Tab U240) and (R217-9) (Tab U241). Note Canada's failure to provide any answer to question 215(d) at page 61 of the Investor's Interrogatories. See comments at (R216A-1) (Tab U210), (R216A-2) (Tab U211), (R216A-3) (Tab U212), (R216A-4) (Tab U213), (R216A-5) (Tab U214), (R216A-6) (Tab U215), (R216A-7) (Tab U216), (R216A-8) (Tab U217), (R216A-9) (Tab U219), (R216A-10) (Tab U223), (R216A-11) (Tab U262), (R216A-12) (Tab U263), (R216A-13) (Tab U266), (R216A-14) (Tab U279), (R216A-15) (Tab U16) and (R216A-16) (Tab U17).

<sup>201</sup> Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 225(c) (AA00404-AA00468 at AA00464) (Tab U290).

<sup>202</sup> "Xpresspost Taking a Charter Flight," undated, *Performance Magazine* at page 5 [D6381] (Tab U399).

Purolator's costs and enables it to sell its services at lower prices. Canada Post does not allow UPS Canada to bid to carry Canada Post letter mail and, therefore, to reduce its costs in the same way that Purolator can.<sup>203</sup>

#### **4. Delivery**

165. [REDACTED]

166. UPS Canada does not have such authorization and cannot deliver to PO,<sup>207</sup> apartment or community mail boxes.<sup>208</sup> UPS Canada is, therefore, denied access to a substantial part of the Canadian market. Canada Post trumpets this competitive advantage, stating in an advertisement that "Priority Courier is the only courier in Canada that can deliver your

<sup>203</sup> See Canada's failure to provide documents in response to question 216(b) (AA00325-AA00404 at AA00384) (Tab U294) of the Investor's Interrogatories - "With respect to the business relationship between Canada Post and Purolator, provide ... any internal Canada Post memoranda or reports comparing the prices charged by Purolator for such transportation, to the prices charged by arm's length providers for similar services."

<sup>204</sup> Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 228(a) (AA00404-AA00468 at AA00465) (Tab U290).

<sup>205</sup> Regarding delivery to apartment mail boxes, see Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, questions 226 (AA00404-AA00468 at AA00464) (Tab U290); and Canada Post's *Corporate Manual System* (January 2003), "Delivery to a Mailroom or a Lock Box Assembly" (R137.10-1) (Tab U261). Regarding delivery to community mail boxes, see Canada Post's *Corporate Manual System* (September 2002) (Tab U261), "Delivery to a Community Mail Box, Group Mail Box or Rural Mail Box" (R137.5-1) (Tab U251).

<sup>206</sup> Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003, question 227(a) (AA00404-AA00468 at AA00464) (Tab U290).

<sup>207</sup> Canada's Interrogatory answers to Investor's Information Request to Canada, question 228(c) (AA00404-AA00468 at AA00465) (Tab 290). See also, for example, letter from Midlake Post Office to PO Box Holders of February 15, 2000: "Due to Canada Post regulations effective March 1<sup>st</sup>, 2000, we will only accept Priority Post and Purolator deliveries for our Postal Box customers. All other courier companies will be refused at the counter, we apologize for this action but we have no choice except to follow the regulations of Canada Post. ..." Cited in e-mail from J. Pierce to UPS Customer Service, February 21, 2000 [10488] (Tab U146).

<sup>208</sup> Canada's answer to question 227(c), Investor's Interrogatories (page 61); decision of Justice Cullen, Federal Court of Canada, June 1995, file T-2075-93 [17263 - 17278] (Tab U73).

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shipments to a mailing address or a physical address.”<sup>209</sup> Customers admit to choosing to deliver parcels through Canada Post because of this advantage.<sup>210</sup>

167. 80% of Canadian households have no one at home during the day.<sup>211</sup> If customers are not present when courier items are delivered to their home or office, Canada Post allows the customer to pick them up from its post offices and outlets.<sup>212</sup> [REDACTED]  
[REDACTED]<sup>213</sup> If a customer is receiving a courier product for which the customer must pay over \$5.00 on delivery, then Canada Post allows the customer to pick up the product and pay for it at a local post office or retail outlet.<sup>214</sup>
168. Customers cannot collect UPS Canada products from post offices or retail outlets. UPS Canada must, therefore, commit to returning to the customer’s address at least three times if the customer is not home, greatly increasing the cost of delivery. Customers who are not likely to be home when the product will be delivered are likelier to choose Canada Post to deliver the product. UPS Canada has been at a considerable disadvantage in residential deliveries.<sup>215</sup>

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<sup>209</sup> Priority Courier Promotional Brochure [2571 - 2574 at 2572] (Tab U25).

<sup>210</sup> Jane Daly, “Team Spirit Computes with MicroWarehouse,” *Performance Magazine*, August/September 1999 at 37 [6150] (Tab U132): “Watson says he views his business relationship with Canada Post as that of partners, rather than as client and supplier. ‘Of course, we need a carrier with the capabilities to deliver our wide cross-section of products - everything from a piece of memory to a full-blown system. Only Canada Post can deliver to a post office box ...’”

<sup>211</sup> Canada Post Business Product Information at page 4 [2399 - 2402 at 2402] (Tab U400).

<sup>212</sup> See clause 2.5 of Canada Post’s Corporate Manual System (2001.11), “Delivery at Postal Outlet” (R105a.1-1) (Tab U12). See also Canada Post document, “Shipping Options for Domestic Destinations,” (D6229) (Tab U176); and Canada Postal Guide, April 2001, Section C, Chapter 1 at page 94 (D20817) (Tab U191). See also Canada’s Interrogatory answers to Investor’s Information Request to Canada dated April 25, 2003, question 122(d) (AA00404-00468 at AA00441) (Tab U290).

<sup>213</sup> See Canada’s Interrogatory answers to Investor’s Information Request to Canada dated April 25, 2003, question 118(c) (AA00404-00468 at AA00441) (Tab U290).

<sup>214</sup> See Canada Post Canada Postal Guide, October 2000, at Section C, Chapter 1, Page 95 (D12861) (Tab U171).

<sup>215</sup> Statement of Alan Gershenhorn at para. 20.

169. Canada Post also trumpets this difference as an advantage that its courier products hold over their competitors:

A private courier's weakness is residential delivery. When there is no one at home, they have to go back. Our delivery force and our infrastructure allows us to leave a card telling the customer the item can be picked up at the nearest postal outlet.<sup>216</sup>

170. Similarly, a Canada Post vice-president recently said:

... there are 7400 post offices [in Canada]. ... you can go to the post office to pick up a package if you missed its delivery at home. Try this with UPS: they have only one pick-up location in Montreal.<sup>217</sup>

171. Canada Post also leverages statutory protections for delivery of Canada Post mail. By putting an electronic postmark on every mail piece sent through the electronic post, or EPOST system, Canada Post ensures that mail is protected by those statutory provisions.<sup>218</sup> An interview with EPOST CEO, Peter Melanson, reveals how Canada Post trumpets this difference as a competitive advantage:

**Reporter:** Since you're an agent of the Canadian government, you have special qualities; you provide special functions so that you can actually tell your customers that they can turn off the paper and they're protected by law.

**Melanson:** Absolutely protected by law.

**Reporter:** Is there any other organization in Canada that can make the same claim?

**Melanson:** Absolutely not.

**Reporter:** That sounds like an incredibly significant advantage.

**Melanson:** It is a significant advantage.<sup>219</sup>

## **5. Management, Administration and Marketing**

172. Canada Post manages its courier services through the same team that manages its

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<sup>216</sup> Richard Saint Laurent, CP Quebec City Account Executive, quoted in Canada Post's *Performance Magazine*, May 1998, at 29 (D3655) (Tab U112).

<sup>217</sup> Alain Guilbert, Vice President of Communications for CP, quoted in *La Presse* newspaper article of February 29, 2000, entitled "E-commerce Messengers" (our translation).

<sup>218</sup> See Press Release: "EPOST WebCast Reveals Critical Steps for Canadian Billers," April 24, 2001 [D18821-18822] (Tab U195).

<sup>219</sup> Transcript of interview between Michael Killen and Peter Melanson, 2001 [21408-21412 at 21411] (Tab U183).

monopoly services.<sup>220</sup> Canada Post controls both letter mail and courier packages at its National Control Centre<sup>221</sup> and fields calls regarding their delivery at its call centres.<sup>222</sup> Canada Post maintains a database containing information on customers' letter purchases, which it provides to its courier services.<sup>223</sup> Courier services can draw from this database to assist with their marketing and to redirect shipments sent to an address that has since changed.<sup>224</sup>

173. Canada Post includes courier services on its letter mail bills.<sup>225</sup> Canada Post will not provide monopoly services to customers who have not paid their bill.<sup>226</sup> Canada Post advertises its courier services in the same advertisements for its monopoly services<sup>227</sup> and advertisements solely for courier services are delivered with letter mail and without stamps.<sup>228</sup>

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<sup>220</sup> Francois Legault, "The Buck Stops in the Local Area Now," *Performance Magazine*, June/July 2000 at 14: "In 89 newly created management areas, formed by either a Local Area or a combination of two Local Areas, a local management team will be empowered to provide their customers with all the services and retail products they require. Every aspect of Canada Post's business in the area -including retail, mail operations and commercial sales - will become the full responsibility of a local area and its manager ..." [2445] (Tab U163).

<sup>221</sup> See Canada Post National Control Centre Brochure [D21102-21107] (Tab U38).

<sup>222</sup> Catherine McCoy, "'Smart' Technology Improves Customer Service," *Performance Magazine*, October 1997, at page 21 (D6147) (Tab U99). See also Purolator brochure advertising the Canada Post Customer Service phone number for more information (D13190) (Tab U168). Canada Post also sells competitive services products to businesses through its Sales and Service Centre [See Purolator promotional material on the internet (D13193-13198 at 13198) (Tab U188)] and customer relations agents [See "Rep Turns Service into Sales," *Performance Magazine* (August/September 1997) 26 (D4042).] (Tab U97).

<sup>223</sup> See Jane Wilson, "At the Core of our Success," *Performance Magazine*, March/April 1996 at page 18, (D13215) (Tab U77).

<sup>224</sup> See note on Canada Post website, (D20901) (Tab U7). See also brochure entitled "Frequently Asked Questions about Mail Forwarding" [D6303] (Tab U36), which says "Xpresspost, Expedited Parcel and Regular Parcel items will be redirected" after Change of Address Notifications have been filed with Canada Post.

<sup>225</sup> See Canada Post document, "Important Changes to Order Processing," (D18788) (Tab U203).

<sup>226</sup> See Canada Post "Credit Application" form, (D18792) (Tab U2).

<sup>227</sup> See, for example, Xpresspost advertisement (D6394) (Tab U148).

<sup>228</sup> See, for example, competitive services promotion website acknowledging that advertisements are delivered with letter mail [14788-14790] (Tab U282). CI Bulletin Package, April 2000 [D3646 - 3650 at 3646]. (Tab U401). See also Canada's confirmation that, in June 2002, Canada Post letter carriers delivered advertisements for competitive products: See Canada's Interrogatory answers to Investor's Information Request to Canada dated April 25, 2003,

174. UPS Canada cannot construct a database which draws from customers' letter purchases. It can neither save costs by including its invoices on letter mail invoices; by threatening not to deliver letter mail to those who do not pay invoices; nor by not paying for distribution of advertisements.

## **6. Monopoly Services Revenue**

175. Canada Post not only gives its competitive services exclusive access to its Monopoly Infrastructure, but also helps develop competitive services with the revenue its monopoly services make from the use of that infrastructure.
176. For example, Canada Post has funded the development of its competitive Internet service. In 1998, Canada Post launched Poste CS, a new global secure electronic mail service.<sup>229</sup> In 1999, Canada Post launched its "E-Parcel" service, which enables merchants selling over the internet to deliver the product through Canada Post's competitive courier services.<sup>230</sup> In the same year, Canada Post launched its "Electronic Post Office" or EPOST, which allows customers to receive and pay bills electronically.<sup>231</sup> These launches were all funded from Canada Post's monopoly services revenue.<sup>232</sup>
177. Canada Post has also used its monopoly services revenue to support Purolator. Canada

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question 144 (b) (AA00404-00468 at AA00441). (Tab U290).

<sup>229</sup> See, for example, Canada Post press release, "Canada Post Offers Free Trial to Demonstrate Security and Efficiency of Electronic Courier Service," (December 15, 1998). (D2963) (Tab U118).

<sup>230</sup> See Canada Post, The New Canada Post at (D2918) (Tab U11) for a description.

<sup>231</sup> Schedule for Electronic Post Office, undated (P234.002-01) (Tab U13).

<sup>232</sup> The Tribunal must infer this fact from Canada's refusal to provide documents explaining how the launches were funded. Canada failed to provide any documents in response to interrogatory question 233(b) (AA00325-AA00403 at AA00391) (Tab U294). "Provide documents confirming the source of funds used by Canada Post to acquire its equity ownership in Intelcom". In response to interrogatory question 235 (AA00325-AA00403 at AA00392) - "Identify the source of funds that Canada Post used to invest \$32.4 million to acquire an ownership position in GD Express" - Canada replied: "Not relevant to this arbitration". In response to interrogatory question 234(c) (AA00325-AA00403 at AA00392) (Tab U294), Canada failed to provide documents indicating "the source of funds used by Canada Post to acquire its equity ownership in Epost".

Post provides a revolving \$25 million line of credit to Purolator<sup>233</sup> and on October 1, 2002, paid \$105 million for additional shares in Purolator, which was used to repay debt.<sup>234</sup>

**C. Canada Post's Courier Services Do Not Appropriately Pay to Use the Monopoly Infrastructure**

178. The consequences of Canada Post's exclusive access to its Monopoly Infrastructure are analyzed in the expert report of Dr. Kevin Neels, an economist with extensive experience in the analysis of postal services, transportation and other network industries. Dr. Neels considers the appropriate standard for equal treatment of courier services in the context of a network that is shared by both monopoly and competitive services.

179. By giving its courier services exclusive use of the Monopoly Infrastructure, Canada Post enables those services to capture economies of scale and scope that are not equally available to competitors. Dr. Neels explains:

... Canada Post has built a complex network of offices, retail outlets, processing centres, and transportation routes and services, the extent and density of which largely result from the substantial volumes of monopoly lettermail that Canada Post alone is permitted to process and deliver. In utilizing this network, to which it maintains essentially exclusive access, Canada Post is able to exploit economies of scale and scope ... that competitors without access to this extensive infrastructure cannot obtain.<sup>235</sup>

180. Dr. Neels emphasizes that private companies like UPS Canada are legally prevented from duplicating the infrastructure necessary to generate such economies of scale and scope. He says:

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<sup>233</sup> Gordon Pitts, "Well-travelled Purolator CEO Sets Corporate Sights on US," *Globe and Mail*, July 23, 2002 [10888] (Tab U39).

<sup>234</sup> Purolator 2002 Annual Review at page 32 [15030-15065 at 15063] (Tab U233).

<sup>235</sup> Neels Report at para. 29. Dr. Neels goes on to explain: "Economies of scale arise when the average cost of producing a unit of output declines as the level of output increases [at para. 30] ... economies of scope arise when the total cost of producing two or more products jointly is less than the cost of producing them separately. In the postal context, such economies can arise if, for example, parcel courier, and lettermail services can be provided using a common delivery infrastructure rather than requiring entirely separate dedicated delivery systems for each [at para. 32]."

Clearly there is no way for UPS or other private competitors to duplicate the network that Canada Post has built over the course of its history, or to replicate directly the economies of scale and scope that this network provides. UPS is prohibited by statute from entering into the markets that this network was primarily built to serve, and is excluded from the many privileges that Canada Post enjoys as a result of its quasi-governmental status.<sup>236</sup>

181. Canada Post's exclusive access to such economies of scale and scope potentially damages private competitors, such as UPS Canada. Professor Fuss' report explains how UPS Canada and Canada Post compete directly in a number of product markets.<sup>237</sup> Dr. Neels explains "[t]he fact that they are direct competitors means that economic and commercial advantages granted to Canada Post and denied to UPS have the potential to distort competition between the two entities and cause economic harm to UPS."<sup>238</sup>
182. Whether Canada Post's advantages constitute unequal treatment of UPS Canada "depends upon the terms and conditions under which Canada Post's competitive service arm is permitted to use those shared facilities."<sup>239</sup> Dr. Neels shows that "there is nothing in principle or practice to prevent Canada Post from making its ... [Monopoly Infrastructure] available to its competitive services arm on competitively neutral terms that do not leave private competitors disadvantaged."<sup>240</sup> His report explains how postal monopolies in other countries do just that.<sup>241</sup>
183. Dr. Neels goes on to explain that "[e]qual treatment for Canada Post and UPS does not ... require that Canada Post actually open its network to access by UPS or other third parties. Equal treatment can also be achieved if Canada Post simply requires its own competitive services arm to access the network on terms equivalent to those that would

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<sup>236</sup> Neels Report at para. 45.

<sup>237</sup> Fuss Report at paras. 13 - 26.

<sup>238</sup> Neels Report at para. 42.

<sup>239</sup> Neels Report at para. 44.

<sup>240</sup> Neels Report at para. 45.

<sup>241</sup> Neels Report at paras. 48 - 51.

be negotiated at arm's length if these businesses were separated."<sup>242</sup> According to Dr. Neels,

... Canada Post's reference point in the negotiations would be not its incremental costs, defined as the additional costs it would incur as a consequence of allowing the use of its network to provide competitive services, but rather the willingness to pay of its prospective private partner. Canada Post would attempt to set transfer prices for shared network use at a level that maximizes the contribution it earned from the deal toward coverage of fixed costs. Maximizing the contribution that it earned by sharing its network with its hypothetical private partner would generate profits that Canada Post could use to defray the fixed costs of its network and hold down the prices charged to users of its basic postal services. Such an outcome would be exactly consistent with Canada Post's rationale for diversifying into the provision of competitive services.<sup>243</sup>

184. Dr. Neels explains that if Canada Post does not charge its courier services market prices for access to the infrastructure, Canada Post not only harms UPS but also harms consumers of Canada Post's USO services who pay higher prices for those services (or enjoy fewer basic services).<sup>244</sup>
185. Canada gives Canada Post complete discretion to determine the cost it allocates to its competitive services for the use of the Monopoly Infrastructure. Dr. Neels notes that Canada is unique in the industrial world in giving its Postal Monopoly such unfettered discretion.<sup>245</sup>
186. Canada Post has abused this discretion by failing to require its courier services to pay the market price for their access to the Monopoly Infrastructure. Indeed, Canada Post does not even require its competitive services to contribute the incremental costs incurred in giving them access to the infrastructure.

**1. Canada Post's Courier Services Have Failed to Pay The Market Price of Access to the Monopoly Infrastructure**

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<sup>242</sup> Neels Report at para. 52.

<sup>243</sup> Neels Report at paras. 53-54.

<sup>244</sup> Neels Report at para. 57.

<sup>245</sup> Neels Report at para. 73.

187. Canada Post does not even try to ensure it charges its courier services the market price for access to the Monopoly Infrastructure. Dr. Neels notes that “Canada Post’s public disclosure of the financial performance of its competitive services focuses on cross-subsidization.”<sup>246</sup> These standard cross-subsidization tests, which merely focus on incremental costs, do not even attempt to address the fundamental issue of equal access to Canada Post’s Monopoly Infrastructure. Refraining from cross-subsidization is a minimum standard that Canada Post must meet, but it is not sufficient to ensure equal treatment.<sup>247</sup>
188. As a result of its unique status as a Crown Corporation and incumbent postal operator, Canada Post is free of some of the constraints that would decrease the ability and motivation of an otherwise comparable private firm to engage in unfair practices. Because it enjoys a protected revenue stream and does not face the same pressures to maximize profits, Canada Post is more likely to set prices at even below the incremental costs of supplying courier services - let alone the proper costs that would maximize the contribution of these services.<sup>248</sup>
189. Even though Dr. Neels identified numerous omissions in Canada’s productions, the documentation produced by Canada leads Dr. Neels to conclude that “it is almost certainly the case that, during the period in question, Canada Post has failed to operate competitive services arm in a way that maximizes its contribution toward support of its network. This failure has adversely affected consumers of letter mail services, who pay higher prices or enjoy lower service quality as a result”. It has also forced UPS Canada to reduce prices and production and robbed UPS of a fair opportunity to earn a full return on its investment in Canada.<sup>249</sup>

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<sup>246</sup> Neels Report at para. 62.

<sup>247</sup> Neels Report at para. 11.

<sup>248</sup> Neels Report at para. 13.

<sup>249</sup> Neels Report at paras. 20-21.

**2. Canada Post's Courier Services Have Not Paid The Incremental Cost of Using the Monopoly Infrastructure**

190. Canada Post's courier services not only failed to pay the market price of access to the Monopoly Infrastructure, they also failed to pay the incremental cost of access. Canada Post's repeated statements that it is not "cross-subsidizing" are largely based on an elaborate public relations exercise that routinely allows Canada Post to proclaim that over 40% of its costs cannot be allocated to specific products. Thus, Canada Post declares that its competitive services earn enough revenues to cover the remaining incremental costs.
191. Dr. Neels confirms that the meagre documents produced by Canada are not sufficient to properly determine costs incurred and the allocation of those costs. He says that "Canada's failure to provide the data and analyses used to generate ... [cost] figures has prevented me or any other outside expert from assessing their accuracy and validity, or determining whether or not they reasonably support Canada Post's claim that it is not engaging in cross-subsidization."<sup>250</sup> Dr. Neels' experience as an expert witness before the U.S. Postal Rate Commission has given him "a clear understanding of the kinds of materials that Canada Post could be expected to possess and that Canada should have produced in response to [The Investor's document] request."<sup>251</sup> He describes those documents Canada chose to produce as "non-responsive," "illegible," and "incomplete in terms of coverage."<sup>252</sup>
192. To be sure, Canada produced internal documents demonstrating that it does undertake an

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<sup>250</sup> Neels Report at para. 82. The Investor's Information Request to Canada, at request 82, sought all documents relating to the ACS (Tab U294). The Investor identified over 100 untimely refusals by Canada and unanswered or incompletely answered information requests in its motion dated June 9, 2004. These refusals and unanswered questions include questions relating to the ACS and constitute a failure to comply with the Tribunal's orders. See *Procedural Directions and Order of the Tribunal* dated April 4, 2003 at sections B and D (Book of Authorities at Tab 15); *Direction of the Tribunal Concerning Document Production* dated August 1, 2003 at paras. 1, 2 (Book of Authorities at Tab 83); and Appendices A and B of the Investor's Motion on Non-Compliance with the Investor's Information Request dated June 9, 2004 (19873-19919) (Tab U155).

<sup>251</sup> Neels Report at para. 110.

<sup>252</sup> Neels Report at para. 112.

Annual Cost Study (“ACS”) and that those studies have always concluded that it has not cross-subsidized its courier services through its monopoly services. These surveys use methodology devised by Canada Post which are not scrutinized:

... Canada Post’s methodology is neither routinely revealed to outsiders nor regularly examined by any outside regulatory body. Canada Post thus has wide discretion to update or fail to update its ACS methodology as it sees fit. *Effectively it has nearly complete control over the standard by which its own conduct is judged.*<sup>253</sup>

193. It is, therefore, not surprising that elements of the methodology that Canada has chosen to reveal are flawed:

The documents that Canada has so far produced about how Canada Post has chosen to revise (or refrain from revising) its costing procedures [REDACTED]

194. Dr. Neels goes on to describe how he “found numerous instances in which Canada Post has failed to correct identified and significant deficiencies in its cost procedures, or has implemented improvements in a selective and apparently results-driven manner.”<sup>255</sup>

195. After a thorough analysis of the methodology and data used in the documents that were provided, Dr. Neels concluded that Canada Post’s methodology unduly maximizes costs that are deemed common to all products. [REDACTED]

[REDACTED] Dr. Neels states:

Although I am inhibited in my ability to draw conclusions by gaps in Canada’s responses to Information Requests in this proceeding, the information I have been able to examine indicates that Canada Post has been lax in its product costing procedures and has published incremental cost

<sup>253</sup> Neels Report at para. 86 (Emphasis added).

<sup>254</sup> Neels Report at para. 80.

<sup>255</sup> Neels Report at para. 80.

estimates for its competitive products that are almost certainly biased downwards.<sup>256</sup>

196. Private courier companies such as UPS devote great efforts to understand their own cost structures in order to ensure that they are selling at prices that cover their costs of service. These efforts have allowed UPS to allocate [redacted] of its costs to specific service offerings.<sup>257</sup> By contrast, Canada Post is not interested in understanding its own costs as it has a protected revenue stream. Canada Post's only interest appears to be in making a yearly announcement that because over 40% of its costs cannot be allocated, it is not cross-subsidizing.<sup>258</sup>

197. Given that the documents Canada has chosen to produce actually damage their argument that Canada Post is not cross-subsidizing its courier services with its monopoly services, this Tribunal must infer that the documents Canada has chosen not to produce are even more damaging.

**D. Canada Post's Aggressive Pricing Strategy**

198. While they only reveal part of the competitive advantage enjoyed by Canada Post, price differences between Canada Post's courier services and UPS Canada's services are illustrative. The price differences between Canada Post's Xpresspost and UPS Canada's competing services are particularly revealing.

199. The rates for Xpresspost are significantly lower than those for comparable courier services. Canada Post has advertised Xpresspost as providing "average savings of 33% over courier services".<sup>259</sup>

200. Price comparisons between Canada Post's Xpresspost and UPS Canada's competing

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<sup>256</sup> Neels Report at para. 132.

<sup>257</sup> Statement of Alan Gershenhorn at paras. 39 - 44.

<sup>258</sup> Neels Report at paras. 87, 109.

<sup>259</sup> Xpresspost Ads (3567, 3568, 2375). Xpresspost Ad (21484) (^Insert Tabs)

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services confirm the price differential advertised by Canada Post. Professor Fuss compared prices for Xpresspost to prices for UPS Canada’s next day morning services for various routes from Halifax and Toronto. On the majority of the routes surveyed, Xpresspost prices for letters were approximately 50 per cent less than the UPS Express Saver prices.<sup>260</sup> Similar differences occurred for other routes.

201. [Redacted]

202. These price differences are particularly striking with respect to Canada Post’s aggressive discounts for large corporate customers. [Redacted]

203. Canada Post is able to offer such low prices and sustain its leading position through its exploitation of its monopoly and other legal privileges. Specifically, Canada Post can offer such low prices because its courier services do not appropriately pay for their exclusive access to the Monopoly Infrastructure. These practices place UPS Canada at an

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<sup>260</sup> See Fuss Report at Appendix C.  
<sup>261</sup> Witness Statement of Alan Gershenhorn at para. 18.  
<sup>262</sup> Witness Statement of Alan Gershenhorn at para. 19.  
<sup>263</sup> Fuss Report at para. 82.  
<sup>264</sup> Witness Statement of Alan Gershenhorn at para. 19.

unfair competitive disadvantage.

**E. Conclusion**

204. Canada gives Canada Post both the exclusive privilege of being able to develop and maintain an infrastructure to fulfil its statutory obligation to deliver letter mail and the exclusive privilege to control access to that infrastructure. Canada Post has abused that privilege. Canada Post denies UPS Canada access to the Monopoly Infrastructure while giving its courier services access without appropriate payment. By not requiring appropriate payment, Canada Post cannot be using the Monopoly Infrastructure so as to enable it to provide cheaper basic postal services. Canada Post can only be abusing its exclusive privilege to give its courier services a competitive advantage. Canada Post's competitive advantage translates into higher sales and lower prices than competitors, like UPS Canada.
205. Comments from Canada Post executives reveal Canada Post gives its services a competitive advantage to help the Corporation expand market share and thereby avoid laying off workers. John Caines, Canada Post Media Spokesperson, has said: "We have a mandate to be in as many businesses as possible to survive as a corporation."<sup>265</sup> Similarly, Peter Melanson, CEO of EPOST affirmed that Canada Post leverages its monopoly privileges "to keep everybody working. To act as not only a defensive, but also an offensive capability to go after business that is ... eroding ..."<sup>266</sup> Dr. Neels draws from various reports to reach the same conclusion.<sup>267</sup>
206. Canada Post's efforts to protect jobs through leveraging its Monopoly Infrastructure for the benefit of its courier services are misguided. Dr. Neels notes that any jobs protected

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<sup>265</sup> Pierre Marcoux, Mike Pettapiece, "Purolator Control Question," *Hamilton Spectator*, August 30, 2000 at D7. [3329] (Tab U169).

<sup>266</sup> Transcript of second part of interview between Michael Killen and Peter Melanson, 2001 [21413 -21416 at 21415] (Tab U184).

<sup>267</sup> Neels Report at paras. 123-127.

at Canada Post are matched by simultaneous elimination of job opportunities at private companies, like UPS Canada. Dr. Neels also says it is inappropriate to use revenues generated from users of Canada Post USO services to preserve jobs given that Canada Post explains its entry into the competitive services as necessary to defray the cost of its USO network.<sup>268</sup> Canada Post's attempts to protect jobs through leveraging the Monopoly Infrastructure is, therefore, inconsistent with its own primary objective and inconsistent with Canada's NAFTA obligations.

207. UPS has filed an expert report of Howard Rosen, Chartered Business Valuator, that confirms that UPS Canada has suffered harm from Canada Post's actions with respect to its courier products.<sup>269</sup>

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<sup>268</sup> Neels Report at para. 127.

<sup>269</sup> Rosen Report at paras. 29-32.

**Chapter IV. LACK OF REGULATORY SUPERVISION OF CANADA POST**

208. Canada Post's exclusive access to the infrastructure associated with its Postal Monopoly, without appropriate allocation of costs, gives it an unfair competitive advantage. Canada has been made aware of this unfair competition by Canada Post, but has chosen to allow this conduct to continue. In doing so, Canada has breached its NAFTA obligations.
209. On several occasions, the Minister responsible for Canada Post has initiated reviews of Canada Post's use of its special privileges in its competition against other firms. On each occasion, these reviews found that Canada Post was likely engaging in unfair competition. On each occasion, the Minister chose to ignore the results of these investigations. While the early reviews were before the entry into force of NAFTA, Canada was no longer free to ignore such findings once it had NAFTA obligations to UPS Canada.
210. The Minister's refusals to restrain Canada Post's unfair competition against UPS Canada and other courier companies has resulted in a situation that is highly unusual, both in Canada, and throughout the rest of the industrial world: a government owned corporation which benefits from a guaranteed monopoly, yet faces no regulation of the use of that monopoly against competitors providing complementary services. As a leading authority on the history of Canada Post, Professor Robert Campbell has remarked, "This complete absence of third-party regulation of a public postal corporation is unique in the industrial world".<sup>270</sup>
211. Given the Minister's refusal to address the issues identified by the Minister's own investigations, Canada has chosen to rely on Canada Post's own board of directors and on general framework legislation in its defence to UPS' claim. Neither of these defences addresses the specific issues raised by UPS. Canada's reliance on Canada Post's own board of directors and its own auditors essentially allows the 'fox to guard the henhouse'. The general framework legislation only treats Canada Post like any other corporation

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<sup>270</sup> Campbell, *The Politics of the Post* at 352 (Book of Authorities at Tab 64).

while allowing Canada Post unfettered discretion to exploit the special privileges accorded to it in the *CPC Act*.

**A. Early Reviews of Canada Post's Conduct**

**1. Initial Failure to Establish A Regulator**

212. In 1980, the then Liberal government of Canada introduced Bill C-42 into Parliament - *An Act to Establish the Canada Post Corporation*. Bill C-42 proposed that Canada Post would be regulated through an already existing regulatory body, the Canadian Transportation Commission ("CTC"). The CTC would have held public hearings and approved or disapproved requests by Canada Post for postal price or service changes.<sup>271</sup>
213. In introducing the legislation, the Hon. André Ouellet, who would become Minister responsible for Canada Post and later, President and Chief Executive Officer of Canada Post, explained the role of the CTC as follows:

The Corporation will have a monopoly ... this procedure is [necessary] to protect the interests of the people and establish the necessary arm's length relationships.<sup>272</sup>

214. Notwithstanding Minister Ouellet's support for a regulatory body, the final *CPC Act* did not include this proposal. Rather, the *Act* merely obliged Canada Post to publish in the Canada Gazette any proposed price increases for a limited class of regulated postal services, as well as proposed changes to Canada Post's regulations. Interested parties would then be allowed sixty days to make representations to the Minister responsible for Canada Post. The Minister would then recommend to Cabinet whether to accept, alter or reject the proposals. If Cabinet did not act on Canada Post's proposal, the proposal would be deemed to be accepted. This procedure remains in the *CPC Act* to this date.<sup>273</sup>

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<sup>271</sup> Bill C-42 (18914-18955) (Tab U46).

<sup>272</sup> House of Commons, *Debates*, October 24, 1980 at 4077-8 (18900-18912) (Tab U47).

<sup>273</sup> *CPC Act*, ss. 19 and 20 (Tab U218).

215. Today, the only postal rates established by regulation are those for basic domestic and international single-piece letters; international printed matter, including newspapers and periodicals; literature for the blind; and some registered mail products. Canada Post has, over time, sought and received approval to remove numerous rate categories from Cabinet oversight. Consequently, most of Canada Post's postal rates are established without issuing regulations and without Cabinet approval, including rates for courier and parcel services.<sup>274</sup>
216. Soon after the creation of Canada Post, government task forces and committees recognized the potential for Canada Post's monopoly to allow it to engage in unfair competition in its sale of courier services. In 1984, a Task Force established by Minister Erik Neilson, of the newly elected Progressive Conservative government, concluded that Canada Post should be regulated in the same manner as monopoly telecommunications services providers.<sup>275</sup>
217. In 1985, Canada established a five member committee headed by Alan Marchment (the "Marchment Committee") to provide a report on the regulation of Canada Post. The Marchment Committee recommended that Canada Post focus its activities on delivering the mail and that a third party independent regulatory body review Canada Post's rate increases and ensure that its monopoly revenues would not cross-subsidize competitive services.<sup>276</sup>

## **2. Postal Services Review Committee**

218. On June 27, 1988, after completing further consultations regarding the Marchment

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<sup>274</sup> General Accounting Office, *Postal Reform in Canada* (extract) at (10414-10415) (Tab U84). See also *CPC Act*, s. 21 (Tab U218).

<sup>275</sup> "Third Party Review of Canada Post's Rates and Structures", Department of Consumer and Corporate Affairs, March 29, 1988 at 11-22 (19012-19025) (Tab U50).

<sup>276</sup> Review Committee on the Mandate and Productivity of Canada Post Corporation (1985) at 27-28 (18956-19011) (Tab U49).

Committee report, the Minister responsible for Canada Post announced the creation of the PSRC. The government indicated its intention to establish a Postal Services Review Board as a permanent, independent national board to review Canada Post's rates and services, once legislation could be passed by Parliament. The PSRC, headed by Alan Marchment, was to perform the full functions of the Board until the necessary legislation could be put in place.<sup>277</sup>

219. The Hon. Harvie André, the Minister responsible for Canada Post, explained that the rationale for the creation of the PSRC was as follows:

Canada Post is unique among the major providers of public services that enjoy a monopoly in this country, as it is not subject to any kind of outside review.<sup>278</sup>

220. Bill C-149 to establish the Postal Services Review Board was given first reading in the House of Commons on August 15, 1988. While Parliament was dissolved before this Bill could be passed, the Bill became the guideline for the PSRC's mandate. In particular, section 15(2)(e) of the Bill required the PSRC to consider "the provision and extension of postal services in a manner that encourages fair competition with other like services".<sup>279</sup>
221. On July 22, 1989, Canada Post published proposed changes in its regulations. Following this notice, the PSRC requested information from Canada Post and held hearings across Canada. In November 1989, the PSRC issued its recommendations to the Minister responsible for Canada Post.<sup>280</sup>

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<sup>277</sup> Postal Services Review Committee, *Recommendations to Canada Post Corporation Regarding Its Proposed January 1990 Changes to Regulations*, November 1989 at 1, (4552-4641) (Tab U54).

<sup>278</sup> Department of Consumer and Corporate Affairs, News Release, June 27, 1988.

<sup>279</sup> Postal Services Review Committee, *Recommendations to Canada Post Corporation Regarding Its Proposed January 1990 Changes to Regulations*, November 1989 at 1-2, (4552-4641) (Tab U54).

<sup>280</sup> Postal Services Review Committee, *Recommendations to Canada Post Corporation Regarding Its Proposed January 1990 Changes to Regulations*, November 1989 at 2-8, (4552-4641) (Tab U54).

222. The PSRC's report "was far more aggressive than the government had anticipated."<sup>281</sup> It recommended that the government reject many of Canada Post's proposed regulatory changes. It also found "major deficiencies" in the volume, cost and revenue information provided by Canada Post with respect to both regulated and unregulated products.<sup>282</sup>
223. The PSRC explained its request for volume, cost and revenue information for unregulated products as follows:

Fairness and reasonableness of regulated rates is intrinsically linked to fairness and reasonableness of unregulated rates. Much of Canada Post's revenue is derived from unregulated services which fall under its exclusive privilege or from markets where it has a near-monopoly position. In addition, the existence of regulated products typically creates unique cost advantages for the offering of unregulated products because many of Canada Post's costs are interdependent. There is therefore a need to review the costs and revenues pertaining to unregulated service offerings.<sup>283</sup>

224. The PSRC then lamented that Canada Post only supplied aggregate level data and that, as a result, "critical tests for cross-subsidization of currently unregulated products and of products proposed for deregulation cannot be performed."<sup>284</sup> It then found that, even the inadequate aggregate data supplied by Canada Post indicated that competitive services had been cross-subsidized:

Canada Post also provided cost and revenue information for the aggregate of all "competitive" products (which includes both regulated and unregulated products). This information suggests that, up to 1988-89, in contrast to exclusive privilege products, revenues from "competitive" products were **not** covering their attributed costs. ... These results reinforce the need for a more detailed scrutiny of Canada Post's unregulated and "competitive" product offerings.<sup>285</sup>

225. Canada Post attempted to justify its costing methodology to the PSRC by submitting a

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<sup>281</sup> Campbell, *The Politics of the Post* at 70 (Book of Authorities at Tab 64).

<sup>282</sup> Postal Services Review Committee, *Recommendations to Canada Post Corporation Regarding Its Proposed January 1990 Changes to Regulations*, November 1989 at 10, (4552-4641) (Tab U54).

<sup>283</sup> Postal Services Review Committee, *Recommendations to Canada Post Corporation Regarding Its Proposed January 1990 Changes to Regulations*, November 1989 at 11, (4552-4641) (Tab U54).

<sup>284</sup> Postal Services Review Committee, *Recommendations to Canada Post Corporation Regarding Its Proposed January 1990 Changes to Regulations*, November 1989 at 11, (4552-4641) (Tab U54).

<sup>285</sup> Postal Services Review Committee, *Recommendations to Canada Post Corporation Regarding Its Proposed January 1990 Changes to Regulations*, November 1989 at 12, [Emphasis in original] (4552-4641) (Tab U54).

consultant's report. The report opined that Canada Post's methodology was reasonable "given the current state of evolution of product costing at Canada Post". The PSRC concluded that "This qualification renders the opinion virtually meaningless ... The [consultant's] report itself avoided any assessment of the reliability of the data employed and of the results obtained".<sup>286</sup>

226. The PSRC then identified a number of deficiencies in the consultant's methodology and concluded that:

The deficiencies in the methodology and the absence of detailed results render the costing information supplied of little value. The public and the Committee can, therefore, not conclude that rates are fair and reasonable or are consistent with fair competition.<sup>287</sup>

227. As Professor Campbell observed, the PSRC's report "was not the sort of result the government had envisioned when it established the review process. It had expected this informal, advisory review process to be benign. The PSRC and CPC were to develop a smooth working relationship, approving CPC plans in a manner that would increase their public legitimacy. This scenario failed to develop for a number of reasons...". As a result, rather than implementing the PSRC's recommendations, the government eliminated the PSRC in its February 1990 budget.<sup>288</sup>
228. Professor Campbell concludes his review of the government's response to the PSRC by observing that "Canada Post thus entered its second decade as an unregulated monopoly, a situation unique in the industrialized world. It is effectively insulated from public scrutiny and governmental criticism. And the government gives the impression that it will continue to provide this protection so long as the corporation continues to realize the

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<sup>286</sup> Postal Services Review Committee, *Recommendations to Canada Post Corporation Regarding Its Proposed January 1990 Changes to Regulations*, November 1989 at 12, (4552-4641) (Tab U54).

<sup>287</sup> Postal Services Review Committee, *Recommendations to Canada Post Corporation Regarding Its Proposed January 1990 Changes to Regulations*, November 1989 at 12, (4552-4641) (Tab U54).

<sup>288</sup> Campbell, *The Politics of the Post* at 349, 304-305 (Book of Authorities at Tab 64).

government's objectives".<sup>289</sup>

**B. The Canada Post Mandate Review**

229. In November 1995, the Hon. David Dingwall, Minister responsible for Canada Post in what was now a Liberal government, initiated a new review of the mandate of Canada Post, chaired by George Radwanski (the "Mandate Review"). The terms of reference of this new Mandate Review expressly included issues relating to Canada Post's competition in the marketplace, in particular:

Is the exclusive privilege business being used to subsidize competitive products? What processes should be developed to satisfy the regulator, the competitors and the general public that CPC competes fairly in the marketplace?<sup>290</sup>

230. The Mandate Review proceeded to conduct an extensive investigation into the affairs of Canada Post. It received 440 formal submissions and 1,084 letters. It held meetings in six Canadian cities and in a number of rural communities, as well as commissioning focus groups and opinion surveys. The Mandate Review also met with a number of experts and employed a small professional staff, many of which were seconded from government departments.

231. The Mandate Review's report, released on October 8, 1996, contained the following key conclusions:

- a. The corporation has created serious issues of fairness and appropriateness by "leveraging" the network it has built through its government-granted monopoly and through past outlays of public funds to compete with private sector companies from a position of strength they cannot match.
- b. Canada Post has developed such a reputation as an over-aggressive, indeed vicious, competitor that a significant number of Canadians, particularly operators of small businesses, are quite literally afraid of it. Even some of Canada's largest businesses have told this Review, in confidence, that they are afraid to publicly criticize the corporation, for fear that it will use its monopoly position to retaliate.

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<sup>289</sup> Campbell, *The Politics of the Post* at 70 (Book of Authorities at Tab 64).

<sup>290</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Introduction at 1, Appendix A at 2, (19026-19183) (Tab U79).

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- c. Canada Post's strategic vision makes highly questionable policy or economic sense. It's a vision that would require the corporation to spread its activities ever wider through the private-sector economy, farther and farther away from the basic reasons for its existence, in order to make up revenue shortfalls and anticipated (perhaps wrongly) letter mail volume declines.
- d. Though it invokes "universal service at an affordable price" as its core mission, Canada Post has lost sight of the focus on public service that is the fundamental reason for its existence.
- e. The corporation is not subject to any adequately effective accountability mechanisms. Neither the Minister responsible for Canada Post, nor any other branch of the Government, nor even the corporation's own Board of Directors has any way of providing the sustained supervision necessary to ensure that its priorities and behaviour are fully consistent with the public interest.<sup>291</sup>
232. The Mandate Review conducted a detailed review of Canada Post's competitive stance and considered Canada Post's claim that it must "leverage" its network to provide universal postal service at uniform rates. The Mandate Review observed that Canada Post's recent ventures into new business lines combined with its lack of regulatory oversight, had created a combination that was highly unusual in both Canada and other industrialized countries.

Previous competitive activities were either *defensive*, intended primarily to protect the core letter mail service from rival means of communications, or *ancillary* to that core service. Today's Canada Post, in contrast, has stepped quite aggressively into the private sector with the aim of carving out new sources of business and revenues. ...

This has created a serious anomaly: an unregulated public sector monopoly engaged in unrestrained competition with the private sector.

Postal services in most other countries have a monopoly, or exclusive privilege, over core letter mail services, and they also compete with the private sector to one extent or another. But there are usually safeguards to mitigate that competition. In the United States, for instance, the Postal Rate Commission consistently exerts downward pressure on the US Postal Service's monopoly prices and upward pressure on the non monopoly ones. The British Post Office has rigid structural separation between its various types of operations. In European countries, there is a movement towards "unbundling" under which competitors can use parts of a postal service's network at the same prices it charges itself, effectively precluding competitively unfair pricing.

In virtually any conceivable scenario, the behaviour of such an entity as Canada Post would be perceived as unfair by those adversely affected by it. Each element of the situation guarantees such a perception. The power and financial resources of the state pitted against individual companies, particularly small businesses, can scarcely avoid seeming disproportionate. The use of monopoly position in one field as a foundation for competitive activity in other fields, whether closely related or not, inevitably invites suspicions of cross-subsidy and other forms of undue advantages. And the absence of regulation, or any other meaningful supervision, precludes the

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<sup>291</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 1 at 1-2, (19026-19183) (Tab U79).

possibility of any reassurance that excesses are not being committed.<sup>292</sup>

233. The Mandate Review then found that Canada Post’s Annual Cost Study did not remedy the lack of regulatory oversight:

The problem is compounded by Canada Post’s own particular competitive style. Despite the understandable concerns that a corporation in its unique position might be using revenues from its monopoly to cross-subsidize unfairly low prices for its competitive activities, Canada Post invokes “commercial sensitivity” in refusing to publicly release detailed cost and profit information for its various products and services. Aggrieved competitors would be unlikely to be fully satisfied by assurances from any third party - however independent - as to an absence of cross-subsidy, without being able to judge for themselves.

Even worse, Canada Post itself still does not *have* accounting systems that identify the actual costs and revenues of each specific product and service with satisfactory precision, despite having been urged repeatedly over the past decade to put such systems into place. Instead, the corporation uses an approach technically known as the “regulatory method” to prepare its Annual Cost Study. This method consists of allocating variable and specific fixed costs to each product line, but leaving common fixed costs unallocated because the corporation says they would remain unchanged if any one product or product group were removed. Roughly 40% of total costs are unallocated.

The Review has noted that Canada Post regularly engages independent experts to verify that its accounting and costing methodology within the Annual Cost Study is appropriate and reasonable. But it does not necessarily follow that the Annual Cost Study approach itself can satisfactorily answer all questions that arise, nor that what is appropriate and reasonable from the standpoint of accountants and economists is sufficient *public policy* term in the case of a public sector monopoly engaged in aggressive private sector competition.

In essence, Canada Post’s premise is that it has a collection, sorting, transportation and distribution network whose costs are virtually immutable, and that therefore only the “extra” costs of providing any given competitive product or service are real costs that can be allocated. These products and services, consequently, don’t show a profit or loss in the parlance of the corporation; they make a “contribution” toward the fixed costs. The fundamental flaw of this approach is that it inherently involves subjective - and potentially inaccurate or self-serving - judgements as to what can or cannot be allocated, and therefore as to what price must be charged for a given product or service to reflect its true cost and avoid cross-subsidization.

The anomaly of an unregulated public sector monopoly corporation in unrestrained competition with the private sector is therefore intensified by a second anomaly; that corporation carries out its competitive activities on the basis of a cost-accounting processes that are neither publicly open, transparent, reliable nor in any possible way confidence-inspiring.<sup>293</sup>

234. In response to Canada Post’s attempts to dismiss these concerns as those of “foreign-based multinationals”, the Mandate Review noted that “large corporations, whether

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<sup>292</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 3 at 1-2, (19026-19183) (Tab U79).

<sup>293</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 3 at 1-2, (19026-19183) (Tab U79).

Canadian- or foreign-owned, are no less entitled to fair and appropriate treatment at the hands of an entity of the Government of Canada.”<sup>294</sup>

235. The Mandate Review examined the issue of cross-subsidization of courier services by the exclusive privilege in considerable detail. It noted the “circumstantial evidence” surrounding a proposed increase in basic postage rates that was announced in October 1994 and accompanied by an announcement of price reductions for Priority Courier, Xpresspost and Regular Post in key market areas. When Cabinet rejected the proposed increase in the postal rate, Canada Post urgently informed its customers that its announced courier rate reductions were cancelled.<sup>295</sup>
236. The Mandate Review then considered the Annual Cost Study performed by Canada Post since 1987 and found it to be severally flawed. It concluded that these flaws in cost allocation were a form of cross-subsidization:

An examination of Canada Post’s non-allocated cost categories has revealed that this discretion in its methodology has led to a number of incidents of cost misallocation. The failure in the methodology to correctly allocate costs was generally found to be related to either how the concept of time was treated in determining long-run incremental costs, or to how the causal links between products and activities were identified or ignored.

There is no evidence that Canada Post deliberately sets out to misallocate costs to its own advantage, but its level of diligence appears to be affected by the fact that there is virtually no penalty if such favourable misallocation occurs. If the volume variability component of an activity is obvious and easily measured, then the costs of that activity will be allocated.

Where it is not obvious and/or difficult to measure, allocation is unlikely to occur. Allocation becomes the exception rather than the rule, because there is no real penalty to Canada Post for getting it wrong.

Without entering into excessive technical detail, it suffices to say here that the work of the Review identified a total of \$180 million in unallocated costs that Canada Post has agreed could have been allocated and will be allocated in future. This will reduce the non-allocated portion of the corporation’s total costs from 44% to 41%. The Review notes that non-allocation of these previously non-allocated costs has a dramatic effect on the contribution levels of three product groups: parcels, courier, and “other”. As well, the work of the Review identified another \$60 million which could be allocatable, but which would require detailed costing and engineering studies.

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<sup>294</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 3 at 3, (19026-19183) (Tab U79).

<sup>295</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 3 at 8, (19026-19183) (Tab U79).

To the extent that cost misallocation is a form of cross-subsidization, it is a finding of this Review that Canada Post has cross-subsidized. Specific product lines were relieved from being directly responsible for paying a portion of their costs. When the misallocated costs that could be measured were reallocated, the contribution margins on certain products - parcels and courier, for example - declines in value. But their contributions still remain positive. Thus Canada Post is able to argue that cross-subsidization does not occur.

Nevertheless, Canada Post has misallocated its costs. Deliberate or not, this has given its competitive products an advantage over those of Canada Post's competitors that they would otherwise not have. Whether this actually places competitors at a significant disadvantage, is to some degree irrelevant if fairness is the only factor being considered. To the extent that Canada Post's ability to misallocate its costs flows directly from being a Crown corporation endowed with a Government-granted monopoly, this can be characterized as an unfair use of its privileged position.<sup>296</sup>

237. Yet the Mandate Review did not limit its analysis to the issue of cross-subsidization. In comments that are consistent with the approach employed in the expert report of Dr. Kevin Neels<sup>297</sup>, the Mandate Review also found that Canada Post's open admission that it "leverages" its network to the exclusion of all other competitors creates unfair advantages distinct from the technical definition of cross-subsidization:

Canada Post openly admits that it does and will continue to leverage its existing network to achieve cost savings in the provision of all its product lines. It argues that this is merely efficient use of resources and sound business practice.

The difficulty is that, for instance, by using the same airline as Purolator for its letter mail shipments, Canada Post is causing the overall costs per piece of transporting both products to decline through volume discounts. The fact that the planes continue to be used primarily for Purolator packages, with Canada Post making up the remaining capacity, indicates that both volumes are necessary to obtain the lower costs per unit. Since Purolator could not have procured such discounts in any other manner, Purolator's costs are lower than they would otherwise be - as a direct result of Canada Post's exclusive privilege. To the extent that Purolator's competitors do not have access to the same volumes and resulting discounts, this constitutes unfair advantage.

The same sort of argument applies to using Canada Post's mail trucks to carry a variety of competitive products including courier, Xpresspost, and admail. In the case of Volume Electronic Mail, likewise, the corporation appears to be cross-subsidizing its production service with its delivery service.

The leveraging issue underscores the fundamental problem with Canada Post's competitive activity. It is undoubtedly true that other multi-product companies regularly use leveraging of their networks to maximize efficiency - but these private sector companies did not build their networks with public funds, on the foundation of a government-granted monopoly. None of Canada Post's competitors have access to the cost advantage that leveraging such a network automatically provides.

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<sup>296</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 3 at 15-16, (19026-19183) (Tab U79).

<sup>297</sup> Neels Report at paras. 58 - 62.

In the opinion of the Review, consequently, the position of the corporation is not made acceptable by a simple finding that its competitive product lines are not actually losing money. Because any contribution they make is really “gravy” - additional revenues to offset network costs that would be incurred in any event - it does not necessarily matter to the corporation if these would make sense for its competitors. The conclusion is inescapable that this makes Canada Post an unfair competitor.<sup>298</sup>

238. The Mandate Review made a formal finding that Canada Post is an unfair competitor, that its misallocation of costs constitutes a form of cross-subsidization and that its ability to leverage a network built up with public funds on the strength of a government-granted monopoly gives it a pricing advantage over competitors that is seriously unfair.<sup>299</sup>

### **C. Canada’s Decision to Ignore Its Own Mandate Review**

#### **1. The Minister’s Response**

239. On October 8, 1996, the Minister responsible for Canada Post, then the Hon. Diane Marleau, released the Mandate Review and an accompanying statement with the following response:

My response is this: The federal government is expected to embody certain values and principles in how it carries out its affairs, in particular: fairness, transparency, openness and accountability. *Canada Post is part of the federal government and must live up to these standards.* As Minister responsible for Canada Post, I expect immediate corrective action wherever these values and principles have been compromised. To this end, I have asked Mr. Ouellet, as Chair of Canada Post Corporation, to develop an action plan for improving the transparency of Canada Post’s activities, and addressing these issues. (Emphasis added).<sup>300</sup>

240. The Mandate Review had recommended that, rather than create a regulator to monitor Canada Post’s use of its monopoly, Canada Post should simply exit all competitive

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<sup>298</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 3 at 16-17, (19026-19183) (Tab U79).

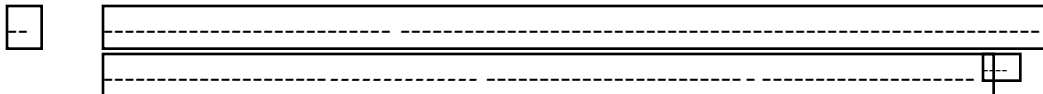
<sup>299</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 3 at 17, (19026-19183) (Tab U79).

<sup>300</sup> Notes for an address by the Hon. Diane Marleau on the announcement of the Release of the Canada Post *Mandate Review Report*, October 8, 1996 at 2, (09798-09802) (Tab U80).

services, divest itself of Purolator and focus on its core letter mail business.<sup>301</sup> In response to this recommendation, Minister Marleau stated that the government needed time to study the financial ramifications for Canada Post and had retained the firm of TD Securities Inc.<sup>302</sup>

241. The confidential report of TD Securities Inc. and Dresdner Kleinwort Benson (the “*TD Securities Report*”) was provided to the Minister responsible for Canada Post on March 31, 1997, but was not released to UPS in unedited form until the completion of the document production phase of this arbitration. Among the key findings of the *TD Securities Report* were that:

- a. Although Canada Post should not withdraw from competitive services, it “should be supervised/regulated by a single regulatory body, either independent or part of a single Government department”. The supervisory authority would prevent cross-subsidization and other abuses of the exclusive privilege, such as the denial of access to Canada Post’s network to competitors.<sup>303</sup>



- c. Canada Post’s financial structure should be made more transparent so that any cross-subsidization from the exclusive privilege letter mail business to the

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<sup>301</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 7 at 13, (19026-19183) (Tab U79).

<sup>302</sup> Notes for an address by the Hon. Diane Marleau on the announcement of the Release of the *Canada Post Mandate Review Report*, October 8, 1996 at 3-4, (09798-09802) (Tab U80).

<sup>303</sup> TD Securities Inc. and Dresdner Kleinwort Benson, *Confidential Report to The Minister responsible for Canada Post Corporation*, March 31, 1997 at 14, Appendix D at 6 (R245-1) (Tab U93).

<sup>304</sup> TD Securities Inc. and Dresdner Kleinwort Benson, *Confidential Report to The Minister responsible for Canada Post Corporation*, March 31, 1997 at 46 (Emphasis added) (R245-1) (Tab U93).

competitive sector be made clear.<sup>305</sup>

[REDACTED]

- e. There was no transparency in the relationship between letter mail and the retail network. “Indeed a cross-subsidy from one to the other is intrinsic and difficult to monitor. If we wish to ensure that the retail network operates under true market conditions ... then a link between the two businesses prejudices this”.<sup>307</sup>

242. The delivery of the *TD Securities Report* gave Minister Marleau the choice between two different options. Either she could accept the recommendations of the Mandate Review and order Canada Post to withdraw from competitive services or she could allow Canada Post to continue to provide these services on the condition that they be regulated in the manner recommended in the *TD Securities Report*. Minister Marleau, however, refused to follow either recommendation.

243. On April 23, 1997, Minister Marleau issued a press release stating that Canada Post would remain in competitive services. However, Minister Marleau did not establish a regulator as recommended by TD Securities. Instead, she merely required Canada Post to provide an annual statement from its auditor on cross-subsidization between its competitive services and its exclusive privilege business.<sup>308</sup> As discussed below, the auditors’ statement is mere ‘window dressing’ and provides no reasonable assurances that Canada Post is not engaging in unfair competition.

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<sup>305</sup> TD Securities Inc. and Dresdner Kleinwort Benson, *Confidential Report to The Minister responsible for Canada Post Corporation*, March 31, 1997 at 45. (R245-1) (Tab U93).

<sup>306</sup> TD Securities Inc. and Dresdner Kleinwort Benson, *Confidential Report to The Minister responsible for Canada Post Corporation*, March 31, 1997 at 94. (R245-1) (Tab U93).

<sup>307</sup> TD Securities Inc. and Dresdner Kleinwort Benson, *Confidential Report to The Minister responsible for Canada Post Corporation*, March 31, 1997 at 100. (R245-1) (Tab U93).

<sup>308</sup> Marleau Outlines Plan for Canada Post, News Release dated April 23, 1997, (14606-14607) (Tab U95).

244. Minister Marleau's press release stated that this announcement "completes the review of the mandate of Canada Post, and is the government's final response to the report of the independent review chaired by Mr. George Radwanski ...".<sup>309</sup> Until this announcement, Canada appeared to be engaged in a serious process of administrative supervision of Canada Post and of weighing the remedies for Canada Post's unfair competition. It was only upon the Minister's announcement of April 23, 1997 that it became apparent that Canada's supervision of Canada Post had come to an end and that no meaningful remedies would be imposed.
245. In this arbitration, UPS has repeatedly requested documents related to Canada's supervision of Canada Post. Canada initially claimed Cabinet privilege in respect of 377 documents or portions of documents. On June 17, 2004, UPS sought an order requiring Canada to provide specifics for these documents, and to produce them.
246. In its Reply to the Investor's Motion on Cabinet Privilege, dated August 13, 2004, Canada identified 170 documents that were responsive in whole or in part.<sup>310</sup> Canada provided UPS with 27 heavily redacted documents, but refused to produce the remaining 143 documents which were responsive to UPS' document requests based on Cabinet privilege.<sup>311</sup>
247. In its Decision dated October 8, 2004, this Tribunal concluded that Canada's claim to Cabinet privilege was not made out.<sup>312</sup> Canada's continuing failure to disclose these documents is unjustifiable. The Tribunal has declared its willingness to draw adverse

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<sup>309</sup> Marleau Outlines Plan for Canada Post, News Release dated April 23, 1997, (14606-14607) (Tab U95).

<sup>310</sup> Canada's Reply to the Investor's Motion on Cabinet Privilege at para. 10, (Book of Authorities at Tab 6).

<sup>311</sup> Schedule A and Schedule B, attached to Canada's Reply to the Investor's Motion on Cabinet Privilege (20926-20979) (Tab U156).

<sup>312</sup> *Decision of the Tribunal Relating to Canada's Claim of Cabinet Privilege*, dated October 8, 2004 at para. 13 (Book of Authorities at Tab 107).

inferences on this issue based on Canada's failure to disclose.<sup>313</sup> The Tribunal should draw an adverse inference that Canada is aware that Canada Post has leveraged its Monopoly infrastructure without a proper allocation of costs, and does not want to disclose this fact.

**2. Inappropriate Reliance on Canada Post to Police Itself**

248. By requiring nothing more than an annual statement from Canada Post's auditors regarding cross-subsidization, Canada essentially allows Canada Post to determine for itself whether or not it engages in unfair competition. As set out in the expert report filed on behalf of UPS by Kenneth M. Dye, former Auditor General of Canada, the auditors' statement included in Canada Post's *Annual Reports* has gradually been weakened over the years to the point that it provides no reasonable assurances regarding Canada Post's behaviour.

249. For the years ended in March 1997, 1998 and 1999, Canada Post's then auditors, KPMG, purported to provide an "assurance engagement audit" of Canada Post's Annual Cost Study. Even that statement, however, was restricted to being in accordance with the cost methodology developed by Canada Post. As auditors, KPMG were not in a position to comment on the validity of that methodology. Canada Post retained an economist to develop the methodology and its auditors did not retain an independent expert to review this economic analysis, as required by relevant audit guidelines.<sup>314</sup>

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[Redacted text block]

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<sup>313</sup> *Decision of the Tribunal Relating to Canada's Claim of Cabinet Privilege*, dated October 8, 2004 at para. 15 (Book of Authorities at Tab 107).

<sup>314</sup> Expert Report of Kenneth M. Dye at para. 9, 12 and 19.

[REDACTED]

251. By March 18, 2002, RCGT modified its audit opinion even further, eliminating the phrase that the audit was conducted [REDACTED] [REDACTED] and substituting the words [REDACTED] [REDACTED].<sup>316</sup> As a result, no assurance opinion is given at all.<sup>317</sup>

252. As the report of Kenneth Dye demonstrates, the auditors' opinion is based on a large number of assumptions including the appropriateness of the methodology used by the economist retained by Canada Post to develop the Annual Cost Study, as well as assumptions about the accuracy of all cost, volume and product revenue information produced by Canada Post. There is no external review of the validity of the methodology used by Canada Post. Mr. Dye concludes that the auditors' statement is 'mere window dressing'.<sup>318</sup>

253. As a result, it is not surprising that, as the expert report of Dr. Kevin Neels demonstrates, Canada Post's costing methodology suffers from severe flaws. The methodology does not even purport to consider the unfairness from Canada Post's discriminatory leveraging of its network, nor does it even meet more basic standard tests for cross-subsidization.

#### **D. Inadequacies of General Framework Legislation**

254. Given Canada's failure to follow the recommendations of the Mandate Review and the *TD Securities Report*, Canada's *Statement of Defence* relies on two types of general framework legislation in response to UPS' allegations that Canada fails to adequately supervise Canada Post. First, Canada relies on the *Financial Administration Act* ("FAA")

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<sup>315</sup> [REDACTED] May 4, 2000, R82A-4 (Tab U147).

<sup>316</sup> [REDACTED] March 18, 2002, R82A-8 (Tab U232).

<sup>317</sup> Expert Report of Kenneth M. Dye at para. 34.

<sup>318</sup> Expert Report of Kenneth M. Dye at para. 32. Canada also failed to produce the working papers of Canada Post's auditors as requested. See Investor's Information Request (Tab U294).

which governs all Crown Corporations. Second, Canada relies on the *Competition Act* which applies to private businesses generally.

255. Neither defence is responsive to UPS' allegations. The *FAA* merely ensures that Canada Post meets certain financial self-sufficiency targets and does not rely on direct subsidies from Canada. Such subsidies are not at issue in this arbitration. The *Competition Act* addresses anti-competitive conduct by private firms, but does not purport to regulate the provision of unfair competitive advantages by the government that favor some competitors over others.

**1. The *Financial Administration Act***

256. Canada's *Statement of Defence* describes Canada Post's obligations under the *FAA* as follows:

Under the *FAA*, Canada Post is obligated to submit annually to the Governor in Council, for approval, a five year Corporate Plan, which broadly describes the Corporation's forward agenda in respect of major activities and strategic issues. Canada Post cannot act in a manner inconsistent with the plan, but otherwise has broad discretion consistent with its status as a state enterprise with a commercial mandate.<sup>319</sup>

257. Thus, according to Canada's own admission, the Corporate Plan is merely a broad description of Canada Posts activities and strategic issues and does not provide any safeguards against unfair competition. On the contrary, the Corporate Plan merely confirms Canada Post's intention to leverage its network to carry out competitive activities.<sup>320</sup>

258. The *Statement of Defence* also relies on the *FAA* for the proposition that Canada Post's directors "owe a duty to act in the best interests of the Corporation".<sup>321</sup> UPS agrees, but

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<sup>319</sup> *Statement of Defence* at para. 44. See also *FAA*, s. 122 (D8654-8742) (Tab U298).

<sup>320</sup> See TD Securities Inc. and Dresdner Kleinwort Benson, *Confidential Report to The Minister responsible for Canada Post Corporation*, March 31, 1997 at 42 for an excerpt. (R245-1) (Tab U93).

<sup>321</sup> *Statement of Defence* at para. 46. See also *FAA*, s. 109 (D8654-8742) (Tab U298).

this is precisely the problem with Canada's reliance on Canada Post to supervise itself. The maintenance of unfair competitive advantages may very well be in the best interests of Canada Post. The absence of any meaningful external review of Canada Post's Annual Cost Study, therefore, ensures that the deficiencies of that study will not be corrected by Canada Post itself.

259. Furthermore, the effectiveness of the *FAA* disciplines should not be overstated. The Auditor General of Canada delivered reports in 2000 and again in February 2005 finding that the boards of directors of Crown Corporations are weak, that Canada regularly approves deficient corporate plans and that it lacks the knowledge and expertise to challenge these plans.<sup>322</sup>

## **2. Limits of The *Competition Act***

260. Canada also relies on the fact that Canada Post is subject to the *Competition Act*, which applies to private firms generally and contains prohibitions against predatory pricing and abuses by corporations of dominant positions. The *Competition Act* is administered and enforced by the Commissioner of Competition, who is supported by staff at the Competition Bureau.<sup>323</sup>
261. However, the *Competition Act* addresses different questions than those raised in this arbitration. Although it is possible that Canada Post has violated the *Competition Act*, that inquiry is distinct from the issue of whether Canada Post has been granted preferential treatment over UPS Canada. The former inquiry examines whether Canada Post's business practices have led to a substantial lessening of competition, for example by forcing rivals out of the market, which would thereby allow Canada Post to raise

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<sup>322</sup> *Auditor General's Report on Governance of Crown Corporations* (December 2000) at 18.26-18.30, D18986-19022 (Tab U178) 18.93-18.110; *Auditor General's Report on Governance of Crown Corporations* (February 2005) at 7.27 and 7.48. (17359-17388) (Tab U315).

<sup>323</sup> *Statement of Defence* at para. 48. See also *Competition Act*, sections 50 and 79 (Tab U408).

prices or reduce service.<sup>324</sup> By contrast, the latter inquiry examines whether rivals are harmed through Canada Post's granting exclusive access to its Monopoly Infrastructure to its Physical Distribution services and to Purolator. There is no need to consider whether rivals are forced out of the market or whether losses by Canada Post will later be recouped through price increases on courier services. On the contrary, in the latter case, courier prices may remain excessively low for an indefinite period.<sup>325</sup>

262. The limits of the *Competition Act* are best illustrated by the submission of the Competition Bureau's own Director of Investigation and Research (as the Commissioner of Competition was then known) to the Canada Post Mandate Review. While the Competition Bureau's submission recommended that Canada Post's exclusive privilege be abolished, it recognized that social policy considerations might lead to the exclusive privilege being maintained. In that eventuality, the Director recommended that existing regulation:

“be modified in order to ... *reduce the incentive to use the revenues derived from markets in which CPC has an exclusive privilege to subsidize competitive activities.* ... The forms of regulation suggested by the Director include contract pricing, regulatory prohibition, regulatory forbearance, structural separation, cost allocation manuals and price cap”.

The Director suggested that each of these alternatives be studied carefully.<sup>326</sup>

263. The Competition Bureau's submission to the Mandate Review demonstrates that it does not view its own authority under the *Competition Act* as being sufficient to address the potential for unfair competition by Canada Post. It is important to note that, unlike European competition authorities, the Commissioner of Competition has no jurisdiction

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<sup>324</sup> Predatory Pricing Enforcement Guidelines (19230-19246) (Tab U330); Abuse of Dominance Enforcement Guidelines (19247-19291) (Tab U329).

<sup>325</sup> Dr. Neels notes that Canada Post's protected source of revenues and lack of profit maximization pressures give it a greater opportunity to engage in anti-competitive conduct than private firms. Neels Report at paras. 63 - 74.

<sup>326</sup> Submission of The Director of Investigation and Research, Competition Bureau, to Canada Post Corporation Mandate Review Committee, February 15, 1996 at 52, (R249-1) (Tab U76).

over “state aid” that favors one competitor over another.<sup>327</sup> In Canada, only NAFTA tribunals can police such conduct.

264. In certain circumstances, cross-subsidization may be relevant to investigations by the Competition Bureau. For example, in its review of Canada Post’s acquisition of Purolator, the Competition Bureau considered the potential cross-subsidization between Canada Post and Purolator in its analysis of whether the merger would result in a “substantial lessening of competition”. However, the Bureau’s statement noted that “several conditions must exist for cross-subsidization to result in a substantial lessening of competition under the Act” and explained that, “While cross-subsidization, on its own, may result in a misallocation of economic resources, it will only give rise to concerns under the merger provisions if it is likely to result in substantial lessening or prevention of competition”. This would only occur if, “upon the competitors’ exit, the merged entity would be able to raise its courier prices above competitive levels or maintain quality and service below competitive levels, without the threat of entry”.<sup>328</sup>
265. When Competition Bureau officials later appeared before the Mandate Review, they were asked to comment on their analysis of cross-subsidization in the context of the review of the Purolator acquisition. They responded that this examination was limited to specific technical questions pertaining only to merger analysis. A senior Bureau representative stated that “I think there has been a great deal of press and a lot of claims by Canada Post to the effect that we have given them a clean bill of health, and that is really not the case.”<sup>329</sup> The Mandate Review concluded that “the mantle of vindication by the Competition Bureau is not currently available to Canada Post”.<sup>330</sup>

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<sup>327</sup> See Article 87, *Treaty Establishing the European Community* (C325) 33 (19716-19863) (Tab U284).

<sup>328</sup> Backgrounder Canada Post Corporation/Purolator Courier Inc. dated November 26, 1993 (P248A-3) (Tab U60).

<sup>329</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 3 at 13, (19026-19183) Tab U79).

<sup>330</sup> Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 3 at 13, (19026-19183) Tab U79).

266. While Canada relies on the Competition Bureau in its *Statement of Defence*, Canada asserted a last minute objection to the production of nine Competition Bureau documents on December 3, 2004. Canada alleged that production of these documents would “impede law enforcement” and was, therefore excused under NAFTA Article 2105. As with its vague and unsubstantiated assertions of Cabinet privilege, Canada has given no particulars that would justify refusal to produce relevant documents.<sup>331</sup>

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<sup>331</sup> Letter from Ivan Whitehall, QC to Barry Appleton dated December 3, 2004 (Tab U404).

**Chapter V. CANADA CUSTOMS' PREFERENTIAL TREATMENT OF CANADA  
POST**

267. Canada Post and UPS Canada both deliver to Canadian destinations courier shipments imported into Canada from the United States and the rest of the world. The same duties and taxes must be collected from importers of these shipments as they cross the border. Yet, Canada has exempted Canada Post from the customs requirements that apply to its competitors. As a result, Canada Post routinely fails to collect duties and taxes. Many shippers are aware of this failure and, as a result of its neglect, Canada Post is allowed to gain a competitive advantage.
268. In its *Statement of Defence*, Canada has sought to excuse these differences by expounding at great length about the rationale for the creation of different postal and courier customs streams. Yet the advantages given to Canada Post are not related to Canada's stated rationale for the existence of separate streams. Rather, they largely arise out of a confidential agreement between Canada and Canada Post that effectively allows Canada Post to be paid for performing tasks that its competitors are required to perform in order to comply with the law. They also arise from Canada's failure to enforce its own laws against Canada Post. This preferential treatment breaches Canada's obligations under NAFTA Chapter 11.

**A. Customs Laws and Procedures**

**1. Canada Customs**

269. Customs administration in Canada is currently performed by the Canada Border Services Agency which succeeded the Canada Customs and Revenue Agency in 2004. That Agency, in turn, succeeded the Department of National Revenue in 1999.<sup>332</sup> These successive customs authorities are referred to below as "Canada Customs".

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<sup>332</sup> *Statement of Defence* at paras. 53, 57. Witness Statement of Lisa Paré at footnote 1.

270. Canada Customs is responsible for administering a number of federal laws regulating, controlling or prohibiting the importation of goods into Canada by all modes of transportation, including the *Customs Act*. A primary function of Canada Customs is to assess and collect duties and taxes, where applicable.<sup>333</sup>

## **2. Postal and Courier Streams**

271. The *Customs Act* and Regulations made thereunder provide for two different programs for processing shipments into Canada: the postal stream which is used for all shipments through Canada Post, including those through many courier services of foreign postal administrations, and the courier stream which applies to private courier companies such as UPS Canada.<sup>334</sup>

272. Canada alleges that two customs streams are needed as mailed items do not have the same information about the identity of the customer or the item being sent as courier shipments.<sup>335</sup> Yet Canada Post's own courier services also complete delivery for courier shipments from other postal administrations, such as the United States Postal Service ("USPS"). USPS often competes together with Canada Post for US customers of UPS making shipments into Canada.<sup>336</sup> There is no suggestion by Canada that these courier services do not have the same information about the shipments as those provided by their competitors.

273. UPS does not take issue with the creation of separate streams for postal and courier products. Rather, UPS states that Canada has granted Canada Post's courier services customs advantages that have nothing to do with the stated rationale for the creation of a separate "postal" stream.

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<sup>333</sup> *Statement of Defence* at paras. 58, 66.

<sup>334</sup> Witness Statement of Lisa Paré at para. 11.

<sup>335</sup> *Statement of Defence* at para. 67.

<sup>336</sup> Witness Statement of Lisa Paré at para. 32.

274. In fact, the postal stream and the courier stream have the following similarities:
- a. The postal stream and the courier stream are not different modes of transportation, such as the entry of goods by sea or by rail. Rather, packages that enter Canada by the post, or by UPS courier, both arrive in Canada by the same mode of transportation, either by truck or by aircraft;
  - b. Both streams are policed and controlled by Canada Customs officers;<sup>337</sup>
  - c. Canada Customs officers located at the premises of UPS Canada perform the same two functions that they perform at the premises of Canada Post, namely:
    - i. interdiction of contraband and other illegal goods contained in packages imported into Canada; and
    - ii. physical examination of certain packages to ensure that the contents of the package correspond to the type of goods and dollar amount that the sender has affixed by sticker or invoice to the package;<sup>338</sup>
  - d. In order to determine the amount of duties and taxes for each item, the Canada Customs officer regularly relies on either the customs declaration or the invoice attached by the sender to the package – in both streams;<sup>339</sup>
  - e. Canada Customs regulations were amended at the same time in about 1992 for both streams, to reduce the dollar amount on goods that would be exempt from

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<sup>337</sup> *Statement of Defence* at para. 54.

<sup>338</sup> At Canada Post, the Canada Customs officer performs the additional function of rating the packages for Canadian import duties and taxes.

<sup>339</sup> Memorandum D5-1-1 prepared by Canada Customs and dated September 23, 2002 on the Customs International Mail Processing System, page 6 numeral 32 (16594-16609) (Tab U253).

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Canadian duties and taxes from the sum of \$40 to only \$20. Both streams use that same dollar limit today;<sup>340</sup>

- f. Both streams use the sum of \$1600 as the dollar level that separates low value imports of goods, from high value import of goods;<sup>341</sup>
- g. Goods imported into Canada by the postal stream as commercial goods and valued at more than \$1600 dollars are removed from the postal stream and processed by Canada Customs officials;<sup>342</sup> and
- h. Canada Post delivers many millions of imported packages in Canada to Canadian addressees. UPS does the same by the courier stream, and often competes with Canada Post for some of the same importing customers.

**B. The *Postal Imports Agreement***

275. Canada's preferential customs treatment of Canada Post arises largely out of an agreement between Canada Post and Canada Customs entered into on April 25, 1994 called the Agreement Concerning Processing and Clearance of Postal Imports ("*Postal Imports Agreement*").<sup>343</sup> The *Postal Imports Agreement* details the responsibilities and tasks that Canada Post and Canada Customs have in the processing of postal imports through the customs clearance process. Canada

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276. UPS Canada first acquired knowledge of the existence of the *Postal Imports Agreement*

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<sup>340</sup> *Statement of Defence* at para. 89.

<sup>341</sup> *Statement of Defence* at para. 77.

<sup>342</sup> *Statement of Defence* at para. 77.

<sup>343</sup> See *Postal Imports Agreement* at (Tab U66).

<sup>344</sup> See Canada's answer to UPS' interrogatories at question 9 (Tab U290).

through a request made pursuant to the *Access to Information Act* in 1999.<sup>345</sup> Canada provided a redacted version of the *Postal Imports Agreement* on November 15, 1999, in which Canada deleted numerous portions of that Agreement on the grounds of “commercial confidentiality”.<sup>346</sup> Canada only provided the full text of the *Postal Imports Agreement* to UPS on February 26, 2004.

277. Only upon receipt of the *Postal Imports Agreement* did UPS Canada discover the secret privileges and preferences that Canada Customs was and is still providing to Canada Post on the importation of packages by the post.<sup>347</sup>
278. The *Postal Imports Agreement* is the basis for providing Canada Post with the following privileges which are not correspondingly provided to UPS Canada:
- a. Canada Customs charges cost recovery fees to UPS Canada, but not Canada Post;
  - b. Canada Customs charges UPS Canada for computer linkage systems, but not Canada Post;
  - c. Canada Customs provides Canada Post customers with valuable brokerage services without charge. Customers of UPS Canada must pay for these services;
  - d. Canada Customs improperly delegates important duties to Canada Post; and
  - e. Canada Customs pays Canada Post for “services” that UPS Canada is required to perform for free.

Each of the above privileges provided to Canada Post will now be reviewed in turn.

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<sup>345</sup> Witness statement of Lisa Paré at para. 15.

<sup>346</sup> Redacted version of *Postal Imports Agreement* (Tab U140).

<sup>347</sup> Witness Statement of Lisa Paré at para.15.

**1. Canada Customs Charges Cost Recovery Fees to UPS Canada, but Exempts Canada Post**

279. The *Special Services (Customs) Regulations* were enacted by Canada in 1997. Their purpose was to enable Canada Customs to recover, from firms operating in Canada, the cost of providing Customs officers outside the “ordinary course of the officer’s duties.” Such activities by Customs officers are defined in those *Regulations* as “Special Services”.<sup>348</sup> The *Regulations* stipulate that:

Where an [Customs] officer is called in on duty to perform a special service for a person, that person shall pay \$54 for the first two hours or portions thereof spent in the performance of that service; and (b) \$27 for each additional hour or portion thereof spent in the performance of that service.<sup>349</sup>

280. UPS Canada has facilities at eight ports of entry that receive packages imported into Canada.<sup>350</sup> All such buildings are located in or near major Canadian cities, where Customs officers have easy access. Canada Customs officers may be posted at various times at some or all of those eight facilities.

281. UPS Canada is obliged by law to sign annual contracts with Canada Customs, drafted by Canada Customs, for each of its eight Canadian buildings. In each such contract, UPS promises to pay Canada Customs the above rates of \$54 and \$27 per hour by way of “cost recovery fees”. The charges are assessed against UPS Canada “from the time the [Customs] inspector leaves their home or office.”

282. These annual contracts signed by UPS Canada with Canada Customs stipulate that UPS Canada will also be obliged to pay Canada Customs for services rendered by Customs officers during *core business hours*. For example, one such contract stipulates:

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<sup>348</sup> See section 3(1) of Canada Customs Memorandum D1-2-1: (Tab U91).

<sup>349</sup> See section 5(1) of Canada Customs Memorandum D1-2-1 (Tab U91), quoting section 5(1) of *Special Services (Customs) Regulations*, SOR/86-1012.

<sup>350</sup> Witness statement of Lisa Paré at para. 6 and 7.

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Cost of service will vary depending on when the service is performed. Courier/LVS program has established core hours to be 0700 – 1800 Monday through Friday. Cost of service during core hours will be determined using cost recovery service rate formula. Outside core hours, the special services rates will be used. These fees are subject to change without notice, the CCRA [Canada Customs] nonetheless will inform UPS regarding fees changes as soon as possible.<sup>351</sup>

283. Thus, UPS Canada is required to pay all Canada Customs' costs related to the inspection of packages, including labour costs and mileage for travel.<sup>352</sup> UPS Canada has paid Canada Customs [REDACTED] each year pursuant to these contracts.<sup>353</sup>

284. Shipments that are sent from anywhere in the world to Canada by post arrive at one of Canada Post's five Customs Mail Centres located in the Canadian cities of Montreal, Mississauga, Winnipeg, Calgary or Vancouver.<sup>354</sup> UPS Canada has facilities in or near each of the same cities. Similarly, Canada Customs officers are posted at each one of those five Canada Post buildings for two consecutive shifts, at least six days a week.

285. However, unlike UPS Canada, there is no "cost recovery charge" or any other charge assessed against Canada Post for the provision of such services by Customs officers.<sup>355</sup> Under the *Postal Imports Agreement*, the services of Customs officers are provided to Canada Post free of charge.

286. A June 1998 report by the United States General Accounting Office ("*GAO Report*") studied the differences in the Canadian customs clearance of postal and private courier

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<sup>351</sup> See, for example, clause 3 and 11 of cost recovery contract between UPS Canada and Canada Customs dated December 8, 2000 for UPS' building in Calgary, Canada: UPS document (Tab U180).

<sup>352</sup> Witness statement of Lisa Paré at para. 20.

<sup>353</sup> Witness statement of Lisa Paré at para. 20.

<sup>354</sup> *Statement of Defence* at para. 72.

<sup>355</sup> The only exception wherein Canada Customs charges Canada Post a form of "cost recovery charges" is under clause 9.6 of the *Postal Imports Agreement*: for the processing of certain courier packages only, to be delivered by Canada Post under its Priority Courier name. According to Canada's figures, the annual charges assessed by Canada Customs to Canada Post for such services range from a low of \$6,360 per year, to a high of \$23,319 (Can.) per year: See Canada's reply to UPS' interrogatories, question 14(a) (Tab U290).

parcels.<sup>356</sup> The *GAO Report* found substantial differences in the customs clearance of postal and private courier parcels. One of the ten categories reviewed by the *GAO Report* was whether “Importer/broker must pay for customs clearance outside normal business hours.” On this point, the *GAO Report* stated that such payments by Canada Post are “not required”. By contrast, with respect to the private courier companies, the GAO confirmed that “regulations respecting special customs services required payment for clearance outside regular business hours.”<sup>357</sup>

287. The *Postal Imports Agreement* states that Canada Customs will go so far as to provide services to Canada Post on weekends and statutory holidays.<sup>358</sup> Thus, while UPS Canada must pay for Customs officers even during business hours, Canada Post receives these services for free even during weekends and holidays.

**2. Canada Customs Charges UPS Canada for Computer Linkage Systems, but not Canada Post**

288. UPS Canada made a substantial investment to develop systems that interface with Canada Customs’ computer systems and rules. This Customs Automated Data Exchange (“CADEX”) reports all calculations of duties and taxes.<sup>359</sup> Since 1999, Canada Customs has required UPS Canada to pay substantial fees for the cost of operating CADEX lines for the transmission of data between itself and UPS Canada.<sup>360</sup> UPS Canada also pays [REDACTED] each year for maintaining dedicated telephone and network lines for the transmittal of electronic reporting to Canada Customs.

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<sup>356</sup> *General Accounting Office Report*, US Postal Service: Competitive Concern About Package Link Service, June 5, 1998, (Tab U115).

<sup>357</sup> *General Accounting Office Report*, US Postal Service: Competitive Concern About Package Link Service, June 5, 1998, (D1352-1458) (Tab U115).

<sup>358</sup> *Postal Imports Agreement*, Annex C(2) (Tab U66).

<sup>359</sup> Witness statement of Lisa Paré at para. 29.

<sup>360</sup> Tables - CADEX Line changes paid by UPS Canada from Dec. 1999 to Nov. 2002 (Tab U31); Witness Statement of Lisa Paré at para. 29.

289. These CADEX lines are not a function of the fact that UPS Canada operates in the “courier stream.” Rather, these charges reflect the fact that UPS Canada collects duties and taxes from importers and remits the same to Canada Customs.
290. By contrast, section 17.1 of the *Postal Imports Agreement* stipulates that Canada Customs is required to construct at its own expense “an electronic data exchange between the Department [Canada Customs] and CPC [Canada Post]...”, to enable Canada Post to report its collection of Canadian import duties and taxes to Canada Customs.<sup>361</sup> While both UPS Canada and Canada Post are obliged to report to Canada Customs their respective collections of duties and taxes, only UPS Canada is obliged to pay the electronic transmission costs thereof. [REDACTED]  
[REDACTED]<sup>362</sup>
291. While UPS Canada pays for the cost of dedicated phone lines,<sup>363</sup> section 12.1 of the *Postal Imports Agreement* imposes the cost of maintaining the analogous PICS (Postal Import Control System) upon Canada Customs, rather than upon Canada Post.
292. As with the other cost recovery charges, Canada Customs treats Canada Post in a completely different manner from UPS Canada and other competitors. This preferential treatment cannot be attributed to the different “streams”.

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<sup>361</sup> *Postal Imports Agreement*, s. 17.1 (Tab U66).

<sup>362</sup> Canada’s reply to UPS’ interrogatories, question 57(b). See also clauses 17.1 [REDACTED] of the *Postal Imports Agreement* (Tab U290) and (Tab U66).

<sup>363</sup> UPS Canada must build at its own expense, and not at the expense of Canada Customs, systems that are compatible with those of Canada Customs. Yet according to Canada, the annual costs incurred by Canada Customs (and not charged back to Canada Post) for upgrading and servicing all computer equipment related to the Postal Imports Control System (PICS), ranged from a low of \$163,966 (Can.) during 1999, to a high of \$369,418 in 2002: Canada’s reply to UPS’ interrogatories, question 57(a) and (d). See also clauses 5.1(xi) and 12.1 of the *Postal Imports Agreement* (Tab U66).

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**3. Canada Customs Provides Canada Post Customers with Valuable Brokerage Services Without Charge**

293. Customs brokers perform services for importers of shipments into Canada. Importing a dutiable shipment into Canada requires the importer to complete an entry reporting and accounting for the shipment with Canada Customs. UPS Canada's customs brokerage operations perform services on behalf of the importer on such matters as Canadian tariff classification, ascertainment of origin of the goods and the value for duty, assessment of Canadian import duties and taxes and arranging for payment to Canada Customs.<sup>364</sup>

294. While UPS Canada incurs costs in performing these services that must be charged to its customers, Canada Customs performs many of the same services for Canada Post for free. Section 5(v) of the *Postal Imports Agreement* outlines the specific responsibilities of Canada Customs officers who are stationed at the five Canada Post buildings, as follows:

The Department [Canada Customs] shall have the following responsibilities with respect to the processing of Postal Imports through the Customs clearance process: ... entering into the PICS System of rating and assessment of information, including tariff classification, origin, value for duty, amount of Duties as well as applicable fees (including the fee payable to CPC) all with respect to Postal Imports.

295. Notwithstanding Canada's denial in its *Statement of Defence*,<sup>365</sup> it is apparent that Canada Customs is providing a valuable brokerage service to Canada Post's customers. The above quoted section of the *Postal Imports Agreement* reveals that Canada Customs is ascertaining the appropriate Canadian tariff classification, origin of the goods, value for duty, and assessing the precise amount of Canadian import duties and taxes that the Canadian importer is liable to pay. Those are precisely the functions of a customs broker.

296. With the exception of one type of package,<sup>366</sup> Canada Customs does not charge any fees

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<sup>364</sup> Witness Statement of Lisa Paré at para. 9.

<sup>365</sup> *Statement of Defence* at para. 87.

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whatsoever for providing such valuable services to Canada Post or to the Canadian importers to whom Canada Post delivers those packages.

297. The *Postal Imports Agreement* also ensures that Canada Customs officers stationed at Canada Post's five Canadian buildings give first priority to releasing all such imported courier packages for delivery by Canada Post's Priority Courier.<sup>367</sup> Thus, Canada Post's Priority Courier service enjoys all of the advantages of expedited customs clearance without Canada Post incurring any of the compliance costs associated with the courier stream.

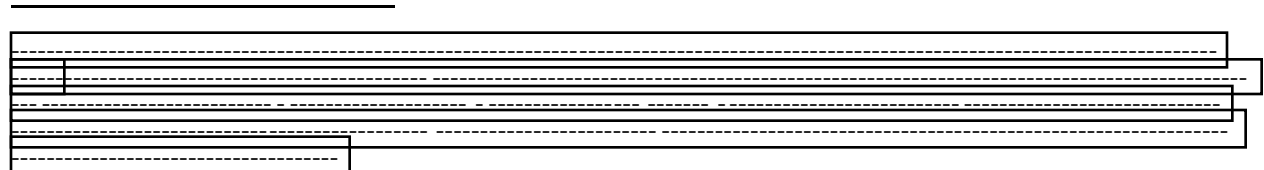
**4. Canada Customs Improperly Delegates Important Duties to Canada Post Employees**

298. The customs clearance process under the postal stream has two distinct stages that should both be performed by Canada Customs personnel only:

- a. Primary Inspection; and
- b. Secondary Inspection.

299. Customs Primary Inspection is defined as:

The CCRA [Canada Customs] reviews all classes of mail received from Canada Post to identify and segregate all items requiring further examination. The review includes Priority Post, first class, registered, and parcel mail. Canada Post maintains and controls registered and Priority Post mail in separate mail streams.<sup>368</sup>



<sup>367</sup> See also para. 82(d) of the *Statement of Defence*, which reflects Canada Customs' commitment to release international "air mail" (that would include Priority Courier packages) within 24 hours.

<sup>368</sup> Section 21 Customs Memorandum D5-1-1 dated September 23, 2002 on the Customs International Mail Processing System, page 5 numeral 21 (Tab U243).

300. If the Canada Customs officers screening the packages are of the view that they require further examination, the packages are sent to secondary inspection which is defined as:

Customs Secondary Inspection: secondary customs inspectors review mail items to determine whether they are subject to duties, controls, such as permits or certificates, enforcement measures, or if they require inspection by another government department”.<sup>369</sup>

301. Canada alleges that only Canada Customs personnel perform the core customs functions of primary screening and secondary inspection.<sup>370</sup> Unfortunately, that is not the case. Rather, Canada Customs has chosen to delegate some of its core functions *at the primary inspection* stage to Canada Post’s employees. Canada Customs allows Canada Post employees to separate letters, magazines and periodicals that need no Customs examination, from the packages that do need such examination.

302. Section 4.1 of the *Postal Imports Agreement* states under the heading, “ Responsibilities of Canada Post” that:

CPC (Canada Post) shall have the following responsibilities with respect to the processing of Postal imports through the customs clearance process: (i) separating or dividing Postal Imports to criteria outlined in Annex “C” and placing the Postal Imports on a conveyor belt; (Emphasis added)

303. Annex “C” of the *Postal Imports Agreement* also assigns duties of separating letters and magazines from parcels to Canada Post’s employees under the heading entitled: “Items to be Screened by Canada Post”.<sup>371</sup> Once Canada Post employees have separated the letter mail from the packages, those employees are then responsible for: [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]<sup>372</sup>

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<sup>369</sup> Memorandum D5-1-1 dated September 23, 2002 5 (Tab U253).

<sup>370</sup> *Statement of Defence* at para. 73.

<sup>371</sup> Annex “C” to the *Postal Imports Agreement* (Tab U66).

<sup>372</sup> Canada’s reply to UPS’ interrogatories, question 23(b).

304. This critical function of separating the mail, newspapers and magazines from packages is a primary inspection task that should be handled by Canada Customs **only**, and should never have been delegated to Canada Post's employees. Canada Post employees, unlike Customs officials, have a vested interest in obtaining the release of as many packages as quickly as possible. Those Canada Post employees are then provided with the opportunity to deliberately or unwittingly separate out and release packages from Customs, for immediate delivery by Canada Post - without a Customs officer ever having the chance to assess the propriety of the separation process.
305. This improper delegation of Customs authority from Canada Customs officers to Canada Post employees is one of the reasons why Canada Customs fails to collect proper duties and taxes on millions of packages that are imported into Canada by the post each year.

**5. Canada Customs Pays Canada Post for "Services" that UPS Canada Must Supply for Free**

306. UPS Canada must present Canada Customs with a cargo/release list containing information about the shipper and the shipment. Customs officers review this list and select shipments for further examination. UPS Canada employees then retrieve and open all packages selected for examination. They scan or enter a bar code number on each package to be inspected. If an invoice is not on a package, they print the invoice for the Customs officer's review. After inspection, UPS Canada employees reseal each package. UPS Canada employees devote substantial amounts of time to assisting Customs officers with this process at no charge to Canada Customs.<sup>373</sup>
307. Pursuant to the *Postal Imports Agreement*, Canada Post provides Canada Customs officers with similar services that UPS Canada must perform for free, yet Canada Post is paid to do so. In particular, Canada Post is paid for:
- a. scanning or entering a bar code identification number on each package to be

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<sup>373</sup> Witness Statement of Lisa Paré para. 18.

inspected by Canada Customs;

- b. resealing postal imports following inspection by Customs officers; and
- c. printing and affixing invoices to packages.<sup>374</sup>

As a result of Canada Post performing such routine services, Canada Customs has paid Canada Post [REDACTED]<sup>375</sup> Canada maintains that the payments are paid to Canada Post on a commercial “fee for service basis”.<sup>376</sup> Yet, UPS Canada must provide similar “services” to Canada Customs without payment.

308. Canada Post has actually outsourced its obligations to perform the services to another firm, [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

309. Canada asserts that:

The Postal Agreement and its central feature – Canada Post performing certain services on behalf of the CCRA [Customs], were made public under a process which began in 1992.<sup>378</sup>

Yet an affidavit filed in the Federal Court of Canada by Canada Post, states that with respect to the material redacted from the version of the *Postal Imports Agreement* released under the *Access to Information Act*: “None of the Exempted Information is

<sup>374</sup> See *para.* 11 of public version of the confidential affidavit of Canada Post’s William R. Price, (23869) (Tab U316). Mr. Price also deposed that Canada Post collects duties and taxes.

<sup>375</sup> See Canada’s reply to UPS’ interrogatories, question 14(a).

<sup>376</sup> *Statement of Defence* at *para.* 92.

<sup>377</sup> See Canada’s reply to UPS’ interrogatories, question 25.

<sup>378</sup> *Statement of Defence* at *para.* 93.

available to the public from other sources.”<sup>379</sup> [redacted]  
[redacted]

310. [redacted]  
[redacted]  
[redacted]  
[redacted]  
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<sup>379</sup> Section 20 to the public version of the confidential affidavit of William R. Price. (Tab U316).

<sup>380</sup> See Canada’s reply to UPS’ interrogatories, question 10(c).

<sup>381</sup> See Canada’s answer to UPS’ interrogatories at question 67.

<sup>382</sup> [redacted] (R64.1-1) (Tab U1 [redacted]).

<sup>383</sup> [redacted] *Postal Imports Agreement* (Tab U66).

<sup>384</sup> See Canada’s reply to UPS’ interrogatories, question 14(h) and (i) [redacted] Parts A and B of the *Postal Imports Agreement* (Tab U66).

312. There are thousands of occasions per year when Canadian addressees refuse to accept delivery of a package from UPS Canada. UPS Canada is then obliged to return the package to the sender in a foreign country, unwind the entire import transaction with Canada Customs, and prepare all of the necessary documentation to satisfy Customs. This is a costly process, for which UPS Canada receives no payment from Canada Customs.

313. When Canadian addressees refuse to accept delivery from Canada Post of a package, Canada Post is also obliged to incur costs in unwinding the import transaction with Canada Customs. [REDACTED]

[REDACTED]

314. In addition, UPS Canada is obliged by law to provide, at its own expense, office space, equipment, supplies, furniture, and parking spaces to the Canada Customs officers who are on duty at the eight UPS Canada facilities that receive imported packages. UPS Canada was obliged to modify its own facilities at its own expense to accommodate Canada Customs personnel.<sup>386</sup>

315. By contrast, section 11.3 of the *Postal Imports Agreement* stipulates that when similar office expenses are incurred at Canada Post's five buildings that receive imported packages, all such expenses are to be paid for by Canada Customs (and not Canada Post).<sup>387</sup>

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<sup>385</sup> See Canada's reply to UPS' interrogatories, question 14(d).

<sup>386</sup> Witness Statement of Lisa Paré at paras. 20 and 21.

<sup>387</sup> *Postal Imports Agreement* (Tab U66).

**C. Canada's Exemption of Canada Post From Other Customs Obligations**

316. In addition to the competitive advantages granted under the *Postal Imports Agreement*, Canada has exempted Canada Post from other customs requirements that apply to its competitors. In particular:
- a. Canada Customs allows Canada Post far more time to remit duties or taxes than it allows to UPS Canada;
  - b. Canada Customs does not impose fines, penalties and interest against Canada Post;
  - c. Canada Customs exempts Canada Post from bonding requirements; and
  - d. Canada exempts Canada Post handling fees from Goods and Services Tax.

Each of these exemptions are discussed thoroughly below.

**1. Canada Customs Allows Canada Post Far More Time to Remit Duties and Taxes**

317. Both UPS Canada and Canada Post are authorized by Canada Customs to collect duties and taxes from Canadian importers on packages imported into Canada. However, Canada Customs requires UPS Canada to remit all such duties and taxes in a much shorter time frame than is allowed to Canada Post.
318. When UPS Canada collects duties and taxes on imported goods valued at less than \$1600, it is obliged by law to remit all such sums to Canada Customs by the end of the following month in which those duties and taxes were collected.<sup>388</sup> When UPS Canada

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<sup>388</sup> This applies for all duties and taxes collected by UPS Canada up to the 24<sup>th</sup> day of the month. Section 10(1)(b)(ii) of the *Accounting for Imported Goods and Payments of Duties Regulations* (Tab U407); Witness Statement of Lisa Paré, para. 29.

collects duties and taxes on imported goods valued at more than \$1600, it is obliged by law to remit all such sums to Canada Customs within only 5 business days after their release.<sup>389</sup>

319.

[REDACTED]

[REDACTED] appears to violate section 8.3 of the *Accounting for Imported Goods and Payment of Duties Regulation*, which reads:

“The Canada Post Corporation shall pay, by cash or certified cheque, the duties required under subsection 147.1(6) of the Act, to be paid in respect of goods imported as mail *no later than the last business day of the month following the month in which the release period ended.*”<sup>391</sup>

320.

[REDACTED]

**2. Canada Customs Fails to Levy Fines, Penalties and Interest Against Canada Post**

321. In spite of its efforts to comply with Customs requirements, UPS Canada occasionally makes inadvertent errors. Fines, penalties and interest are then imposed on UPS Canada for breaching the *Customs Act Regulations* including for incorrectly calculating duties and taxes on imported goods and for releasing goods before Canada Customs inspection. Between 1997-2002, UPS Canada paid approximately [REDACTED] to Canada Customs in

<sup>389</sup> Section 10(1)(b)(I) of the *Accounting for Imported Goods and Payments of Duties Regulations* (Tab U407).

<sup>390</sup> [REDACTED]

<sup>391</sup> *Accounting for Imported Goods and Payment of Duties Regulations*, SOR/86-1062 (Tab U407).

<sup>392</sup> See Canada’s reply to interrogatories, question 38(d), (f).

this regard.<sup>393</sup>

322. [REDACTED]

Canada Post is by no means immune from committing Customs infractions simply because its packages are cleared by Canada Customs. Rather, Canada has decided to exempt Canada Post from paying any such fines or penalties.

**3. Canada Post is Exempted from Posting Bonds**

323. UPS Canada is required by Canada Customs regulations to post a number of bonds in order to carry on its business of importing packages into Canada.<sup>395</sup> [REDACTED]

324. By posting the appropriate bonds, couriers like UPS Canada are allowed by Canada Customs to move un-cleared shipments across the US border into bonded warehouses located in Canada.<sup>397</sup> [REDACTED]

325. Both UPS Canada and Canada Post operate warehouses. In their respective warehouses,

<sup>393</sup> See Interest and Penalties for CCRA Infractions 1997 - 2002 (Tab U114); Witness Statement of Lisa Paré at para. 27.

<sup>394</sup> Canada's reply to interrogatories, questions 51 and 53.

<sup>395</sup> Witness Statement of Lisa Paré at para. 28.

<sup>396</sup> See Canada's answer to UPS' interrogatories at question 61.

<sup>397</sup> *Statement of Defence* at para. 82(a).

<sup>398</sup> Canada has not provided a full reply to UPS' interrogatory on this same point. The *GAO Report* compared the treatment of Canada Post by Canada Customs under the heading of "Posting bonds or other security". The *GAO Report* concluded that posting bonds is "not required" of Canada Post, but "required" for private express couriers." (Tab U115).

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Canada Post and UPS Canada hold goods that have been imported into Canada and are awaiting Customs authorization for release to the Canadian addressees. UPS Canada is compelled by the provision of the *Customs Sufferance Warehouse Regulations* of Canada to post a bond with Canada to ensure the payment of duties payable in respect of goods stored in the sufferance warehouse.<sup>399</sup> [REDACTED]

[REDACTED]

326. This difference in treatment is not a function of the existence of different postal and courier streams. The explanation for the difference in treatment was provided in a memo from Canada Customs to a UPS Canada consultant, in the following words: “CPC [Canada Post] is not required to be bonded as it is a Crown Corporation. UPS is not a Crown Corporation and thus must have a sufferance warehouse bond.”<sup>401</sup>

**4. The \$5.00 Fee Collected by Canada Post is Exempt from Canada’s Goods and Services Tax**

327. Canada has enacted a Regulation that enables Canada Post to charge Canadian addressees a sum of \$5.00 for each imported package that it delivers, on which Customs has assessed Canadian import duties or taxes.<sup>402</sup> [REDACTED]

[REDACTED]

328. However, Canada exempts Canada Post from charging Canadian addressees the 7 per cent Goods and Services Tax (GST) on this \$5.00 fee. The *Excise Tax Act* of Canada determines that services provided by Canada Post to Customs are “government services”

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<sup>399</sup> Section 4(2) of the *Customs Sufferance Warehouse Regulations* (Tab U164).

<sup>400</sup> See Canada’s answer to UPS’ interrogatories at question 61.

<sup>401</sup> Laurie Bratina, Director, Import Process Agency, Canada Customs’ response to Allan Cocksedge. (Tab U403).

<sup>402</sup> Section 3 of the *Fees in Respect of Mail Regulations* (Tab U406).

<sup>403</sup> See Canada’s answer to UPS’ interrogatories at question 67.

and, therefore, do not require the charging of GST tax.<sup>404</sup>

329. UPS Canada charges a similar fee to its Canadian customers to defray the cost of collecting duties and taxes from them and remitting same to Customs. However, UPS Canada is required to charge its customers the full 7 per cent GST tax on its fees.

**D. Canada Post Fails to Collect Duties and Taxes**

330. Regardless of any differences between the postal and courier streams, the dollar amounts of duties and taxes on identical goods entering Canada are exactly the same. Except for goods valued under \$20 and gifts under \$60, both UPS Canada and Canada Post have a legal obligation to collect the full amount of import duties and taxes on each package imported into Canada. UPS Canada carries out its legal responsibilities in this regard. Canada Post does not.
331. The magnitude of the failure by Canada Customs to collect duties, GST and provincial sales tax on postal items, can be demonstrated by comparing the total amount of duties and taxes collected by UPS Canada each year from Canadian addressees, against the relevant figure for Canada Post. Since Canada Post imports more packages each year than UPS Canada does, Canada Post would be expected to collect more duties and taxes than UPS Canada. However, the following figures demonstrate that this is not the case:

<b>Year</b>	<b>Canada Post</b>	<b>UPS</b>
1997	<input type="text"/>	<input type="text"/>
1998	<input type="text"/>	<input type="text"/>
1999	<input type="text"/>	<input type="text"/>
2000	<input type="text"/>	<input type="text"/>

<sup>404</sup> *Excise Tax Act*, R.S.C. 1985, c. E-15, Part IX, Division I, section 123(1); Division II, section 165(3); Schedule VI, Part X (Book of Authorities at Tab 59). Canada has confirmed this in its reply to UPS' interrogatories at question 66(c).

2001		
2002		

332. Large repeat shippers learn of the customs advantages of shipping through the postal stream and choose this stream instead of UPS for these reasons.<sup>406</sup> UPS Canada has had to deal with many irate Canadian customers that demand to know why it assesses customs charges against them, when Canada Post does not do so when delivering the same packages to their doors. Many of these customers threaten never to use UPS services again.<sup>407</sup> This places UPS at a serious competitive disadvantage when competing with Canada Post for the business of importing packages into Canada.
333. In order to confirm that Canada Post's preferential treatment by Canada Customs causes it to fail to collect duties and taxes, UPS retained the services of Mr. James Nelems, an expert in the design of surveys and controlled experiments. Mr. Nelems conducted an objective study comparing the compliance rates for collection of duties and taxes for packages imported into Canada by the postal stream and UPS (the "Customs Study"). The results of the Customs Study present striking differences in compliance between UPS Canada and Canada Post.
334. The Customs Study involved 450 comparable packages of equivalent dollar value sent to Canada by Canada Post and UPS. For each shipment the customs charges (duty and GST) were recorded.<sup>408</sup> Four product categories were chosen and within each category, half the products were of US manufacturing origin and the other half of foreign origin. Approximately half the products were sent by ground services, the other half by air.

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<sup>405</sup> Canada Post figures are the cumulative total of Canada's reply to UPS' interrogatories, question 38(d) (Tab U290). For UPS Canada's figures see (23807) (Tab U130).

<sup>406</sup> Witness Statement of Lisa Paré at para. 32.

<sup>407</sup> Witness Statement of Lisa Paré at paras. 30 and 31.

<sup>408</sup> As all of the products were sent to commercial addresses, Provincial Sales Tax was not charged on any of the packages.

Within the different shipment methods, half the products were sent by UPS and the other through the US Postal Service and Canada Post. Shipments were sent from three geographically dispersed locations in the United States to five geographically dispersed Canadian receiving locations. The invoices from the shipments were then collected and tabulated.

335. The results of the Customs Study clearly showed that UPS Canada's compliance rates for the collection of duties and taxes on imported packages into Canada significantly exceeded those of Canada Post in every category. The major findings of the Customs Study were as follows:
- a. On dutiable products of foreign origin (ie. other than the US), UPS' compliance rate was 95% as compared to just 5% for Canada Post;
  - b. Products of US origin imported into Canada are exempt from duty. This is generally proven if the importer presents a NAFTA Certificate of Origin or equivalent statement. Nevertheless, Canada Post did not charge duty on any packages of US origin that were not presented with the required NAFTA certificate. This compares to the 76% compliance rate for UPS in this category;
  - c. With respect to the collection of GST, UPS' compliance rate was 98% as compared to a much lower rate for Canada Post of 66%; and
  - d. GST charges are based on duty as well as product value. Since UPS was more likely to charge duty as compared to Canada Post, it was more likely to have higher charges for GST.<sup>409</sup>
336. The Customs Study demonstrates that Canada Post does not reliably collect duties and taxes on courier products imported into Canada through the postal stream. The striking difference in customs treatment between parcels presented by Canada Post to be

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<sup>409</sup> Marketing Workshop Report at pp. 8-10.

processed through the postal system and parcels presented by UPS that are processed by the courier stream, has a significant detrimental impact on UPS, and places UPS at a competitive disadvantage.

**E. Harm to UPS Canada**

337. Canada Post receives various payments, services, permissions, and exemptions from Canada Customs. These benefits permit Canada Post to set lower prices for its competitive products. UPS Canada incurs loss and damage by the failure of Canada Customs to provide it with the same preferential treatment. UPS Canada does not receive any payments from Canada Customs, and must pay for all of the same services, permissions, and exemptions received by Canada Post. As set out in the Rosen Report, this results in financial harm and reduced market share for UPS Canada.<sup>410</sup>
338. UPS has filed numerous customer complaints regarding the differences between customs charges incurred when importing with UPS as opposed to importing with Canada Post. It has also listed customers who ship with UPS in the United States, but choose to ship with the United States Postal Service/Canada Post for deliveries to Canada. These customers have identified Canada Post's failure to collect duties and taxes as a reason for choosing this competing service.<sup>411</sup>

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<sup>410</sup> Rosen Report at paras. 34-36.

<sup>411</sup> See witness statement of Lisa Paré at para. 30 and list of US customers of UPS that use USPS/Canada Post for shipments to Canada (at Tab U272).

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**Chapter VI. CANADA'S EXEMPTION OF CANADA POST FROM LABOUR LAWS**

339. The special treatment granted by Canada to Canada Post extends to labour laws and related matters. For much of the period covered by this arbitral claim, Canada Post employees involved in the delivery of courier services were prevented by Canada from exercising basic collective bargaining rights provided by Canadian law. These restrictions were not only unfair to Canada Post's employees, they also provided Canada Post an unfair competitive advantage.

**A. Rural Route Contractors**

340. Canada Post has entered into agreements with independent contractors to, among other things, provide courier services in certain rural communities in Canada ("Rural Contractors").<sup>412</sup> [REDACTED]

[REDACTED]

[REDACTED]<sup>414</sup>

341. Until 2004, Rural Contractors were precluded from forming a union for the purpose of bargaining collectively with Canada Post. The *Canada Labour Code* ("Code"), which both UPS Canada and Canada Post are subject to, permits non-management employees to be represented by a union and to bargain collectively if the majority of the employees in a bargaining unit wish to have the trade union represent them.<sup>415</sup> The word "employee" is defined in section 3(1) of the *Code* to include "dependent contractors" which would include Rural Contractors.

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<sup>412</sup> See [REDACTED] at (R147.1) (Tab U87). See also [REDACTED] (Tabs U108, U158 and U2----

<sup>413</sup> See Canada's answer to interrogatory question 152 of UPS' Information Request. (AA00404-AA00468 at AA00447) (Tab U290).

<sup>414</sup> See Canada's answer to interrogatory question 153 of UPS' Information Request (AA00404-AA00448 at AA00447) (Tab U290).

<sup>415</sup> *Canada Labour Code*, s. 28.

342. However, pursuant to section 13(5) of the *CPC Act*, Rural Contractors are specifically excluded from the meaning of an “employee” under the *Code*. The restrictive effect of section 13(5) of the *CPC Act* prevented Rural Contractors from forming a union and consequently, bargaining collectively for higher wages. In the past, Canada Post had strenuously resisted previous court challenges to this statutory prohibition.<sup>416</sup> As a result, Canada Post was able to continue its practice of paying Rural Contractors low wages in relation to its employees who are allowed to form unions and bargain collectively.<sup>417</sup>
343. On January 1, 2004, Canada Post recognized its 6,000 Rural Contractors for the first time as employees of the Corporation, notwithstanding the legislative prohibition of section 13(5) of the *CPC Act*. As a result, these employees received, for the first time, certain employee benefits from Canada Post and a wage increase.<sup>418</sup>

## **B. Pensions**

344. Canada’s restrictions of collective bargaining rights also extended to all of Canada Post’s other employees who, until recently, were prevented from bargaining over their pensions. Between 1981 and 2000, Canada Post employees were covered by the Public Service Superannuation Plan (“PSSA”) administered by Canada. However, Canada prohibited Canada Post’s labour union from negotiating with Canada over the terms of the pension plan.<sup>419</sup>

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<sup>416</sup> *Rural Route Mail Carriers of Canada, Local 1801 v. Canada (Attorney General)* [1989] F.C.J. No. 701 (T.D.) (Book of Authorities at Tab 128).

<sup>417</sup> Rosen Report at paras. 39-41.

<sup>418</sup> See *CUPW Negotiations Bulletin* no. 44 dated July 7, 2003 entitled “A Victory for Rural and Suburban Mail Carriers”: (16050, at 16051) (Tab U322). According to the collective agreement signed by Canada Post with the union representing these former Rural Contractors, the additional cost incurred by Canada Post in converting these workers to employee status was \$29 million dollars during 2004. During the second and subsequent years of the collective agreement, Canada Post will incur a further cost of \$15 million dollars per year. Clause 35.01 of Canada Post’s collective agreement with Canadian Union of Postal Workers (16042, at 16046-7) (Tab U369). See also “Rural Mail Carriers Happy with Contract”, in *The Western Producer*, August 11, 2003 (16058, at 16059) (Tab U371). See also *CUPW Perspective newsletter*, volume 31, dated August 2003 (16055) (Tab U370).

<sup>419</sup> Canada’s answers to question 170 of UPS’ interrogatories (Tab U290). See also s. 46.5(1) of the *Public Service Superannuation Act*, R.S.C. c. P-36 (Tab U375).

345. When Canada Post was required to set up its own pension plan to mirror the PSSA in 1999, Canada extended the prohibition on collective bargaining to October 1, 2001. Since Canada Post's collective agreement was renewed on August 1, 2000 for a period expiring on January 31, 2003, this legislation effectively extended the prohibition to February 1, 2003.<sup>420</sup>
346. Canada's exemption of Rural Contractors from the *Canadian Labour Code* and restrictions on collective bargaining over pensions resulted in lower salaries and benefit packages for its workers. This exemption unfairly allowed Canada Post to pay lower wages, and, therefore, enjoy lower operating costs than its competitors. As set out in the Rosen Report, this resulted in financial harm and reduced market share for UPS Canada.<sup>421</sup>

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<sup>420</sup> *Public Service Superannuation Act*, ss. 46.5(1) and (2) (Tab U375).

<sup>421</sup> Rosen Report at paras. 41-43.

## **Chapter VII. PUBLICATIONS ASSISTANCE PROGRAM RESTRICTIONS**

347. The *Publications Assistance Program* (“PAP”) subsidizes the distribution of a broad range of Canadian weekly newspapers and magazines to communities across Canada.<sup>422</sup> In its *Statement of Defence*, Canada describes the objectives of the program, which include encouraging the dissemination of Canadian cultural products, supporting community newspapers, supporting minority communities and ensuring all Canadians can access publications.<sup>423</sup>
348. UPS accepts the value of these objectives and only objects to the manner in which Canada implements the PAP. In particular, Canada has chosen to restrict the benefits of the PAP to publishers who use Canada Post to distribute their publications. Canada can implement the PAP to fulfill its policy objectives and also fulfill Canada’s NAFTA obligations, by allowing publishers to choose their carrier.
349. Canada began subsidizing the distribution of Canadian periodicals before Confederation. The government previously administered these subsidies by imposing a lower postal rate on domestic periodicals than foreign periodicals.<sup>424</sup> Canada currently provides up to \$46.4 million through the PAP each year.<sup>425</sup>
350. In the late 1990s, both a WTO Panel and the Appellate Body decided that Canada’s subsidization of domestic periodicals was inconsistent with the national treatment provisions of the GATT 1994.<sup>426</sup> To bring the PAP in line with the ruling, Canada

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<sup>422</sup> *Statement of Defence* at para. 95. See *Publications Assistance Program* Activity Report 1999-2000 (21325) (Tab U409) for a description of the broad range of periodicals that benefit from the Plan. These include widely read Canadian magazines such as *Maclean’s* and *Chatelaine*.

<sup>423</sup> *Statement of Defence* at para. 94.

<sup>424</sup> Canadian Business Press Publications Assistance Program Discussion Paper (R263B-3) (Tab U9).

<sup>425</sup> *Statement of Defence* at para. 97.

<sup>426</sup> Decision of the WTO panel in *Canada - Certain Measures Concerning Periodicals*, WT/DS31/R (1997) (Book of Authority at Tab 66). ; Decision of the WTO Appellate Body in *Canada - Certain Measures Concerning Periodicals*, WT/DS31/AB/R, (1997). (Book of Authority at Tab 65).

subsidized publications directly. [REDACTED]  
[REDACTED]  
[REDACTED]<sup>427</sup> Publishers are, therefore, forced to distribute through Canada Post to access the subsidy.

351. By forcing publishers to distribute through Canada Post to access the subsidy, Canada discriminates against other companies, such as UPS Canada. Canada claims the PAP is not discriminatory because “[n]o Canadian or US courier company can perform affordable distribution of magazines required by the program on a national basis.”<sup>428</sup> Canada has failed to explain why it does not leave this decision to publishers by directly paying them the subsidy and letting them choose their distribution company.

352. In its response to UPS’ document request, Canada refused to provide a 1994 report recommending that Canada allow the distribution of publications by distributors other than Canada Post, if those other distributors could do the work more cost effectively.<sup>429</sup> UPS, however, has been able to obtain a copy of this report from other sources. Given that this report makes a specific recommendation that is contrary to Canada’s position, it is a further justification for drawing adverse inferences where Canada has failed to produce requested documents.<sup>430</sup>

353. Canada also failed to provide any internal documents considering the feasibility of implementing these recommendations. Canada merely provided a [REDACTED]  
[REDACTED] and publishers responses to the paper.<sup>431</sup> These responses

<sup>427</sup> [REDACTED]. See [REDACTED]  
[REDACTED] (R26- [REDACTED])

<sup>428</sup> *Statement of Defence* at para. 144.

<sup>429</sup> See Investor’s Information Request to Canada dated April 25, 2003, question 263(a) (AA00325-AA00403 at AA00401) (Tab U294).

<sup>430</sup> “Replacement of the Publications Distribution Assistance Program: A Discussion Paper” by Hank Intver and Eileen Clarke of McCarthy Tetrault (March 1994) at pp. 4, 9, 30-33 (5999-6045) (Tab U402).

<sup>431</sup> [REDACTED] (R263B.3)  
(Ta- [REDACTED])

highlight publishers' desire for a choice of distributor:

a. The Canadian Community Newspapers Association ("CCNA") claimed it:

... is concerned that Canada Post is adjusting its profit margins on the backs of its publications clients without taking the steps necessary to cut costs. The CCNA and other associations in the section have also pointed out that the greatest impact is seen in PAP. Canada Post is the exclusive contractor in the Publications Assistance Program and thus, argue the industry, there is little incentive to keep rates competitive.<sup>432</sup>

b. Similarly, the [redacted] stated:

[redacted]

c.

[redacted]

[redacted]

354. UPS Canada's existing clients include many large retailers who sell Canadian publications as well as many clients with retail outlets in shopping malls that are close to news stands. UPS Canada could deliver bulk shipments of publications to these news stands and has solicited the business of Canadian publishers who ship to retailers across Canada. However, UPS Canada found that it was unable to attract any of this business. UPS Canada could not compete with Canada Post which receives an advantage through

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<sup>432</sup> CCNA's Community News, available at: [www.communitynews.ca](http://www.communitynews.ca), 6 February 2002 (D21533-21534) (Tab U238).

<sup>433</sup> [redacted] at 15 (R263B.3) (Tab U9).

<sup>434</sup> [redacted] at 1  
(R2-)

its administration of this subsidy granted to publishers.<sup>435</sup>

**Chapter VIII. THE FRITZ STARBER BID**

355. In 2001, Canada Post issued a solicitation for Global Airfreight Services. Fritz Starber submitted a competitive response to this solicitation. Canada Post rejected Fritz Starber's bid upon learning that Fritz Starber had become an affiliate of UPS. This rejection was a retaliation against UPS and its investment, Fritz Starber, for having initiated this NAFTA arbitration.

356. In early 2001, Don Lavictoire of Canada Post met Leslie Ross, a sales representative from Fritz Starber, at a trade conference.<sup>436</sup> At the time, Fritz Starber was not affiliated with UPS.

357. During the conference, Mr. Lavictoire told Mr. Ross of Canada Post's plans to outsource a portion of its airfreight operations, and he encouraged Fritz Starber to bid on the work. Fritz Starber had previously had a business relationship with Canada Post as its freight forwarder for Canada's diplomatic mail sent during the late 1990s.<sup>437</sup>

358. On April 12, 2001, Mr. Lavictoire sent Mr. Ross an invitation to bid describing Canada Post's proposal for the carriage of international surface mail to South America, Central America, and the Caribbean.<sup>438</sup>

359. Over the next month, Fritz Starber devoted considerable resources to its response to

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<sup>435</sup> [REDACTED] 47 and 48. See also [REDACTED] 263A-1) (Tab U239)

<sup>436</sup> Witness Statement of Leslie Ross Statement at para. 4.

<sup>437</sup> Witness Statement of Leslie Ross Statement at para. 4.

<sup>438</sup> Lavictoire e-mail dated April 12, 2001 (Tab U194); *Ross Statement* at para. 5.

Canada Post's solicitation.<sup>439</sup> Fritz Starber considered the Canada Post proposal to be a "high-priority" project. The successful bidder would be well positioned to obtain a more lucrative contract for Canada Post's European airfreight operations.

360. On May 9, 2001, Fritz Starber submitted its bid to Canada Post.<sup>440</sup> On June 15, 2001, Mr Lavictoire acknowledged that Fritz Starber's rates were competitive and Canada Post informed Fritz Starber that its bid was being moved up for consideration by more senior officials at Canada Post.<sup>441</sup>
361. In late August 2001, Mr. Ross telephoned Mr. Lavictoire to inquire about the status of the bid. During their conversation, Mr. Lavictoire again confirmed that Fritz Starber's rates were competitive, but noted Canada Post's displeasure upon learning of an unspecified company with whom Fritz Starber was involved.<sup>442</sup> That company, of course, was UPS which had acquired Fritz Starber on May 24, 2001.
362. On December 5, 2001, after repeating further enquiries, Mr. Lavictoire responded with an e-mail indicating that he was previously unaware of Fritz Starber's affiliation with UPS. As a result of UPS' legal action against Canada Post, he could not entertain a bid from Fritz Starber.<sup>443</sup>
363. Canada Post rejected Fritz Starber's bid solely as a result of UPS' NAFTA claim. As a result of Canada Post's retaliation, Fritz Starber suffered harm by way of lost profits.<sup>444</sup>

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<sup>439</sup> Witness Statement of Leslie Ross at para. 6.

<sup>440</sup> Fritz Starber Bid dated May 9, 2001 (Tab U199) and spreadsheets (Tab U198).

<sup>441</sup> Witness Statement of Leslie Ross at para. 9. E-mail from Ross to Valiquette, Lipinski, Bevilaqua, dated June 15, 2001 (Tab U209).

<sup>442</sup> Witness Statement of Leslie Ross at para. 10.

<sup>443</sup> Lavictoire E-mail dated December 5, 2001 (Tab U228).

<sup>444</sup> Witness Statement of Leslie Ross at para. 15; Rosen Report.

### **PART THREE: LEGAL ARGUMENT**

#### **Chapter I. OVERVIEW OF THE LEGAL ARGUMENT**

364. Part Three of this Memorial demonstrates why Canada has failed to act in a manner consistent with its obligations contained in Section A of NAFTA Chapter 11 and Articles 1502(3)(a) and 1503(2).
365. Preliminary Matters are covered in Chapters II and III of Part Three of this Memorial. Chapter II deals with the law governing this arbitration while Chapter III covers the issue of state responsibility, which holds an important role for Investor-state arbitrations generally and for this arbitration involving a state organ of Canada in particular.
366. Canada has raised a number of procedural and jurisdictional matters. These issues are covered in Chapter IV of this Part of the Memorial. Substantive legal issues raised in this claim are then considered as follows:
- Chapter V - National Treatment
  - Chapter VI - International Law Standards of Treatment
  - Chapter VII - Most Favored Nation Treatment
  - Chapter VIII - State Enterprises and Monopolies
367. Claims regarding Canada's failure to meet its national treatment obligation are canvassed in Chapter V of this Part of the Memorial. These claims deal with:
- a. Canada's discriminatory use of its Postal Monopoly Infrastructure;
  - b. Canada's failure to provide the most favorable customs treatment to UPS Canada that it provides to Canada Post; and
  - c. Canada's preference of Canada Post amongst all delivery providers operating in Canada when it administers programs to assist magazines.

368. Claims regarding Canada's failure to meet international law standards of treatment in its treatment of UPS Canada and Fritz Starber (now UPS SCS Inc.) are canvassed in Chapter VI of this Part of the Memorial. These claims deal with:
- a. Actions taken by Canada Post to retaliate against UPS' investment in Canada as a result of its recourse to NAFTA Investor-State arbitration;
  - b. Canada's failure to properly enforce its customs laws with respect to courier and parcel imports;
  - c. Canada's failure to ensure that Canada Post did not abuse the authority and discretion granted to it by Canada regarding imports of packages and parcels into Canada taken under the *Postal Imports Agreement*;
  - d. Canada Post's abuse of its customs authority; and
  - e. Canada's failure to meet its international law obligations (including the obligation of good faith and *pacta sunt servanda*) regarding core labour standards with regard to its continued deprivation of collective bargaining rights for Canada Post workers until 2004.
369. Claims regarding Canada's failure to meet its most favored nation treatment obligation are canvassed in Chapter VII of Part Three of this Memorial. Canada has failed to provide international law standards of treatment as favorable to UPS and its Investments as it is obligated to provide to investments and investors of non-NAFTA Parties under other investment protection treaties ratified by Canada since the NAFTA came into force on January 1, 1994. There is a violation of MFN treatment by Canada to the extent that the level of international law treatment offered by Canada under those treaties exceeds that provided by Canada to the Investor and its Investments under NAFTA Article 1105.
370. Canada has two obligations under provisions of NAFTA Chapter 15 which can be raised

by an investor in a NAFTA Investor-State claim and which are canvassed in Chapter VIII of Part Three of this Memorial. These claims deal with Canada's failure to adequately supervise or regulate Canada Post's monopoly or state enterprise activities where there has been a breach of an obligation arising under Section A of NAFTA Chapter 11. In particular, the Investor raises the following specific violations of these Chapter 15 obligations:

- a. Canada has failed to properly supervise Canada Post's activities where it has improperly leveraged its Postal Monopoly privileges to compete in courier services contrary to NAFTA Article 1102;
  - b. Canada has failed to properly supervise Canada Post where it has used its customs authority delegated to Canada Post and failed to properly collect duties and taxes; and
  - c. Canada has failed to properly supervise Canada Post to prevent it using its privileges to retaliate against the Investor and its investments as a result of the Investor's initiation of Investor-state dispute settlement with regard to the treatment of its investments in Canada contrary to NAFTA Article 1105.
371. Before dealing with the substantive issues, it is important to clarify an issue raised by Canada. Canada asserts that the Investor has attempted to circumvent the Tribunal's *Award on Jurisdiction* by raising national treatment concerns over issues upon which UPS had raised anti-competitive treatment concerns. Concerns about Canada's failure to provide national treatment to UPS Canada over access to Canada Post's non-Postal Monopoly Infrastructure are not only questions of anti-competitive practices law. National Treatment is a relative standard rather than an absolute treatment standard like that required under the provisions relating to anti-competitive practices in NAFTA Article 1502(3)(d). Canada is required to provide more favorable treatment than it currently provides to UPS Canada because it does provide better treatment to UPS Canada's domestically-owned competitors, namely Canada Post and Purolator. This obligation may overlap with NAFTA Article 1502(3)(d), but such overlapping

obligations are common in international treaties.

372. Canada has generally raised vague defences to these particular allegations. These defences are either blanket denials of inconsistency with NAFTA obligations,<sup>445</sup> general reliance on public policy justifications<sup>446</sup> or unsubstantiated references to subsidy or procurement exceptions in NAFTA Article 1108(7).<sup>447</sup> It is Canada's burden to establish any defence it wishes to raise. Canada's failure to provide particularity about these defences in its *Statement of Defence* makes it impossible for the Investor to be able to respond to these issues within this Memorial.

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<sup>445</sup> *Statement of Defence* at para. 4.

<sup>446</sup> *Statement of Defence* at para. 119.

<sup>447</sup> *Statement of Defence* at para. 10.

**Chapter II. GOVERNING LAW, INTERPRETATION AND BURDEN OF PROOF**

373. The Investor has pleaded that Canada has acted in a manner inconsistent with specific obligations under NAFTA Articles 1102 (National Treatment), 1105 (Treatment in Accordance with International Law Standards), 1103 (Most Favored Nation Treatment) and 1502(3)(a) and 1503(2) (Monopolies and State Enterprises). The Investor has also suffered loss or damage arising from those inconsistent measures.

**A. Relevant Provisions in NAFTA**

374. The NAFTA is an agreement between three sovereign Parties, Canada, the United States and Mexico, dealing with a vast range of matters relating to the liberalization of trade, including trade in goods, services and investment.

375. NAFTA Article 102(2) sets out the manner in which this Agreement is to be interpreted and applied by the Parties:

**Article 102: Objectives**

2. The Parties shall interpret and apply the provisions of this Agreement *in the light of its objectives* set out in paragraph 1 and *in accordance with applicable rules of international law*. (Emphasis added)

376. Interpretation in accordance with *both* the objectives of the NAFTA and the applicable rules of international law is confirmed in the direction to Tribunals constituted under Section B of Chapter 11 of NAFTA contained in Article 1131(1) that they:

... shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.

377. The objectives of the NAFTA, critical to the interpretive task, are set out in Article 102(1), as follows:

**Article 102: Objectives**

1. The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favored-nation treatment and transparency, are to:
  - (a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
  - (b) *promote conditions of fair competition in the free trade area;*
  - (c) *increase substantially investment opportunities in the territories of the Parties;*
  - (d) provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;
  - (e) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and
  - (f) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement. (Emphasis added)

378. Part Five of the NAFTA, containing Chapters 11 through 16, is entitled “Investment, Services and Related Matters”. The Investor brings this claim under Chapter 11, entitled “Investment.” Chapter 11 comprises three sections.

- a. Section A - Investment sets out various substantive obligations assumed by the Parties to the NAFTA (Articles 1101-1114).
- b. Section B - Settlement of Disputes between a Party and an Investor of Another Party sets out the procedural mechanism by which an investor can bring a claim directly against a NAFTA Party (Articles 1115 to 1138).
- c. Section C - Definitions defines certain relevant terms for the purposes of Chapter 11 (Article 1139).

379. The relevant obligations for the purposes of this proceeding are:

**Article 1101: Scope and Coverage**

1. This Chapter applies to measures adopted or maintained by a Party relating to:
  - (a) investors of another Party;
  - (b) investments of investors of another Party in the territory of the Party; and
  - (c) with respect to Articles 1106 and 1114, all investments in the territory of the Party.
2. A Party has the right to perform exclusively the economic activities set out in Annex III and to refuse to permit the establishment of investment in such activities.

**Article 1102: National Treatment**

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

**Article 1103: Most-Favored-Nation Treatment**

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

and:

**Article 1105: Minimum Standard of Treatment**

1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

380. This claim is specifically brought pursuant to NAFTA Article 1116(1) which permits an

Investor to submit a claim for harm caused to the Investor by a Party in certain defined circumstances:

**Article 1116: Claim by an Investor of a Party on Its Own Behalf**

1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:
  - (a) Section A or Article 1503(2) (State Enterprises), or
  - (b) Article 1502(3)(a) (Monopolies and State Enterprises) *where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A,*and that the investor has incurred loss or damage by reason of, or arising out of, that breach. (Emphasis added)

381. NAFTA Article 1116(1)(b) permits a claim to be brought against Canada where Canada has breached NAFTA Article 1502(3)(a) and the government monopoly has acted in a manner inconsistent with Canada's obligations under Section A of Chapter 11. NAFTA Article 1502(3)(a) specifically imports an obligation on the Party, to ensure that its government monopoly acts consistently with the obligations of Section A of NAFTA Chapter 11.

**Article 1502: Monopolies and State Enterprises**

3. Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any privately-owned monopoly that it designates and any government monopoly that it maintains or designates:
  - (a) acts in a manner that is not inconsistent with *the Party's obligations under this Agreement* wherever such a monopoly exercises any regulatory, administrative or other governmental authority that the Party has delegated to it in connection with the monopoly good or service, such as the power to grant import or export licenses, approve commercial transactions or impose quotas, fees or other charges; (Emphasis added)

382. NAFTA Article 1116(1)(a) permits a claim to be brought against Canada where Canada has breached NAFTA Article 1503(2). NAFTA Article 1503(2) specifies that state enterprises must act consistently with NAFTA Chapter 11 and NAFTA Chapter 14. The Article reads:

**Article 1503: State Enterprises**

2. Each party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under Chapters Eleven (Investment) and Fourteen (Financial Services) wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions or impose quotas, fees or other charges.

**B. Principles to be Followed in Interpreting the NAFTA**

**1. The Vienna Convention**

383. Article 1131 of the NAFTA refers the Tribunal to both the Treaty and the "applicable rules of international law". The "applicable rules of international law" are set out in Articles 31 and 32 of the *Vienna Convention*.<sup>448</sup> Article 31(1) requires a treaty to be interpreted in good faith in accordance with the ordinary meaning of the words used, in their context, and in light of the treaty's object and purpose.
384. The objects and purposes of the NAFTA are set out in Article 102(1). They include trade liberalization, the promotion of conditions of fair competition and increasing substantially investment opportunities between the Parties.
385. Article 31(3)(c) of the *Vienna Convention* provides that "relevant rules of international law applicable in the relations between the Parties" should be taken into account in interpreting treaty provisions.

**2. Approach Taken by Prior NAFTA Tribunals**

386. Prior NAFTA Tribunals have recognized the importance of interpreting the NAFTA in light of its objects and purposes. Thus, in the very first NAFTA decision, *Canadian Marketing Practices*, the Chapter 20 panel said:

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<sup>448</sup> *The Vienna Convention on the Law of Treaties* (Book of Authorities at Tab 89).

The Panel also attaches importance to the trade liberalization background against which the agreements under consideration must be interpreted. Moreover, as a free trade agreement, the NAFTA has the specific objective of eliminating barriers to trade among the three contracting Parties. The principles and rules through which the objectives of the NAFTA are elaborated are identified in NAFTA Article 102(1) as including national treatment, most-favored nation treatment and transparency. Any interpretation adopted by the Panel must, therefore, promote rather than inhibit the NAFTA's objectives.<sup>449</sup>

387. In *Ethyl Corporation and Canada (Award on Jurisdiction)*, the Chapter 11 Tribunal rejected Canada's arguments that the NAFTA should be interpreted narrowly, saying this about the approach to interpretation:

The Tribunal considers it appropriate first to dispose with any notion that Section B of Chapter 11 is to be construed "strictly". The erstwhile notion that "in case of a doubt a limitation of sovereignty must be construed restrictively" as long since been displaced by Articles 31 and 32 of the Vienna Convention.<sup>450</sup>

388. The NAFTA Chapter 11 Tribunal in *S.D. Myers and Canada*, in discussing the approach to interpreting the NAFTA, considered that the appropriate place to begin was with the Preamble, which asserted the Parties resolve to:

Create an expanded and secure market for the goods and services produced in their countries...to ensure a predictable commercial framework for business planning and investment...and to do so in a manner consistent with environmental protection and conservation.<sup>451</sup>

389. The *Pope & Talbot and Canada* Tribunal similarly interpreted the specific obligations under NAFTA Chapter 11 in light of its liberalizing objectives set out in Article 102. In rejecting an argument advanced by Canada concerning the interpretation of the national treatment obligation under NAFTA Article 1102, the Tribunal concluded:

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<sup>449</sup> NAFTA Arbitration Panel Established Pursuant to Article 2008. *In the Matter of Tariffs Applied by Canada to Certain US - Origin Agricultural Products* (Secretariat File No. CDA-95-2008-01). Final Report of the Panel, December 2, 1996 at 34, para. 122 (Book of Authorities at Tab 87).

<sup>450</sup> *Ethyl Corporation and Canada*, UNCITRAL/NAFTA Arbitration, *Award on Jurisdiction*, June 24, 1998 at para. 55 (Book of Authorities at Tab 50).

<sup>451</sup> *S.D. Myers and Canada, Partial Award*, November 12, 2000 at para. 196 (Book of Authorities at Tab 4).

...Indeed, the recognition that national treatment can be denied through *de facto* measures has always been based on an unwillingness to allow circumvention of that right by skillful or evasive drafting. Applying Canada's proposed more onerous rules to *de facto* cases could quickly undermine that principle. That result would be inconsistent with the investment objectives of NAFTA, in particular Article 102(1)(b) and (c), to promote conditions of fair competition and to increase substantially investment opportunities.<sup>452</sup>

390. The Chapter 11 Tribunal in *Metalclad* also confirmed the importance of the NAFTA objectives in concluding that Mexico had breached its obligation to accord fair and equitable treatment under NAFTA Article 1105:

An underlying objective of NAFTA is to promote and increase cross-border investment opportunities and ensure the successful implementation of investment initiatives....<sup>453</sup>

391. Thus, NAFTA Tribunals in *Ethyl Corporation*, *Pope & Talbot*, *Metalclad* and *S.D. Myers* have all interpreted the specific obligations contained in NAFTA Chapter 11 as fitting within the broad liberalizing context of the treaty and its objectives. Accordingly, any interpretation of the NAFTA Articles 1102, 1103, 1105, 1116, 1502(3) or 1503(2) must be undertaken having full regard for the objective of investment promotion identified in Article 102(1)(c), together with the objectives of trade liberalization and fair competition.

### **3. The Cumulative Principle**

392. International law obligations often overlap so that the same facts fall within the scope of more than one obligation. International law addresses this situation by deeming that, in such a situation, the state is in breach of each international law obligation. WTO tribunals have consistently applied this principle to find the same facts breach more than one provision in the GATT or provisions in both the GATT and the GATS.<sup>454</sup>

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<sup>452</sup> *Pope & Talbot, Award on the Merits Phase 2* at para. 70 (Book of Authorities at Tab 7).

<sup>453</sup> *Metalclad Corporation and Mexico, Award*, August 30, 2000 40 ILM 36 (2001) at paras. 75-76 (Book of Authorities at Tab 86).

<sup>454</sup> See, for example, *EC-Bananas*, WT/DS27/AB/R, September 9, 1997 at para. 222: "... we agree with the Panel that the EC banana import licensing procedures are subject to both the GATT 1994 and the GATS, and that the GATT 1994 and the GATS may overlap in application to a particular measure." (Book of Authorities at Tab 14).

393. NAFTA obligations also overlap. Within NAFTA Chapter 11, for example, a NAFTA Party's actions can fall within its specific NAFTA Article 1110 obligation to provide compensation upon an act of expropriation and the general international law standard of treatment obligation in NAFTA Article 1105. Consistent with principles of international law, NAFTA tribunals have held that the same facts can lead to breaches of more than one provision. Hence, the *Pope & Talbot* Tribunal said, with respect to the overlap between NAFTA trade in goods chapters and NAFTA Chapter 11:

... the fact that a measure may primarily be concerned with trade in goods does not necessarily mean that it does not relate to investment or investors. By way of example, an attempt by a Party to require all producers of a particular good located in its territory to purchase all of a specified necessary raw material from persons in its territory may well be said to be a measure relating to trade in goods. But it is clear from the terms of Article 1105 that it is also a measure relating to investment insofar as it might affect an enterprise owned by an investor of a Party.<sup>455</sup>

394. In *S.D. Myers*, the Tribunal relied upon the *Pope & Talbot* decision with approval and concluded:

The view that different chapters of the NAFTA can overlap and that the rights it provides can be cumulative except in cases of conflict, was accepted by the decision of the Arbitral Tribunal in *Pope & Talbot*. The reasoning in the case is sound and compelling. There is no reason why a measure which concerns goods (Chapter 3) cannot be a measure relating to an investor or an investment (Chapter 11).<sup>456</sup>

### **C. The Tribunal's Power to Draw Adverse Inferences**

395. Article 28(3) of the UNCITRAL Rules explicitly confirms this Tribunal's powers to draw adverse inferences from a failure to produce documents. It provides that:

If one of the parties, duly invited to produce documentary evidence, fails to do so within the established period of time, without showing sufficient cause for such failure, the arbitral tribunal may make the award on the evidence before it.

The *Pope & Talbot* Tribunal has interpreted this Article of the UNCITRAL Arbitration

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<sup>455</sup> *Pope & Talbot, Decision on Motion to Dismiss Relating to NAFTA Article 1101*, January 26, 2000 at para. 33 (Book of Authorities at Tab 54).

<sup>456</sup> *S.D. Myers, Partial Award*, November 12, 2000 at para. 294 (Book of Authorities at Tab 4).

Rules as granting NAFTA tribunals the power to draw adverse inferences.<sup>457</sup>

396. In its Procedural Order concerning disclosure of documents, the NAFTA Tribunal in the *Waste Management and Mexico* case observed that the IBA Rules on the Taking of Evidence in International Commercial Arbitration provide that the ultimate sanction for non-disclosure is the drawing of an adverse inference against the non-disclosing party. After the Claimant failed to produce documents from a third party under its control, the Tribunal then put the Claimant on notice that these documents would be in issue and that it might draw corresponding inferences at the merits phase.<sup>458</sup> In *Feldman and Mexico*, the NAFTA Tribunal drew an adverse inference from Mexico's failure to produce documents.<sup>459</sup>
397. On August 1, 2003, the UPS Tribunal directed both disputing parties to produce documents "at once".<sup>460</sup> The Tribunal specifically cautioned Canada not to refuse production because the documents allegedly raise jurisdictional issues or contain information related to third parties. Failure to comply with a Tribunal order should be sanctioned by a declaration that the Tribunal will draw an adverse inference from this non-compliance.<sup>461</sup>
398. On October 8, 2004, this Tribunal issued its *Decision of the Tribunal relating to Canada's claim of Cabinet Privilege*. In this decision, the Tribunal had to consider Canada's refusal to produce numerous relevant and necessary documents covered by

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<sup>457</sup> *Pope & Talbot Decision on State Secrecy September 6, 2000* at paras. 1.3, 1.4 (Book of Authorities at Tab 108).

<sup>458</sup> *Re: Waste Management, Inc. and Mexico* (ICSID Case N. ARB(AF)/00/3), *Procedural Order concerning Disclosure of Documents* at para. 6 citing the IBA Rules on the Taking of Evidence in International Commercial Arbitration (1999) at Article 9(4) (Book of Authorities at Tab 92). *Re: Waste Management, Inc. and Mexico* (ICSID Case N. ARB(AF)/00/3), *Procedural Order No. 2 concerning Disclosure of Documents* at para. 15 (Book of Authorities at Tab 129).

<sup>459</sup> *Feldman and Mexico* at para. 178 (Book of Authorities at Tab 8).

<sup>460</sup> *UPS - Direction of the Tribunal Concerning Document Production*, August 1, 2003 at paras. 3 and 5 (Book of Authorities at Tab 107).

<sup>461</sup> Redfern & Hunter, *Law and Practice of International Commercial Arbitration* (3rd ed) at 317 (Book of Authorities at Tab 93).

Information Requests made by UPS. The Tribunal found that Canada had not adequately sustained its claim to privilege over these documents. It found that the Clerk of the Privy Council “has not on the record before us undertaken the necessary weighing” as to whether the Cabinet privilege applied.<sup>462</sup> The Tribunal warned Canada that:

A failure to disclose, found by the Tribunal to be unjustifiable,<sup>463</sup> may lead to the Tribunal drawing adverse inferences on the issue in question.

Canada refused to provide these documents to the Investor and the Tribunal within the three weeks allocated to them by the NAFTA Tribunal.

399. Canada also failed to produce necessary and relevant documents with respect to the Investor’s Information Request in other areas. In many of these areas, Canada’s refusal has simply been without any attempt at justification. Such behaviour should not be lightly tolerated by an international arbitration tribunal and merits serious consequences, including cost sanctions and the drawing of adverse inferences.
400. In its *Procedural Direction* of December 17, 2004, the Tribunal noted that it has the power to draw adverse inferences from a party’s failure to disclose documents or answer interrogatories. In particular, “it puts Canada on notice of this possibility and calls attention to the role of a costs order in this respect”.<sup>464</sup>
401. In light of Canada’s non-compliance with its orders, this Tribunal should make the following findings of fact by way of adverse inference:
- a. *Annual Cost Study* - Canada’s failure to produce documents supporting its Annual Cost Study leads to the inference that the Study is flawed or improperly implemented and that Canada Post’s courier services do not make either an

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<sup>462</sup> *UPS - Decision of the Tribunal relating to Canada’s Claim of Cabinet Privilege*, October 8, 2004 at para. 12 (Book of Authorities at Tab 107).

<sup>463</sup> *UPS - Decision of the Tribunal relating to Canada’s Claim of Cabinet Privilege*, October 8, 2004 at para. 15 (Book of Authorities at Tab 107).

<sup>464</sup> *Procedural Direction*, December 17, 2004 at para. 4 (Book of Authorities at Tab 140).

incremental or a fair contribution to covering the costs of basic postal services.

- b. *Purolator's Use of Monopoly Infrastructure* - Canada's failure to produce documents relating to Purolator's use of Canada Post's Monopoly Infrastructure leads to the inference that Purolator is using Canada Post's employees for the pick up, sorting and transportation or delivery of its packages.
- c. *Canada Post's Use of Monopoly Infrastructure* - Canada Post's failure to produce documents relating to the manner in which Priority Courier and Xpresspost access the Monopoly Infrastructure leads to the inference that these services access the infrastructure in the manner described in these document requests.
- d. *Supervision* - Canada's failure to justify its claims of Cabinet Privilege in accordance with the Tribunal's directions, leads to the inference that the Cabinet has been made aware of Canada Post's actions and has refused to supervise or regulate them. Canada's last minute objections to documents in the possession of the Competition Bureau leads to the inference that Canada cannot rely on the Competition Bureau to support its defence of supervision of Canada Post.
- e. *Publications Assistance Program* - Canada's failure to produce documents regarding the *Publications Assistance Program* leads to the inference that there is no justification for the restriction of the benefits of that plan to distribution by Canada Post.

**D. The Burden of Proof**

- 402. Canada has raised a number of jurisdictional and procedural objections as well as several affirmative defences that rely on general public policy exceptions or the specific subsidij and government procurement exceptions in Article 1108(7). Canada bears the burden of proof with respect to these objections and affirmative defences.
- 403. Article 24(1) of the UNCITRAL Arbitration Rules establishes that "each party shall have

the burden of proving the facts relied on to his claim or defence.”

404. This principle has been followed by Investor-state tribunals widely. For example, in *Asian Agricultural Products Limited v. Republic of Sri Lanka*,<sup>465</sup> the Tribunal ruled that, “In case a party adduces some evidence which *prima facie* supports his allegation, the burden of proof shifts to his opponent.”

405. Similarly, the WTO Appellate Body has held:

... various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or respondent, is responsible for providing proof thereof. *Also, it is a generally accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a claim or defence.*<sup>466</sup>

406. In its decision on a motion by Canada asserting a jurisdictional objection, the *Pope & Talbot* Tribunal stated the following:

Canada’s contention that the Harmac claim is time barred is in the nature of an affirmative defence, and, as such, Canada has the burden of proof of showing factual predicate to that defence.<sup>467</sup>

407. A respondent’s failure to adequately support defence leads to its refusal. In *Feldman*, the Tribunal faulted the respondent for failing to present evidence to rebut the Investor’s *prima facie* claim:

Here, the Claimant in our view has established a presumption and a *prima facie* case that the Claimant has been treated in a different and less favorable manner than several Mexican owned

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<sup>465</sup> *Asian Agricultural Products Limited v. Republic of Sri Lanka*, ICSID Reports, pp. 246, 272, 1990 (Book of Authorities at Tab 47). See also Bin Cheng, *General Principles of Law as Applied by International Courts and Tribunals* at 334 (Grotius: Cambridge, 1987) (“the general principle [is] that the burden of proof falls upon the claimant . . . .”) (Book of Authorities at Tab 26).

<sup>466</sup> *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, Adopted 23 May 1997, WT/DS33/AB/R, p. 14 (Emphasis added) (Book of Authorities at Tab 62).

<sup>467</sup> *Pope & Talbot, Award in Relation to Preliminary Motion by Government of Canada to Strike Paragraphs 34 and 103 of the Statement of Claim from The Record (“The Harmac Motion”)*, February 24, 2000. (Book of Authorities at Tab 63).

cigarette resellers, and the Respondent has failed to introduce any credible evidence into the record to rebut that presumption.<sup>468</sup>

408. Dr. Bin Cheng introduces further precision in this matter. He states that:

The term burden of proof may, however, also be used in a more restricted sense as referring to proof of individual allegations advanced by the parties in the course of proceedings. This burden of proof may be called procedural. As has been seen at the beginning of the present Chapter, in this sense of the term, the burden of proof rests upon the party alleging the fact (...) In the absence of convincing evidence, the Tribunal will disregard the allegation.<sup>469</sup>

409. Canada is thus required to present evidence in support of its jurisdictional and procedural objections that it has raised in the Merits Phase. Because of the principle of *res judicata*,<sup>470</sup> Canada's objections must go beyond the matters already decided by the Tribunal in its *Award on Jurisdiction*.

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<sup>468</sup> *Feldman* at para. 177 (Book of Authorities at Tab 8).

<sup>469</sup> Bin Cheng, *General Principles of Law as Applied by International Courts and Tribunals* at 334, 335 (1987) (Book of Authorities at Tab 26).

<sup>470</sup> The *Trail Smelter* Arbitral Tribunal confirms that *res judicata* is a principle of international law (Book of Authorities Tab 42).

### **Chapter III. STATE RESPONSIBILITY**

410. A state is responsible under international law for the actions of government, including all the actions of its officials, agencies, diplomatic representatives and organs.
411. The International Law Commission (“ILC”) *Articles on State Responsibility* (“*ILC Articles*”) set out the customary international law on state responsibility. In its *Award on Jurisdiction*, this Tribunal pointed out that Canada has admitted that the draft articles upon which these are based, constituted an expression of the customary international law.<sup>471</sup>
412. In addition, the *Loewen and United States NAFTA Tribunal* described the immediate predecessor to the *ILC Articles*, the *ILC Draft Articles on State Responsibility*, as expressing the “modern view” of state responsibility and as “a highly persuasive statement of the law of state responsibility as it presently stands.”<sup>472</sup>

#### **A. The Threshold for State Responsibility is Inconsistency**

413. The *ILC Articles* provide that every internationally wrongful act of a state entails the international responsibility of that state. The articles define an internationally wrongful act of a state as being a state action or omission that is attributable to the state under international law and which constitutes a breach of an international obligation of the state.<sup>473</sup>
414. A similar view on the basis for state responsibility has been expressed in the *Restatement*

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<sup>471</sup> *Award on Jurisdiction* at para. 78 (Book of Authorities at Tab 48).

<sup>472</sup> *Loewen and United States, Decision On Hearing of Respondent’s Objection to Competence and Jurisdiction*, January 5, 2001 at para. 70 (Book of Authorities at Tab 51).

<sup>473</sup> International Law Commission, *Articles on State Responsibility*, annexed to GA Res 56/83, UN Doc. A/CN.4/L.602/Rev.1 (2001), Articles 1 and 2 (Book of Authorities at Tab 1).

(*Third*) of the *Foreign Relations Law of the United States*.<sup>474</sup> The *Restatement (Third)* provides in §711 (State Responsibility for Injury to Nationals of Other States) that:

A state is responsible under international law for injury to a national of another state caused by an official act or omission that violates:

- (a) A human right that, under §701, a state is obligated to respect for all persons, subject to its authority;
- (b) A personal right that, under international law, a state is obligated to respect for individuals of foreign nationality; or
- (c) A right to property or another economic interest that, under international law, a state is obligated to respect for persons, natural or juridical, of foreign nationality, as provided in §712.

Commentary (e) to §711 of the *Restatement (Third)* says:

Clause (b) refers to individuals but the interests of a juridical person of foreign nationality also enjoy some protection, for instance, against denials of procedural justice; for a juridical person, such violations would normally result in economic injury and fall within clause (c) of §712.

## **B. Actions of State Organs are Attributable to the State**

415. Canada can act in a manner inconsistent with its NAFTA obligations through the actions of its organ, Canada Post. Article 4 of the *ILC Articles on State Responsibility* reflects the customary international law rule that the actions of a state organ are attributable to the state. Paragraph 1 of the Article states:

The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central government or of a territorial unit of the State.

The customary international law rule reflects “the principle of the unity of the State [which] entails that the acts or omissions of all of its organs should be regarded as acts or omissions of the State for the purposes of international responsibility.”<sup>475</sup>

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<sup>474</sup> *The Restatement (Third) of the Foreign Relations Law of the United States* (Book of Authorities at Tab 2).

<sup>475</sup> J.R. Crawford, *ILC Articles* at 95 (Book of Authorities at Tab 3).

**C. Canada Post is an Organ of Canada**

416. Paragraph 2 of Article 4 of the *ILC Articles* says: “An organ includes any person or entity which has that status in accordance with the internal law of the State.”
417. The *CPC Act* accords Canada Post status as an organ under Canadian law as it states that Canada Post is “an institution of the Government of Canada.”<sup>476</sup> Article 23 of the *CPC Act* also states that Canada Post is “an agent of Her Majesty in right of Canada.”
418. Other Canadian legislation confirms Canada Post’s status as an organ of the Canadian government under Canadian law. For example, the *Excise Tax Act* exempts Canada Post from the obligation to pay Goods and Services Tax because Canada Post is supplying a government service.<sup>477</sup>
419. In interpreting Canadian law, Canadian courts have confirmed Canada Post is part of the government.<sup>478</sup> The Federal Court of Canada has found that Canada Post is part of the government’s “decision-making machinery” in both the *Canadian Daily Newspaper*<sup>479</sup> and the *Rural Dignity*<sup>480</sup> cases. In both cases, the Federal Court ruled that Canada Post’s business practices, such as delivery of non-monopoly postal services to locked apartments or the closure of post offices, were subject to the Federal Court’s jurisdiction to review government action.
420. Canada’s own practices demonstrate its understanding that Canada Post is an organ under

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<sup>476</sup> *Canada Post Corporation Act* s. 5(2)(e) (Tab U218).

<sup>477</sup> *Excise Tax Act*, R.S.C. 1985, c. E-15, Part IX, Division I, section 123(1); Division II, section 165(3); Schedule VI, Part X (Book of Authorities at Tab 59).

<sup>478</sup> See the discussion of these cases in Part Two of this Memorial.

<sup>479</sup> *Canadian Daily Newspaper Association v. Canada Post Corp.*, [1995] 3 F.C.131 (Book of Authorities at Tab 68).

<sup>480</sup> *Rural Dignity of Canada v. Canada Post Corp.*, [1991] F.C.J. No. 33 affirmed (1992) 88 D.L.R. (4<sup>th</sup>) 191 (F.C.A.) (Book of Authorities at Tab 75).

Canadian law. Canada Post has been described as part of the Government of Canada by the Minister responsible for Canada Post.<sup>481</sup> In its *Statement of Defence*, Canada defends Canada Post's actions as necessary to fulfill its Universal Service Obligation<sup>482</sup> - a public obligation it alleges is delegated to it by the *CPC Act*.

421. Canada Post is expressly listed as being subject to Canada's NAFTA procurement Chapter obligations under NAFTA Chapter 10.<sup>483</sup> This demonstrates that Canada intended that Canada Post's actions be subject to NAFTA.
422. NAFTA Article 105 sets out the extent of obligation of NAFTA Parties. It confirms that each NAFTA Party is required to take all necessary measures to give effect to the provisions of the NAFTA.<sup>484</sup> It does not express any exceptions to this extent of obligations for specific organs or branches of national governments.
423. While its status under Canadian law is sufficient to accord Canada Post status as an organ for the purposes of Article 4, commentary to the *ILC Articles* and jurisprudence on the customary international law of state responsibility confirms this conclusion.
424. The official commentary to the *ILC Articles* confirms that customary international law defines state organs broadly. The commentary says:

Thus the reference to a State organ in article 4 is intended in the most general sense. It is not limited to the organs of the central government, to officials at a high level or to persons with responsibility for the external relations of the State. It extends to organs of government of whatever kind of classification, exercising whatever functions, and at whatever level in the hierarchy ...<sup>485</sup>

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<sup>481</sup> See speech of Minister Marleau dated October 8, 1996 (Tab U80).

<sup>482</sup> *Statement of Defence* at paras. 25-33 and paras. 118-119.

<sup>483</sup> NAFTA Annex 1001.1a-2

<sup>484</sup> NAFTA Article 105 states that "The Parties shall ensure that all necessary measures to give effect to the provisions of this Agreement, including their observance, except as otherwise provided by this Agreement, by state and provincial governments."

<sup>485</sup> J.R. Crawford, *ILC Articles* at 95 (Book of Authorities at Tab 3).

The commentary goes on to say:

[t]he term “person or entity” ... used in article 4 ... is used to include [sic] in a broad sense to include any natural or legal person, including an individual office holder, a department, commission or other body exercising public authority, etc.<sup>486</sup>

“Person or entity” within Article 4 is, therefore, broad enough to include a state corporation, such as Canada Post.

425. In addition to defining state organs broadly, international law invokes state responsibility for a broad range of actions of state organs. The commentary recognizes that:

... [w]here such a person acts in an apparently official capacity, or under colour of authority, the actions in question will be attributable to the State.<sup>487</sup>

426. This principle also emerges from the *Caire* case, in which the French-Mexican Claims Commission held Mexico responsible for the acts of two officers who attempted to rob and then shot a French national because the officers had acted under the colour of authority.<sup>488</sup> According to the Commission, a state will only not be responsible for the acts of its organs where “the act had no connection with the official function and was, in fact, merely the act of a private individual.”<sup>489</sup>
427. Canada Post’s actions fall well within the broad range of actions of a state organ that are imputable to the state. Applying the language of the ILC commentary, far from acting

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<sup>486</sup> J.R. Crawford, *ILC Articles* at 98-99 (Book of Authorities at Tab 3).

<sup>487</sup> J.R. Crawford, *ILC Articles* at 99 (Book of Authorities at Tab 3).

<sup>488</sup> The Tribunal held: “Dans ces conditions, il ne reste aucun doute que les deux officiers, meme s’ils doivent etre censes avoir agi en dehors de leur competence, ce qui n’est nullement certain, et meme si leurs superieurs ont lance un contre-ordre, ont engage la responsabilite de l’Etat, comme s’etant couverts de leur qualite d’officiers et servis des moyens mis, a ce titre, a leur disposition (at 531).” (Book of Authorities at Tab 110).

<sup>489</sup> At 531, Translation in J.R. Crawford, *ILC Articles* at 99 (Book of Authorities at Tab 3). The original reads: “l’Etat n’etant pas reponsable dans le seul cas ou l’acte n’a eu aucun rapport avec la fonction officielle et n’a ete, en realite, qu’un acte d’un particulier.” (Book of Authorities at Tab 110).

under apparent authority, Canada Post acts under actual authority. Applying the language of the *Caire Tribunal*, Canada Post's actions not only had a substantial connection with its official functions, they were part of its official functions.

428. Commentary and jurisprudence confirms that, as a state organ, Canada Post's acts are imputable to Canada, even if they have commercial characteristics. The commentary to Article 4 of the *ILC Articles* said "[i]t is irrelevant for the purposes of attribution that the conduct of a state organ may be classified as 'commercial'."<sup>490</sup> Similarly, in *Hyatt International Corporation v. Government of the Islamic Republic of Iran*,<sup>491</sup> the Iran-US Claims Tribunal found that the Iran-based Foundation for the Oppressed was a state organ, despite its commercial activities.<sup>492</sup>
429. The *Canada - Measures Affecting the Export of Civilian Aircraft* WTO decision confirms that the commercial nature of an entity's acts does not affect the attribution of those acts to the state. The Panel considered Article 1.1(b) of the WTO Agreement on Subsidies and Countervailing Measures, which provides that a "subsidy" exists when a government or any "public body" gives a "financial contribution." Although the Canadian Export Development Corporation provided commercial financing to exporters in competition with private banks, both parties to the dispute, including Canada, accepted that it was a public body.<sup>493</sup>
430. Indeed, another WTO Panel considered and rejected Canada's arguments that Canada Post's actions were not attributable to Canada because they were commercial. In *Canada - Periodicals*, the Panel had to determine whether the prices Canada Post charged for delivery of periodicals breached the national treatment obligation in Article III:4 of the

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<sup>490</sup> J.R. Crawford, *ILC Articles* at 96 (Book of Authorities at Tab 3).

<sup>491</sup> (1985) 9 Iran-US CTR 72 at 88-94 (Book of Authorities at Tab 111).

<sup>492</sup> Article 2 of the Foundation's Articles of Association stated that the Foundation was to manage and utilize "all liquid funds, shares, securities, movable and immovable assets" of confiscated wealth (at 89). Article 13 stated that the President of the Foundation had the authorization to appoint managers "to head the financial, administrative, commercial, industrial, agricultural and other affairs of the Foundation ... (at 90.) (Emphasis added)."

<sup>493</sup> Case WT/DS70/R, 14 April 1999, Panel Report at para. 9.160 (Book of Authorities at Tab 137).

GATT. Canada argued that “since Canada Post is a privatized agency (a Crown Corporation) with a legal personality distinct from the Canadian Government, the “commercial Canadian” or “international” rates it charges for the delivery of periodicals are out of the Government’s control and do not qualify as “regulations” or “requirements” within the meaning of Article III:4.”<sup>494</sup> In considering this argument, the Panel resolved that “[t]he essential question, then is, whether Canada Post is implementing Canadian Government policy in such a manner that its postal rates on periodicals may be viewed as *governmental* regulations or requirements for the purposes of Article III:4.”<sup>495</sup> In concluding that Canada Post’s pricing of periodicals was governmental, the Panel said:

First, it is clear that Canada Post generally operates under governmental instructions. Canada Post has a mandate to operated on a “commercial” basis in this particular sector of periodical delivery: a mandate that was set by the Canadian Government. Second, Canada admits that if the Canadian Government considers Canada Post’s pricing policy to be inappropriate, it can instruct Canada Post to change the rates under its directive power based on Section 22 of the Canada Post Corporation Act. Thus, the Canadian Government can effectively regulate the rates charged on the delivery of periodicals.<sup>496</sup>

431. Canada has argued some of Canada Post’s actions impugned by the Investor in this case are “commercial” and, therefore, not attributable to Canada.<sup>497</sup> Just as the *Canada - Periodicals* Panel found Canada Post’s actions, alleged by Canada in that case to be “commercial,” were attributable to Canada, all Canada Post’s impugned actions in this case are attributable to Canada too. The impugned conduct of Canada Post relates to the manner in which it exercises the exclusive privilege and related legal privileges granted by the *CPC Act*. Ordinary commercial corporations, whether privately or governmentally-owned, do not have such legal privileges.

432. Canada Post acts under statutory authority. All its actions are subject to government direction under section 22 of the *CPC Act*. By Canada’s own admission, Canada Post’s

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<sup>494</sup> *Canada - Periodicals* Panel decision at para. 5.33 (Book of Authorities at Tab 66).

<sup>495</sup> *Canada - Periodicals*, Panel decision at para. 5.34 (Emphasis added) (Book of Authorities at Tab 66).

<sup>496</sup> *Canada - Periodicals*, Panel decision at para. 5.34 (footnotes omitted) (Book of Authorities at Tab 66).

<sup>497</sup> *Statement of Defence* at para. 104.

actions are all taken to help fulfil Canada's USO - a governmental purpose. Canada Post managers also admit that Canada Post acts in pursuit of the non-commercial goal of maintaining Canada Post's workforce.<sup>498</sup> Dr. Neels draws from various Canada Post documents to reach the same conclusion.<sup>499</sup>

433. As an organ of the Canadian government, all Canada Post's actions, including the actions impugned by the Investor in this case, are attributable to Canada.

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<sup>498</sup> Transcript of second part of interview between Michael Killen and Peter Melanson, 2001 [ 21413-21416 at 21415] (Tab U184).

<sup>499</sup> Neels Report at paras. 123-127.

#### **Chapter IV. CANADA'S PRELIMINARY OBJECTIONS**

434. Canada has raised a variety of jurisdictional objections and procedural defences against the UPS Claim. While the Tribunal considered many of these issues already within its *Award on Jurisdiction*, each of Canada's concerns will be addressed in this Chapter of the Memorial.<sup>500</sup> The jurisdictional objections are based on the meaning of various terms in NAFTA Article 1101 while the procedural defences arise out of the preliminary steps for initiating a claim referred to in Articles 1116 and 1117.

##### **A. Jurisdictional Objections**

435. Canada has raised the following jurisdictional objections in its *Statement of Defence* based on the language of NAFTA Article 1101.

- a. UPS is not an Investor that owns an investment in Canada;
- b. UPS has not complained about Canadian Government measures; and
- c. The measures do not relate to UPS or UPS Canada.

##### **1. UPS Owns or Controls an Investment in Canada**

436. Canada alleges that UPS has not established that it is an American Investor that owns or controls an investment in Canada. Accordingly, Canada argues that UPS does not have standing for this Claim.

437. UPS has described, in detail, the business operations of its investments in Canada within this Memorial. The Tribunal has taken notice of UPS and its investment in its *Award on Jurisdiction*, where it found that it had jurisdiction to rule over UPS' claims.<sup>501</sup>

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<sup>500</sup> *Award on Jurisdiction*, of November 22, 2003 at paras. 134-139 (Book of Authorities at Tab 48).

<sup>501</sup> *Award on Jurisdiction* at paras. 6-9 (Book of Authorities at Tab 48).

438. UPS, as an American corporation, constitutes an enterprise of the United States of America pursuant to NAFTA Article 201.<sup>502</sup> NAFTA Article 1139 defines an investor to include an enterprise of NAFTA Party that “makes, seeks to make or has made an investment”. The term “investment” is further defined in Article 1139 as, amongst other things, “an enterprise”, an intercompany loan or “an interest in an enterprise that entitles the owner to share in income or profits ...”.
439. UPS directly owns and controls UPS Canada, which is a juridical entity organized under the laws of Ontario. UPS appoints the board of directors of UPS Canada, shares in UPS Canada’s profits and has an inter-company loan to UPS Canada. Accordingly, UPS’ ownership of UPS Canada meets many of the requisite definitions of investment set out in the definition of Investment in NAFTA Article 1139.
440. Similarly, UPS’ indirect ownership and control of UPS SCS, Inc. (formerly Fritz Starber) also satisfies the definition of investment. NAFTA Article 1139’s definition of “investment of an investor of a Party” confirms that the investor may own the investment indirectly, such as through a subsidiary.

## **2. Measures Adopted or Maintained by Canada**

441. Article 1101 of the NAFTA states that the scope and coverage of Chapter 11 extends to “*measures adopted or maintained by a Party* relating to investments of investors of another Party in the territory of the Party”. Article 201 of the NAFTA in turn defines measures to include any “law, regulation, procedure, requirement or practice”. The measures detailed in UPS’ Revised Amended Statement of Claim (“RASC”) have been adopted or maintained by the Government of Canada.
442. Canada has challenged various allegations in UPS’ RASC on the basis of UPS’ failure to specifically identify the measure adopted or maintained by Canada with respect to the

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<sup>502</sup> NAFTA Article 201 states “**enterprise of a Party** means an enterprise constituted or organized under the law of a Party”. The term “enterprise” is further defined as “any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation ...”.

alleged breach. Canada's arguments must be dismissed. UPS has clearly identified the measures adopted or maintained by Canada with respect to each allegation, as will be detailed below.

443. NAFTA Tribunals have defined the outer bounds of what may be understood to be a measure adopted or taken by a party. In *Ethyl Corporation*, the Tribunal looked to Canada's *Statement of Implementation* whereby "measure is a non exhaustive definition of the ways in which governments impose discipline in their respective jurisdictions".<sup>503</sup>
444. In *Loewen Group Inc*, the Tribunal broadly interpreted the definition of "measure". The Tribunal stated:

The text, context and purpose of Chapter Eleven combine to support a liberal rather than a restricted interpretation of the words 'measures adopted or maintained by a Party', that is, an interpretation which provides protection and security for the foreign investor and its investment...<sup>504</sup>

445. In the *Pope & Talbot* claim, the Tribunal considered whether an international agreement could be a "measure" under NAFTA Article 201.<sup>505</sup> Canada argued that the Canada - United States Softwood Lumber Agreement ("SLA") was an international agreement, not a domestic measure. The Investor countered that it was not challenging the SLA, but rather the measures taken by Canada to implement the SLA. The Tribunal agreed with the Investor, noting:

... the steps taken by Canada to implement its obligations under the SLA are capable of constituting measures within the meaning of Articles 201 and 1101 of NAFTA.<sup>506</sup>

446. In its *Statement of Defence*, Canada identifies three areas in which UPS has allegedly failed to identify the measure adopted or maintained by Canada or in which the alleged

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<sup>503</sup> *Ethyl Corporation* at para. 66. (Book of Authorities at Tab 50).

<sup>504</sup> *Loewen Group, Jurisdiction Award* at para. 53 (Book of Authorities at Tab 51).

<sup>505</sup> *Pope & Talbot, Award on "Measures Relating to Investment"* at paras. 36-37 (Book of Authorities at Tab 54).

<sup>506</sup> *Pope & Talbot, Award on "Measures Relating to Investment"* at para. 37 (Book of Authorities at Tab 54).

treatment does not result from a measure adopted or maintained by Canada: breaches of national treatment; breaches of the international law standard of treatment; and breaches of the MFN obligation by Canada.<sup>507</sup>

*a. National Treatment Measures*

447. Canada has failed to provide UPS Canada national treatment through its discriminatory:
- a. leveraging of the Monopoly Infrastructure without appropriate allocation of costs;
  - b. customs treatment; and
  - c. implementation of the *Publications Assistance Program*.

Each of these actions fall within the non-exhaustive list of measures in NAFTA Article 201.

448. Canada has enacted a law, the *CPC Act*, which creates Canada Post, grants it the Postal Monopoly and authorizes Canada Post to provide courier services without independent regulatory supervision. The *CPC Act* prevents UPS Canada and other competitors of Canada Post from reaping the economies of scale and scope available to Canada Post. Regulations under the *CPC Act* give Canada Post other privileges, such as the right to place red letter mailboxes in public places without payment of fee or the right to enter locked apartment buildings. These regulations do not restrict the benefits of these privileges to the supply of monopoly services.
449. Canada Post's failure to charge its courier services market rates for access to the Monopoly Infrastructure is a practice. Canada defends Canada Post's use of the Monopoly Infrastructure as necessary to fulfil its USO and, therefore, necessary to fulfil Canada's international obligations under the Universal Postal Convention. By Canada's

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<sup>507</sup> *Statement of Defence* at para. 105(a).

own admission, Canada Post's use of the Monopoly Infrastructure is a step to implement Canada's treaty obligations which would thereby constitute a measure following the findings of the NAFTA Investor-State Tribunal in *Pope & Talbot*.<sup>508</sup>

450. Canada's discriminatory customs system also falls within the non-exhaustive list of "measures" in NAFTA Article 201. Canada Post enjoys most of its preferential treatment under the *Postal Imports Agreement*, which is a procedure and practice authorized by regulations under the *Customs Act*. In addition to the *Postal Imports Agreement*, Canada Post enjoys preferential treatment under various regulations, procedures, requirements and practices:
- a. Regulations under the *Customs Act* create different postal and courier streams and establish different customs requirements and procedures in each stream;
  - b. Canada charges cost recovery fees to UPS Canada, but not to Canada Post, under the *Special Services (Customs) Regulations*, which is a regulation, as well as a requirement and practice;
  - c. Canada's charging UPS Canada for computer linkage systems, but exempting Canada Post, is a requirement and a practice;
  - d. Canada's performance of brokerage services for Canada Post's customers is a practice;
  - e. Canada's allowing Canada Post to perform customs duties, but not allowing UPS Canada to perform the same duties, is a practice;
  - f. Canada's paying Canada Post ----- for "services" that UPS Canada is required to perform for free, is a practice. UPS Canada is governed by regulations, requirements and procedures that require it to

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<sup>508</sup> *Pope & Talbot, Award on "Measures Relating to Investment"* at para. 37 (Book of Authorities at Tab 54).

perform such services;

- g. allowing Canada Post more time to remit duties and taxes than it allows to UPS Canada, is a practice. In its reply to UPS interrogatories, Canada said: [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]<sup>509</sup> UPS Canada is required by regulation to make

such payments within 30 days;

- h. Canada Post's exemption from fines and penalties for breaches of the *Customs Act Regulations* is a practice. UPS Canada is required by laws and regulations to pay fines, penalties and interest;

- i. Canada's exempting of Canada Post from the application of the *Customs Suffrance Warehouse Regulations* is a practice. UPS Canada must comply with these regulations;

- j. Canada Post is exempted from charging GST on imported packages by the *Excise Tax Act*, which is a law.

451. Finally, the *Publications Assistance Program* is administered through a Memorandum between the Heritage Department and Canada Post, which outlines the discriminatory practice of only subsidizing publications delivered by Canada Post.

*b. Breaches of Article 1105*

452. Canada's actions constituting breaches of Article 1105 fall within several of the non-exclusive examples of measure in NAFTA Article 201. All those actions are practices. Canada's restrictions on collective bargaining rights for Canada Post's worker were under the *CPC Act* and other legislation. The *Excise Tax Act*, which exempts Canada Post

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<sup>509</sup> Canada's reply to interrogatories, question 48(a) (Tab U290).

from charging GST on imported packages, is a law. The *Special Services (Customs) Regulations*, under which Canada Customs charges cost recovery fees to UPS Canada but not Canada Post, is a regulation and requirement. Other discriminatory measures arise from the differences in the regulations under the *Customs Act* regarding the postal and courier streams.

*c. Breaches of the MFN obligation*

453. Canada is in breach of its obligation to provide UPS and UPS Canada with treatment no less favorable than treatment provided to Investors of any other Party, pursuant to Articles 1103 and 1104.
454. At paragraph 105(c) of its *Statement of Defence*, Canada argues that UPS does not identify a measure or treatment that violates Articles 1103 and 1104. Canada misunderstands the Investor's reliance on Articles 1103 and 1104.
455. The difference between the national treatment and MFN obligations lies in the appropriate Investors or Investments to use for comparison purposes. The national treatment obligation ensures that no better treatment can be given to a domestic competitor. The MFN obligation ensures that no better treatment can be given to a foreign competitor either.
456. UPS relies on the MFN obligation as another basis to establish Canada's violation of its NAFTA obligations. In so doing, UPS relies on the same measures: namely, Canada's practices, laws, and regulations. UPS also relies on the same activities arising from such measures, detailed above. The only relevant difference is that NAFTA Article 1103 entitles the Investor to look at the treatment provided by Canada to non-Parties of the NAFTA. Similarly, NAFTA Article 1104 requires this Tribunal to provide the best level of treatment, to the Investor and its investments, provided under either NAFTA Articles 1103 or 1102.

*d. The Measures Relate to UPS Canada*

457. NAFTA Article 1101(1) applies the obligations of NAFTA Chapter 11 to “measures adopted or maintained by a Party *relating to*” an investor or investment. In its *Statement of Defence*, Canada argues that “this Tribunal lacks jurisdiction over the majority of UPS claims because the subject measures do not ‘relate to’ UPS or its alleged investments in Canada.”<sup>510</sup> Canada argues that “the term ‘relating to’ requires a direct and substantial link between the measure and the investor or its investment”<sup>511</sup> and only the customs treatment measures have this link.<sup>512</sup>
458. Canada’s interpretation of the phrase “relating to” in Article 1101(1) is inconsistent with NAFTA’s objectives, the ordinary meaning of the term, its own *Statement on Implementation*, NAFTA decisions and other international jurisprudence.
459. NAFTA Article 102(2) says NAFTA provisions must be interpreted “in light of its objectives set out in paragraph 1 ...”. These objectives include the promotion of investment.<sup>513</sup> Including a broad range of investors and investments within NAFTA’s protection helps fulfill this objective to promote investment. For this reason, the NAFTA applied the protections contained in Chapter 11 to measures “relating to” investments or investors.
460. Black’s Law Dictionary defines “relate” as “to have bearing or concern.”<sup>514</sup> The drafters did not limit “relating to” with prefixes like “directly” or “substantially.” Thus, under the ordinary meaning of the words, the impugned measures “relate to” UPS Canada as they

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<sup>510</sup> *Statement of Defence* at para. 107.

<sup>511</sup> *Statement of Defence* at para. 108.

<sup>512</sup> *Statement of Defence* at para. 108.

<sup>513</sup> Objective (a) says “to facilitate the cross-border movement of ... services between the territories of the Parties.” Objective (c) says “to increase substantially investment opportunities in the territories of the Parties.”

<sup>514</sup> *Black’s Law Dictionary* at page 1158. (Book of Authorities at Tab 52).

have bearing on UPS Canada.

461. Canada's own *Statement of Implementation* supports the interpretation that Article 1101 was intended to broadly bring foreign investors and investments within Chapter 11's protection. This statement, issued on the coming into force of the NAFTA, says:

Article 1101 states that Section A covers measures by a Party (i.e., any level of government in Canada) that *affect*:

- investors of another Party (i.e., the Mexican or American parent company or individual Mexican or American investor);
- investments of investors of another Party (i.e., the subsidiary company or asset located in Canada); and
- for purposes of the provisions on performance requirements and environmental measures, all investments (i.e., all investments in Canada).<sup>515</sup>

The term "affect" is synonymous with "to have bearing or concern."<sup>516</sup>

462. NAFTA tribunals have interpreted Article 1101 consistently with its ordinary meaning and NAFTA's objectives by deciding that a measure "relates to" an investor or investment if it affects the investor or investment. Partly relying on Canada's *Statement of Implementation*, the *Pope & Talbot* Tribunal rejected Canada's arguments that the term required the measure to be "primarily directed" at the investor or investment, accepting that "it is also a measure relating to investment insofar as it might affect an enterprise owned by an investor of a Party."<sup>517</sup>
463. The NAFTA Tribunal in *GAMI Investments v. Mexico* also rejected arguments that the measure must have a direct link to the investor or investment to be "relating to." In that case, the US investor, GAMI Investments, claimed for damage to its minority shareholding in a Mexican company owning five sugar mills. GAMI claimed Mexico

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<sup>515</sup> *Statement on Implementation, Canada Gazette* Part 1, January 1, 1994, 68 at 148 (Book of Authorities at Tab 9) (Emphasis added).

<sup>516</sup> *Black's Law Dictionary* at p. 262: "Concern" means "to affect the interest of" (Book of Authorities at Tab 52).

<sup>517</sup> *Pope & Talbot v. Canada, Award on Measures Relating to Investment Motion* at para. 33 and 34. (Book of Authorities at Tab 54).

damaged its investment through general measures affecting the sugar industry. Mexico argued:

The problem for GAMI is that it has not identified a measure that has this legally significant nexus with it or its shares. What is true is that the Government of Mexico has not adopted nor has it maintained nor does it maintain a measure that refers to the legal interest of GAMI protected by the Treaty ...<sup>518</sup>

464. In deferring the issue to be considered to the Merits Phase, the Tribunal disagreed with Mexico's interpretation, saying:

Considering that *although the Arbitral Tribunal is not convinced by the Respondent's thesis with respect to the meaning of the words "related to" (Article 1101(1)) ... it cannot be excluded, especially in light of the oral debate, that the Arbitral Tribunal's reasoning will be effected by developments in the merits phase.*<sup>519</sup>

465. This NAFTA jurisprudence is consistent with jurisprudence from tribunals considering other international treaties. In *Indonesia - Automobiles*, the WTO Panel considered a claim that Indonesia breached Article 2.1 of the WTO Trade Related Investment Measures (TRIMs) Agreement. That Article says: "... no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994."

466. In considering this WTO case, the Panel had to determine whether the impugned measures were "trade related investment measures" and, therefore, whether the measures were "trade related." The Panel said:

We now have to determine whether these investment measures are "trade-related." We consider that, if these measures are local content requirements, they would necessarily be "trade-related" because such requirements, by definition, always favour the use of domestic products over imported products, *and therefore affect trade.*<sup>520</sup>

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<sup>518</sup> *GAMI Investments v. Mexico*, Transcript of Jurisdictional Hearing, September 17, 2003 at page 8. (Book of Authorities at Tab 55).

<sup>519</sup> *GAMI v. Mexico, Procedural Order No. 4*, September 25, 2003 at 1 (Emphasis added). The Tribunal's ultimate decision meant that it did not need to consider the issue at the merits phase. (Book of Authorities at Tab 56).

<sup>520</sup> *Indonesia - Certain Measures Affecting the Automobile Industry* at para. 14.82 (Emphasis added.) (Book of Authorities at Tab 57).

467. One NAFTA Tribunal has found “the phrase ‘relating to’ ... signifies something more than the mere effect of a measure on an investor or an investment.”<sup>521</sup> The *Methanex* Tribunal said that “relating to” “requires a legally significant connection between”<sup>522</sup> the measure and the investment and investor. Canada has adopted the position advanced by this Tribunal as its position in this NAFTA claim.
468. The *Methanex* Tribunal did not refer to a legal dictionary, NAFTA’s objectives, the *Pope & Talbot* or *Indonesia - Automobiles* decisions or Canada’s *Statement of Implementation*. The Tribunal’s comments are, therefore, best understood as resulting from the facts of that case. Methanex challenged the Governor of the State of California’s Executive Order banning the use of the chemical MTBE in gasoline. The claimant supplied methanol to producers of MTBE, who then supplied MTBE to gasoline makers. While MTBE producers were, therefore, directly affected by the Order, Methanex was not as Methanex did not produce MTBE. Rather, the Claimant was among a group of suppliers of the ingredients of MTBE who were indirectly affected. For understandable policy reasons, the Tribunal, therefore, decided that the protection in NAFTA Chapter 11 cannot extend to up-stream suppliers. This Tribunal does not face such facts.
469. Canada’s measures not only affect UPS and UPS Canada but they are so strongly connected to the companies that they satisfy any definition of “relating to” that Canada can provide. Canada accepts that its discriminatory treatment of UPS Canada regarding customs treatment relates to UPS Canada and UPS.<sup>523</sup> The four remaining Canadian measures impugned in this claim are its:
- a. Discriminatory use of the Monopoly Infrastructure without appropriate allocation of costs: The *CPC Act* directly regulates UPS Canada by preventing it from replicating the economies of scale and scope available to Canada Post. Canada

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<sup>521</sup> *Methanex, Decision on Jurisdiction* at para. 147 (Book of Authorities at Tab 61).

<sup>522</sup> *Methanex, Decision on Jurisdiction* at para. 147. (Book of Authorities at Tab 61).

<sup>523</sup> *Statement of Defence* at para. 108.

Post then uses its Monopoly Infrastructure to compete directly against UPS Canada. [REDACTED]

[REDACTED]

- b. Exemption of Canada Post from operation of general laws relating to labour matters: This measure allows Canada Post to compete directly against UPS Canada without complying with the labour laws that UPS Canada is subject to.
- c. Granting to Canada Post the exclusive right to act as carrier for magazine publishers: This measure directly penalizes potential UPS Canada customers if they choose a courier other than Canada Post.
- d. Canada Post's decision to retaliate against UPS' investment in Fritz Starber: This measure directly targeted UPS's investment as a result of this NAFTA claim.

**B. Procedural Defences**

470. Canada has also raised the following procedural defences that rely upon the preliminary steps referred to in NAFTA Articles 1116 and 1117:

- a. UPS has not asserted proper claims regarding damages to its US Subsidiaries;
- b. UPS has improperly raised claims that were not contained in the Notice of Intent;
- c. This claim is outside of the Limitation Period permitted in Article 1116; and
- d. UPS has brought its claim under the wrong enabling provision of NAFTA and should thus not be permitted to have this claim heard.

**1. Claims Relating to US Subsidiaries Are Proper**

471. Within the RASC, the Investor refers to the US Subsidiaries of UPS which have suffered

damage arising from Canada's breach of its NAFTA obligations owed to UPS Canada.

472. Canada argues in its *Statement of Defence* that UPS' claims relating to the US Subsidiaries are not within the Tribunal's jurisdiction because "these enterprises are not investments of investors in the territory of another Party as required by Articles 1101 and 1139". Canada also argues in this same paragraph that "UPS has not alleged that they are investors with investments in Canada."<sup>524</sup>
473. These arguments are similar to arguments already raised by Canada in its failed jurisdictional challenge before this Tribunal. Canada's arguments were summarized by the Tribunal in its *Award on Jurisdiction* as follows:

120. Canada says that the references to US Subsidiaries in these paragraphs should be struck. They do not allege either that the Subsidiaries are "in" Canada or that the loss was suffered by UPS itself. So far as the wording of the ASC itself is concerned, we note that the final sentence of para. 19 is indeed limited to UPS and UPS Canada and that the final paragraph of the ASC under the heading Relief Sought and Damages Claimed is further restricted, just to UPS:

The Tribunal found that UPS had given Canada adequate notice of its claims as required by Chapter 11 of the NAFTA and it noted that UPS would shoulder the burden of showing at the merits stage that damage suffered by US Subsidiaries may be properly attributed to UPS.<sup>525</sup>

474. Canada has yet again re-argued as a jurisdictional objection the point that was dismissed by the Tribunal in its jurisdictional award. The doctrine of *res judicata* applies to prevent such an argument from being raised.<sup>526</sup> The Investor submits that this issue should be considered by the Tribunal when it considers the matter of costs in this claim.
475. Canada's re-argument on this point also is simply incorrect. There is no requirement that

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<sup>524</sup> *Statement of Defence* at para. 102.

<sup>525</sup> *Award on Jurisdiction* at paras. 120-122 (Book of Authorities at Tab 48).

<sup>526</sup> *Trail Smelter Arbitration* (Book of Authorities at Tab 42).

harm caused to the US Subsidiaries arising from Canada's breach of its NAFTA obligations only occur within the territory of Canada.

476. In paragraph 31 of the RASC, the Investor sets out a plea regarding damage caused to the US Subsidiaries.

31. By reason of the benefits and privileges set out above, which are not correspondingly made available by Canada to UPS Canada, UPS, and the US Subsidiaries have suffered harm, loss and damage, including but not limited to competitive disadvantage, reduced profit, reduced market share, and increased out of pocket expense. Canada has violated its obligation to accord national treatment pursuant to NAFTA Article 1102 to UPS and UPS Canada, and is therefore liable to pay compensation.

At no point does the Investor claim that the damage caused to the US Subsidiaries arose due to treatment of these subsidiaries operating in Canada as such a claim is unnecessary to make.

477. This Tribunal has already pointed out to Canada that UPS has not raised any independent claim for harm caused by Canada to the US Subsidiaries. What clause 31 of the RASC simply states, (as did clause 35 of the earlier ASC) is that there was harm caused to the Investor's US Subsidiaries arising out of Canada's breach of its NAFTA Article 1102 obligations owed to UPS Canada.

478. NAFTA Article 1116 provides that the Investor may claim for loss or damage arising out of the breach of Canada's obligations to the Investor or the Investment. This provision does not limit the harm to only harm caused within the territory of Canada.

479. Canada unsuccessfully raised this territory limit argument before the NAFTA tribunals in both the *Ethyl Corporation* and the *S.D. Myers* claims, despite the fact that none appears in either NAFTA Article 1102 or 1105. That argument was soundly rejected by the *Ethyl* Tribunal during the jurisdiction phase of that arbitration:

Canada asserts that "Ethyl's claim in respect of expropriation of its intellectual property, reputation, and goodwill throughout the world is not within the scope of NAFTA" since Article 1101(1)(b) applies Chapter 11 only to "investments of investors of another [NAFTA] Party *in the territory* of the Party," and Article

1110, one of the three provisions alleged to have been breached by Canada, likewise addresses nationalizations or expropriations by a NAFTA Party of “an investment of an investor of another Party in its territory”.

A distinction must be made, however, between the locus of the Claimant’s breach and that of the damages suffered. It is beyond doubt that the MMT Act was adopted, and purports to have, and in fact has, legal force only in Canada. It bans MMT from importation into Canada and prevents its movement between provinces. Ethyl’s claim is premised on the legal force the MMT Act has in relation to its investment in Canada, *i.e.* Ethyl Canada.

Ethyl has argued, however, that the damages resulting to it in consequence of the MMT Act include losses suffered outside of Canada. As Ethyl itself succinctly notes (at Paragraph 97 of its Counter-Memorial on Jurisdiction), “the Investor [Ethyl] claims that an expropriation occurred inside Canada, but the Investor’s resulting losses were suffered both inside and outside Canada.”<sup>527</sup>

The Tribunal rejected Canada’s request of Canada to exclude any portion of the claim on the basis of territoriality.

480. In its *Second Partial Award*, the *Myers* Tribunal rejected Canada’s similar arguments and found that:

118. An investor may submit to arbitration a claim that a provision of Chapter 11 has been breached and that .... *the investor has incurred loss or damage by reason of, or arising out of, that breach.* To be recoverable, a loss must be linked causally to interference with an investment located in a host state. **There is no provision that requires that all of the investor’s losses must be sustained within the host state in order to be recoverable.** The test is that the loss to the (foreign) investor must be suffered as a result of the interference with its investment in the host state.

.....  
121. The purpose of virtually any investment in a host state is to produce revenues for the investor in its own state. The investor may recover losses it sustains when, as a proximate cause of a Chapter 11 breach, there is interference with the investment and the financial benefit to the investor is diminished.

122. The Tribunal concludes that compensation should be awarded for the overall economic losses sustained by SDMI that are a proximate result of CANADA’s measure, not only those that appear on the balance sheet of its investment.<sup>528</sup>

481. Thus, the text of NAFTA Chapter 11 permits compensation for harm caused to UPS and its subsidiaries outside of the territory of Canada if such harm arises out Canada’s breach of its NAFTA Chapter 11 obligations owed to UPS Canada.

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<sup>527</sup> *Ethyl Corporation, Award on Jurisdiction* at para. 70-72 (Book of Authorities at Tab 50).

<sup>528</sup> *S.D. Myers Second Partial Award* at paras. 118-122. (Italics Emphasis as *per* original, Bolding Emphasis added) (Book of Authorities at Tab 49).

**2. Breaches Not Contained in the Notice of Intent May be Pleaded**

482. Canada has challenged the ability of UPS to raise claims which were not contained in its original Notice of Intent. In particular, Canada states:

109. Allegations of breaches introduced for the first time in the Revised Amended Statement of Claim are outside the Tribunal's jurisdiction UPS failed to meet the requirement of Article 1119 that the Notice of Intent identify the issues and factual basis for the claim and the provisions of the NAFTA alleged to have been breached, with respect to:
- (a.) the new Article 1105 claim with respect to Fritz Starber (par. 36-39, par. 52(c)); and
  - (b.) the claim that the sale of Purolator products by Canada Post in its retail outlets (par. 28 vi, par. 41) is contrary to national treatment
  - (c.) the claim of "unfair treatment" under Article 1105 with respect of Xpresspost to the US and Epost (par. 41): and
  - (d.) the new allegations of breaches of NAFTA Articles 1103 and 1104 (par. 21, 32-35, par. 52(b) and 53).<sup>529</sup>

483. The Tribunal's *Award on Jurisdiction* found that neither the NAFTA nor the UNCITRAL Arbitration Rules required a claimant to exhaustively list every claim it intended to make. The Tribunal further provided that the Investor would have an opportunity to give its claims more precision once it has had an opportunity to review documents produced by Canada.<sup>530</sup>

484. UPS is entitled to claim for breaches not contained in its Notice of Intent. Canada has yet again failed to respect the *res judicata* nature of the Tribunal's award by raising for a second time a claim that was previously dismissed by this Tribunal.

485. An investor is entitled to make further or ancillary claims with respect to an Investor-state arbitration claim. Such additional claims often add precision to the proceeding or raise issues which have been discovered in the course of the arbitration or which have arisen after the initiation of the claim.

486. For example, the NAFTA Tribunal in *Pope & Talbot* found that Canada engaged in

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<sup>529</sup> *Statement of Defence* at paras. 109-110.

<sup>530</sup> *Award on Jurisdiction* at paras. 131 and 132 (Book of Authorities at Tab 48).

conduct inconsistent with their obligations of fairness to the Investor (contrary to NAFTA Article 1105) after the arbitration was commenced.<sup>531</sup> Such conduct did not have to be listed in the Notice of Intent, nor could it.

487. The *Ethyl Corporation* Tribunal also considered this issue. It looked at the very general requirements necessary in a Notice of Arbitration and found it natural that there should be a greater elaboration of detail respecting claims within the Investor's subsequent pleadings.<sup>532</sup>
488. In any event, the claims made by the Investor in the RASC all relate to the same subject matter of this dispute and this Tribunal has already ruled upon their admissibility. Canada's further jurisdictional challenge thus must be dismissed yet again.
489. As a related matter, Canada alleges that there were no consultations with respect to these four specific claims, and therefore that it did not provide the requisite consent to this arbitration for those matters.<sup>533</sup>
490. Canada's objection must be dismissed. UPS has adequately consulted with Canada. Article 1118 of the NAFTA requires the disputing parties to first attempt to settle a claim through consultation or negotiations. Unsuccessful consultations pursuant to Article 1118 of the NAFTA were held on March 17, 2000 in Ottawa. Additional consultations between the disputing parties lasting nearly one year were held in 2003, after the RASC was filed.
491. In any event, if there were to be any procedural defect found by this Tribunal, such an issue would be cured by the fact that more than six months time has elapsed from the date when the new allegations were raised by the Investor. The NAFTA award in *Ethyl Corporation* confirms the proposition that such procedural matters can be dispensed with

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<sup>531</sup> *Pope & Talbot, Award on Merits Phase 2* at para. 171 (Book of Authorities at Tab 7).

<sup>532</sup> *Ethyl Corporation* at para. 94 (Book of Authorities at Tab 50).

<sup>533</sup> *Statement of Defence*, para. 30.

when the six month period has elapsed.<sup>534</sup>

### **3. Limitation Period Issues**

492. Canada has alleged that the claims raised by UPS are not within the three year time limitation period required by NAFTA Article 1116.<sup>535</sup> NAFTA Article 1116(2) requires that an investor first make its claim within three years of the time that it “first acquired, or should have first acquired, knowledge of an alleged breach and knowledge of a loss or damage”.
493. The claims that have been asserted by UPS are within the three year time limits required by NAFTA Article 1116:
- a. With respect to the claims made under NAFTA Article 1502(3)(a) and 1503(2) regarding the adequacy of Canada’s Supervision of Canada Post, UPS first acquired knowledge of Canada’s final determination regarding the findings of the Canada Post Mandate Review on April 23, 1997, when the Minister responsible for Canada Post issued a press release indicating that she would not follow any recommendations made by the Review. It was only at this time that UPS became aware that Canada had authorized Canada Post to engage in discriminatory leveraging of its Monopoly Infrastructure contrary to Canada’s obligations under NAFTA Article 1102.
  - b. With respect to the claims relating to Fritz Starber made under NAFTA Article 1105, UPS first acquired knowledge of Canada Post’s retaliation against it as a result of its launch of the NAFTA Claim on December 5, 2001. On that date, Canada Post informed Fritz Starber that its bid was denied due to Fritz Starber’s affiliation with UPS’ NAFTA claim.

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<sup>534</sup> *Ethyl Corporation and the Government of Canada* at para. 84 (Book of Authorities at Tab 50).

<sup>535</sup> *Statement of Defence* at paras. 128-129.

- c. With respect to most customs claims under NAFTA Article 1102 and Article 1105, UPS first acquired knowledge of the breaches when it obtained a heavily redacted copy of the *Postal Imports Agreement* through an Access to Information Request on November 15, 1999.
494. In addition, many of Canada's measures have continued to breach its NAFTA obligations until now and are, therefore, not time-barred under Article 1116. As a result, UPS is entitled to claim for all losses caused by Canada's measures that have continued since 1997.
495. The *Feldman* NAFTA Tribunal recognized that Article 1116 does not bar claims impugning state action beginning more than three years before the claim but continuing after that date. In that case, the Tribunal considered claims that Mexico breached its NAFTA obligations by failing to rebate tax expenses to the investor. Mexico first refused to rebate the taxes in 1990 but continued to refuse to rebate until the investor claimed in 1999. The Tribunal applied Articles 1116 and 1117 to limit the investor's claim to Mexico's actions occurring after May 1996.<sup>536</sup> Examining only that action, the Tribunal found Mexico breached its national treatment obligation through actions beginning six years earlier.<sup>537</sup>
496. Other international tribunals have also found that limitation articles do not bar continuing

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<sup>536</sup> *Feldman, Jurisdiction Award* at para. 47 (Book of Authorities at Tab 8).

<sup>537</sup> The Tribunal said: "The inescapable fact is that the Claimant has been effectively denied IEPS rebates for the April 1996 through November 1997 period, while domestic export trading companies have been given rebates not only for much of that period but through at least May 2000 ..." [*Feldman, Award*, at para. 187]. The Tribunal went on to say "...the factual pattern in this case ... demonstrates a pattern of official action (or inaction) over a number of years, as well as de facto discrimination that is actionable under Article 1102." (para. 188). Other NAFTA Chapter 11 tribunals have accepted that some breaches of international law continue over time. The *Mondev* Tribunal said: "... the Tribunal agrees ... that an act, initially committed before NAFTA entered into force, might in certain circumstances continue to be of relevance after NAFTA's entry into force, thereby becoming subject to NAFTA obligations. But there is a distinction between an act of a continuing character and an act, already completed, which continues to cause loss or damage. Whether the act which constitutes the gist of the (alleged) breach has a continuing character depends both on the facts and on the obligation said to have been breached." (para. 58) (Book of Authorities at Tab 8).

acts. In *Peter Blaine v Jamaica*,<sup>538</sup> the Inter-American Commission of Human Rights considered a claim regarding conduct occurring more than six months before the claim. Although Article 46 of the *Inter-American Convention on Human Rights* says that claims must be made within six months of the claimant becoming aware of the breach,<sup>539</sup> the Commission found the claim was timely. The Commission said: “The six-months rule does not apply where the allegations concern a continuing situation.”<sup>540</sup> The Commission then endorsed these comments in *Neville Lewis v Jamaica*.<sup>541</sup> The European Commission on Human Rights has reached the same conclusion.<sup>542</sup>

497. International tribunals do not apply limitation articles to continuing acts because barring the claim when the state action continues does not fulfill the purpose of such articles. Jurisprudence and commentary indicates limitation articles ensure “legal certainty and stability once a decision has been taken”<sup>543</sup> and that defendants have a fair opportunity to collect evidence in support of their defence.<sup>544</sup>

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<sup>538</sup> *Case 11.827*, Report No. 96/98, Inter-Am. C.H.R., OEA/Ser.L/V/II.95 Doc. 7. rev. at 312 (1998) (Book of Authorities at Tab 84).

<sup>539</sup> Article 46 actually says the claimant must claim within six months of the domestic judgment refusing relief. However, international tribunals have concluded that where there is no domestic remedy available, the time period runs from the date of the act complained of or knowledge of that act. See, for example, *Kevin McDaid*: “It is established case-law that “the final decision” refers only to domestic remedies which can be considered “effective and sufficient” for the purpose of rectifying the complaint (eg. No. 9599/81, Dec. 11.3.85, D.R. 42 p. 33). Where there is no remedy available, the six month period runs from the date of the act or decision complained of (eg. No. 9360/81, Dec. 28.2.83, D.R. 32 p. 21) (Book of Authorities at Tab 82).

<sup>540</sup> *Peter Blaine v. Jamaica* at para. 52 (Book of Authorities at Tab 84).

<sup>541</sup> *Case 11.825*, Report No. 97/98, Inter-Am.C.H.R., OEA/Ser.L/V/II.95 Doc. 7 rev at 327 (1998) at para. 52 (Book of Authorities at Tab 74).

<sup>542</sup> *Kevin McDaid and Others v. the United Kingdom*, ECHR Application No. 25681/94, 9 April 1996, (Book of Authorities at Tab 82): “Insofar as the applicants complain that they are victims of a continuing violation to which the six month is inapplicable, the Commission recalls that the concept of a “continuing situation” refers to a state of affairs which operates by continuous activities by or on the part of the State to render the applicants victims”, *Hilton v. UK*, ECHR Application No. 12015/86, 6 July 1988 (Book of Authorities at Tab 112): “The Commission further recalls that the six months rule ... does not apply to a complaint which concerns a continuing situation” *Montion v. France*, ECHR Application No. 11192/84, 14 May 1987 (Book of Authorities at Tab 130): “le délai de six mois ne s’applique pas, ... lorsque le requérant se prétend victime d’une violation continue ...”.

<sup>543</sup> *Peter Blaine v. Jamaica* at para. 52 (Book of Authorities at Tab 84).

<sup>544</sup> G. Mew, *The Law of Limitations*, 2nd ed., (Markham: Butterworths, 2004) at 12 (Book of Authorities at Tab 105).

498. Barring claims impugning continuing state action fulfils neither of these purposes. The state's continuing breach of its treaty obligations undermines certainty and stability. Furthermore, the continuing action continually generates new evidence.
499. Barring claims impugning continuing state action also produces absurd results, inconsistent with the international treaty's objectives. It is inconsistent with the NAFTA objective to "create effective procedures ... for the resolution of disparities"<sup>545</sup> if NAFTA Parties could continue to breach their NAFTA obligations when potential claimants miss a three year window.
500. Canada's measures that continue to breach its NAFTA obligations are, therefore, not time barred under Article 1116. Canada Post continues to discriminate against UPS Canada through Canada Post's leveraging of the Monopoly Infrastructure in breach of Article 1102. Canada continues to fail to supervise Canada Post in breach of Articles 1502(3)(a) and 1503(2). Canada continues to give Canada Post preferential customs treatment and to deny Canada Post's workers collective bargaining rights. Canada continues to operate the PAP in breach of Article 1102.

**4. UPS Properly Brought its Claim Under Article 1116 and not Article 1117**

501. Canada alleges that the UPS claim should not have been brought under Article 1116 because the claim "does not disclose any treatment of UPS as an investor". Canada argues that UPS fundamentally asserts clauses about the treatment of its investments, and thus it should have brought its claim under Article 1117. In the alternative, Canada contends that UPS is precluded from claiming damages suffered by its investments.<sup>546</sup>
502. Canada's arguments are without merit. The Investor properly brought its claim under

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<sup>545</sup> NAFTA Article 102(1)(e).

<sup>546</sup> *Statement of Defence* at para. 111.

Article 1116. UPS directly owns and controls UPS Canada and indirectly owns the former Fritz Starber, now UPS SCS Inc. All of these entities have suffered harm, loss and damage arising from Canada's inconsistency with its NAFTA Chapter 11 obligations. UPS suffers harm through harm occasioned to itself directly as well as by harm caused to its investments. Accordingly, UPS is entitled to bring an Article 1116 claim on behalf of an investment that it directly owns and controls.

503. In *Pope & Talbot*, the Investor brought its claim under Article 1116. The Tribunal found the wording of Article 1121(1) to be decisive of the matter.

**In the view of the Tribunal it could scarcely be clearer that claims may be brought under Article 1116 by an investor who is claiming for loss or damage to its interest in the relevant enterprise, which is a juridical person that the investor owns.** In the present case, therefore, where the investor is the sole owner of the enterprise (which is a corporation, and thus an investment within the definitions contained in Articles 1139 and 201), it is plain that a claim for loss or damage to its interest in that enterprise/investment may be brought under Article 1116.<sup>547</sup>

504. Other NAFTA tribunals have interpreted the scope of Articles 1116 and 1117 broadly to permit Investor claims. Indeed, NAFTA tribunals have demonstrated a clear preference for substance over form with respect to preserving the originating claim.
505. For example, in *Mondev*, the Investor brought its claim pursuant to Article 1116. The United States argued that *Mondev* did not assert its claim properly as it could only claim under NAFTA Article 1117. The Tribunal demonstrated a clear preference for preserving the originating claim.

There are various ways of achieving this, most simply by treating such a claim as in truth brought under Article 1117, provided there has been clear disclosure in the Article 1119 notice of the substance of the claim, compliance with Article 1121 and no prejudice to the Respondent State or third parties. **International law does not place emphasis on merely formal considerations, nor does it require new proceedings to be commenced where a merely procedural defect is involved.**<sup>548</sup>

506. The Tribunal in *Pope & Talbot* permitted a claim to be raised by the US Investor under

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<sup>547</sup> *Pope & Talbot, Award on Damages* at para. 80 (Emphasis added) (Book of Authorities at Tab 38).

<sup>548</sup> *Mondev, Award* at para. 86 (Emphasis added) (Book of Authorities at Tab 37).

Article 1116 for harm caused to two indirectly controlled subsidiaries in Canada. Similarly, in the *S.D. Myers* claim, the Tribunal permitted the US company to pursue its claim under NAFTA Article 1116 for a claim that involves harm to its Canadian affiliate, Myers Canada, as well as to itself.

507. In the event that this Tribunal determines that the Investor has filed under the wrong article, this Tribunal should permit the Investor to modify its claim accordingly.
508. NAFTA tribunals have indicated that claims can be amended easily upon the order of the tribunal. For example, the *Methanex* Tribunal permitted the Investor to modify its claim after it was presented from being solely under Article 1116 to be a claim jointly made under Articles 1116 and 1117.

We make it plain, however, that applying Article 20 of the UNCITRAL Arbitration Rules, Methanex may include in a fresh pleading reliance on Article 1117 NAFTA, in addition to Article 1116 NAFTA.<sup>549</sup>

509. UPS was entitled to elect between Article 1116 and 1117 in bringing its claim. UPS was perfectly entitled to bring its claim under Article 1116 as an Investor claiming loss and damage to its interest in UPS Canada and Fritz Starber, investments that it owns and controls. NAFTA tribunals have confirmed the scope of Article 1116 and have broadly interpreted Article 1116 claims. Accordingly, there is no merit to Canada's jurisdictional challenge on this issue and it should be dismissed.

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<sup>549</sup> *Methanex, Award on Jurisdiction* at para. 79 (Book of Authorities at Tab 61).

## **Chapter V. NATIONAL TREATMENT**

### **A. The Origins and Context of the NAFTA Chapter 11 National Treatment Obligation**

510. NAFTA Article 1102 obliges the NAFTA Parties to treat investors from other NAFTA Parties and their investments as favorably as domestic investors and their investments.

The Article says:

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

511. National treatment is a fundamental principle supporting the NAFTA, which is used to fulfill its trade and investment liberalizing objectives. In addition to Article 1102, several other NAFTA provisions oblige the Parties to accord national treatment.<sup>550</sup> National treatment is also one of three interpretative principles informing the meaning of the entire agreement.<sup>551</sup>

512. While appearing several times throughout the NAFTA, the term national treatment is not further defined in the NAFTA because it is a term of art. The term and the obligation originated over a century ago but the main influences on NAFTA Article 1102 are equivalent provisions in the WTO's GATT and GATS.

513. The NAFTA and WTO provisions are virtually identical. GATT Article III:4 states:

The products of the territory of any contracting party imported into the territory of any other

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<sup>550</sup> For example, there are national treatment obligations for goods (Article 301), for energy (Article 602), for services (Article 1202) and for financial services (Article 1405).

<sup>551</sup> Article 102(1).

contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

Similarly, Article XII of the GATS says:

... each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favorable than it accords to its own like services and service suppliers...

514. Both articles contain similar elements to those contained in NAFTA Article 1102.<sup>552</sup> The requirement of no less favorable treatment is the same. The articles also limit the measures to which the articles apply, albeit in different ways. Finally, NAFTA Article 1102 applies to investors and investments in “like circumstances,” whereas the GATT and GATS articles apply to “like products” and “like services,” respectively.<sup>553</sup>
515. NAFTA Article 1102’s application to all investors and investments in like circumstances means it is broader than the GATT and GATS articles. In recognizing this broader application, the UNCTAD has said:

The scope of national treatment in the investment field goes well beyond its use in trade agreements. In particular, the reference to “products” in article III of the GATT is inadequate for investment agreements in that it restricts national treatment to trade in goods. The activities of foreign investors in their host countries encompass a wide array of operations, including international trade in products, trade in components, know-how and technology, local production and distribution, the raising of finance capital and the provision of services, not to mention the range of transactions involved in the creation and administration of a business enterprise. *Hence, wider categories of economic transactions may be subjected to national treatment disciplines under investment agreements than under trade agreements.*<sup>554</sup>

516. NAFTA Article 1102 also fulfills a similar purpose to that fulfilled by its equivalent GATT and GATS articles. The GATT *US - Petroleum* Panel recognized that the purpose

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<sup>552</sup> Indeed, the *Pope & Talbot* Tribunal described Article 12 of the GATS as “identical” to NAFTA Article 1102(2): *Pope & Talbot, Partial Award*, 10 April 2001 at para. 52 (Book of Authorities at Tab 7).

<sup>553</sup> These GATT and GATS obligations are subject to WTO public policy exceptions which permit public policy exceptions for certain specified reasons if such measures are the least trade restrictive possible and do not constitute an arbitrary means of discrimination (for example, see GATT Article XX).

<sup>554</sup> United Nations Conference on Trade and Development, *National Treatment* (New York: United Nations, 1999) at 9 (Emphasis added) (Book of Authorities at Tab 10).

of Article III is to protect expectations of equality of competitive opportunity. The Panel said the purpose of the Article is “to protect expectations of the contracting parties as to the competitive relationship between their products and those of the other contracting parties[,] ... to protect current trade [and] to create the predictability needed to plan future trade.”<sup>555</sup>

517. In its *Statement of Implementation*, Canada acknowledged the influence of the GATT/WTO on the NAFTA:

The NAFTA and the Uruguay Round agreements cover much of the same ground and the two sets of rules are largely complementary and mutually reinforcing. In many respects, the NAFTA built on progress that had been made in the Uruguay Round while the Round in turn profited from the experience of Canada, the United States and Mexico in negotiating the NAFTA.<sup>556</sup>

518. NAFTA Article 1102’s origins in GATT Article III, the similar wording in the provisions, the equivalent purposes, and Canada’s acknowledgement of the influence of the WTO provisions on the NAFTA, ensures GATT/WTO national treatment jurisprudence informs the meaning of NAFTA Article 1102’s three elements. Consequently, several NAFTA Tribunals have drawn from GATT/WTO jurisprudence in interpreting the elements of Article 1102.<sup>557</sup>

519. There are three distinct elements which an investor or investment must establish to prove that a NAFTA Party has acted in a manner inconsistent with its obligations under NAFTA Article 1102. These are:

- a. the foreign investor or investment must be in like circumstances with local

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<sup>555</sup> *United States - Taxes on Petroleum and Certain Imported Substances*, 17 June 1987 at para. 5.2.2. (Book of Authorities at Tab 109)

<sup>556</sup> *Canadian Statement of Implementation* at 75 (Book of Authorities at Tab 9).

<sup>557</sup> *S.D. Myers, Partial Award*, 13 November 2000 at para. 244 (Book of Authorities at Tab 4). *Pope & Talbot, Partial Award*, 10 April 2001 at para. 68 - 69, footnote 68 (Book of Authorities at Tab 7). *Feldman v. Mexico, Award* at para. 165: “The national treatment/non-discrimination provision is a fundamental obligation of Chapter 11. The concept is not new with NAFTA. Analogous language in Article III of the GATT has applied between Canada and the United States since 1947, and with Mexico since 1985, with regard to trade in goods.” (Book of Authorities at Tab 8).

investors or investments;

- b. the NAFTA Party must treat the foreign investor or investment less favorably than it treats the local investors or investments; and
- c. the treatment must be with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

520. Even if these elements are satisfied, a NAFTA Party can still rely on a number of specific exceptions and reservations that have been set out within the text of the NAFTA if that Party can prove that these limitations apply.<sup>558</sup>

**B. In Like Circumstances**

**1. The Same Business or Economic Sector**

521. The GATT *US - Petroleum* Panel recognized that national treatment provisions protect expectations of equal competitive opportunity.<sup>559</sup> It naturally follows that national treatment provisions compare treatment of investments and investors which compete. Investments and investors are, therefore, in like circumstances if they compete or, in other words, operate in the same business or economic sector.

522. NAFTA Investor-State tribunals have confirmed that foreign investors and investments are in like circumstances with locals when they operate in the same business or economic sector. The *Pope & Talbot* Tribunal said:

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<sup>558</sup> NAFTA Article 1108 provides for reservations from national treatment in Annexes I and II. Canada took no reservations respecting national treatment for Canada Post in these Annexes, despite its opportunity to do so before January 1, 1994. Article 1108(7) also provides other specific exceptions from national treatment in certain circumstances.

<sup>559</sup> *United States - Taxes on Petroleum and Certain Imported Substances*, 17 June 1987 at para. 5.2.2. (Book of Authorities at Tab 109).

... the Tribunal believes that, as a first step, the treatment accorded a foreign owned investment protected by Article 1102(2) should be compared with that accorded domestic investments in the same business or economic sector.<sup>560</sup>

523. Similarly, the *S.D. Myers* Tribunal said:

“[L]ike circumstances” invites an examination of whether a non-national investor complaining of less favorable treatment is in the same “sector” as the national investor. The Tribunal takes the view that the word “sector” has a wide connotation that includes the concepts of “economic sector” and “business sector.”<sup>561</sup>

The Tribunal applied these principles to find that the US investor and its Canadian investment were in like circumstances with Canadian investors as they were in the same business sector of “PCB waste remediation services.”<sup>562</sup> The Tribunal also relied on the fact that they competed against each other to establish that they were in “like circumstances”. It said that the US investor:

... was in a position to attract customers that might otherwise have gone to the Canadian operators because it could offer more favorable prices and because it had extensive experience and credibility. It was precisely because ... [the US investor] was in a position to take business away from its Canadian competitors that ... [the Canadian investors] lobbied the Minister of the Environment to ban exports when the US authorities opened the border.<sup>563</sup>

524. In *Feldman*, the NAFTA Tribunal also concluded that the foreign and domestic investors were in “like circumstances” because they operated in the same business sector. The Tribunal said:

In the Tribunal’s view, the “universe” of firms in like circumstances are those foreign-owned and domestic-owned firms that are in the business of reselling/exporting cigarettes.<sup>564</sup>

525. GATT/WTO jurisprudence presents factors which help indicate if the foreign investor or

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<sup>560</sup> *Pope & Talbot, Award on Merits Phase 2*, 10 April 2001 at para. 78 (Book of Authorities at Tab 7).

<sup>561</sup> *S.D. Myers, Partial Award*, November 12, 2000 at para. 250 (Book of Authorities at Tab 4).

<sup>562</sup> At para. 251 (Book of Authorities at Tab 4).

<sup>563</sup> At para. 251 (Book of Authorities at Tab 4).

<sup>564</sup> *Feldman Award* at para. 171 (Book of Authorities at Tab 8).

investment competes with the domestic investor or investment that is alleged to receive the better treatment. The *Japan - Taxes on Alcoholic Beverages* Panel said:

... the interpretation of the term [like products] should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a “similar” product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is “similar”: [1] the product’s end-uses in a given market; [2] consumers’ tastes and habits, which change from country to country; [3] the product’s properties, nature and quality.<sup>565</sup>

526. The WTO Appellate Body held in the *EC - Asbestos* case that “a determination of likeness under [National Treatment] is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products”.<sup>566</sup> The Appellate Body went on to emphasize that it is evidence of a competitive relationship that is probative of “likeness” for purposes of National Treatment. They stated: “it is important under Article III:4 to take account of evidence which indicates whether, and to what extent, the products involved are or could be in a competitive relationship in the marketplace”.<sup>567</sup>

## **2. Limiting the Scope of Factors Affecting Likeness**

527. Some tribunals suggest that domestic investors or their investments are not in like circumstances with investors from another NAFTA Party or their investments if the measure pursues a legitimate public policy objective in a manner that is most compliant with the Party’s international investment law obligations.<sup>568</sup>

528. The “like circumstances” test in NAFTA Article 1102 does not permit a Tribunal to

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<sup>565</sup> *Japan - Taxes on Alcoholic Beverages* at 22 (Book of Authorities at Tab 79).

<sup>566</sup> *EC - Asbestos* (AB), WT/DS135/AB/R at para. 99. (Book of Authorities at Tab 135).

<sup>567</sup> *EC - Asbestos* (AB) at para. 103. (Book of Authorities at Tab 135).

<sup>568</sup> See, for example, *S.D. Myers Partial Award* at para.250 (Book of Authorities at Tab 4). *Pope & Talbot, Award on Merits Phase 2* at para. 79 (Book of Authorities at Tab 7).

consider a large number of public policy considerations.<sup>569</sup> Had the drafters of the NAFTA wished such policy considerations to be included, they would have included Chapter Eleven in the list of NAFTA Chapters in NAFTA Article 2101 to which the GATT public policy exceptions in GATT Article XX apply. Chapter Eleven was specifically not enumerated in this list, which encompasses most of the NAFTA.

529. The NAFTA establishes a special regime for dealing with reservations and exceptions for national treatment. Chapter Eleven permitted the filing of reservations when the NAFTA was negotiated (and for a very limited time thereafter) that would permit otherwise NAFTA inconsistent measures to continue notwithstanding the Chapter Eleven national treatment obligation.
530. Relying on reservations in the area of investment is consistent with the objective of providing legal security to investors. It also is consistent with the more limited nature of a NAFTA Party's state responsibility for violations of the obligations in the Investment Chapter subject to an Investor-state dispute. The payment of damages for an Investor-state dispute is a lower standard than the international law state-to-state requirement to bring the inconsistent measure into compliance. Thus, this is an area where an investor's interests require the greater security afforded by fully disclosed specified limitations, as opposed to a more vague legal standard being applied in a general type of public policy exception.
531. The only policy exception within national treatment is in the area of likeness. It is a narrow exception and it must be strictly proven with the burden of proof being on the party relying upon it.<sup>570</sup> In applying such an exception to national treatment, a tribunal

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<sup>569</sup> The NAFTA text is explicit about the like circumstances limitation. The exceptions and reservations to the national treatment obligation in Chapter 11 are very broad (under Article 1108) and do not permit any general public policy reservation other than those explicitly reserved by the Parties on January 1, 1994. In addition, Article 2201 sets out specific general public policy exceptions (similar to those in Chapter XX of the GATT) from other NAFTA chapters, but specifically does not apply such exceptions to NAFTA Chapter 11.

<sup>570</sup> *In the Matter of Cross-Border Trucking Services (US - Re: Mexican Trucking)*, Final Report of the Panel, February 6, 2001. (Secretariat File No. USA - MEX 98 - 2008 - 01) at para. 258 and 270 (Book of Authorities at Tab 106).

must ensure that the balance of rights and obligations carefully negotiated in the NAFTA text is respected so that it is not applied in an arbitrary or discriminatory manner or in any way which would unbalance the protections of the treaty. To prevent an abuse of rights, Parties invoking an exception must also show that the policy is applied through a transparent, non-arbitrary regulatory framework, with objective criteria and due process. Considerations of abuse of rights apply in advance where an exception is implied, such as with respect to “like circumstances” in NAFTA Article 1102, and where the Party has had an opportunity to address its policy concerns through the making of reservations, but failed to do so.<sup>571</sup>

532. Jurisprudence establishes that the Respondent has the burden of proving on the facts of a case that investors or investments are not “like” for policy reasons. This shifting of the burden is merely an application of general principles on the burden of proof in international law. The ICSID Tribunal considering the *Asian Agricultural Products* recognized these general principles when it said that “in case a party adduces some evidence which *prima facie* supports his allegation, the burden of proof shifts to his opponent.”<sup>572</sup> Similarly, in *US - Shirts and Blouses*, the WTO Appellate Body said:

... various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or respondent, is responsible for providing proof thereof. Also, it is a generally accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.<sup>573</sup>

533. In the *US - Section 337* case, the GATT Panel described how this general principle applies to national treatment provisions. The Panel decided that once it is shown the state

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<sup>571</sup> The WTO Appellate Body held in the *US - Shrimp/Turtle* case at paras 158 - 160 and para. 180 that the chapeau of GATT Article XX reflects the general international law principle that an exception cannot be allowed to gut or unbalance the treaty and must be applied in a transparent manner. Such an approach needs to be taken by an investor-state tribunal as well. (Book of Authorities at Tab 132).

<sup>572</sup> *Asian Agricultural Products Limited v. Sri Lanka* at page 273 (Book of Authorities at Tab 47).

<sup>573</sup> *United States - Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, 25 April 1997, WT/DS33/AB/R, p. 13 (Book of Authorities at Tab 62).

has treated the foreign product less favorably, the burden shifts to the state to justify that less favorable treatment by showing the foreign product is not like the domestic product. The Panel said:

Given that the underlying objective is to guarantee equality of treatment, it is incumbent on the contracting party applying differential treatment to show that, in spite of such differences, the no less favorable treatment standard of Article III is met<sup>574</sup>

534. The *Feldman* Tribunal applied this principle to NAFTA Article 1102. In concluding that Mexico failed to provide national treatment, in breach of Article 1102, the Tribunal said: “The majority’s view is based first on the conclusion that the burden of proof was shifted from the Claimant to the Respondent, with the Respondent then failing to meet its new burden ...”<sup>575</sup>

### **C. Less favorable treatment**

535. NAFTA parties are required to provide “treatment no less favorable” to investors and investments of investors from other NAFTA Parties. If an investor of another NAFTA Party or its investment is in like circumstances with a local investor or investment, then the less favorable treatment test can be applied.

#### **1. Equality of Competitive Opportunities**

536. The obligation to provide no less favorable treatment is an obligation to provide equality of competitive opportunities. In commenting on the unqualified nature of the same obligation in the GATT and its repetition throughout WTO agreements, the *Section 337 of the Tariff Act of 1930*<sup>576</sup> Panel said:

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<sup>574</sup> *US – Section 337 of The Tariff Act of 1930*, L/6439 - 36S/345, January 16, 1989, at para. 5.11 (Book of Authorities at Tab 13).

<sup>575</sup> *Feldman* at para. 176 (Book of Authorities at Tab 8).

<sup>576</sup> *United States - Section 337 of the Tariff Act of 1930* (Report by panel adopted on November 7, 1989) (L/6439-365/345), January 16, 1989 (Book of Authorities at Tab 13).

[The] “no less favorable” treatment requirement set out in Article III:4, is unqualified. These words are to be found throughout the General Agreement and later agreements negotiated in the GATT framework *as an expression of the underlying principle of equality of treatment* of imported products as compared to the treatment given either to other foreign products, under the most favored nation standard, or to domestic products, under the national treatment standard of Article III. The words “treatment no less favorable” in paragraph 4 call for effective equality of opportunities for imported products in respect of the application of laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products. This clearly sets a minimum permissible standard as a basis.<sup>577</sup>

537. This national treatment obligation applies to *de jure* and *de facto* measures. It also clearly applies to existing measures and policies which are capable of providing better treatment, even if that better treatment has not yet been provided. Thus, national treatment broadly protects the entire spectrum of potentially discriminatory measures. Hence, the *Canada - Automotive Industry Panel* said:

The “no less favorite treatment obligation” in Article III:4 has been consistently interpreted as a requirement to ensure effective equality of opportunities between imported products and domestic products. In this respect, it has been held that, since a fundamental objective of Article III is the protection of expectations on the competitive relationship between imported and domestic products, a measure can be found to be inconsistent with Article III:4 because of its potential discriminatory impact on imported products. The requirement of Article III:4 is addressed to “relative competitive opportunities created by the government in the market, not to the actual choices made by enterprises in that market”.<sup>578</sup>

538. The WTO Panel, therefore, explained that the national treatment provision ensures foreigners enjoy *equality of competitive opportunity*. Foreigners cannot enjoy this equality if they must operate under measures which potentially discriminate against them. The Panel applied this principle to find Canada breached its GATS national treatment obligation through a measure that potentially discriminated against foreign car makers. The Panel said:

In our view, the import duty exemption, as provided in the [measure], results in less favorable treatment accorded to services and service suppliers of any other Member within the meaning of Article II:1 of the GATS, as such benefit is granted to a limited and identifiable group of manufacturers/wholesalers of motor vehicles of some members, selected on the basis of criteria

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<sup>577</sup> *United States - Section 337 of the Tariff Act of 1930* (Report by panel adopted on November 7, 1989) (L/6439-365/345), January 16, 1989 at para. 5.11 (Book of Authorities at Tab 13).

<sup>578</sup> *Canada - Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R, 31 January 2000, at para. 10.78; (Book of Authorities at Tab 12) citing: *US - Section 337*, at paras. 5.11 and 5.13 (Book of Authorities at Tab 13) and *US - Malt Beverages*, at para. 5.31. (Emphasis added) (Book of Authorities at Tab 80).

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such as the manufacturing presence in a given base year. We also note that the manufacturing presence requirements in the [measure] explicitly exclude suppliers of wholesale trade services of motor vehicles, which do not manufacture vehicles in Canada, from qualifying for the import duty exemption. In addition, the fact that in 1989 the Government of Canada stopped granting [a classification under the measure] makes the list of the beneficiaries of the import duty a closed one. As a result, manufacturers/wholesalers of other Members are explicitly prevented from importing vehicles, duty free into Canada.<sup>579</sup>

539. The *Japan - Alcoholic Beverages* Panel applied the same principle to find Japan had breached its GATT Article III obligation. The Panel said:

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures...Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products...Moreover, it is irrelevant that the “trade effects” of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products.<sup>580</sup>

The *Japan - Alcoholic Beverages* Panel, therefore, expressed a state’s obligation to provide equality of opportunity as an obligation to protect expectations of an equal competitive relationship.

540. The *United States – Section 301* Panel recognized that not protecting expectations of an equal competitive relationship can influence behaviour and therefore harmfully distort the market. The Panel said:

In treaties which concern only the relations between States, State responsibility is incurred only when an actual violation takes place. By contrast, in a treaty, the benefits of which depend in part on the activity of individual operators, the legislation itself may be construed as a breach, since the mere existence of legislation could have an appreciable “chilling effect” on the economic activities of individuals. . . . A domestic law which exposed imported products to future discrimination was recognized by some GATT panels to constitute, by itself, a violation of Article III, even before the

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<sup>579</sup> *Canada - Autos*, February 11, 2000 at para. 10.262. Essentially, the Panel determined that Canada’s practice of only providing certain foreign-owned or controlled enterprises with exemptions from paying customs duties on their automobile imports (contingent upon their manufacturing a certain number of cars in Canada) constituted a violation of Canada’s obligation under the GATS to provide most favored nation treatment to enterprises from all GATS Members. The “best treatment” available to enterprises from GATS members was to be able to qualify for advantage of importing cars duty free if the domestic-manufacturing performance requirement could be met. (Book of Authorities at Tab 12).

<sup>580</sup> *Japan - Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, October 4, 1996 (Book of Authorities at Tab 79); Cited in *Korea - Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, Appellate Body Report, January 18, 1999 at para. 119 (Book of Authorities at Tab 78).

law came into force. *Finally, and most tellingly, even where there was no certainty but only a risk under the domestic law that the tax would be discriminatory, certain GATT Panels found that the law violated the obligation in Article III. . . .* The rationale in all types of cases has always been the negative effect on economic operators created by such domestic laws. An individual would simply shift his or her trading partners – buy domestic products, for example, instead of imports – so as to avoid the would be taxes announced in the legislation or even the mere risk of discriminatory taxation. . . . In this sense, Article III:2 is not only a promise not to discriminate in a specific case, but is also designed to give certain guarantees to the market place and the operators within it that discriminatory taxes will not be imposed.<sup>581</sup>(Emphasis added)

541. The *S.D. Myers Award* demonstrates that a NAFTA Party’s broad obligation to provide equality of opportunity or to protect expectations of an equal competitive relationship, through a national treatment provision, includes the obligation not to discriminate *de facto*, as well as *de jure*. In that case, the US investor complained about a Canadian measure prohibiting the export of PCB waste. The US investor was, therefore, prevented from collecting the waste in Canada before processing it in the US. The US investor’s Canadian competitors were not affected by the measure because they all processed the PCB waste in Canada. Canada argued that its measure banning the export of PCB waste was not discriminatory because it prevented both Canadians and foreigners from exporting the waste. The Tribunal rejected Canada’s argument as “one dimensional” because it “does not take into account the basis on which the different interests in the industry were organized to undertake their business.”<sup>582</sup>
542. In *Pope & Talbot*, the Tribunal also accepted that *de facto* discriminatory treatment breaches Article 1102 and rejected Canadian arguments that *de facto* discrimination must pass a more stringent test than *de jure* discrimination before it can amount to such a breach. The Tribunal said:

... Canada has presented no reasons to justify treating the two forms of disadvantage differently. Indeed, the recognition that national treatment can be denied through *de facto* measures has always been based on an unwillingness to allow circumvention of that right by skillful or evasive drafting. Applying Canada’s proposed more onerous rules to *de facto* cases could quickly undermine that principle. That result would be inconsistent with the investment objectives of NAFTA, in particular Article 102(1)(b) and (c), to promote conditions of fair competition and to increase

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<sup>581</sup> *US - Section 301 Case* at 322-323 (Book of Authorities at Tab 27).

<sup>582</sup> *S.D. Myers, Partial Award*, 12 November 2000 at para. 242 (Book of Authorities at Tab 4).

substantially investment opportunities.<sup>583</sup>

543. The *Feldman* Tribunal also concluded that *de facto* discrimination can breach Article 1102<sup>584</sup> and WTO jurisprudence has consistently reached the same conclusion regarding the GATT and GATS equivalent provisions.<sup>585</sup>

## **2. Best Treatment in Jurisdiction**

544. To fulfill their NAFTA Article 1102 obligation to provide no less favorable treatment to foreign investors and investments, NAFTA Parties must treat a foreign investor or its investment as well as the *best* treated domestic investor or investment.<sup>586</sup> NAFTA and GATT/WTO jurisprudence support this conclusion. For example, the *Pope & Talbot* Tribunal said:

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<sup>583</sup> *Pope & Talbot, Partial Award*, 10 April 2001 at para. 70 (Book of Authorities at Tab 7).

<sup>584</sup> *Feldman Award* at para. 169 (Book of Authorities at Tab 8):

Also, given that this is a case of likely *de facto* discrimination, it does not matter for purposes of Article 1102 whether, in fact, Mexican law authorizes SHCP to provide IEPS rebates to persons who are not formally IEPS taxpayers and do not have invoices setting out the tax amounts separately, as has been required by the IEPS law consistently since at least 1987 and perhaps earlier. The question, rather, is whether rebates have *in fact* been provided for domestically owned cigarette exporters while denied to a foreign re-seller, CEMSA. Mexico is, of course, entitled to strictly enforce its laws, but it must do so in a non-discriminatory manner, as between foreign investors and domestic investors. Thus, if the IEPS Article 4 invoice requirement is ignored or waived for domestic cigarette reseller/exporters, but not for foreign owned cigarette reseller/exporters, that *de facto* difference in treatment is sufficient to establish a denial of national treatment under Article 1102.

<sup>585</sup> *Japan - Alcoholic Beverages* at pages 17-18 (Book of Authorities at Tab 79); *Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies* Report by the Panel adopted on 18 February 1992 (DS17/R - 39S/27) (October 16, 1991) at para. 5.31 (Book of Authorities at Tab 131); *EC-Bananas*, (AB) at para. 234 (Book of Authorities at Tab 14): “For these reasons, we conclude that ‘treatment no less favorable’ in Article II:1 of the GATS should be interpreted to include *de facto*, as well as *de jure*, discrimination;” and *US - Section 337* (Book of Authorities at Tab 13): “it also has to be recognised that there may be cases where application of formally identical legal provisions would, in practice, accord less favorable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that the treatment accorded them is in fact no less favorable ... In such cases, it has to be assessed whether or not such differences in the legal provisions applicable do or do not accord to imported products less favorable treatment.”

<sup>586</sup> UNCTAD, “*National Treatment*” at 26. In commenting on the similarly worded US Model BIT, the UNCTAD said: “Although the United States model is ambiguous on the issue, it may be presumed that the comparable treatment should be with the best treated ... United States investor, otherwise the treatment would be ‘less favorable.’” (Book of Authorities at Tab 10).

The Tribunal also interprets both standards to mean the right to treatment equivalent to the “best” treatment accorded to domestic investors or investments in like circumstances. The Tribunal thus concludes that “no less favorable” means equivalent to, not better or worse than, the best treatment accorded to the comparator.<sup>587</sup>

Similarly, the GATT Panel in *United States - Measures Affecting Alcoholic and Malt Beverages* said:

The Panel did not consider relevant the fact that many of the State provisions at issue in this dispute provide the same treatment to products of other states of the United States as that provided to foreign products. The national treatment provisions require contracting Parties to accord to imported products treatment no less favorable than that accorded to any like domestic product, whatever the domestic origin. Article III consequently requires national treatment of imported products no less favorable than that accorded to the *most-favored domestic products*.<sup>588</sup>

545. A NAFTA Party has the obligation to treat foreign investors and investments as well as the best treated local investor and its investment. This obligation means that a NAFTA Party breaches its obligation even if it does not discriminate on the basis of the other NAFTA Party’s investor’s nationality (or the nationality of its investment). The NAFTA Party can discriminate against local investors and investments, as well as those from other NAFTA Parties and still breach its national treatment obligation.
546. Accordingly, the *Feldman* Tribunal came to the conclusion that proof of discrimination based on nationality could not be an appropriate basis for finding a violation of the NAFTA Article 1102 national treatment obligation. Such an approach would effectively undermine the purposes for having national treatment in the NAFTA Investment Chapter. The Tribunal stated:

... requiring a foreign investor to prove that discrimination is based on his nationality could be an insurmountable burden to the Claimant, as that information may only be available to the government. It would be virtually impossible for any claimant to meet the burden of demonstrating that a government’s motivation for discrimination is nationality rather than some other reason. Also, as the Respondent argues, if the motives for a government’s actions should not be examined, there is effectively no way for the Claimant or this Tribunal to make the subjective determination that the discriminatory action of the government is a result of the Claimant’s nationality, again in the absence of credible evidence from the Respondent of a different motivation. If Article 1102 violations are limited to those where there is explicit (presumably *de jure*) discrimination against

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<sup>587</sup> *Pope & Talbot, Award on the Merits Phase 2* at para. 42 (Emphasis added) (Book of Authorities at Tab 7).

<sup>588</sup> *United States - Measures Affecting Alcoholic and Malt Beverages*, Report by the Panel adopted on June 19, 1992 (DS23/R) at para. 5.17 (Emphasis added) (Book of Authorities at Tab 80).

foreigners, e.g., through a law that treats foreign investors and domestic investors differently, it would greatly limit the effectiveness of the national treatment concept in protecting foreign investors.<sup>589</sup>

A similar conclusion was reached by the *Pope & Talbot* Tribunal.<sup>590</sup>

547. Canada's arguments that its discriminatory treatment of UPS and its Investments is not motivated by the Investor's American nationality<sup>591</sup> are irrelevant to the test before this Tribunal.

548. This is particularly true given the fact that Canada Post has itself described its competitors as "largely foreign owned multinationals".<sup>592</sup> By providing better treatment to Canada Post than to its competitors, Canada effectively preserves the majority of the courier market from foreign firms.

**D. Establishment, Acquisition, Expansion, Management, Conduct, Operation and Sale or Other Disposition of an Investment**

549. NAFTA Article 1102 obliges NAFTA Parties to provide investors and investments treatment as favorable as that provided to others in like circumstances with respect to establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of an investment. While this requirement acts as a limitation of sorts upon the scope of the NAFTA investment chapter national treatment obligations, it is a very broad limitation that has never been carefully assessed by a NAFTA tribunal. Almost all activity that is reasonably connected with a foreign investor and its investment is covered by the scope of this broad limitation.

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<sup>589</sup> *Feldman* at para. 183 (Book of Authorities at Tab 8).

<sup>590</sup> *Pope & Talbot, Award on Merits Phase 2* at para. 78 (Book of Authorities at Tab 7).

<sup>591</sup> *Statement of Defence* at paras. 112, 119 and 138.

<sup>592</sup> Letter from Andre Ouellet, Chairman of Canada Post to Konrad von Finkenstein, Competition Bureau dated October 21, 1999 (Tab U139).

**E. Subsidies Exception from National Treatment**

550. NAFTA Article 1108(7)(b) permits a NAFTA Party to take a measure that would otherwise be inconsistent with the Chapter Eleven national treatment obligation if the measure is a subsidy. The provision states:

7. Articles 1102, 1103 and 1107 do not apply to:
  - (a) procurement by a Party or a state enterprise; or
  - (b) subsidies or grants provided by a Party or a state enterprise, including government-supported loans, guarantees and insurance.

Canada has relied heavily on this subsidy exception in its *Statement of Defence*.<sup>593</sup>

551. The NAFTA does not provide any definition of the term “subsidy”. Article 1108 refers to subsidies or grants and includes within them government-supported loans, guarantees and insurance. It is important to note that Article 1108(7)(b) did not use the language of NAFTA Article 1106 which refers to “the receipt or continued receipt of an advantage”. The term “advantage” in Article 1106(3) presumably applies to a broader variety of government assistance than mere subsidies.

552. The ordinary meaning of the term subsidy is clear. Black’s Law Dictionary defines the term subsidy to mean “a grant of money”.<sup>594</sup>

553. The term subsidy is regularly applied by treaty interpreters dealing with trade issues. For example, the WTO Agreement on Subsidies and Countervailing Measures (“SCM”) has specific language which applies a special broad definition of subsidy.<sup>595</sup> The SCM agreement looks to a financial contribution and a benefit. The definition of financial contribution includes many situations, including non-cash transfers such as provision of

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<sup>593</sup> *Statement of Defence* at paras 10, 139 and 142.

<sup>594</sup> Blacks Law Dictionary (3<sup>rd</sup>) at page 1280 (Book of Authorities at Tab 52).

<sup>595</sup> WTO Agreement on Subsidies and Countervailing Measures (Book of Authorities at Tab 5).

goods and services below market value.

554. Canada has suggested that non-cash transfers constitute subsidies. For certain non-cash transfers to be legally treated as subsidies, the drafters of the SCM agreement used special language. The drafters included a detailed and limited list of specified situations in which there is a deemed “financial contribution” in the absence of a cash transfer. There is no equivalent language in the NAFTA that would give a special meaning to non-financial contributions as a subsidy aside from “government - supported loans, guarantees and insurance”. Unless the measure falls into one of these three specified categories, the ordinary meaning of a “subsidy” as a cash payment governs the NAFTA.<sup>596</sup>
555. In light of Canada’s failure to particularize its defence, it is impossible for the Investor to be able to identify those areas where Canada intends to rely upon the subsidy exception. The Investor puts Canada to the strict proof where it relies upon such an exception to permit it to engage in policies that would otherwise be inconsistent with its obligations under NAFTA Article 1102.

**F. Canada’s Breaches of its National Treatment Obligation**

556. Canada has acted in a manner inconsistent with its obligation to provide national treatment as set out in NAFTA Article 1102 by treating an investor of another Party, UPS, and its investment, UPS Canada, less favorably than it treats Canada Post.
557. The Investor has already established that UPS and UPS Canada constitute an “Investor” and an “Investment” for the purposes of Chapter 11.<sup>597</sup>
558. Canada is not only a Party to the NAFTA but through its ownership of Canada Post,

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<sup>596</sup> It is particularly useful to note that the wording in the SCM Agreement drafts would have been known to Canada as the NAFTA was being negotiated simultaneously with the SCM Agreement in the Uruguay Round of the GATT.

<sup>597</sup> See the discussion in Chapter IV(b) of Part Three of this Memorial.

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Canada is an Investor owning Canada Post as an Investment. NAFTA Article 1139 defines an “enterprise” as an “investment”. NAFTA Article 201 includes government owned corporations as an “enterprise.” Canada owns the investment and therefore must be an “Investor.” NAFTA Article 1139 includes Parties in its definition of “investor”.

559. Moreover, as [REDACTED] has stated, Canada Post’s competitors are “largely foreign-owned multinationals,”<sup>598</sup> such as UPS Canada, FedEx and DHL. By granting advantages to its national champion, Canada Post, Canada is able to limit the market access of Canada Post’s foreign-owned competitors with only an incidental impact on Canadian companies.
560. Canada has acted in a manner inconsistent with its obligations under NAFTA Article 1102 by giving Canada Post a series of legal privileges, which are not provided to UPS Canada. Canada Post takes advantage of these privileges to compete unfairly in the courier market and maintain market share that would otherwise go to its competitors, including UPS Canada.
561. Specifically, Canada takes measures inconsistent with NAFTA Article 1102 through the following:
- a. leveraging of the Monopoly Infrastructure without appropriate allocation of costs;
  - b. applying its unfair customs system; and
  - c. the Publications Assistance Program.

**1. Canada Breaches Article 1102 by Allowing Canada Post’s  
Discriminatory Leveraging of the Monopoly Infrastructure**

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<sup>598</sup> [REDACTED]

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562. Canada has authorized Canada Post’s discriminatory leveraging of its Monopoly Infrastructure which meets the necessary conditions constituting a breach of Article 1102.

*a. Like Circumstances*

563. UPS and UPS Canada are in like circumstances with Canada and Canada Post because UPS Canada and Canada Post compete in the same economic sector. The evidence regarding the competition between UPS Canada and Canada Post is reviewed in detail in the expert report of Professor Fuss.<sup>599</sup> Professor Fuss examines the functional interchangeability of the services offered by these two investments and the businesses’ internal documents using a method that is consistent with the WTO *Alcoholic Beverages* cases and with the approaches of competition authorities around the world.<sup>600</sup>

564. Professor Fuss’ report demonstrates that for each UPS Canada service, there is a competing service offered by Canada Post, both directly and through its subsidiary Purolator. [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED] The relevant service features of these products are very similar [REDACTED]  
[REDACTED]

565. Canada’s argument that only Canada Post pursues a public policy function<sup>601</sup> does not disrupt the conclusion that UPS and UPS Canada are in like circumstances to Canada and

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<sup>599</sup> See Part Two of this Memorial.

<sup>600</sup> Fuss Report at paras. 61 - 70; The WTO *Alcoholic Beverages* cases generally refer to the following decisions: *Japan - Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, October 4, 1996 (Book of Authorities at Tab 79); *Korea - Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, Appellate Body Report, January 18, 1999 (Book of Authorities at Tab 78); *Chile - Taxes on Alcoholic Beverages*, WT/DS87/AB/R, WT/DS110/AB/R, Appellate Body Report, December 13, 1999 (Book of Authorities at Tab 90).

<sup>601</sup> *Statement of Defence* at paras. 119 and 144.

Canada Post. Canada has the burden of proof to establish this justification. A Party relying on an exception has the burden of proving:

- a. that the measures are necessary to fulfill a policy function; and
- b. the measures are the most consistent with the State's international obligations.

*(i) Canada Must Demonstrate its Measures are Necessary to Fulfil a Policy Function*

566. Canada claims that only Canada Post is obliged to pursue the USO policy goal. Canada also claims Canada Post gives its courier services exclusive access to the Monopoly Infrastructure in order to fund the Monopoly Infrastructure and the provision of the USO.<sup>602</sup> Canada has failed to explain how minimizing Canada Post's courier services' payment for access to the infrastructure helps fund that infrastructure.

*(ii) Canada Must Demonstrate the Measures are the Most Consistent with the State's International Obligations*

567. Canada has failed to even assert that the manner in which Canada Post pursues its alleged policy objective is the manner most consistent with the State's international obligations. This is not surprising because Canada cannot meet such a burden. Canada Post unnecessarily pursues its alleged policy objective in a manner inconsistent with Canada's NAFTA Article 1105 obligations. Canada controls the terms of access to the Monopoly Infrastructure in a non-transparent fashion, which is inconsistent with the Investor's basic and reasonable expectations. Canada Post also ignores that it can pursue its alleged policy objective in a manner more consistent with its NAFTA Article 1102 obligations by charging competitive services at market rates, thereby maximizing the contribution these competitive services make to the maintenance of the Monopoly Infrastructure.

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<sup>602</sup> *Statement of Defence* at para. 33.

*b. Treatment less favorable*

568. Canada treats UPS and UPS Canada less favorably than Canada Post through Canada Post's Courier Services failure to pay market rates for exclusive access to the Postal Monopoly Infrastructure.

569. Canada gave Canada Post the exclusive privilege to deliver letter mail and other related legislative privileges. In this manner, Canada has given Canada Post the exclusive right to develop and maintain a uniquely vast monopoly postal infrastructure. UPS Canada is legislatively prohibited from developing as expansive an infrastructure due to Canada Post's Postal Monopoly.

570. Canada has also given Canada Post the discretion to control the access, and terms of access, to that infrastructure. Canada Post has used that discretion to give exclusive access to the Monopoly Infrastructure to its own courier services. In his expert report, Dr. Neels explains that:

[i]n order to provide UPS ... with treatment equivalent to that ... enjoyed by the competitive services arm of Canada Post ... the transfer prices that the competitive services arm of Canada Post pays for use of the Canada Post network should equal the prices that would emerge from arm's length negotiations between Canada Post and a private firm seeking equivalent access.<sup>603</sup>

571. Canada Post courier services do not pay such market prices for its exclusive access to the Monopoly Infrastructure and therefore is treated more favorably than UPS Canada. UPS Canada is not even given the opportunity to access the Monopoly Infrastructure.

*c. Canada's treatment is with respect to the establishment, expansion, management, conduct and operation of UPS Canada*

572. Canada's discriminatory leveraging of the Monopoly Infrastructure prevents UPS Canada from competing with Canada Post on equal terms and therefore affects the establishment, expansion, management, conduct and operation of UPS Canada's business.

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<sup>603</sup> Neels Report at para. 46.

573. Canada has argued in its *Statement of Defence* that questions dealing with access to public infrastructure do not fall within the scope of Article 1102.<sup>604</sup> Canada identifies that NAFTA Chapter 13 addresses access to telecommunications infrastructure and argues that the absence of similar provisions addressing postal infrastructure evidences a conscious decision to exclude issues of access to postal infrastructure from the scope of the NAFTA.
574. Canada's argument is without foundation. Fundamentally, the NAFTA drafters considered the scope of Article 1102 and decided to limit it to "treatment ... with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." So long as Canada's discriminatory treatment falls within these limits, UPS' claim falls within the scope of Article 1102. Obligations set out within other NAFTA chapters do not affect this scope.
575. Moreover, UPS Canada is not seeking an order from this Tribunal to gain access to Canada Post's infrastructure. UPS Canada seeks damages resulting from the harm caused to it arising from the discriminatory terms upon which Canada Post's courier services enjoy access to the Monopoly Infrastructure. Other NAFTA provisions addressing simple access to infrastructure are, therefore, irrelevant.
576. Canada fails to adequately consider the background to Chapter 13. Chapter 13 is a compromise after the NAFTA Parties failed to agree upon a comprehensive national treatment regime for the complex and sensitive telecommunications area.<sup>605</sup> There is nothing, either in Chapter 13 or its publicly available history, to suggest that it was selected from all areas of public infrastructure as the sole area in which the NAFTA Parties chose to make commitments.

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<sup>604</sup> *Statement of Defence* at paras. 116-117.

<sup>605</sup> Hermann von Bertras gives his account of this complicated negotiation from a Mexican perspective in *Negotiating NAFTA: A Mexican Envoy's Account* (The Washington Papers/173) (Westport, Connecticut Praeger, 1997) at 63 (Book of Authorities at Tab 134).

577. Canada's NAFTA *Statement of Implementation* discusses how Chapter 13 "adds to" and does not detract from NAFTA Parties' Chapter 11 commitments. The *Statement of Implementation* says:

This chapter represents an extension of the FTA and builds upon the approach taken in the multilateral GATT negotiations. The chapter will establish common North American rules of the road for providers and users of telecommunications and computer services. **This chapter adds to the commitments on services set out in chapters eleven on investment and twelve on cross-border trade in services. These other chapters address the treatment to be accorded to service providers and investors from other NAFTA countries.** Other chapters in the Agreement on goods will create a more competitive environment for telecommunications and computer equipment companies through the phased elimination of all tariffs.<sup>606</sup>

Even at the time of the ratification of the NAFTA, Canada acknowledged that the Investment Chapter and the Telecommunications Services Chapters, both, were capable of applying to different aspects of the telecommunications sector.

*d. Canada's Defences Do Not Apply*

578. Canada argues its discriminatory leveraging of the Monopoly Infrastructure "cannot constitute a breach of NAFTA Article 1102" because "the NAFTA recognizes that monopolies or state enterprises may compete in the commercial market place." According to Canada, "[p]roviding other couriers with access to Canada Post's infrastructure, as demanded by UPS, is incompatible with such right of competition."<sup>607</sup>
579. Canada mischaracterizes UPS' claim. UPS does not claim Canada Post cannot compete in the commercial market place and does not demand access to Canada Post's infrastructure on any terms. UPS claims that, if Canada Post chooses to compete in the commercial market place, it must compete consistently with Canada's NAFTA obligations. By failing to require its courier services to pay *market rates* for access to the infrastructure, Canada Post is leveraging its monopoly privileges at the expense of companies like UPS Canada. This leveraging amounts to less favorable treatment in

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<sup>606</sup> *Statement of Implementation* at 168. (Emphasis added) (Book of Authorities at Tab 9).

<sup>607</sup> *Statement of Defence* at para. 117.

breach of NAFTA Article 1102.

580. Canada also argues its discriminatory leveraging of the Monopoly Infrastructure is not a breach of NAFTA Article 1102 because, in this leveraging, Canada Post does not exercise any delegated governmental authority and its actions are, therefore, not attributable to Canada.<sup>608</sup> Canada's argument is baseless. Canada Post is an organ of Canada and, according to customary international law as reflected in Article 4 of the *ILC Articles*, all of Canada Post's actions are internationally attributable to Canada.<sup>609</sup>

*e. Harm*

581. Through its discriminatory leveraging of the Monopoly Infrastructure, Canada has harmed UPS and its investment, UPS Canada. UPS Canada has lost customers and market share that it would otherwise have obtained but for Canada's breaches.<sup>610</sup> The Investor will provide a full valuation of these losses during the damages phase of these proceedings.

**2. Canada Breaches Article 1102 by its Discriminatory Customs System**

582. Canada's discriminatory customs system satisfies the necessary elements constituting a breach of NAFTA Article 1102.

*a. Like Circumstances*

583. As part of their competition in the same sector, both UPS Canada and Canada Post complete the delivery of courier services into Canada. In completing this delivery, both UPS Canada and Canada Post are subject to customs obligations.

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<sup>608</sup> *Statement of Defence* at para. 113.

<sup>609</sup> See the discussion in Chapter III, Section E of Part Three of this Memorial.

<sup>610</sup> The issue of showing some loss or damage arising out of the NAFTA inconsistent action as required by NAFTA Article 1116 has been considered in the Valuation Report prepared by Howard Rosen LECG (Rosen Report).

584. Canada claims UPS Canada and Canada Post are not in like circumstances, with regard to customs treatment, because mail and courier are subject to different streams.<sup>611</sup> In addition to importing by mail, Canada Post also imports courier items. Canada fails to explain how Canada Post and UPS Canada are not in like circumstances with regard to the import of such courier items.

*b. Treatment Less Favorable*

585. Canada treats UPS Canada less favorably than Canada Post by:

- a. charging cost recovery fees to UPS Canada, but exempting Canada Post;
- b. charging UPS Canada for computer linkage systems, but exempting Canada Post;
- c. supplying brokerage services to Canada Post's customers free of charge;
- d. allowing Canada Post to perform customs duties, but not allowing UPS Canada to perform the same duties;
- e. paying Canada Post ----- for "services" that UPS Canada is required to perform for free;
- f. allowing Canada Post more time to remit duties and taxes than it allows to UPS Canada;
- g. levying fines, penalties and interest against UPS Canada for errors in its customs compliance but not fining Canada Post;
- h. requiring UPS Canada to post bonds, but exempting Canada Post;

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<sup>611</sup> *Statement of Defence* at paras. 136 and 137.

i. charging UPS Canada GST on handling fees, but exempting Canada Post.

*c. Canada's Treatment is with Respect to the Expansion, Management, Conduct and Operation of UPS Canada*

586. Canada's NAFTA inconsistent treatment of UPS Canada prevents UPS Canada from fairly competing with Canada Post and therefore affects the expansion, management, conduct and operation of UPS Canada's business.

*d. Canada's Defences Do Not Apply*

587. Canada asserts Canada Post's performance of "non-core administrative services," and receipt of payments, under the *Postal Imports Agreement* falls within the procurement and subsidies exceptions, respectively, of NAFTA Article 1108(7).<sup>612</sup> The Investor holds Canada to its strict burden to establish these defences apply.

588. Under the *Postal Imports Agreement*, Canada Customs is supplying services rather than procuring them. Moreover, to the extent that any procurement occurs, this is only because Canada Post is not subject to the same regulations that apply to UPS Canada. Canada Customs relies on both Canada Post and UPS Canada to perform tasks relating to customs matters.

*e. Harm*

589. The Rosen Report confirms UPS Canada is harmed by Canada's discriminatory customs system. UPS Canada pays higher costs than Canada Post and loses businesses from customers who are aware they can courier products quicker and cheaper with Canada Post. The Investor will provide a full valuation of these losses during the damages phase of these proceedings.

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<sup>612</sup> *Statement of Defence* at para. 139.

**3. Canada Breaches NAFTA Article 1102 by its Discriminatory Application of the Publications Assistance Program**

590. Canada breaches Article 1102 by requiring publishers to distribute their publications through Canada Post in order to access the *Publications Assistance Program* (“PAP”) subsidy.

*a. Like Circumstances*

591. UPS Canada has sought to compete with Canada Post in the provision of courier services to publishers that qualify for the *Publications Assistance Program*. UPS Canada has solicited the business of large Canadian publishers who ship to retailers across Canada. Although it counts many of Canada’s largest retailers amongst its customers, UPS Canada found that it was unable to attract any of this business because it could not compete with Canada Post which receives an advantage through its administration of this subsidy granted to publishers. Canada’s implementation of the *Publications Assistance Program*, therefore, prevents UPS Canada from competing with Canada Post.

592. UPS and UPS Canada are in like circumstances with Canada Post because they have sought and continue to seek to compete with Canada Post in the provision of courier services to publishers that qualify for the *Publications Assistance Program*. To find that UPS and UPS Canada are not in like circumstances with Canada Post because they are not currently delivering publications that qualify for the *Publications Assistance Program* would reward Canada’s discrimination against UPS and UPS Canada.

593. Canada claims that UPS and UPS Canada are not in like circumstances because of the “inherent nature of Canada Post’s delivery system.” According to Canada, “[n]o Canadian or US courier company can perform affordable distribution of magazines required by the program on a national basis.”<sup>613</sup> Canada’s argument does not address

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<sup>613</sup> *Statement of Defence* at para. 144.

whether UPS and UPS Canada are in the same sector as Canada Post and therefore ignores the test for like circumstances prescribed by every tribunal to consider the issue. Furthermore, Canada attempts to exculpate itself from its NAFTA obligations by a subjective assessment of which company is best able to provide “affordable” delivery. Canada does not explain why it does not leave this decision to the very publishers the *Publications Assistance Program* is designed to assist.

*b. Less Favorable Treatment*

594. Canada treats UPS and UPS Canada less favorably than it treats Canada Post because it requires publishers to distribute their publications through Canada Post in order to access the *Publications Assistance Program* subsidy. Despite the recommendations of a 1994 Report and continued complaints from publishers, Canada refuses to pay the subsidies directly to publishers to enable them to choose the most efficient distributor.
595. Canada claims it does not provide less favorable treatment because “there is no discrimination ‘on the basis of nationality.’” According to Canada, “[i]t is not possible or cost efficient for courier companies, whether Canadian or American, to carry out the distribution of magazines under the Publications Assistance Program.”<sup>614</sup> A Party’s actions need not be motivated by nationality to breach Article 1102. Furthermore, Canada seeks to rely on its same subjective assessment of what is efficient in addressing the “less favorable” element that it erroneously attempts to rely on in addressing the “like circumstances” element. Whichever element Canada seeks to apply its argument to, it cannot avoid its NAFTA obligations through its own subjective assessments of which company can provide a more affordable service.

*c. Canada’s Treatment is with Respect to the Establishment and Expansion of UPS Canada*

596. Canada’s discriminatory application of the *Publications Assistance Program* prevents

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<sup>614</sup> *Statement of Defence* at para. 145.

UPS Canada delivering publications subject to the *Publications Assistance Program* and therefore prevents the expansion of its current market and business operations.

*d. Canada's Defences Do Not Apply*

597. Canada claims its discriminatory application of the *Publications Assistance Program* falls within the cultural industries exemption in Article 2106 and Annex 2106 and the subsidies exemption in Article 1108(7)(b).<sup>615</sup>
598. The manner in which Canada provides more favorable treatment to Canada Post's non-monopoly publications delivery services is not properly covered by the cultural industries exemption in the NAFTA. Canada has the burden to establish how this exception applies, and the Investor puts Canada to the strict proof thereof.
599. The NAFTA does not include provisions in its text regarding cultural industries but it incorporates by reference an obligation in the text of the *Canada - US Free Trade Agreement*. NAFTA Annex 2106 incorporates the provisions of the *Canada-U.S. Free Trade Agreement* directly into the NAFTA text. Thus, the benefits and peculiarities of the cultural exemption have been continued into the later Agreement. Article 2012 of the *Canada- US Free Trade Agreement* set out a detailed exemption of cultural industries from the application of most of the trade Agreement's obligations. The definition of cultural industries covers five different types of activity, namely <sup>616</sup>:
- a. printed publications;
  - b. film and video;
  - c. music recording;
  - d. music publishing; and

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<sup>615</sup> *Statement of Defence* at para. 142.

<sup>616</sup> *Canada-US Free Trade Agreement* Article 2012 (Book of Authorities at Tab 133).

e. broadcasting.

600. For these specifically enumerated activities, there is an exemption for *Canada-U.S. Free Trade Agreement* Party governments. Article 2005 states:

1. Cultural industries are exempt from the provisions of this agreement, except as specifically provided in Article 401 (Tariff Elimination), paragraph 4 of Article 1607 (divestiture of an indirect acquisition) and Articles 2006 and 2007<sup>617</sup> of this Chapter.
2. Notwithstanding any other provision of this Agreement, a Party may take measures of equivalent commercial effect in response to actions that would have been inconsistent with this Agreement but for paragraph 1.

By its terms, this exemption has two elements. First, paragraph 1 provides that cultural industries will be exempt from the operation of that agreement other than in specified circumstances. Paragraph 2 provides that a Party may retaliate against the use of the cultural exemption by taking actions of "equivalent commercial effect".

601. Canada's *Publication Assistance Program* provides assistance to Canadian magazine publishers. With respect to assistance to publishers, the terms of the exemption clearly apply. However, the terms of the cultural industries exception apply to cultural industries themselves. Canada Post's involvement in the program has no rational connection to the cultural interests protected or advanced by this program. Canada Post simply is one of a variety of different delivery mechanisms that could be available to disseminate magazines. The objectives protected by the NAFTA for cultural industries simply does not extend to its delivery and thus the exception does not apply in this context.

602. Similarly, Canada's reliance on the subsidy exception is also not properly placed. The *Publication Assistance Program* does not provide a subsidy to Canada Post, but it provides legislative advantages to Canada Post which give it superior competitive opportunities over its commercial rivals in this non-monopoly delivery service area. The WTO Appellate Body has confirmed that a subsidy which provides the recipient with an incentive to discriminate is not exempt from national treatment obligations. In *US-FSC*,

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<sup>617</sup> These articles detailed obligations regarding retransmission rights and print-in-Canada publishing requirements.

the Appellate Body accepted that tax relief could be a subsidy,<sup>618</sup> but said that a US law, under which companies producing goods received tax relief if more than 50% of the inputs into their goods were produced in the US, was inconsistent with the US' national treatment obligation in Article III:4 of the GATT.<sup>619</sup> It is difficult, therefore, to conceive of how the subsidies exception applies and Canada has the strict burden of proving this reliance in its Counter-Memorial.

*e. Harm*

603. The Rosen Report concludes that Canada's actions deny UPS and UPS Canada the opportunity to distribute publications subject to the *Publications Assistance Program* and cause it to lose the profits that it would make from such distribution.<sup>620</sup>

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<sup>618</sup> *United States - Tax Treatment for "Foreign Sales Corporations,"* Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/AB/RW, 14 January 2002 at paras. 190, 194 (Book of Authorities at Tab 136).

<sup>619</sup> *US - FSC* (Book of Authorities at Tab 136) at paras. 218-222.

<sup>620</sup> Rosen Report at paras. 44-47.

**Chapter VI. THE INTERNATIONAL LAW STANDARD OF TREATMENT**

604. The Investor has claimed that Canada has failed to meet its international law standard of treatment obligation owed to the investment. This obligation has not been met in at least, the following ways:

- a. Canada failed to treat the investment fairly and in a manner free from arbitrary and discriminatory acts when it retaliated against Fritz Starber, an investment in the territory of Canada owned by the Investor, as a result of the Investor's launch of its NAFTA Investor-State arbitration against Canada. This action violated Canada's obligation of fair and equitable treatment and affected the legitimate expectations of the Investment contrary to Canada's international law obligations.
- b. Canada fails to provide international law standards of treatment, including fair and equitable treatment and full protection and security in permitting Canada Customs to not fairly enforce Canadian law.
- c. Canada fails to provide international law standards of treatment, including fair and equitable treatment, full protection and security and freedom from arbitrary or discriminatory treatment by delegating to Canada Post the discretion to self-inspect most of its own courier and parcel imports. As a result, Canada Post has systemically not properly collected duties and taxes.
- d. Canada failed to treat the investment in accordance with international law including fair and equitable treatment and full protection and security when it failed to observe its international law obligations respecting the observance of core labour standards, such as the right of collective bargaining for Canada Post's workers.

605. This Chapter of the Memorial will set out the basis of Canada's international law obligations under NAFTA Article 1105 and will then address how Canada's behaviour has failed to rise to the level of these obligations.

**A. The Content of the International Law Standard**

**1. Fair and Equitable Treatment**

606. NAFTA Article 1105(1) sets out the international law standard of treatment that a Party is obliged to accord to investments of investors from the other Party. It says:

Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

607. Regardless of the influence of the Free Trade Commission's Note of Interpretation (which is addressed in Chapter VII of this Part of the Memorial), NAFTA Article 1105 recognizes the international law obligation of each NAFTA Party to treat foreign investors fairly and equitably. The NAFTA Parties' obligation to treat investors fairly and equitably is grounded in their obligation to act in good faith<sup>621</sup> - perhaps the most fundamental peremptory norm of international law.<sup>622</sup> Dr. F.A. Mann, a significant authority on this topic, recognizes the fair and equitable treatment standard's origins in good faith:

The paramount duty of States imposed by international law is to observe and act in accordance with the requirements of good faith. From this point of view it follows that, where these treaties express a duty which customary international law imposes or is widely believed to impose, they give very strong support to the existence of such a duty and preclude the Contracting States from denying its existence.

These remarks apply, in particular, to the overriding effect of the standard of fair and equitable treatment ...<sup>623</sup>

608. Dr. Mann draws from the fair and equitable standard's foundations in the fundamental peremptory norm of good faith to designate the fair and equitable treatment standard as the pre-eminent substantive standard in investment treaties:

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<sup>621</sup> J.F. O'Connor, *Good Faith in International Law* (Dartmouth: 1991) at 1 (Book of Authorities at Tab 22).

<sup>622</sup> Thomas Franck, *Fairness in International Law and Institutions* (Clarendon Press: 1995) at pp.42-43 (Book of Authorities at Tab 25).

<sup>623</sup> Mann, F.A., "British Treaties for the Promotion and Protection of Investments" 52 *BYIL* 241 (1981) at 249-250 at Tab 78 (Book of Authorities at Tab 23).

... it is submitted that the right to fair and equitable treatment goes much further than the right to most-favored-nation and to national treatment .... So general a provision is likely to be almost sufficient to cover all conceivable cases, and it may well be that other provisions of the Agreements affording substantive protection are no more than examples of specific instances of this overriding duty.<sup>624</sup>

609. Modern investor-state tribunals have repeated Dr.Mann’s views. Recognizing the fair and equitable standard’s origins in the obligation of good faith, the *S.D. Myers* NAFTA Tribunal said:

Article 1105 of the NAFTA requires the Parties to treat investors of another Party in accordance with international law, including fair and equitable treatment. Article 1105 imports into the NAFTA, the international law requirements of due process, economic rights, obligations of good faith and natural justice.<sup>625</sup>

610. Similarly, drawing from this passage in *S.D. Myers*, the *Tecmed* Tribunal said that “the commitment of fair and equitable treatment included in Article 4(1) of the [Spain-Mexico] Agreement is an expression and part of the *bona fide* principle recognized in international law...”<sup>626</sup>

611. The obligation to act in good faith entails several specific obligations. For the purposes of this NAFTA claim, four obligations are particularly important:

- a. the obligation to perform undertakings (*pacta sunt servanda*);
- b. the obligation to provide treatment free from abuse of rights;
- c. the obligation to provide treatment free from arbitrary and discriminatory conduct; and

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<sup>624</sup> Mann, F.A., “British Treaties” at 243-244 (Book of Authorities at Tab 23); Mann, F.A., “British Treaties for the Promotion and Protection of Investments” 52 BYIL 241(1981) at 243-244 (Book of Authorities at Tab 23).

<sup>625</sup> *S.D. Myers, Inc Partial Award*, November 12, 2000 at para. 134 (Book of Authorities at Tab 4).

<sup>626</sup> *Tecnicas Medioambientales TECMED SA v. The United Mexican States ARB (AF)/00/2 Award* May 29, 2003 at para. 153 (Book of Authorities at Tab 24).

d. the obligation to fulfill legitimate expectations.

a. *Pacta Sunt Servanda*

612. Governments are expected to observe their obligations in good faith. Bin Cheng has noted the *pacta sunt servanda* principle's foundations in good faith. He said that the principle is "but an expression of the principle of good faith which above all signifies the keeping of faith, the pledged faith of nations, as well as that of individuals."<sup>627</sup>
613. International tribunals have repeatedly affirmed the obligation of governments to perform their undertakings, even contractual undertakings.<sup>628</sup> For example, the arbitrator in *Texaco Overseas Petroleum (TOPCO) and Libya*<sup>629</sup> stated:

No international jurisdiction, whatsoever, has ever had the least doubt as to the existence, in international law, of the rule *pacta sunt servanda*; it has been affirmed vigorously both in the *Aramco Award* in 1958 and in the *Sapphire Award* in 1963. One can read, indeed, in the *Sapphire Award*, that "it is a fundamental principle of law, which is constantly being proclaimed by international Courts, that contractual undertakings must be respected. The rule '*pacta sunt servanda*' is the basis of every contractual relationship"...This Tribunal cannot but reaffirm this in its turn by stating that the maxim *pacta sunt servanda* should be viewed as a fundamental principle of international law.<sup>630</sup>

The arbitrator hearing the *LIAMCO* case reached a similar conclusion:

International custom and case-law has always sustained the proposition of "*Pacta sunt servanda*". It has been upheld in many arbitration awards...The principle of the respect for agreements is thus applicable to ordinary contracts and concession agreements.<sup>631</sup>

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<sup>627</sup> Bin Cheng, *General Principles of Law* (1987) at 113 (Book of Authorities at Tab 26).

<sup>628</sup> *Amco Asia Corporation et. al. v. The Republic of Indonesia, Award on Merits*, November 20, 1984 1 ICSID Rep. 413 at para. 248 (Book of Authorities at Tab 28); *Saudi Arabia v. Arabian American Oil Company (Aramco)* (1958) 27 ILR 117 at 163-164 (Book of Authorities at Tab 29); *Sapphire International Oil Company v. National Iranian Oil Company* (1963) 35 ILR 136 at 181 (Book of Authorities at Tab 30); *Libyan American Oil Company v. Government of the Libyan Arab Republic* (1977) 62 ILR 41 at 170, 190 (Book of Authorities at Tab 31); *TOPCO Award on the Merits*, unreported at para. 51 (Book of Authorities at Tab 33).

<sup>629</sup> (1977) 53 ILR 422 (Book of Authorities at Tab 33). The *TOPCO* case (Book of Authorities at Tab 33) was governed by international law as is the BIT Article II(3)(a) obligation.

<sup>630</sup> *TOPCO* at para. 51 (Book of Authorities at Tab 33).

<sup>631</sup> *LIAMCO Award*, 20 ILM at 56 (Book of Authorities at Tab 31).

614. *Pacta sunt servanda* obliges governments to observe their treaty undertakings, especially as they affect interested parties' rights. Hence, the WTO panel in the *US - Section 301 Case*<sup>632</sup> said:

The good faith requirement in the *Vienna Convention* suggests, thus, that a promise to have recourse to and abide by the rules and procedures of the DSU, also in one's legislation, includes the undertaking to refrain from adopting national laws which threaten prohibited conduct.

615. Furthermore, the ILC has recognized that State's obligation to treat investors with good faith includes an obligation to negotiate in good faith.<sup>633</sup>

*b. Protection from Arbitrary and Discriminatory Conduct*

616. The obligation to act in good faith also entails the obligation not to act in an arbitrary or discriminatory manner. In the *Metalclad Award*, for example, the Tribunal decided Mexico breached its NAFTA Article 1105 obligation by acting on the basis of irrelevant considerations.<sup>634</sup>
617. Other investor - state tribunals have said a State breaches its obligation not to act in an arbitrary or discriminatory manner when it acts on the basis of prejudice or preference and not on reason or fact. In *Lauder v Czech Republic*, for example, the ICSID Tribunal said:

The Treaty does not define an arbitrary measure. According to Black's Law Dictionary, arbitrary means "depending on individual discretion; ... founded on prejudice or preference rather than on reason or fact".<sup>635</sup>

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<sup>632</sup> *United States - Sections 301-310 of The Trade Act of 1974*, WT/DS152/R, December 22, 1999 at para. 7.68 ("*US - Section 301 Case*") (Book of Authorities at Tab 27).

<sup>633</sup> Commentary to Article 17 at p. 31 in *Report on Injurious Consequences Arising out of Acts not Prohibited by International Law*, ILC, 1996 (Book of Authorities at Tab 35).

<sup>634</sup> *Metalclad Award* at para. 92 (Book of Authorities at Tab 86).

<sup>635</sup> *Lauder v. Czech Republic, Final Award*, September 2001 at paras. 221 and 232 (Book of Authorities at Tab 43).

In applying this definition to find the Czech Republic acted arbitrarily, the Tribunal said:

The measure was arbitrary because it was not founded on reason or fact, nor on the law ... but on mere fear reflecting national preference.

618. The *Pope & Talbot* NAFTA Tribunal also found Canada breached its Article 1105 obligation by acting on prejudice rather than on reason or fact. The Tribunal found Canada breached the obligation by threatening the investor, denying its “reasonable requests for pertinent information” and requiring the investor “to incur unnecessary expense and disruption in meeting SLD’s requests for information.”<sup>636</sup>
619. The WTO Appellate Body in *US - Shrimp Turtle*<sup>637</sup> found that opaque administrative frameworks which facilitate arbitrary decisions are a breach of international law. The Tribunal found that a certification process established under US legislation was not “transparent” nor “predictable” and provided “no formal opportunity for an applicant country to be heard, or to respond to any arguments that may be made against it ... before a decision ... is made.” The Tribunal also found that “no formal written, reasoned decision, whether of acceptance or rejection, is rendered on applications for either type of certification” and “[n]o procedure for review of, or appeal from, a denial of an application is provided.”<sup>638</sup>

Based on these features, the Tribunal decided that “[t]he certification processes followed by the United States thus appear to be singularly informal and casual, and to be conducted in a manner such that these processes could result in the negation of rights of Members.” The Tribunal found that Members could not be certain the rules “were being applied in a fair and just manner” and, consequently, “exporting Members applying for certification whose applications are rejected are denied basic fairness and due process,

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<sup>636</sup> *Pope & Talbot, Award on the Merits Phase 2*, April 10, 2001 at paras. 177-181 (Book of Authorities at Tab 7).

<sup>637</sup> *United States - Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, October 12, 1998 at para.180 (Book of Authorities at Tab 46).

<sup>638</sup> *United States - Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, October 12, 1998 at para.180 (Book of Authorities at Tab 46).

and are discriminated against, *vis-a-vis* those Members which are granted certification.”

*c. Protection Against Abuse of Rights*

620. Professor Bin Cheng has explained that the obligation to act in good faith includes the obligation not to abuse exclusive privileges:

The principle of good faith requires that every right be exercised honestly and loyally. Any fictitious exercise of a right for the purpose of evading either a rule of law or a contractual obligation will not be tolerated. Such an exercise constitutes an abuse of the right, prohibited by law.<sup>639</sup>

621. Professor Sir Hersch Lauterpacht further expanded on the meaning of this customary international law standard:

The conspicuous feature of these awards is the view that the undoubted right of expulsion degenerates into an abuse of rights whenever an alien who has been allowed to take up residence in the country, to establish his business and set up a home, is expelled without just reason, and that such an abuse of rights constitutes a wrong involving the duty of reparation.<sup>640</sup>

622. The NAFTA Investor-State Tribunal in the *Azinian* claim discussed how protection against the abuse of rights was contained within the international law standard of treatment covered by NAFTA Article 1105. It stated:

There is a fourth type of denial of justice, namely clear and malicious misapplication of the law. This type of wrong doubtless overlaps with the notion of “pretence of form” to mask a violation of international law.<sup>641</sup>

*d. Legitimate Expectations*

623. The fair and equitable treatment obligation includes the obligation to protect legitimate expectations. The *Tecmed* Tribunal said that the fair and equitable provision:

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<sup>639</sup> Bin Cheng, *General Principles of Law* at 123 (Book of Authorities at Tab 26).

<sup>640</sup> Lauterpacht, *The Function of Law in the International Community* (1933) at 289 (Book of Authorities at Tab 39).

<sup>641</sup> *Re: Azinian and Mexico* (NAFTA Investor-State Claim) (2000) 39 ILM 537 at para. 103 (Book of Authorities at Tab 40).

... in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment.<sup>642</sup>

624. The *Tecmed* Tribunal went on to explain that legitimate expectations included the expectation that the state will conduct itself in a coherent manner, without ambiguity and transparently in order for the investor to be able to plan its activities and adjust its conduct to the statutes or regulations that will govern them, the policies embedded therein and the relevant practices and administrative directions.<sup>643</sup>
625. The *Metalclad Award* supports the application of the *Tecmed* Tribunal's description of the standard to NAFTA Article 1105. The *Metalclad* arbitration arose out of Mexico's refusal to grant a US investor, Metalclad, a permit to construct a landfill. Mexico refused to issue the permit when construction was almost completed, in conflict with earlier representations. Metalclad began arbitration proceedings, claiming that Mexico's conduct breached the international law standard of treatment to investors. The Tribunal found that Mexico failed to fulfill its obligation because it affected Metalclad's basic expectations:

Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.<sup>644</sup>

626. Recent investor-state arbitration tribunal decisions have affirmed this description of the standard. In *MTD v. Chile*, after stating that it would apply the *Tecmed* standard to the facts of the case, the Tribunal found that Chile failed to meet that standard by

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<sup>642</sup> *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2 (Award of May 29, 2003), available at <http://www.worldbank.org/icsid/cases/laudo-051903%20-English.pdf> at para. 154. (Book of Authorities at Tab 24).

<sup>643</sup> *Tecmed* at para. 154 (Book of Authorities at Tab 26).

<sup>644</sup> *Metalclad Award*, August 30, 2000 at para. 99. (Book of Authorities at Tab 86). The *Metalclad Award* was subsequently partially set aside by the Supreme Court of British Columbia in *Mexico v. Metalclad Corporation* (2001) BCSC 664 (Book of Authorities at Tab 104) because NAFTA Chapter 18 exhaustively addressed transparency within the NAFTA. However, only the Tribunal's incorporation of transparency in the international minimum standard was set aside (at para. 72). Their remaining comments on the standard were not questioned.

“authorizing an investment that could not take place for reasons of its urban policy.”<sup>645</sup> Similarly, the *Occidental v. Ecuador* Tribunal found that, after Occidental had invested, Ecuador changed its tax law “without providing any clarity about its meaning and extent.” The Tribunal also found that the state’s “practice and regulations were also inconsistent with [the] changes [to the law].”<sup>646</sup> The Tribunal concluded that these actions fell below the standard, as described in the *Tecmed* case, and accordingly found a breach of the BIT.

The *Occidental* Tribunal, therefore, recognized a state may act inconsistently with an investor’s legitimate expectations, and therefore breach its obligation to treat an investor fairly and equitably, when it fails to follow its own laws. The Tribunal’s conclusion is consistent with subsequent comments from the Tribunal hearing the *GAMI v. Mexico* dispute. That Tribunal also found that a state’s failure to implement its laws may breach Article 1105.<sup>647</sup>

## **2 Full Protection and Security**

627. NAFTA Article 1105 affirms States’ obligation under the international law standard of treatment to provide full protection and security to investments. The *CME v. Czech Republic* decision confirms the obligation extends beyond an obligation to protect physical property and includes the obligation to protect the *legal* security of investments. In finding that a broadcast regulator breached the state’s obligation by cancelling a broadcast licence, the Tribunal said

The Media Council’s actions in 1996 and its actions and inactions in 1999 were targeted to remove the security and legal protection of the Claimant’s investment in the Czech Republic. The Media Council’s (possible) motivation to regain control of the operation of the broadcasting after the Media Law had been amended as of January 1, 1996 is irrelevant. *The host State is obligated to*

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<sup>645</sup> *MTD Equity Sdn. Bhd. and MTD Chile S.A. and The Republic of Chile, Award* (May 21, 2004) at paras. 114-115, 188 (CLA156) (Book of Authorities at Tab 20).

<sup>646</sup> *Occidental v. Ecuador* at para. 184 (Book of Authorities at Tab 94).

<sup>647</sup> *GAMI Investments v. Mexico* at para. 108: “The record shows that Mexico failed to implement key struts of its Sugar Program notwithstanding its duties .... GAMI alleges an abject failure to implement a regulatory program indispensable for the viability of foreign investments that had relied upon it. GAMI urges that in law this is no different from a violation by the government of the rules of that program. Both action and inaction may fall below the international standard. So far the Arbitral Tribunal is prepared to accept GAMI’s proposition.” (Book of Authorities at Tab 100)

*ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor's investment withdrawn or devalued.* This is not the case. The Respondent therefore is in breach of this obligation.<sup>648</sup>

628. The *CME* decision also confirms that the full protection and security obligation extends to actions of government officials as well as to actions of the public.
629. Modern investor-state tribunals also clarify the *standard* of protection expected under the obligation. The *Lauder*, *CME* and *AAPL* Tribunals have said that the obligation to provide full protection and security means that the state must exercise reasonable due diligence to protect foreign investment. The *Lauder* Tribunal said:

Article 11(2)(a) of the Treaty provides that “[i]nvestment (...) shall enjoy full protection and security”. There is no further definition of this obligation in the Treaty. *The Arbitral Tribunal is of the opinion that the Treaty obliges the Parties to exercise such due diligence in the protection of foreign investment as reasonable under the circumstances.*<sup>649</sup>

630. In *American Manufacturing & Trading v Zaire*, the ICSID Tribunal held states to a higher standard. The Tribunal interpreted a BIT that contained provisions analogous to NAFTA Article 1105 and held that the obligation owed by Zaire to the US Investor was an *obligation of vigilance*, in that Zaire should have taken *all measures necessary* to ensure the full enjoyment of protection and security of the US Investor.<sup>650</sup>

## **B. The Threshold For a Breach of the International Law Standard**

631. Article 1 of the *ILC Articles on State Responsibility* confirms that mere failure to provide the international law standard of treatment is a breach of international law. The Article

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<sup>648</sup> *CME* at para. 613 (Emphasis added) (Book of Authorities at Tab 34).

<sup>649</sup> *Lauder* at para. 308(Emphasis added) (Book of Authorities at Tab 43). *Asian Agricultural Products Limited v. Republic of Sri Lanka*, Award of June 27, 1990, 6 ICSID Rev - FILJ 526 (Book of Authorities at Tab 47). This arbitration concerned a Hong Kong - Sri Lankan governmental agency joint venture to cultivate and export shrimp to Japan. In 1986 a local insurgency resulted in the loss of governmental control of the area where the shrimp farm was located. In 1987, a counter-insurgency was conducted by the government to regain control. In the process of regaining control of the territory, the investment was destroyed. *CME* at para. 353 (Book of Authorities at Tab 34).

<sup>650</sup> *American Manufacturing & Trading v. Republic of Zaire*, (ICSID Reports) Yearbook Comm. Arbitration 22 (1997) 60 at para. 38 (Book of Authorities at Tab 32).

says:

Every internationally wrongful act of a State entails the international responsibility of that State.

632. Canada is, therefore, wrong when it argues a State only breaches Article 1105 when its misconduct rises to a higher threshold than mere inconsistency. Canada argues there must be “an outrage, ... bad faith, ... wilful neglect of duty, or ... an insufficiency of government action so far short of international standards that every reasonable person would readily recognize its insufficiency” before State conduct breaches Article 1105.<sup>651</sup> Canada referred to the *Neer v. Mexico* and *Chattin v. Mexico* decisions to support its argument. Canada’s argument is not only inconsistent with the *ILC Articles* but numerous modern investor-state tribunals have specifically considered and rejected it.

633. In *Pope and Talbot*, the Tribunal said:

Canada considers that the principles of customary international law were frozen in amber at the time of the *Neer* decision. It was on this basis that it urged the Tribunal to award damages only if its conduct was found to be an “egregious” act or failure to meet internationally required standards. The Tribunal rejects this static conception of customary international law for the following reasons: First, as admitted by one of the NAFTA Parties, and even by counsel for Canada, there has been evolution in customary international law concepts since the 1920’s...Secondly, since the 1920’s, the range of actions subject to international concern has broadened beyond the international delinquencies considered in *Neer* to include the concept of fair and equitable treatment....<sup>652</sup>

634. The *Mondev* Tribunal followed a similar approach. The Tribunal rejected the application of the *Neer* standard to investment protection cases because *Neer* did not deal with foreign investment but rather a state’s duty to investigate crimes:

The Tribunal would observe, however, that the *Neer* case, and other similar cases that were cited, concerned not the treatment of foreign investment as such but the physical security of the alien. Moreover the specific issue in *Neer* was that of Mexico’s responsibility for failure to carry out an effective police investigation into the killing of a United States citizen by a number of armed men who were not even alleged to be acting under the control or at the instigation of Mexico. In

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<sup>651</sup> Canada’s Memorial (Jurisdiction Phase) at para. 96.

<sup>652</sup> *Pope & Talbot, Damages Award*, May 31, 2002 at para. 57-65 (Book of Authorities at Tab 38). A similar conclusion was reached in *S.D. Myers Partial Award*, November 12, 2000 at para. 259 (Book of Authorities at Tab 4).

general, the State is not responsible for the acts of private parties, and only in special circumstances will it become internationally responsible for a failure in the conduct of the subsequent investigation. Thus, there is insufficient cause for assuming that provisions of bilateral investment treaties, and of NAFTA, while incorporating the *Neer* principle in respect of the duty of protection against acts of private parties affecting the physical security of aliens present on the territory of the State, are confined to the *Neer* standard of outrageous treatment where the issue is the treatment of foreign investment by the State itself.<sup>653</sup>

635. The Tribunal also rejected the *Neer* standard as being inapplicable to contemporary international law. The Tribunal stated:

Secondly, *Neer* and like arbitral awards were decided in the 1920s, when the status of the individual in international law, and the international protection of foreign investments, were far less developed than they have since come to be. In particular, both the substantive and procedural rights of the individual in international law have undergone considerable development. In the light of these developments it is unconvincing to confine the meaning of 'fair and equitable treatment' and 'full protection and security' of foreign investments to what those terms - had they been current at the time - might have meant in the 1920s when applied to the physical security of an alien. To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.<sup>654</sup>

636. The *Mondev* Tribunal's rejection of Canada's argument was subsequently approved in *Tecmed*.<sup>655</sup>

### **C. Canada's Breaches of Article 1105**

637. Canada's course of conduct towards UPS Canada is inconsistent with Canada's obligations to provide international law standards of treatment reflected in NAFTA Article 1105.

#### **1. Canada's NAFTA Breach in the Fritz Starber Affair**

638. Canada failed to provide international law standards of treatment, including fair and equitable treatment and protection from the abuse of rights in its retaliation against UPS'

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<sup>653</sup> *Mondev Award*, October 11, 2002 at para. 115 (Book of Authorities at Tab 37).

<sup>654</sup> *Mondev Award*, October 11, 2002 at para. 116 (Book of Authorities at Tab 37).

<sup>655</sup> *Tecmed* at para. 154 (Book of Authorities at Tab 26).

investment in Fritz Starber arising out of its commencement of this NAFTA arbitration. Fritz Starber's bid was deemed ineligible simply because Fritz Starber became an affiliate of UPS and UPS was involved in NAFTA proceedings against Canada at the time.

639. Before this time, Canada Post and Fritz Starber had enjoyed a long-standing business relationship. It was this relationship that originally prompted Canada Post to solicit Fritz Starber to submit a bid for Canada Post's air freight operation to Latin America and the Caribbean.
640. Fritz Starber devoted significant time and resources to submit a bid to Canada Post. The Fritz Starber bid was prepared in reliance of Canada Post's solicitation and in expectation of a future contract for Canada Post's European airfreight.
641. After Fritz Starber submitted its bid, Canada Post assured Fritz Starber that its bid was competitive and merited consideration by Canada Post senior officials. Given Canada Post's assurances, Fritz Starber, therefore, had a reasonable and legitimate expectation that Canada Post would conduct itself with transparency and fairness.
642. Upon Canada Post's knowledge that Fritz Starber had been acquired by UPS, Canada Post overtly engaged in retaliatory conduct against Fritz Starber. Canada Post's conduct was arbitrary, unfair and detached from an objective and proper consideration of Fritz Starber's bid. Canada Post conduct was harmful and directly impacted UPS' expected profits.

## **2. Canada Breached NAFTA Article 1105 with Respect to Customs Inspections**

643. Canada breaches Article 1105 by discriminating against UPS Canada with regard to customs treatment. Canada discriminates to give Canada Post's courier services a competitive advantage against UPS Canada and its actions are therefore inconsistent with Canada's obligation to act in good faith. Canada's discriminatory treatment is based on

preference and not reason or fact and is therefore arbitrary treatment, inconsistent with the international law standard of treatment prescribed in Article 1105. Specifically, Canada treats UPS Canada arbitrarily, and inconsistently with its obligation to act in good faith, by:

- a. charging cost recovery fees to UPS Canada, but exempting Canada Post;
  - b. charging UPS Canada for computer linkage systems, but exempting Canada Post;
  - c. performing brokerage services for Canada Post that UPS Canada's customers must pay for;
  - d. allowing Canada Post to perform customs duties that should be performed by Canada Customs alone;
  - e. paying Canada Post ----- for "services" that Canada Post is required to perform for free;
  - f. allowing Canada Post more time to remit duties and taxes than it allows to UPS Canada;
  - g. fining UPS Canada for inadvertently circumventing customs regulations but not fining Canada Post;
  - h. requiring UPS Canada to post bonds, but exempting Canada Post; and
  - i. charging UPS Canada Goods and Services Tax on handling fees, but exempting Canada Post.
644. By enabling Canada Post to perform its own customs duties, and therefore failing to ensure Canada Post properly collects duties and taxes, and by failing to fine Canada Post for failing to comply with regulations, Canada fails to enforce Canadian law to give

Canada Post a competitive advantage. Canada's failure to enforce its own laws fails to fulfil UPS and UPS Canada's legitimate expectations and is therefore a breach of its obligation to treat UPS and UPS Canada fairly and equitably.

**3. Canada Breached NAFTA Article 1105 with Respect to its Failure to Follow its International Law Obligations Regarding Core Labour Standards**

645. Canada failed to provide international law standards of treatment, including fair and equitable treatment and good faith observation of treaty obligations by its denial of collective bargaining rights to Canada Post's workers.
646. Section 13(5) of the *CPC Act* excluded Rural Contractors from forming a union for the purpose of bargaining collectively with Canada Post. Rural postal workers were specifically excluded from the meaning of the term "employee" under the *Canadian Labour Code*. This policy was changed by Canada in 2004.<sup>656</sup> All Canada Post employees were prohibited from negotiating over pension benefits, effectively until February 2003.
647. Canada's failure to respect core labour standards for Canada Post's workers violates Canada's Article 1105 obligation. The resulting effects create unfairly low wages to be paid by Canada Post which it uses to compete against UPS Canada.
648. The USO does not require countries to exempt postal workers from collective bargaining legislation. Moreover, the USO is only one of Canada's international legal obligations. Canada has many more international legal obligations related to core labour standards, all of which were violated by section 13(5) of the *CPC Act*. These treaties are summarized below.

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<sup>656</sup> See *CUPW Negotiations Bulletin* No. 44 dated July 7, 2003 - "A Victory for Rural and Suburban Mail Carriers" (16060, at 16051) (Tab U322).

*a. The International Labour Organization*

649. In 1972, Canada ratified the International Labour Organization's ("ILO") *Freedom of Association and Protection of the Right to Organise Convention (87)* ("Convention No. 87").<sup>657</sup> *Convention No. 87* establishes the right to freedom of association for workers and employers, and protection of the right to organize.

Workers and employers, without distinction whatsoever, shall have the right to establish, and subject only to the rules of the organisation concerned, to join organisations of their own choosing without previous authorisation.<sup>658</sup>

650. Article 3 requires that public authorities refrain from interfering with the right to freedom of association. Article 9 establishes two possible exceptions to the application of *Convention No. 87*: the armed forces and the police.<sup>659</sup> Clearly, Canada Post does not fall within either of these two exceptions.

651. Canada is also in breach of its obligations under the *ILO Declaration on Fundamental Principles and Rights at Work* ("Fundamental Declaration"). Adopted in 1998, the *Fundamental Declaration* commits ILO Member States to respect and promote rights in four categories, regardless of whether or not they have ratified the relevant Conventions. Canada is a Member State of the ILO, and is required to respect the principles and rights in the Declaration.<sup>660</sup>

652. The rights and principles embodied in the *Fundamental Declaration* are also referred to as core labour standards. One of these core labour standards is the right to freedom of association and the right to collective bargaining. The *Fundamental Declaration* requires Canada to respect freedom of association and the effective recognition of the right to

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<sup>657</sup> *ILO Convention 87: Convention concerning Freedom of Association and Protection of the Right to Organise* (Date of coming into force: 04:07:1950.) (Book of Authorities at Tab 96).

<sup>658</sup> *Convention No. 87*, Article 2 (Book of Authorities at Tab 96).

<sup>659</sup> *Convention No. 87*, Article 9 (Book of Authorities at Tab 96).

<sup>660</sup> *International Labour Organization: Alphabetical List of Member Countries* (Book of Authorities at Tab 138).

collective bargaining.

653. Canada Post's denial of trade union rights and collective bargaining rights for its rural workers violated its ILO obligations. The exemption for rural workers contained in the *CPC Act* did not conform with *Convention No. 87* or the *Fundamental Declaration*.
654. The general principle that emerges from interpretations of *Convention No. 87* by ILO bodies is that freedom to form and organize unions, even in the public sector, must include freedom to pursue the essential activities of unions, such as collective bargaining, subject to reasonable limits.<sup>661</sup>

*b. The Universal Declaration of Human Rights*<sup>662</sup>

655. In addition to the ILO, Canada has a number of international obligations under other declarations and covenants that are relevant to its domestic labour responsibilities. Principal among these documents are the *Universal Declaration of Human Rights* ("*Universal Declaration*"), the *International Covenant on Political and Civil Rights* ("*CPCR*"), and the *International Covenant on Economic, Social and Cultural Rights* ("*CESCR*").
656. The *Universal Declaration* was adopted by the United Nations General Assembly in 1948. It provides for the right to freedom of association and the right to form and join trade unions in two separate articles.

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<sup>661</sup> E. Osieke, "The Exercise of Judicial Function with respect to the International Labour Organization" (1974-75), 47 *Brit. Y.B. of Int'l L.* 315 (Book of Authorities at Tab 99); See ILO 291st Report, Case No. 1557, para. 285(a) (Book of Authorities at Tab 97); ILO 243rd Report, Case No. 1348, para. 289 (Book of Authorities at Tab 98); See also ILO 259th Report, Cases Nos. 1429, 1434, 1436, 1457 and 1465, para. 677 (Book of Authorities at Tab 101); CFA Digest of Decisions 1985, para. 602 (Book of Authorities at Tab 127).

<sup>662</sup> Adopted and proclaimed by General Assembly resolution 217 A (III) of 10 December 1948 (Book of Authorities at Tab 102).

657. Article 20 of the *Universal Declaration* sets out the right to freedom of association.

Everyone has the right to freedom of peaceful assembly and association.

658. Article 23(4) of the *Universal Declaration* sets out the right to form and join trade unions.

Everyone has the right to form and to join trade unions for the protection of his interests.

659. The fact that the right to form and join a trade union has been given specific legal recognition over and above other forms of association is a reflection of the fact that freedom of association for trade union purposes has become a “major postulate of democratic government in an industrial society”.<sup>663</sup>

660. Professor Ian Brownlie has emphasized that the *Universal Declaration* is frequently regarded as part of the “law of the United Nations”.<sup>664</sup> Indeed, some of the provisions of the *Universal Declaration* either constitute general principles of law or represent elementary considerations of humanity. It is an authoritative guide to the interpretation of the United Nations Charter.<sup>665</sup>

*c. The International Covenant on Political and Civil Rights*<sup>666</sup>

661. In an effort to make more specific the broad principles under the *Universal Declaration*, the United Nations General Assembly adopted two human rights covenants. The *International Covenant on Political and Civil Rights* (“CPCR”) and the *International*

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<sup>663</sup> W. Jenks, *Human Rights and International Labour Standards* (1960) at 50, cited in M. Craven, *The International Covenant on Economic, Social and Cultural Rights* (New York: Oxford University Press, 1998) at fn 3 p. 249 (Book of Authorities at Tab 67).

<sup>664</sup> I. Brownlie, *Principles of Public International Law* at 575 (Book of Authorities at Tab 18).

<sup>665</sup> I. Brownlie, *Principles of Public International Law* at 575 (Book of Authorities at Tab 18).

<sup>666</sup> Adopted and opened for signature, ratification and accession by General Assembly resolution 2200A (XXI) of 16 December 1966. Entry into force 23 March 1976, in accordance with Article 49 (Book of Authorities at Tab 60).

*Covenant on Economic, Social and Cultural Rights* (“*CESCR*”) are treaties with legal force for those state parties.

662. Article 22 of the *CPCR* establishes the right to freedom of association.

Everyone shall have the right to freedom of association with others, including the right to form and join trade unions for the protection of his interests.<sup>667</sup>

663. Canada ratified the *CPCR* on August 19, 1976.<sup>668</sup> The *CPCR* specifically states that nothing in Article 22 authorizes state parties to the ILO’s *Convention No. 87* to take legislative measures that prejudice the guarantees provided for in that Convention.

*d. The International Covenant on Economic, Social and Cultural Rights*<sup>669</sup>

664. Canada ratified the *CESCR* on the same date as the *CCPR*.<sup>670</sup> The *CESCR* requires parties to “recognize” various rights. The nature of these obligations is promotional. However, the exception is the provision related to trade unions. The wording of Article 8 requires that state parties “undertake to ensure”.

665. Article 8 of the *International Covenant on Economic, Social and Cultural Rights* (“*CESCR*”) establishes the right to form and join trade unions.

The right of everyone to form trade unions and join the trade union of his choice, subject only to the rules of the organization concerned, for the promotion and protection of his economic and social interests. No restrictions may be placed on the exercise of this right other than those

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<sup>667</sup> *CPCR*, Article 22 (Book of Authorities at Tab 60).

<sup>668</sup> United Nations High Commissioner for Human Rights: Status of Ratifications of the Principal International Human Rights Treaties (Book of Authorities at Tab 139).

<sup>669</sup> Adopted and opened for signature, ratification and accession by General Assembly resolution 2200A (XXI) of 16 December 1966, Entry into force 3 January 1976, in accordance with Article 27 (Book of Authorities at Tab 73).

<sup>670</sup> United Nations High Commissioner for Human Rights: Status of Ratifications of the Principal International Human Rights Treaties (Book of Authorities at Tab 139).

prescribed by law and which are necessary in a democratic society in the interests of national security or public order or for the protection of the rights and freedoms of others.<sup>671</sup>

666. The right to form and join trade unions may be seen to derive from the more general right to freedom of association.<sup>672</sup> The right of trade unions to function freely is considered a necessary corollary of the right to form and join trade unions. As an independent provision, it includes the right to collective bargaining.<sup>673</sup>
667. Article 8(2) appears to legitimize certain restrictions. It provides that the Article “shall not prevent the imposition of lawful restrictions ... by members of the armed forces or of the police or of the administration of the state”. In contrast, Article 9 of the ILO’s *Convention No. 87* permits restrictions on trade union rights only for members of the armed forces and the police.
668. Article 8(3) of the *CESCR*, however, specifically states that state parties to the ILO’s *Convention No. 87* are still bound by the provisions of that Convention. Article 8(3) requires that state parties to *Convention No. 87* read the terms of Articles 8(1) and (2) subject to the provisions of the Convention. Thus, a state that imposed restrictions on the ability of public servants to form or join trade unions would be in violation not only of the ILO’s *Convention No. 87*, but also of the *CESCR*.<sup>674</sup>

#### **4. Canada Has Failed to Provide International Law Standards of Treatment and Good Faith Observation of its Treaty Obligations**

669. The *Universal Declaration* constitutes part of customary international law. These human

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<sup>671</sup> *CESCR*, Article 8 (Book of Authorities at Tab 73).

<sup>672</sup> M. Craven, *The International Covenant on Economic, Social and Cultural Rights* (New York: Oxford University Press, 1998) at 248; Article 22(1) CCPR, Article II(1) ECHR (Book of Authorities at Tab 67).

<sup>673</sup> Craven, *The International Covenant on Economic, Social and Cultural Rights* at 256 (Book of Authorities at Tab 67).

<sup>674</sup> Craven, *The International Covenant on Economic, Social and Cultural Rights* at 263 (Book of Authorities at Tab 67).

rights documents also create a binding obligation for Canada to protect the right to freedom of association, the right to form and join trade unions, and the right to collective bargaining.

670. As a state party to *Convention No. 87*, Canada has a binding international obligation to protect the freedom of association of workers.
671. Canada's failure to respect the collective bargaining rights of Canada Post's workers is in breach of its international obligations. Both customary international law and Canada's status as a state party to *Convention No. 87* require Canada to uphold the right to collective bargaining, without exception for lowering costs for rural mail delivery. Canada's actions were simply inconsistent with its obligations under NAFTA Article 1105, and were used to increase Canada Post's competitive position over competitors such as UPS Canada.

## **Chapter VII. MOST FAVORED NATION TREATMENT**

672. NAFTA Article 1103 says:

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

673. Most Favored Nation (MFN) treatment obligations, like those contained in Article 1103, are commonly used in investment treaties. These clauses ensure investors receive the best treatment offered by a treaty party to any non-treaty party once the treaty is concluded. MFN clauses fulfill several purposes. These clauses protect the expectations of investors whose governments adopt an investment treaty early on, by automatically providing such investors the ensuing benefits negotiated by the host country in later investment treaties. MFN clauses also assist treaty parties by ensuring they are not compelled to renegotiate their treaties every time one of the treaty parties negotiates a more liberal treaty commitment with another government.

674. Treaty Parties commonly include exceptions to the scope of MFN clauses within their treaties. The NAFTA Parties have included their exceptions to the scope of Article 1103 in Annex IV of the NAFTA. In Annex IV, Canada has excluded from the scope of Article 1103 obligations in international agreements, which were signed or came into force after the NAFTA (1 January 1994). Canada has also excluded specific sectors of its economy from the scope of Article 1103. The postal sector is not one of these excluded sectors. By excluding these treaties and sectors from the scope of Article 1103, Canada has signaled that Article 1103 gives investors the benefit of better protection offered in all other treaties regarding all other sectors.

675. Both Article 1103 and similarly worded MFN articles have been considered by NAFTA and BIT tribunals. These tribunals have universally interpreted such clauses to give

investors the better substantial protection offered in other treaties. For example, the *Pope & Talbot* Tribunal said in obiter dicta that Article 1103 gives investors the benefit of better substantial protection offered in BITs to which Canada is a party. The Tribunal said:

Of course ... under Article 1105, every NAFTA investor is entitled, by virtue of Article 1103, to the treatment accorded nationals of other States under BITs containing the fairness elements unlimited by customary international law.<sup>675</sup>

676. Tribunals considering BIT MFN clauses, similar to NAFTA Article 1103, have also appropriately interpreted such clauses to ensure the clauses fulfill their purpose. In *Asian Agricultural Products v Sri Lanka*, the Tribunal hearing the very first claim under a BIT held that the *Sri Lanka-UK BIT* equivalent of Article 1103:

may be invoked to increase the host State's liability in case a higher standard of international protection becomes granted to investments pertaining to nationals of a Third state.<sup>676</sup>

677. The meaning of a BIT MFN clause, similar to Article 1103, was also considered in *MTD v. Chile*.<sup>677</sup> The dispute in that case arose from the failure of an urban development in Chile. The Malaysian claimants argued that Chile breached its obligations in the *Malaysia-Chile BIT* by approving their investment in the country, even though the project was eventually deemed inconsistent with planning laws.
678. In support of their claim, the claimants relied on Article 3(2) of the *Croatia BIT*. That Article says: "When a Contracting Party has admitted an investment in its territory, it shall grant the necessary permits in accordance with its laws and regulations." The claimants argued Article 3(2) gave Croatian investors better treatment than that provided to Malaysian investors under the *Malaysia-Chile BIT* and that Chile had breached the MFN Article of the *Malaysia-Chile BIT* by failing to provide that better treatment.

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<sup>675</sup> *Pope & Talbot, Damages*, Footnote 54 at para. 63 (Book of Authorities at Tab 38).

<sup>676</sup> *Asian Agricultural Products, Award* at para. 43 (Book of Authorities at Tab 47).

<sup>677</sup> *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award, May 25, 2004 (Book of Authorities at Tab 20).

679. The Tribunal accepted the claimant’s interpretation of the MFN clause.<sup>678</sup> The Tribunal noted the parties had excluded tax treatment and regional cooperation from the scope of the MFN clause. According to the Tribunal, “[a] *contrario sensu*, other matters that can be construed to be part of the fair and equitable treatment of investors would be covered by the clause.”<sup>679</sup>
680. The Tribunal also added that giving the claimants the protection offered in the Croatian treaty was consonant with the purpose of interpreting the treaty standards “in the manner most conducive to fulfill the objective of the BIT to protect investments and create conditions favorable to investments.”<sup>680</sup> The Tribunal eventually found Chile had not breached the MFN clause because the Croatian treaty only required Chile to issue permits in accordance with local law and issuing the permits to the Malaysian investors would have required a change of law.
681. The *Siemens* Tribunal interpreted the MFN clause in the treaty before it in a similar way. In deciding to give the investor the protection offered in the clause, the Tribunal said “the term ‘treatment’ [in the MFN clause] is so general that the Tribunal cannot limit its application except as specifically agreed by the parties.”<sup>681</sup>
682. The tribunal awards on MFN treatment, therefore, confirm that, under the terms of an MFN clause, investors are entitled to rely upon better treatment accorded in investment protection treaties to investors from any third country. If the Tribunal accepts that the FTC Note of Interpretation limits Article 1105 to customary international law, the NAFTA’s MFN obligation in NAFTA Article 1103 ensures that the Investor and its Investment receives the protection of all the sources of international law.

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<sup>678</sup> *MTD* at para. 204 (Book of Authorities at Tab 20).

<sup>679</sup> *MTD* at para. 104 (Book of Authorities at Tab 20).

<sup>680</sup> *MTD* at para. 104 (Book of Authorities at Tab 20).

<sup>681</sup> *Siemens v. Argentina*, (Jurisdiction) (ICSID Case No. ARB/02/8) (August 3, 2004) at para. 106 (Book of Authorities at Tab 88).

**A. The FTC Note of Interpretation**

683. Article 1105(1) obliges NAFTA Parties to treat investments of investors of other NAFTA Parties in accordance with international law. Article 38 of the Statute of the International Court of Justice<sup>682</sup> (the “ICJ”) describes the generally accepted sources of international law as:<sup>683</sup>

- a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
- b. international custom, as evidence of a general practice accepted as law;
- c. the general principles of law recognized by civilized nations;
- d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determinations of the rules of law.

684. The NAFTA Free Trade Commission Note of Interpretation sought to exclude some of these sources of law from the scope of Article 1105(1). The Note says:

Having reviewed the operation of proceedings conducted under Chapter Eleven of the North American Free Trade Agreement, the Free Trade Commission hereby adopts the following interpretations of Chapter Eleven in order to clarify and re-affirm the meaning of certain of its provisions:

...

**B. Minimum Standard of Treatment in Accordance with International Law**

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concepts of “fair and equitable treatment” and “full protection and security”

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<sup>682</sup> The Statute of the International Court of Justice is a part of the United Nations Charter and the Court is the principal judicial organ of the United Nations according to Article 92 of the U.N. Charter (Book of Authorities at Tab 17).

<sup>683</sup> See I. Brownlie, *Principles of Public International Law* (1990) at p. 3 (Book of Authorities at Tab 18).

do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

685. The UPS Tribunal made the following observations on the impact of the Note of Interpretation for the meaning of Article 1105:

97. We do not address the question of the power of the Tribunal to examine the Interpretation of the Free Trade Commission. Rather, we agree in any event with its conclusion that the obligation to accord fair and equitable treatment is not in addition to or beyond the minimum standard. Our reasons in brief are, first, that that reading accords with the ordinary meaning of article 1105. That obligation is “included” within the minimum standard. Secondly, the many bilateral treaties for the protection of investments on which the argument depends vary in their substantive obligations; while they are large in number, their coverage is limited; and, as we have already said, in terms of *opinio juris* there is no indication that they reflect a general sense of obligation. The failure of efforts to establish a multilateral agreement on investment provides further evidence of that lack of a sense of obligation. Thirdly, the very fact that many of the treaties do expressly create a stand-alone obligation of fair and equitable treatment may be seen as giving added force to the ordinary meaning of article 1105(1) and particularly the word “including” (“*notamment*” and “*incluido*”). And the likely availability to the investor of the protection of the most favored nation obligation in article 1103, by reference to other bilateral investment treaties, if anything, supports the ordinary meaning.

686. The Tribunal, therefore, agreed that NAFTA Article 1105 does not oblige the NAFTA Parties to provide fair and equitable treatment and full protection and security in addition to their obligations under international law. The Tribunal did not address the meaning of the influence of the Note on the international law standard in NAFTA Article 1105. The Tribunal did recognize that the Investor can enjoy a higher level of protection than they enjoy under NAFTA Article 1105 through the operation of MFN in NAFTA Article 1103.

687. While the FTC describes its note as an “interpretation,” their note must be taken to be an amendment to the NAFTA. The note is too inconsistent with international law principles of treaty interpretation to be accepted as an interpretation. The Commission inserts the word “customary” in front of “international law” in direct conflict with Article 31 of the *Vienna Convention’s* direction to interpret treaty provisions in accordance with their ordinary meaning. The Commission’s interpretation is also inconsistent with Article 102 of the NAFTA. Article 102(2) directs the Parties to interpret the Agreement “in the light

of its objectives set out in paragraph 1 ...” Paragraph 1’s objectives include to “eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;” to “increase substantially investment opportunities in the territories of the Parties;” and to “create effective procedures for the implementation and application of this Agreement, for its joint administration and the resolution of disputes.”<sup>684</sup> NAFTA, therefore, has the objectives to facilitate and promote investments and to create effective mechanisms for such facilitation and promotion.

688. Artificially limiting the protection provided by Article 1105 undermines rather than promotes investment.
689. The FTC’s note is inconsistent with Article 102’s direction to interpret NAFTA in light of MFN principles. NAFTA States are party to several BITs, in which they commit to treat investors from other States in accordance with international law.<sup>685</sup> An interpretation of Article 1105, which provides a lower level of protection to NAFTA foreign investors than is enjoyed by investors from non-NAFTA countries, is not consistent with the principle of guaranteeing the highest level of protection to all NAFTA investors.
690. The Commission’s interpretation is inconsistent with Article 31(2)(b) of the *Vienna Convention*, which directs that treaties shall be interpreted in accordance with their context, including “any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.” Canada’s *NAFTA Statement on Implementation*<sup>686</sup> is such an instrument.<sup>687</sup> In its *Statement*, Canada says that its aim in entering the NAFTA was to:

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<sup>684</sup> NAFTA Article 102(1)(e).

<sup>685</sup> See Chapter VII, Section B, of Part III of the Memorial.

<sup>686</sup> *Canadian Statement on Implementation, Canada Gazette*, Part I, January 1, 1994, 68 (Book of Authorities at Tab 9).

<sup>687</sup> See *Pope & Talbot, Award on Measures Relating to Investment Motion* at paras. 29-34 (Book of Authorities at Tab 54) and *S.D. Myers v. The Government of Canada*, Separate Opinion by Dr. Bryan Schwartz, November 13, 2000 at paras. 61 and 62 (Book of Authorities at Tab 4).

... broaden the scope of rules-based international trade and investment and increase the opportunities for Canadian traders and investors around the world  
... We must trade in order to prosper, and in order to trade we need an international trading system that is fair and open.<sup>688</sup>

691. Part of the benefit of the Canadian approach to international trade and investment, articulated outside the context of its defence to this NAFTA claim, is that it provides stability and predictability for business. As Canada's *NAFTA Statement on Implementation* acknowledges:<sup>689</sup>

For the business sector, Canadian tradecraft involves establishing a more stable and more predictable economic climate at home and abroad. It recognizes that business thrives in an orderly setting and stagnates when there is sudden and unpredictable change. Only by having a set of rules which treat all traders the same, which are widely known and uniformly applied and which provide for the orderly and equitable resolution of disputes will entrepreneurs have the confidence to compete, invest in the future and look beyond their own shores. And only if we can have a business sector that has confidence about its future can we expect it to invest, innovate and generate jobs with a future.

692. The FTC's Interpretation undermines rather than promotes a rules based system governing international trade and investment.
693. The FTC Interpretation would exclude evolving developments in international law. The impact of the existence of thousands of bilateral investment treaties must be considered upon the foundations of customary international law. These widespread and prevalent treaties have demonstrated in practice that governments will follow the terms of international economic law to promote and protect investments and legal security in an ever interdependent globalized economy. While there is some diversity within the content of these treaties, they all generally share formulations which call upon governments to provide four obligations to investors:
- a. national treatment to investors;

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<sup>688</sup> Canadian *Statement of Implementation*, *Canada Gazette*, Part I, 1994, 68 at 69, 71 (Book of Authorities at Tab 9).

<sup>689</sup> Canadian *Statement on Implementation*, *Canada Gazette*, Part I, January 1, 1994, 68 at 72 (Book of Authorities at Tab 9).

- b. most favored nation treatment;
- c. international law standards of treatment (either through the invocation of treatment in accordance with international law standards of treatment or calling specifically for fair and equitable treatment, protection against arbitrary and discriminatory treatment and full protection and security); and
- d. a requirement for the payment of compensation upon expropriation.

694. The *Mondev* Tribunal concluded that the meaning of the international law standard of treatment obligation was evolutionary and that its content was affected by developments such as the negotiation of over two thousand bilateral investment treaties.<sup>690</sup>

695. This view from the *Mondev* Tribunal was heavily influenced by a similar view expressed by the *Pope & Talbot* Tribunal. It stated:

Canada's views on the appropriate standard of customary international law for today were perhaps shaped by its erroneous belief that only some 70 bilateral investment treaties have been negotiated; however, the true number, now acknowledged by Canada, is in excess of 1800. *Therefore, applying the ordinary rules for determining the content of custom in international law, one must conclude that the practice of states is now represented by those treaties.*<sup>691</sup>

696. Given its inconsistency with international law principles of treaty interpretation, the Commission's note cannot be accepted as an interpretation and must be accepted as an amendment.

697. This Tribunal is not bound by the Commission's amendment. The Commission is authorized to "resolve disputes that may arise regarding [the] interpretation or application" of NAFTA.<sup>692</sup> The Commission can resolve these disputes by issuing

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<sup>690</sup> *Mondev* at para. 125 (Book of Authorities at Tab 37).

<sup>691</sup> *Pope & Talbot Award in Respect of Damages*, May 31, 2002 at para. 62 (Emphasis added) (Book of Authorities at Tab 38).

<sup>692</sup> Article 2001(2)(c).

binding interpretations on the meaning of NAFTA provisions.<sup>693</sup> The Commission is not authorized to amend the Agreement. NAFTA Article 2202 describes how amendments to the Agreement must be made by the three parties and must be approved by each party's domestic legislatures.

698. The *Pope & Talbot* Tribunal agreed with this conclusion, saying that it was up to the Tribunal to decide whether the Note was an interpretation, and that it was more like an amendment.<sup>694</sup>
699. While this Tribunal may be bound by the Free Trade Commission's proposed amendment of NAFTA Article 1105, this Tribunal is also bound to give meaning to the NAFTA Article 1103 obligation, which in fact, restores the natural meaning to NAFTA Article 1105 and all the sources of international law.

**B. Other Treaties Provide Better Treatment to Investors**

700. Canada has entered into bilateral investment treaties which provide the Investor a remedy analogous to NAFTA Chapter 11, where "international law" encompasses all sources of international law. In such circumstances, in the event that this Tribunal determines that the FTC Interpretation requires a standard of treatment under NAFTA which is more constrained than that otherwise provided under international law, then this Tribunal is required to apply the higher standard available to Investments of Investors of non-NAFTA Parties under the NAFTA Article 1103's MFN obligation.
701. There are sixteen bilateral investment treaties that have come into force since January 1, 1994. These treaties are based on the NAFTA model, and contain similar language.
702. The most common provision appears in eleven bilateral investment treaties.

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<sup>693</sup> NAFTA Article 1131(2).

<sup>694</sup> *Pope & Talbot Inc, Award in Respect of Damages*, 31 May 2002 at para. 24 and 47 (Book of Authorities at Tab 38).

Each Contracting Party shall accord investments or returns of investors of the other Contracting Party

- (a) fair and equitable treatment in accordance with principles of international law, and
- (b) full protection and security.<sup>695</sup>

703. This provision provides the Investments of Investors with the fair and equitable treatment concept together with the protection of international law, as well as full protection and security.

704. In the *Canada - Venezuela Bilateral Investment Treaty*, the wording is very similar to NAFTA Article 1105.

Each Contracting Party shall, in accordance with international law, accord investments or returns of investors of the other Contracting Party fair and equitable treatment and full protection and security.<sup>696</sup>

705. Similarly, in the *Canada - Panama Bilateral Investment Treaty*, the Investment receives fair and equitable treatment and full protection and security in accordance with the principles of international law.

Each Contracting Party shall accord investments or returns of investors of the other Contracting Party

- (a) fair and equitable treatment, and
- (b) full protection and security in accordance with the principles of international law.<sup>697</sup>

706. Each of these bilateral treaty provisions provides the Investment of the Investor with the

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<sup>695</sup> Ukraine (July 24, 1995) at Article II(2) (Book of Authorities at Tab 113); Egypt (November 3, 1997) at Article II(2) (Book of Authorities at Tab 114); Philippines (November 13, 1996) at Article II(2) (Book of Authorities at Tab 115); Barbados (January 17, 1997) at Article II(2) (Book of Authorities at Tab 116); Armenia (March 29, 1999) at Article II(2) (Book of Authorities at Tab 117); Lebanon (June 19, 1999) at Article II(2) (Book of Authorities at Tab 118); Latvia (July 27, 1995) at Article II(2) (Book of Authorities at Tab 119); Trinidad and Tobago (July 8, 1996) (Book of Authorities at Tab 120); Ecuador (June 6, 1997) at Article II(2) (Book of Authorities at Tab (Book of Authorities at Tab 121); Thailand (September 24, 1998) at Article II(2) (Book of Authorities at Tab 122); Uruguay (June 2, 1999) at Article II(2) (Book of Authorities at Tab 123); Costa Rica (September 29, 1999) at Article II(2) but does not include “returns of investors” (Book of Authorities at Tab 124).

<sup>696</sup> Venezuela (January 28, 1998) at Article II(2) (Book of Authorities at Tab 125).

<sup>697</sup> Panama (February 13, 1998) at Article II(2) (Book of Authorities at Tab 126).

full protection of international law. The protection accorded by these provisions is not restricted to customary international law. If the Tribunal provides a restricted interpretation of NAFTA Article 1105 on the basis of the FTC Interpretation, then the Investment of the Investor receives better treatment under these bilateral investment treaties.

707. The Investor relies on NAFTA Article 1103 and the interpretative principle of most-favored nation treatment contained in NAFTA Article 1102 to require that this Tribunal provide the most favorable meaning of the international law standard of treatment provided by Canada to nationals of any non-NAFTA Party.
708. Under each of these bilateral investment treaties, which have been entered into force since the coming into force of NAFTA on January 1, 1994, Canada is obliged to provide to investments of investors the full panoply of sources of international law without restriction to customary international law alone. For example, the breach of international treaty obligations or the impact of writings or decisions of eminent international legal jurists would have to give meaning to international law under these other treaties, and thus must be applied under the NAFTA MFN provision.

**C. Canada Has Breached its Article 1103 Obligation**

709. In the event that the Tribunal restricts the meaning of NAFTA Article 1105 to the narrower standard advanced in the FTC's Note of Interpretation, Canada has acted inconsistently with its Most Favored Nation treatment obligation in Article 1103. Canada has not met its MFN obligation by failing to treat the Investor and its Investments in accordance with the most favorable treatment that Canada accords to non-NAFTA Party investors and their investors with regard to the meaning and protections of international law standards of treatment to investors and investments.

**D. The Content of the Article 1105 Standard under the FTC's Interpretation**

710. In the event that this Tribunal decides it must apply the standard of treatment described in

the FTC's Note of Interpretation, it still must apply almost the same substantive international law standard described above in Chapter VI of Part III. The effective NAFTA Article 1105 standard informed by the FTC's Note of Interpretation is identical to that standard, other than the prohibition against international treaty obligations as a source of international law in Paragraph B(3) of the Note of Interpretation.

711. The FTC's Note of Interpretation said that Article 1105 refers to customary international law and that breaches of another NAFTA provision or other treaties do not breach the Article. NAFTA tribunal decisions interpreting Article 1105 in a manner consistent with the FTC Note of Interpretation, illustrate those obligations which satisfy this criteria.
712. After a review of statements surrounding the implementation of the NAFTA, and submissions by the NAFTA Parties to the Tribunal, the *Mondev* Tribunal concluded that the NAFTA Parties included provisions for fair and equitable treatment and full protection and security in the NAFTA with the intention to incorporate principles of customary international law. The Parties, therefore, accepted those standards as law - fulfilling the *opinio juris* requirement of customary international law.
713. In commenting on the US' intention, the Tribunal said:

when adopting provisions for fair and equitable treatment and full protection and security in NAFTA (as well as in other BITs), the intention was to incorporate principles of customary international law. Whether or not explanations given by a signatory government to its own legislature in the course of ratification or implementation of a treaty can constitute part of the travaux preparatoires of the treaty for the purposes of its interpretation, they can certainly shed light on the purposes and approaches taken to the treaty, and thus can evidence *opinio juris*.<sup>698</sup>

714. The *Mondev* Tribunal also recognized that "the Canadian Statement on Implementation of NAFTA states that Article 1105(1) 'provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law.'" Furthermore, "[a]s Mexico noted in its post-hearing submission to the Tribunal, it did not have a practice prior to NAFTA of concluding BITs, but it expressly associated itself

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<sup>698</sup> *Mondev* at para. 111 (Book of Authorities at Tab 37).

with the Canadian Statement on Implementation.”<sup>699</sup>

715. The *Mondev* Tribunal drew from these intentions to conclude:

Thus, the question is not that of a failure to show *opinio juris* or to amass sufficient evidence demonstrating it. The question rather is: what is the content of customary international law providing for fair and equitable treatment and full protection and security in investment treaties?<sup>700</sup>

The *Mondev* Tribunal went on to say:

In light of the FTC’s interpretation ...[i]t also makes it clear that the standard of treatment, including fair and equitable treatment and full protection and security, is to be found by reference to international law, i.e., by reference to the normal sources of international law determining the minimum standard of treatment of foreign investors.<sup>701</sup>

In applying this standard, the *Mondev* Tribunal drew from other tribunals’ description of the fair and equitable and full protection and security standard. The Tribunal drew the denial of justice standard from the *Azinian v. Mexico* NAFTA Award<sup>702</sup> and drew the arbitrary standard from the ICJ *ELSI* decision.<sup>703</sup>

716. The *ADF v. US*<sup>704</sup> Tribunal also considered the meaning of Article 1105, consistent with the FTC’s Note of Interpretation, and endorsed the *Mondev* Tribunal’s approach. The Tribunal said:

We understand *Mondev* to be saying - and we would respectfully agree with it - that any general requirement to accord “fair and equitable treatment” and “full protection and security” must be disciplined by being based upon State practice and judicial or arbitral case law or other sources of customary or general international law.<sup>705</sup>

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<sup>699</sup> *Mondev* at para. 112 (Book of Authorities at Tab 37).

<sup>700</sup> *Mondev* at para. 113 (Book of Authorities at Tab 37).

<sup>701</sup> *Mondev* at para. 120 (Book of Authorities at Tab 37).

<sup>702</sup> *Mondev* at para. 126 (Book of Authorities at Tab 37).

<sup>703</sup> *Mondev* at para. 127 (Book of Authorities at Tab 37).

<sup>704</sup> *ADF v. US*, (ICSID Case No. ARB(AF)/00/1) (“*ADF*”) (Book of Authorities at Tab 95).

<sup>705</sup> *ADF* at para. 184 (Book of Authorities at Tab 95).

It continued by stating:

It does not appear inappropriate, however, to note that it is not necessary to assume that the customary international law on the treatment of aliens and their property, including investments, is bereft of more general principles or requirements, with normative consequences, in respect of investments, derived from - in the language of *Mondev* - ‘established sources of [international] law.’<sup>706</sup>

In support of this conclusion, the *ADF* Tribunal quoted Professor Georg Schwarzenberger, who said: “It is arguable that the law-creating process on which [the minimum] standard [of treatment of aliens] now rests is either international customary law or the general principles of law recognized by civilized nations.”<sup>707</sup> The Tribunal also referred to Bin Cheng’s *General Principles of Law* and his description of “the organic nature of general principles of law as one of the sources of international law.”<sup>708</sup>

717. The *ADF* Tribunal drew from this background to ask the question: “are the US measures, here involved, inconsistent with a general customary international law standard of treatment requiring a host State to accord “fair and equitable treatment” and “full protection and security” to foreign investments in its territory?”<sup>709</sup>
718. The Investor’s description of the international law standard draws from precisely the same sources that the *Mondev* and *ADF* Tribunals endorsed as informing the meaning of Article 1105. The source of the standard is the obligation of governments to act in good faith - a part of customary international law, a general principle of law and, indeed, perhaps the most fundamental peremptory norm of international law.<sup>710</sup> While the precise manifestations of the obligation to act in good faith have been refined by tribunals and

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<sup>706</sup> *ADF* at para. 185 (Book of Authorities at Tab 95).

<sup>707</sup> Georg Schwarzenberger, *International Law*, vol. 1 (Praeger Publishers: 3d edition, 1957) at page 231, cited in *ADF* at footnote 176 (Book of Authorities at Tab 95).

<sup>708</sup> Bin Cheng, *General Principles of Law*, cited in *ADF* at footnote 176 (Book of Authorities at Tab 95).

<sup>709</sup> *ADF* at para. 186 (emphasis in original) (Book of Authorities at Tab 95).

<sup>710</sup> Thomas Franck, *Fairness in International Law* at page 1 (Book of Authorities at Tab 25).

writings, these manifestations' grounding in the customary international law obligation to act in good faith is unchanged. Thus, even if this Tribunal were to interpret NAFTA Article 1105 in accordance with the FTC Interpretation, most of the content of the international law standard would still be available.

**Chapter VIII. NAFTA MONOPOLIES AND STATE ENTERPRISE  
OBLIGATIONS [Articles 1502(3)(a) and 1503(2)]**

719. Two provisions of NAFTA Chapter 15 give rise to investor-state obligations under the NAFTA. NAFTA Article 1502(3)(a) says:

Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any privately-owned monopoly that it designates and any government monopoly that it maintains or designates:

- (a) acts in a manner that is not inconsistent with the Party's obligations under this Agreement wherever such a monopoly exercises any regulatory, administrative or other governmental authority that the Party has delegated to it in connection with the monopoly good or service, such as the power to grant import or export licences, approve commercial transactions or impose quotas, fees or other charges; ...

720. A NAFTA Party acts in a manner inconsistent with its obligations under NAFTA Article 1502(3)(a) if five elements are satisfied:

- i. The monopoly acts inconsistently with the Party's NAFTA obligations;
- ii. The monopoly acts under delegated authority;
- iii. That delegated authority is governmental;
- iv. The Party has delegated that authority in connection with the monopoly good or service; and
- v. The Party failed to ensure, through regulatory control, administrative supervision or the application of other measures, that the monopoly acted inconsistently with the Party's NAFTA Chapter 11 obligations.

721. Article 1503(2) generally mirrors Article 1502(3)(a), but applies only to state enterprises, and does not require the governmental authority to be delegated *in connection* with a

particular good or service.<sup>711</sup> NAFTA Article 1503(2) says:

Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under Chapters Eleven (Investment) and Fourteen (Financial Services) wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions or impose quotas, fees or other charges.

722. Articles 1502(3)(a) and 1503(2) supplement NAFTA Parties' obligations under NAFTA Chapter 11. Customary international law principles of state responsibility attribute responsibility to Governments for breaches of international obligations by agents acting under delegated governmental authority. The NAFTA Party is, therefore, already responsible under NAFTA Chapter 11 for the monopoly's or state enterprise's acts that are inconsistent with Chapter 11's obligations. Articles 1502(3)(a) and 1503(2) impose an additional obligation on NAFTA Parties to prevent monopolies and state enterprises breaching Chapter 11.

723. The need for this additional obligation arises from the unique opportunity of monopolies and state enterprises to abuse their privileges to treat foreign investors unfairly. Monopolies and state enterprises' unique opportunity to disrupt international economic relations is widely recognized. The OECD says that:

The impact that state trading enterprises, monopolies, and enterprises with special or exclusive rights can have on market access for imports has been a matter of longstanding concern in international trade relations.<sup>712</sup>

Consequently,

the WTO includes a number of competition-related provisions regarding monopolies, state enterprises and enterprises with exclusive or special privileges. Similarly, many RTAs [regional

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<sup>711</sup> Article 1503(2) also applies to breaches of obligations in Chapters 14 in addition to inconsistencies with NAFTA Chapter 11.

<sup>712</sup> OECD, Working Party of the Trade Committee, *The Relationship between Regional Trade Agreements and the Multilateral Trading System: Competition*, 7 May 2002, at para. 31 (Book of Authorities at Tab 103).

trade agreements] provide for extensive obligations regarding the conduct of such enterprises.<sup>713</sup>

724. Of the WTO provisions addressing monopoly and state enterprise conduct, GATS Article VIII says:

1. Each Member shall ensure that any monopoly supplier of a service in its territory does not, in the supply of the monopoly service in the relevant market, act in a manner inconsistent with that Member's obligations under Article II and specific commitments.
2. Where a Member's monopoly supplier competes, either directly or through an affiliated company, in the supply of a service *outside the scope of its monopoly rights* and which is subject to that Member's specific commitments, the Member shall ensure that such supplier does not abuse its monopoly position to act in its territory in a manner inconsistent with such commitments [emphasis added].

725. Article XVII(1)(a) of the GATT (1947) is similar, but applies to state enterprise actions regarding imports and exports.

726. Canada described the impact of NAFTA Chapter 15 in its *Statement on Implementation*. It looked at the role of competition policy on trade and investment issues.<sup>714</sup> The *Statement on Implementation* considered the impact that its provisions would have to protect the private sector and stated:

Market integration under NAFTA will generate a dynamic transitional period resulting in increased competition throughout the free-trade area. The response by the private sector, whether through pricing or other business practices, must be competitively appropriate.

727. Through its leveraging of the Monopoly Infrastructure, unfair performance of customs services, and unfair denial of Fritz Starber's bid, Canada Post abused its privileges to treat UPS unfairly. Rather than seek to prevent Canada Post abuse its privileges, Canada *endorsed* that abuse by failing to respond to reviews identifying that abuse. Canada's

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<sup>713</sup> OECD, Working Party of the Trade Committee, *The Relationship between Regional Trade Agreements and the Multilateral Trading System: Competition* at para. 31 (Book of Authorities at Tab 103).

<sup>714</sup> At p. 180 - 181, the *Statement on Implementation* (Book of Authorities at Tab 9) provides:

With the increasing globalization of production and markets, the role of competition policy in influencing trade, investment and technology exchange has suggested the need or governments to address differences in approach to competition. Recent experience demonstrates the extent to which differences in competition policy can act as a barrier to trade or as a source of dispute. The FTA made brief reference to monopolies (article 2010); the NAFTA devotes considerably more attention to the subject.

endorsement of Canada Post's abusive behavior amounts to an egregious breach of Articles 1502(3)(a) and 1503(2).

**A. Canada's Specific Breaches of Articles 1502(3)(a) and 1503(2)**

728. Canada's breach of NAFTA Articles 1502(3)(a) and 1503(2) can be seen through the satisfaction of all elements contained in those Articles.

**1. Canada Post Acted Inconsistently with Canada's NAFTA Obligations**

729. While several Canada Post acts are inconsistent with Canada's NAFTA obligations, three fall within the scope of Articles 1502(3)(a) and 1503(2):

- a. Canada Post's discriminatory leveraging of the Monopoly Infrastructure;
- b. Canada Post's unfair performance of customs services; and
- c. Canada Post's unfair denial of Fritz Starber's bid.

The manner in which these acts breach NAFTA Chapter 11 obligations has been described in Chapter V, Section F and Chapter VI, Section F of Part Three of the Memorial. Under the cumulative principle, it is immaterial that the acts amounting to a breach of Chapter 11 obligations also contribute to the breach of Articles 1502(3)(a) and 1503(2).

**2. Canada Post Acted Under Delegated Authority**

730. The plain meaning of NAFTA Articles 1503(2)(a) and 1502(3) indicates that the manner in which the government delegates the authority to the agent is immaterial. These articles do not prefix the word "delegated" with "specifically" or any other kind of adverb. NAFTA Note 44 supports this interpretation by indicating that the authority can be delegated by a broad range of government acts. The Note says that in Article 1502, "a

‘delegation’ includes a legislative grant, and a government order, directive or other act transferring to the monopoly, or authorizing the exercise by the monopoly of, governmental authority”.

731. Customary international law also informs the meaning of “delegation” within NAFTA Articles 1502(3)(a) and 1503(2). The commentary to the *ILC Articles* says that States still attract responsibility for agents’ actions taken under discretionary authority. The commentary says:

... an entity is covered even if its exercise of authority involves an independent discretion or power to act; there is no need to show that the conduct was in fact carried out under the control of the State.<sup>715</sup>

This interpretation is consistent with the purpose of attributing responsibility to states for the actions of agents to which the state has delegated authority. Just as the state cannot escape responsibility for delegating precise authority to non-state entities, the state cannot escape responsibility for simply delegating that same authority in a vague manner. Otherwise, customary international law would reward States that delegate authority in such a vague manner.<sup>716</sup>

732. Canada Post performed all three acts identified above under delegated authority, as that term is informed by Note 44 and customary international law.
733. Canada delegated to Canada Post control over the right and terms of access to the Monopoly Infrastructure through the *CPC Act*. Article 14(1) of the *CPC Act* gives Canada Post the “sole and exclusive privilege of collecting, transmitting and delivering letters to the addressee thereof within Canada”. Article 19 of the *CPC Act* gives Canada Post the authority to make regulations for “carrying the purposes and provisions of this

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<sup>715</sup> J.R. Crawford, *ILC Articles* at 102 (Book of Authorities at Tab 3).

<sup>716</sup> The United States, therefore, has no support in the text, customary international law, or the principles which underlie it, when it argues that authority must be “specifically” delegated to the agent to fall within Articles 1502(3)(a) and 1503(2). US Second Submission on Jurisdiction, May 13, 2002, at para. 9 (Book of Authorities at Tab 85).

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Act [including Article 14(1)] into effect”. The legislative grant in the *CPC Act*, including Articles 14(1) and 19, entails the privilege to develop an infrastructure to enable Canada Post to collect, transmit and deliver letters. The grant also entails the privilege to control the right and terms of access to the infrastructure.

734. In addition to this *general* grant of authority, *CPC Act* provisions and regulations delegate control over the right and terms of access to *specific* aspects of the Monopoly Infrastructure. Article 57 of the *CPC Act* gives Canada Post the authority to control the right and terms of access to stamps.<sup>717</sup> Article 2 of the *Act* gives Canada Post exclusive authority to provide private locked post office boxes on its premises.<sup>718</sup> The *Mail Receptacles Regulations* delegates authority to control the location and use of red letter mailboxes throughout Canada.<sup>719</sup> The *Mail Receptacles Regulations* also give Canada Post custody of keys for access to locked apartment, condominium, and office complexes and mailboxes.<sup>720</sup> The *Postage Meter Regulations* give Canada Post authority to control the right and terms of access to postage meters.<sup>721</sup>
735. Canada Post also unfairly performed customs services under delegated authority. Through amendments to the *Customs Act* in 1992, Canada authorized the Minister of National Revenue and Canada Post to enter agreements. In 1994, the Department of National Revenue and Canada Post entered the *Postal Imports Agreement*,<sup>722</sup> under which Canada Post is delegated authority to perform its own customs duties<sup>723</sup>

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<sup>717</sup> Article 57 says “Every person commits an offence who, without the consent of the Corporation, engages in the business of selling postage stamps to the public for the purpose of payment of postage” (Tab U218).

<sup>718</sup> *CPC Act*, ss.2(1) and (2) (Tab U218).

<sup>719</sup> *Mail Receptacle Regulations*, s. 3 (Tab U30).

<sup>720</sup> *Mail Receptacle Regulations*, s. 10(h), Schedule IV (para. 10(c)) (Tab U30).

<sup>721</sup> See *Postage Meter Regulations* SOR / 83-748 (D14153-14160) (Tab U37).

<sup>722</sup> *Agreement Concerning Processing and Clearance of Postal Imports Between Canada Post Corporation and the Department of National Revenue*, November 15, 1999, (D1620-1645) (Tab U66).

<sup>723</sup> Article 4.1 (Tab U66).

[REDACTED]<sup>24</sup>

736. Canada Post unfairly retaliated against Fritz Starber because of UPS' NAFTA claim. This retaliation occurred using delegated governmental authority. Through its delegation of monopoly privileges, Canada delegated to Canada Post the authority to sub-contract freight forwarding services. Canada Post operated under this authority when it unfairly denied Fritz Starber's bid.

### **3. The Delegated Authority is Governmental**

#### *a. The Meaning of "Governmental"*

737. The NAFTA gives no indication of the meaning of "governmental" in Articles 1502(3)(a) and 1503(2). Customary international law does provide guidance.

738. The first four elements in Article 1502(3)(a), and the first three elements in Article 1503(2), track customary international law principles on State responsibility applicable to authority delegated to agents. The elements' foundations in customary international law is evident from a comparison of the elements with Article 5 of the *ILC Articles*, which captures customary international law on the issue. Article 5 says:

The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.

739. Just as Article 5 refers to entities which "exercise elements of the governmental authority," Articles 1502(3)(a) and 1503(2) refer to entities exercising "any regulatory, administrative or other governmental authority." Just as Article 5 refers to an entity "which is empowered by the law of that State" to exercise this authority, Articles 1502(3)(a) and 1503(2) refer to authority "that the Party has delegated to it." "Empowering" an entity to exercise authority is the same as "delegating" authority to that entity.

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<sup>724</sup> [REDACTED] Tab U66).

740. *ILC Article 5* limits state responsibility to situations where the entity is “acting in [the] ... capacity” given to it to act on behalf of the State. The NAFTA Articles similarly limit state responsibility to situations “wherever” the entity exercises the delegated authority.
741. Customary international law informs the meaning of “governmental” within Article 5 of the *ILC Articles*. The official commentary on the *ILC Articles* summarizes that customary international law. The commentary says:

The justification for attributing to the State under international law the conduct of “*para-statal*” entities lies in the fact that the internal law of the State has conferred on the entity in question the exercise of certain elements of the governmental authority. *If it is to be regarded as an act of the State for the purposes of international responsibility, the conduct of an entity must accordingly concern governmental activity and not other private or commercial activity in which the entity may engage.*<sup>725</sup>

The commentary, therefore, recognizes that the purpose of the restriction to *governmental* authority is that States will not be liable for the purely commercial actions of agents to which the government has delegated that authority.

742. NAFTA Note 43 indicates that the NAFTA Parties viewed charging different prices in different markets for commercial reasons as an example of such purely commercial action beyond the scope of the Article. The Note says:

**Article 1502 (Monopolies and State Enterprises):** nothing in this Article shall be construed to prevent a monopoly from charging different prices in different geographic markets, where such differences are based on normal commercial considerations, such as taking account of supply and demand conditions in those markets.<sup>726</sup>

743. The commentary to the *ILC Articles* also discusses what sort of authority is “governmental” for the purposes of customary international law. It says:

Beyond a certain limit, what is regarded as “governmental” depends on the particular society, its

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<sup>725</sup> J.R. Crawford, *ILC Articles* at 101, para. 5 (Book of Authorities at Tab 3).

<sup>726</sup> It is important to point out that this note only canvassed one particular situation (differential pricing) and not any other type of commercial behaviour.

history and traditions. Of particular importance will be not just the content of the powers, but the way they are conferred on an entity, the purposes for which they are to be exercised and the extent to which the entity is accountable to government for their exercise.<sup>727</sup>

The commentary, therefore, identifies six sources to help identify whether a particular delegated authority is sufficiently “governmental” to warrant the attribution to the State of acts performed in pursuit of that authority:

- a. the particular society's history;
- b. the particular society's traditions;
- c. the content of the powers;
- d. the way the powers are conferred on an entity;
- e. the purposes for which the powers are conferred on an entity; and
- f. the extent to which the entity is accountable to government for their exercise.

*b. Canada Has Delegated Broad Governmental Authority to Canada Post*

744. Canada Post is an organ of the Canadian government and has, therefore, been delegated the broadest possible governmental authority - everything it does is in the exercise of delegated governmental authority. The six sources identified in the official commentary on the *ILC Articles* reveal everything Canada Post does, including the three acts contributing to Canada’s breach of Articles 1502(3)(a) and 1503(2), is under delegated governmental authority.

745. Historically, the Post Office Department, the government department that ran postal

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<sup>727</sup> J.R. Crawford, *ILC Articles* at 101, para. 6 (Book of Authorities at Tab 3).

services in Canada prior to 1981, had similar authority to that Canada Post enjoys today, including its exclusive privilege.<sup>728</sup> Traditionally, Canada has delegated to Canada Post broad governmental authority. In Canada, the law of *Crown agency* stipulates that a public corporation designated by legislation as an agent of the Crown retains this designation and, therefore, acts within government authority so long as it acts within its statutory authority.<sup>729</sup> Section 23 and subsection 5(2)(e) of the *CPC Act* designates Canada Post as an agency. In addition, section 5(1)(e) of the *CPC Act* obliges Canada Post to maintain a corporate identity program approved by the Governor in Council that reflects its role as an institution of the Government of Canada. A series of cases have held Canada Post was acting within its statutory authority and, therefore, exercised governmental authority even when the statute did not confer the authority to exercise the specific action that was impugned.<sup>730</sup>

746. The exercise of Canada Post's powers is directed by the board,<sup>731</sup> which is entirely appointed by the government.<sup>732</sup> The Government of Canada is the sole shareholder of Canada Post.<sup>733</sup>
747. Canada Post's powers are conferred by statute and regulations. Canada admits that the authority under which Canada Post performed the impugned acts in this matter was conferred to enable Canada Post to fulfill its public policy obligation to provide universal service.<sup>734</sup>

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<sup>728</sup> Campbell, *Politics of the Post* at 50 (Book of Authorities at Tab 64).

<sup>729</sup> Peter Hogg, *Liability of the Crown* (Toronto, Carswell: 1989) at p. 253 (Book of Authorities at Tab 41).

<sup>730</sup> *Canadian Daily Newspaper* (Book of Authorities at Tab 68); *CUPW* (Book of Authorities at Tab 69); *Rural Dignity* (Book of Authorities at Tab 75); *City of Nepean* (Book of Authorities at Tab 71).

<sup>731</sup> *CPC Act*, s. 10(1) (Tab U218).

<sup>732</sup> *CPC Act.*, s. 6 (Tab U218).

<sup>733</sup> Short term filing under s. 121 *Competition Act*, Notifiable Transactions (R248B-19) at Appendix A-6, p.36, 459 (Tab U59).

<sup>734</sup> *Statement of Defence* at paras 25-33.

748. Finally, Canada Post is accountable to Canada for the exercise of all its authority. Article 22(1) of the *CPC Act* says: “In the exercise of its powers and the performance of its duties, the Corporation shall comply with such directives as the Minister may give to it.”
749. A WTO Panel has also drawn from the sources identified in the *ILC Articles’* commentary to conclude Canada has delegated broad governmental authority to Canada Post. In *Canada - Periodicals*, the Panel had to determine whether the prices Canada Post charged for delivery of periodicals breached the national treatment obligation in Article III:4 of the GATT. Canada argued that “since Canada Post is a privatized agency (a Crown Corporation) with a legal personality distinct from the Canadian Government, the “commercial Canadian” or “international” rates it charges for the delivery of periodicals are out of the Government’s control and do not qualify as “regulations” or “requirements” within the meaning of Article III:4.”<sup>735</sup> In considering this argument, the Panel resolved that “[t]he essential question then, is whether Canada Post is implementing Canadian Government policy in such a manner that its postal rates on periodicals may be viewed as *governmental* regulations or requirements for the purposes of Article III:4.”<sup>736</sup> The Panel relied on two of the sources identified by the ILC’s official commentary: the way the powers are conferred and accountability to the State, to conclude that Canada Post’s pricing of periodicals was governmental. The Panel said:

First, it is clear that Canada Post generally operates under governmental instructions. Canada Post has a mandate to operate on a “commercial” basis in this particular sector of periodical delivery: a mandate that was set by the Canadian Government. Second, Canada admits that if the Canadian Government considers Canada Post’s pricing policy to be inappropriate, it can instruct Canada Post to change the rates under its directive power based on Section 22 of the *Canada Post Corporation Act*. Thus, the Canadian Government can effectively regulate the rates charged on the delivery of periodicals.<sup>737</sup>

The Panel, therefore, found that even though pricing of periodicals fell outside Canada Post’s letter mail monopoly privileges, it was still attributable to Canada for the purposes

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<sup>735</sup> *Canada - Periodicals* Panel decision at para. 5.33 (Book of Authorities at Tab 66).

<sup>736</sup> *Canada - Periodicals*, Panel decision at para. 5.34 (Emphasis added) (Book of Authorities at Tab 66).

<sup>737</sup> *Canada - Periodicals*, Panel decision at para. 5.34 (footnotes omitted) (Book of Authorities at Tab 66).

of international law.

*c. Canada Misinterprets the Term “Governmental”*

750. During the jurisdictional phase of these proceedings, Canada argued that authority is only governmental if it “relate[s] to the regulation or administration ... of the activities of others”.<sup>738</sup> Canada argued that none of the authority, under which Canada Post exercised the impugned action in this case, gives Canada Post the authority to regulate or administer the activities of others.
751. To support its interpretation, Canada argued the term “other governmental authority” must be read in its context. That context includes the terms “regulatory” and “administrative” and the listed examples of governmental authority. Canada argued that dictionary definitions of “regulatory” and “administrative” indicate they require the regulation and administration of the activities of others. Canada argued that, according to the *ejusdem generis* rule, “governmental” includes the same requirement. Canada further argued the examples all involve regulation and administration of the activities of others.<sup>739</sup>
752. Canada’s interpretation is wrong. Fundamentally, Canada’s interpretation is inconsistent with the text of Articles 1502(3)(a) and 1503(2). The Articles do not prefix “governmental” with “administrative” and “regulatory”. They simply list “administrative” and “regulatory” as examples of governmental authority. Furthermore, the Articles do not refer to the specific examples as exclusive. Second, Canada draws its interpretation of “governmental” merely from the *content* of the authority and ignores the other five sources used in customary international law.
753. Canada’s interpretation also conflicts with the principles underlying that customary

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<sup>738</sup> Canada’s Memorial on Preliminary Jurisdiction Objections at para. 84.

<sup>739</sup> Canada’s Memorial on Preliminary Jurisdiction Objections at paras. 80-86 and Canada’s Reply Memorial on Preliminary Jurisdictional Objections, April 12, 2002 at paras. 76-80.

international law. Canada's interpretation allows it to escape responsibility under international law for a broad range of actions that fall outside its narrow definition of "governmental." The interpretation encourages States to avoid its responsibility under international law by delegating authority. In *Japan - Film*<sup>740</sup>, the WTO Panel highlighted the need to guard against such risks. After finding Japan responsible for the actions of a private body to which it had delegated authority, the Panel said: "... we note that a finding to the contrary would create a risk that WTO obligations could be evaded through a Member's delegation of quasi-governmental authority to private bodies."<sup>741</sup>

754. Indeed, accepting Canada's argument would allow it to avoid responsibility under international law for failing to differentiate its postal monopoly operations from its non monopoly operations. Accepting Canada's argument, therefore, rewards Canada for the very action harming UPS Canada in breach of international law.
755. Canada's interpretation is inconsistent with other NAFTA provisions. These provisions provide that Canada is responsible for its state enterprises' actions that do not regulate or administer the activities of others. For example, Canada is responsible under some Chapter 11 provisions for its state enterprises' procurements, subsidies and grants. This is the only conclusion that can be drawn from NAFTA Article 1108's specific exclusion of state enterprise procurement, subsidies and grants from certain Chapter 11 obligations.<sup>742</sup> It is nonsense to suggest Canada is liable for state enterprises' procurements, subsidies

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<sup>740</sup> *Japan - Measures Affecting Consumer Photographic Film and Paper*, Panel Report, WT/DS44/R, March 31, 1998 (Book of Authorities at Tab 21).

<sup>741</sup> *Japan - Film* at para. 10.328 (Book of Authorities at Tab 21).

<sup>742</sup> Article 1108(7) says:

Articles 1102, 1103 and 1107 do not apply to:

- (a) procurement by a Party or a state enterprise; or
- (b) subsidies or grants provided by a Party or a state enterprise ...

Similarly, Article 1108(8)(b) says:

Article 1106(1)(b), (c), (f) and (g), and (3)(a) and (b) do not apply to procurement by a Party or a state enterprise ...

and grants under Chapter 11 but not for failure to supervise those actions under Articles 1502(3)(a) and 1503(2). Under this interpretation, Canada would face a narrower scope of obligation in Articles 1502(3)(a) and 1503(2) than it does in Chapter 11.

756. Canada's interpretation is inconsistent with NAFTA's objectives and purpose. NAFTA Article 102(1)(c) says that the NAFTA Parties should "promote conditions of fair competition in the free trade area." Canada's restrictive interpretation of "governmental" frustrates rather than promotes such conditions.

**4. Canada Delegated the Authority in Connection with the Postal Monopoly**

757. To contravene NAFTA Article 1502(3)(a), but not 1503(2), the NAFTA Party must have delegated the governmental authority *in connection with the monopoly good or service*. Throughout its pleadings in these proceedings, Canada has justified its delegation of all authority to Canada Post as necessary to help it fulfill its Universal Service Obligation. Regardless of the definition of USO, monopoly services fall squarely within the Universal Service Obligation. It follows that, by Canada's own admission, authority delegated to Canada Post is delegated in connection with Canada Post's monopoly services.

**5. Canada Failed to Ensure, Through Regulatory Control, Administrative Supervision or Other Measures, that Canada Post did not Abuse its Monopoly Privileges**

758. Canada has always been aware of the dangers of Canada Post abusing its monopoly privileges. In addition to reporting on the dangers of state monopolies, the OECD, for example, has consistently reported on the dangers of postal monopolies cross-subsidizing. One report says:

... the vast majority of incumbent postal operators are state-owned. The precise objectives of state-owned firms are contested, and probably differ according to the governance arrangements for state-owned firms in each country, but generally speaking profit-maximization is typically merely one amongst a number of objectives pursued by such firms. *Where a firm, for whatever reason, does not seek to strictly maximize profits, it may be able to sustain profits below cost indefinitely,*

*supported by either prices above cost in some other segment or by some other source of funds.*<sup>743</sup>

759. Every OECD country, except Canada, has taken action to address this danger. Some countries have completely privatized their postal service, others have split monopoly services from competitive services, while others have imposed strict supervision.<sup>744</sup>
760. Canada Post was also aware that Canada Post was abusing its monopoly privileges. The Postal Service Review Committee, the Canada Post Mandate Review and the TD Securities Report found that Canada Post abused its monopoly privileges and recommended increased supervision or withdrawal from competitive services.
761. Canada responded by disbanding the Postal Service Review Committee and rejecting the Mandate Review's suggestions. Canada relied on the TD Securities Report to justify its refusal to follow the Mandate Review's recommendation that Canada Post withdraw from competitive services, but ignored the TD Securities Report's recommendation that Canada regulate Canada Post.
762. Canada Post's Annual Report's auditor's Statement does not satisfy Canada's obligation under Articles 1502(3)(a) and 1503(2). Fundamentally, the Statement only addresses whether Canada Post's competitive services pay for the incremental cost of using the monopoly infrastructure, yet Canada Post breaches NAFTA Chapter 11 through its failure to charge its competitive services market prices for that access. Even then, the Statement assumes the validity of Canada Post's costing methodology and, therefore, assumes the validity of the very thing it should be addressing to determine whether Canada Post's competitive services do cover incremental costs. As a result, Canada's former Auditor General describes it as mere "window dressing".<sup>745</sup>
763. Canada has, therefore, failed to provide *any* regulatory control, administrative

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<sup>743</sup> OECD Survey, p. 55 (18300-18661 at 18354)(Tab U119). Cited in the Neels Report at para. 71.

<sup>744</sup> OECD Survey (18300-18661)(Tab U119). Summarized in the Neels Report at paras. 72-73.

<sup>745</sup> Expert Report of Kenneth M. Dye at para. 32.

supervision or other measures to Canada Post, let alone sufficient measures to prevent Canada Post from breaching Chapter 11 obligations. Indeed, through its failure to respond to numerous independent recommendations it implement such measures, Canada has endorsed Canada Post's actions in an egregious breach of Articles 1502(3)(a) and 1503(2).

**PART FOUR: RELIEF REQUESTED**

764. In view of the facts and arguments set out in this Memorial, UPS respectfully requests that the Tribunal grant the following relief:
- a. A Declaration that Canada has acted in a manner inconsistent with its NAFTA Chapter 11 obligations of national treatment, international law standards of treatment and most favored nation treatment in breach of its obligations arising under NAFTA Articles 1102, 1103, 1105 and that Canada has failed to properly supervise and regulate Canada Post in breach of its obligations arising under NAFTA Articles 1502(3)(a) and 1503(2);
  - b. A Declaration that this arbitration claim should proceed forthwith to the Quantification of Damages Phase; and
  - c. An award in favor of United Parcel Service of America, Inc. for its costs, disbursements and expenses incurred in the liability phase of the arbitration for legal representation and assistance, plus interest and for the costs of the Tribunal.

ALL OF WHICH IS RESPECTFULLY SUBMITTED



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Appleton & Associates International Lawyers

Date: March 23, 2005