UNDER CHAPTER ELEVEN OF THE NAFTA AND UNCITAL ARBITRATION RULES

BETWEEN:

UNITED PARCEL SERVICE OF AMERICA, INC.

Claimant/Investor

- and -

GOVERNMENT OF CANADA

Respondent/Party

GOVERNMENT OF CANADA

REPLY OF THE GOVERNMENT OF CANADA TO THE UNITED STATES' AND MEXICO'S SUBMISSION UNDER ARTICLE 1128 ON CANADA'S PRELIMINARY JURISDICTIONAL OBJECTIONS

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REPLY OF THE GOVERNMENT OF CANADA TO THE UNITED STATES' AND MEXICO'S SUBMISSIONS UNDER ARTICLE 1128 ON CANADA'S PRELIMINARY JURISDICTIONAL OBJECTIONS

Overview

1. Canada, the United States and Mexico are *ad idem* as to the fundamental errors of interpretation of the NAFTA which underlies the UPS claim. Consequently the NAFTA Parties agree that the UPS claim is not arbitrable under the investor-state provision of Chapter 11.

2. Specifically, Mexico endorses Canada's interpretation of the NAFTA and rejects the UPS interpretation in the following critical respects:

   a.) UPS cannot allege a breach of any provision of the NAFTA other than those proscribed by Section A of Chapter Eleven and in limited circumstances, Articles 1502(3)(a) and 1503(2);
   b.) Breaches of Article 1502(3)(d), on which the UPS claim is premised, are not arbitrable by an investor, and cannot be read into Article 1502(3)(a) so as to circumvent this exclusion;
   c.) The grant of the monopoly itself is not, and cannot, constitute the grant of any "regulatory, administrative or other governmental authority" as required to support a claim based on Article 1502(3)(a); and
   d.) Article 1105 does not encompass Article 1502(3)(d) obligations, nor can UPS' allegations of anti-competitive practice constitute violations of customary international law.

3. The United States follows suit, supporting Canada's core jurisdictional arguments:

   a.) UPS cannot allege a breach of any provision of the NAFTA other than those proscribed by Section A of Chapter Eleven and in limited circumstances Articles 1502(3)(a) and 1503(2);
   b.) The mere allegation that a monopoly has breached a provision of the NAFTA other than a Chapter 11 obligation does not confer jurisdiction under Article 1116 or 1117;
   c.) A monopoly or state enterprise is not exercising "delegated governmental authority" within the meaning of Article 1502(3) or 1503(2) simply because it participates in the commercial marketplace;

d.) Moreover, in addition to the requirement that the delegation be a delegation of an inherently governmental authority, the delegation of authority must be express;

e.) Customary international law does not impose obligations with respect to the promulgation or enforcement of national competition law; and

f.) No valid distinction exists between a taxation measure and its application.

4. In sum, the NAFTA Parties agree that the UPS claim is not arbitrable under the investor-state provisions of Chapter 11 and as Mexico has noted, "...a Tribunal has a duty at the preliminary stage to strike claims that obviously do not, and regardless of the facts, cannot fall within its jurisdiction *ratione materiae*." This applies *a fortiori* where the NAFTA Parties hold common and unequivocal positions as to the errors in principle upon which the UPS claim is predicated.

Mexico's Submissions, par. 2

5. Canada notes that in the event that it is successful in its preliminary objections to the proper jurisdiction of the Tribunal, that issues, such as UPS' allegations about customs clearance procedures, may nonetheless remain before the Tribunal for adjudication. In connection with this Canada notes the usefulness of *Mexico's Submission at par. 7* that the Tribunal's jurisdictional decision has implications for the subsequent conduct of the case and is useful to keep the case within the bounds prescribed by Articles 1116 and 1117.

6. This Tribunal should adopt the interpretation of the NAFTA advanced by the Parties. More than anyone, the Parties are best situated to understand the meaning of the treaty they concluded and what they truly intended.

Relationship between Chapter 11 and Chapter 15 of the NAFTA

7. The NAFTA Parties agree that Articles 1116 and 1117 limit the Tribunal's jurisdiction to examining allegations of breaches of Section A of Chapter 11 and Articles 1502(3)(a) and 1503(2). The Tribunal does not have jurisdiction to consider allegations of breaches of any other NAFTA provisions.

Second Submission of the United States of America at par. 3 and *Mexico's Submission under NAFTA Article 1128 at par. 10.*

8. In particular, the NAFTA Parties agree that in the case of an investor claim based on Article 1502(3)(a) or 1503(2), it is necessary for the Claimant to establish that the monopoly or state enterprise has breached an obligation under Section A of Chapter 11, as provided by Articles 1116(1)(b) and 1117(1)(b).

U.S. Submission par. 2, 4 and 6 and *Mexico's Submission par. 15(8).*

9. The cornerstone of the UPS argument that it can use Article 1502(3)(a) to incorporate all the obligations under the NAFTA (not only those under Section A of Chapter 11) is rejected by the NAFTA Parties. *UPS Counter-Memorial, at par. 109 ff.* The NAFTA Parties concur that, for the purposes of an investor-state claim, Article 1502(3)(a) cannot serve to bring in the obligation under Article 1502(3)(d), as it is, not an obligation under Section A of Chapter 11.

10. Further, Mexico and Canada agree that subparagraphs (a) to (d) of Article 1502(3) address different aspects of a monopoly's behaviour. Each provision must be given effect and have a different meaning from others. Accordingly, Article 1502(3)(a) does not cover the same aspect of the monopoly conduct that would be covered under Article 1502(3)(d), nor can it be read as having the same content.

11. Moreover, the NAFTA Parties are *ad idem* that there are two additional jurisdictional requirements which must be satisfied by UPS before the Tribunal can consider a breach based on Article 1502(3)(a) or 1503(2). First, the claim must involve the exercise of "regulatory, administrative or other governmental authority that the Party has delegated to it in connection with the monopoly." Second, the authority must have been delegated by the NAFTA Party to the monopoly or state enterprise. *U.S. Submission par. 7,8,9* and *Mexico's Submission par. 15(6).*

12. As to the first jurisdictional requirement, defining the nature of the authority required, the United States and Canada observe that the term "governmental authority" must be read in light of the examples of the authority listed in Article 1502(3)(a) and Article 1503(2), such as "the power to grant import or export licenses, approve commercial transactions or impose quotas, fees or other charges" or the "power to expropriate". This perspective on the proper interpretation of "governmental authority", is succinctly put by the United States:

> "[...] the examples in Articles 1502(3)(a) and 1503(2) make clear that the term "governmental authority" means the authority of the NAFTA Party in its sovereign capacity: a monopoly or state enterprise is not exercising "governmental authority" merely because it acts as a commercial participant in the marketplace. Each of the examples refers in this context, to acts **that are inherently governmental in nature, not to acts that commercial enterprises could legally perform absent a delegation of governmental authority".**
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> *U.S. Submission par. 8*

13. This conclusion is consistent with the purpose of the Article 1502(3)(a), as noted by Canada and Mexico, which is to ensure that "a state does not use a monopoly that exercises delegated powers to take action that would be inconsistent with the Agreement if such action were undertaken by the State itself". *Mexico's Submission at par. 15(1).*

14. As to the second jurisdictional requirement, that of requiring a "delegation" of governmental authority, the Parties reject the UPS assertion that a mere grant of monopoly power is sufficient to trigger the provisions of Article 1502(3). The Parties are *ad idem* that the governmental authority in question must have been specifically delegated by a Party. In addition, the NAFTA Parties agreed that the grant of monopoly authority does not constitute the grant of any "regulatory, administrative or other governmental authority". As the U.S. observes: ".....an affirmative government act is called for to establish such a delegation of governmental authority", *U.S. Memorial par. 2, and 9.* Mexico also makes the

point: "...the actions of the monopoly in the absence of any delegated governmental authority are not arbitrable..." *Mexico Submission, par. 15(7).*

Minimum Standard of Treatment

15. Both the United States and Mexico reaffirm the July 31, 2001 Interpretation of the Free Trade Commission clarifying the meaning of Article 1105, is part of the governing law in this case and is binding on this Tribunal. *Mexico's Submission at par. 18, 19, 20 and U.S. Submission at par. 10, 11.* Mexico, in particular, notes the weakness of the UPS position on this point; the fact that UPS finds the note "unacceptable " is "irrelevant." Canada agrees.

16. The NAFTA Parties are unanimous with respect to two key elements of the FTC Interpretation. First, a breach of another provision of the NAFTA does not establish that there has been a breach of Article 1105. Therefore, and contrary to the UPS claim, a breach of Article 1502(3)(d) cannot establish a breach of the Minimum Standard of Treatment. Second, Article 1105 refers to the customary international law minimum standard of treatment of aliens; however there is no customary international law of competition.

17. The Parties further agree that, as there is no widespread or substantial uniformity of state practice on competition law, on rules governing the conduct of government monopolies or on anticompetitive practices by government monopolies, there can be no customary international law in that regard. Therefore, allegations of anticompetitive practices cannot be relevant to the Parties obligations under Article 1105. All Parties have observed that many sovereign states do not even have competition laws. In such circumstances, widespread state practice, a necessary element of the formation of customary international law is not present. *Mexico's submission at par. 21-32 and U.S. submission at par. 12 and footnote 9.*

18. In the result, a tribunal, properly reading the NAFTA and applicable law, could not construe Article 1105 to include an obligation to ensure that a monopoly not engage in anticompetitive conduct. As Mexico notes:

> While a NAFTA Party's alleged failure to prevent cross-subsidization by a designated monopoly, for example, may amount to a breach of Article 1502(3)(d) that can be alleged by a NAFTA Party, it cannot form the basis of a claim under Article 1105.

19. UPS' final argument in support of its claim under Article 1105 is that it can only be considered in light of evidence of custom or international law principles led by the Parties. *UPS Memorial, par. 85, UPS Rejoinder, par. 31.* Mexico quickly disposes of this argument:

> "contrary to the assertion made in the Claimant's Counter-memorial, it will not be possible for the Claimant to adduce evidence of a customary international law rule dealing with cross-subsidization or other like activities by a monopoly."
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> *Mexico's Submissions, par. 21*

Taxation Measures

20. Canada agrees with the United States' comments that for the purposes of Article 2103, no valid distinction exists between a taxation measure and a practice with respect to the application of taxation measure. As the U.S. notes: "just as Article 1105 does not apply to challenges to the adoption or imposition of a tax, it does not apply to a practice of applying a tax." *U.S. Submission at par. 15.*

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

DATED in the City of Ottawa, the Province of Ontario, this 21st day of May 2002.

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