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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 REPLY
(MERITS PHASE)

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PART ONE: OVERVIEW

Introduction

1. The Government of Canada has granted Canada Post great powers without clear responsibilities. It has awarded Canada Post a monopoly and other legal privileges ordinarily reserved for the state, yet it has failed to define the services that Canada Post must provide with those powers and to ensure that there are rules that it must follow in exercising them.
2. As a result, Canada Post uses its public powers for its own private purposes. It uses the vast network for the delivery of postal services that derives from its monopoly and special status as a Crown Corporation to improve its position in the courier market against its largely foreign-owned competitors. It grants its affiliate, Purolator, and its own competitive services arm the full benefits of this critical resource on terms that are much more favorable than those offered to its competitors. The Minister responsible for Canada Post has been warned repeatedly about the pernicious consequences of this discriminatory conduct, yet has chosen to authorize it.
3. These actions by Canada, either directly or through its state organ, Canada Post, violate the national treatment obligation in NAFTA Article 1102 and the requirement that NAFTA Parties *ensure* that state enterprises and monopolies that have been granted governmental authority exercise these special powers in a manner consistent with NAFTA Article 1102. While Canada is entitled to maintain a governmental postal monopoly, it has agreed that such a firm will be bound by the disciplines of international economic law when it competes aggressively in the courier market. These disciplines guarantee foreign investors a level playing field in that market.

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4. Canada's preferential treatment of Canada Post extends beyond its authorization of Canada Post's discriminatory conduct. It includes:
 - a. a series of special privileges granted to it by Canadian customs authorities that assist Canada Post's competitive services arm in the lucrative market for express package and parcel imports from the United States and other countries and reduce its compliance costs;
 - b. the granting to Canada Post of the exclusive right to deliver magazines for Canadian publishers who benefit from a government program; and
 - c. the exemption of certain of its labour practices from fundamental collective bargaining norms that have formed part of customary international law.

 5. Canada's Counter-Memorial largely fails to respond to the specific claims advanced in this arbitration by UPS. Canada dwells at great length on lofty public policy objectives that are not in dispute, such as the merits of providing basic postal services to remote communities, the need to control its borders or promote its culture. Yet, it fails to identify the rational connection between these objectives and the discriminatory measures that are at issue. On the contrary, the measures run contrary to the public policy objectives that Canada purports to pursue:
 - a. the provision of universal basic postal services is undermined rather than advanced by a regulatory regime that fails to define a specific Universal Service Obligation for its postal operator and ensure that revenues from courier services are properly contributing to the provision of basic services. Most other industrialized countries impose specific universal service burdens on their postal administrations and use independent regulation to ensure that their monopolies are not being exploited to compete unfairly against competitors;

- b. the economic and security interests of Canada are undermined rather than advanced by Canada Customs' failure to enforce laws against Canada Post and Canada Post's resulting failure to collect duties and taxes. The creation of separate postal and courier streams does not imply that parties performing the same customs tasks should be treated less favorably simply depending on which stream they happen to be in; and
 - c. Canada's right to subsidize magazine publishers is not in dispute, but the interests of its publishers are not advanced when their subsidies are conditioned on a restriction of their choice of courier.
6. These abuses of state powers, which provide competitive advantages for a dominant local firm at the expense of its foreign competitors, present all the classic characteristics of disputes under international trade and investment treaties such as NAFTA. Contrary to Canada's allegations, the fact that this dispute requires an analysis of the competitive opportunities afforded to rival firms does not turn this dispute into one that should be left for domestic competition law. The analysis of the competitive relationship between like products, like service providers or investments in like circumstances and whether they are being accorded effective equality of competitive opportunities is a staple of WTO and NAFTA jurisprudence.
7. Similarly, the fact that Canada has repeatedly sought to justify the differences in treatment between UPS Canada and Canada Post on public policy grounds does not mean that this case ceases to be an investment dispute. As in most international trade and investment disputes involving public policy issues, this Tribunal cannot take Canada's assertions on faith and must examine whether public policy considerations are generally relevant to the discriminatory treatment in question.

Canada's Jurisdictional Objections Are Groundless

8. The UPS claim fits squarely within the framework of NAFTA Chapter 11 as well as NAFTA Articles 1502(3)(a) and 1503(2). The Claimant is an investor with an investment in Canada challenging measures that are still in existence. These measures discriminate against or otherwise relate to its investment and cause harm to the Investor and its investment.

9. Canada acknowledges that UPS Canada is an investment of an investor of the United States. Its allegation that UPS Canada's ownership has been transferred from the Claimant, UPS, to its parent, United Parcel Service, Inc., is groundless. Canada ignores conclusive evidence filed with the Investor's Memorial and misunderstands certain securities filings of the Investor's parent.

10. UPS Canada is prohibited by the *Canada Post Corporation Act* from competing with Canada Post in certain markets. At the same time, the *Canada Post Corporation Act* authorizes Canada Post, which it identifies as "an institution of the Government of Canada", to compete against UPS Canada using unfair advantages derived from its monopoly.¹ UPS Canada is regulated by Canadian Customs laws and regulations that are effectively not applied equally to postal imports by Canada Post. UPS Canada is prohibited from competing on equal terms for the business of Canadian magazine publishers by an administrative practice of Canada. All of these measures remain in effect today and continue to cause additional harm to UPS and its investment. The fact that some of these measures were introduced more than three years before the UPS claim was filed does not entitle Canada to continue to allow them to remain in effect.

¹ *Canada Post Corporation Act*, s.5(2)(e), Investor's Schedule of Documents (Tab U218).

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11. Canada's attempts to immunize the conduct of Canada Post from the national treatment obligation seek to revive previous failed efforts dealing with the definition of "measure" and "relating to". Just as NAFTA Chapter 11 tribunals have repeatedly rejected Canada's narrow definitions of these terms, other international tribunals have also rejected Canada's attempts to limit its responsibility for the actions of its state enterprises. GATT tribunals long ago rejected Canada's argument that special rules dealing with state enterprises and monopolies replace general obligations of national treatment. WTO tribunals have also repeatedly rejected Canada's arguments that the actions of its state enterprises do not constitute "treatment" or an exercise of government authority.

 12. Canada has raised merits defences (not true jurisdictional objections) seeking to characterize the *Postal Imports Agreement* as procurement and the *Publications Assistance Program* restrictions as a cultural subsidy. However, UPS Canada is not complaining about being denied an opportunity to bid on a procurement contract but rather about the differences between the laws, regulations and administrative practices of Canada Customs that result in differential treatment as reflected in the *Postal Imports Agreement*. Similarly, UPS does not challenge the existence of the *Publications Assistance Program*, merely the administrative requirement that its beneficiaries use only Canada Post.

UPS Canada and Canada Post Are in Like Circumstances

13. Canada has admitted that Purolator is an investment of a Canadian investor in like circumstances with UPS Canada. It seeks to differentiate Canada Post by referring to a series of purported differences between its services and those of UPS Canada. These differences are either non-existent or immaterial. Canada fails to provide any economic evidence that Canada Post does not compete in the same economic sector as UPS Canada. It has instead filed a report -----

----- yet fails to disclose that he submitted a report to the Canadian Competition Bureau on behalf of Canada Post that identified UPS Canada as one of Canada Post's closest competitors.

14. Canada has also alleged that Canada Post does not compete with UPS for imports of packages from the United States into Canada. It purports to merely passively await packages from other countries which it completes under treaty requirements. This allegation simply ignores business realities. Canada Post has an entire division devoted to obtaining more import business from the United States, it markets itself directly to US shippers, it has entered into a "partnership" with the US Postal Service pursuant to which it receives lucrative terminal dues established under a bilateral, "commercially sensitive" agreement.

Canada Post and Purolator Receive More Favorable Treatment Through the Discriminatory Leveraging of Canada Post's Monopoly

15. Canada admits that Purolator is in like circumstances with UPS Canada. However, Purolator alone benefits from a series of unique arrangements giving it access to a network whose size and scope no other courier company can replicate. Canada claims that Purolator obtains this access to the network at "market rates". This claim is simply implausible in light of the fact that Purolator is the only courier company to benefit from access to many facets of the network.
16. Canada does not even attempt to argue that its own courier services obtain access to the network at market rates. Its own experts admit that Canada Post receives competitive advantages from its monopoly. Instead, Canada asserts that access below market rates is fair as long as these courier services meet the standard incremental cost test for cross-subsidization. Canada confuses the issue of cross-subsidization with the issue of equal

treatment. The avoidance of cross-subsidization is a necessary but not sufficient condition for non-discriminatory conduct. Contrary to Canada's claims, the definition of equal treatment proposed by UPS expert Dr. Kevin Neels is consistent with established economic principles and regulatory practices. Dr. Neels' evidence is corroborated by the reports of distinguished economic and regulatory experts filed with this Reply. As demonstrated therein, the assumptions employed by Canada's economists are inconsistent with Canada's own evidence and international regulatory practice uniformly rejects the incremental cost test as a measure of fair competition in the courier sector. In any event, there is sufficient evidence to justify an inference that Canada Post does not even meet its own fairness standard. Canada's attempts to excuse its failure to produce responsive documents are without merit.

17. In light of its experts' admissions that Canada Post receives a competitive advantage from its monopoly, Canada repeatedly invokes the public policy objective of universal service to justify this advantage. The words "Universal Service Obligation" or "USO" appear over one hundred times in Canada's Counter-Memorial.² However, there is no definition of these words anywhere in the *Canada Post Corporation Act* or the *Universal Postal Convention*. Canada has failed to provide any definition of the USO and, as a result, the USO is whatever Canada Post says it is.

18. Canada Post has been delegated the governmental authority to define universal service and has been provided with a monopoly and other powers to provide such a service. It exercises this governmental authority in a manner that favors its own competitive services or those of its affiliate. Canada Post's decisions regarding the access that it provides to an infrastructure that it has due to its special legal privileges are just as much an exercise of delegated governmental authority as the approval of transactions or the granting of licenses.

² Expert Report of James Campbell at para. 58.

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19. There is no evidence of any burden on Canada Post from a USO. Nor would such a burden justify unfair competition. Most other industrialized countries that maintain postal monopolies impose both a well-defined USO on their postal administrations and take measures to ensure that these postal administrations refrain from unfair competition. Canada has not established similar regulatory controls or administrative supervision and none of the other measures relied upon by Canada ensure that Canada Post's delegated governmental authority over postal services is exercised in a non-discriminatory manner.

Canada Post Receives More Favorable Customs Treatment

20. Canada repeatedly attempts to clothe its discriminatory measures in the mantle of international respectability. However, just as its reliance on the *Universal Postal Convention* fails, so too do its references to the *Kyoto Convention* and the World Customs Organization ("WCO"). Neither the current nor the revised *Kyoto Convention* apply to Express Mail Service ("EMS") and the WCO has explicitly excluded EMS from its definition of postal imports. While the *Kyoto Convention* and the WCO do provide for simplified customs treatment of postal parcels imports, they do not require less favorable treatment of courier imports. Postal and courier imports can easily be treated in a commercially neutral manner.
21. Canada Customs, Canada Post and UPS all benefitted from the creation of the courier/LVS program. This distinction between the two streams is not in dispute. Instead, the dispute centres around whether express mail or parcels should receive different customs treatment unrelated to the rationale for distinguishing between the two streams. The same duties and taxes must be assessed by Canada Customs and collected by the carrier in both streams. Many of the same tasks related to assessment and collection must be performed in each stream. There is no reason why UPS Canada

should be charged for tasks that Customs performs for free for Canada Post. Conversely, there is no reason why Canada Post must be paid for tasks that UPS Canada is required to perform for free.

22. Much of Canada's Counter-Memorial on the issues of customs relies on a series of legal fictions. Canada claims it is only completing delivery pursuant to a treaty when in fact it actively markets its services to US shippers and the treaty terms are "commercially sensitive". It claims the treatment is provided to the foreign postal administration when it is in fact controlling the goods and presenting them to customs. It attempts to find legal loopholes to explain away the widespread failure to collect taxes documented by the Customs Study, but none of those loopholes apply.

The Investor's Memorial Remains Accurate

23. In its introduction, Canada purports to identify a series of inaccuracies in the Investor's Memorial. These are nothing of the sort. They are mostly misstatements of the evidence by Canada, objections by Canada to the terminology used by the Investor to refer to certain undisputed facts or weak attempts to distinguish certain case law. For example, the Investor defined the Monopoly Infrastructure as the infrastructure whose size and scope could not be sustained in the absence of a monopoly - a fact which Canada has admitted in its Counter-Memorial. Canada falsely accuses the Investor of stating that Canada Post's infrastructure was designed for letter mail as a matter of industrial engineering. No such claim was ever made.
24. Similarly, Canada falsely accuses the Investor of misquoting Professor Robert Campbell regarding Canada Post's unusual absence of third party regulation. The quote offered by the Investor was accurate and did not state that Canada Post was not subject to any regulation in all areas, only that its use of its monopoly in the provision of competitive

services was not regulated. This point remains valid notwithstanding Professor Campbell's efforts to explain away his quoted remark. This remark was one of a series in his earlier writings that are completely inconsistent with the positions that he now advocates on behalf of Canada.

25. The legal authorities referred to in Canada's introduction were also properly relied upon by the Investor. The weakness of Canada's efforts to distinguish these is illustrated by its complaint that the Investor's quote of the definition of "arbitrary conduct", although accurate, does not apply to the international law standard of treatment in NAFTA Article 1105. Canada appears to suggest that arbitrary conduct is permitted by customary international law. This statement is contrary to numerous legal authorities.
26. It is Canada's Counter-Memorial that contains numerous misrepresentations, not the Investor's. For example, although Canada places such a reliance on the USO in its Counter-Memorial, Canada's description of the Universal Postal Union ("UPU") and the *Universal Postal Convention* is strewn with fundamental errors and inaccuracies. Canada's discussion of the USO misstates the origins of the UPU, misrepresents obligations dealing with rights of transit as relating instead to universal service, claims that Canada is bound by obligations that it has taken reservations against and refers to purely non-binding, hortatory statements as containing legal obligations. Further examples of serious errors and inaccuracies are contained elsewhere in this Reply.

PART TWO: STATEMENT OF FACTS

27. Canada has chosen to file very few documents with its Counter-Memorial and many of those filed by it already appear in the record. Instead of filing the documents that are the best evidence in international arbitration, Canada has chosen to rely on witness statements and expert reports. These statements and reports often refer to documents without attaching them as exhibits. Nonetheless, as will be shown below, a number of critical facts can still be established based on the documents alone and the admissions of Canada's own witnesses and experts.
28. By contrast, the Investor's Memorial was filed together with thirteen volumes of documents to corroborate the facts alleged therein, in addition to its witness statements and expert reports. Together with this Reply, the Investor has filed additional documents as well as the statements and expert reports referred to below. These statements and reports include the following:
- a. The statement of Joseph Amsbary, Assistant Secretary of UPS, confirming UPS' ownership of UPS Canada;
 - b. The statement of Geoffrey Bastow, former Vice-President, Business Development of UPS Canada, correcting errors in Canada's description of its discussions with UPS Canada regarding its retail network;
 - c. The expert report of James I. Campbell, Jr., an attorney specializing in international and comparative laws relating to postal regulation;
 - d. The expert report of David Sappington, a distinguished Professor of Economics at the University of Florida, regarding Canada Post's unequal treatment of competitors;

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- e. The expert report of Robert H. Cohen, a former Director of the US Postal Rate Commission, attesting to Canada's failure to produce readily-available documents that would permit a full assessment of its claims that it is not cross-subsidizing;
 - f. The expert report of Denise Polesello, a former Canada Customs manager with responsibilities for the postal and courier import programs;
 - g. The expert report of Allan Cocksedge, a former Assistant Deputy Minister for Customs at the Department of National Revenue;
 - h. The statement of Darrell Pearson, a leading Canadian customs lawyer, confirming that the goods in the UPS Customs Study were subject to duty; and
 - i. The expert report of Dr. Anindya Sen, a Professor of econometrics at the University of Waterloo, confirming the validity of the statistical methods in the Customs Study.
29. In addition, the Investor has filed reply statements and reports from:
- a. Mr. Alan Gershenhorn of UPS regarding UPS Canada's network;
 - b. Kenneth Dye, former Auditor General of Canada, regarding the sufficiency of Canada Post's Audit Opinion;
 - c. Professor Melvyn Fuss regarding competition between UPS Canada and Canada Post;
 - d. Dr. Kevin Neels regarding Canada Post's discriminatory leveraging of its network;

- e. Mr. James Nelems regarding the Customs Study methodology; and
- f. Mr. Howard Rosen regarding harm to UPS and the lack of evidence that Purolator has access to Canada Post's network at market rates.

I. THE CLAIMANT OWNS UPS CANADA

30. In its Memorial, the Claimant, United Parcel Service of America, Inc. (“UPS”), provided the following evidence that it is the owner of United Parcel Service Canada Ltd. (“UPS Canada”) and that UPS Canada is its investment in Canada:

- a. The witness statement of Alan Gershenhorn, former President of UPS Canada and member of its board of directors, stating that -----
----- shares in its profits and appoints its board of directors;³

- b. The officer’s certificate of John Ferreira dated June 16, 2004 which attached the following exhibits:
 - i. UPS Canada’s shareholder’s ledger at that date in respect of UPS Canada’s ----- shares. Mr. Ferreira certified that -----
----- as indicated on the ledger, these ----- shares had been held by UPS since August 25, 1977;

 - ii. A share certificate of UPS Canada issued to UPS on June 15, 2004 confirming that UPS holds the ----- shares of UPS Canada;

 - iii. UPS Canada’s shareholder’s ledger at that date in respect of UPS Canada’s ----- shares. Mr. Ferreira certified that ----- and

³ Witness Statement of Alan Gershenhorn at para. 16, Investor’s Memorial (Tab 1).

-
-
- iv. Share certificates of UPS Canada issued to UPS on June 15, 2004 confirming that UPS holds ----- shares and has done so since July 26, 1989;⁴
- c. A loan agreement showing that UPS made a loan to UPS Canada in 2002 in the amount of----- and
- d. A license agreement showing that UPS is entitled to share in the profits of UPS Canada.⁶
31. Notwithstanding this conclusive evidence, Canada states that the relationship between UPS and UPS Canada remains “unclear” and that the evidence is “contradictory”.⁷ Canada relies on the conclusions of a report by Kroll Lindquist Avey (“Kroll”), which alleges that public documents indicate that UPS has not been the owner of UPS Canada since November 1999.⁸
32. Kroll misstates the documents produced by UPS in this arbitration, misunderstands securities filings by UPS’ parent, United Parcel Service, Inc., and places undue emphasis on a clerical error in information provided to Statistics Canada.

⁴ Officer’s Certificate of John Ferreira dated June 16, 2004, Investor’s Schedule of Documents (Tab U295).

⁵ Loan Agreement dated August 25, 2002, Investor’s Schedule of Documents (Tab U250).

⁶ License Agreement dated January, 1989, Investor’s Schedule of Documents (Tab U53).

⁷ Canada’s Counter-Memorial at para. 53.

⁸ Expert Report of Deborah Gold dated June 16, 2005 at para. 4, Canada’s Brief of Affidavits and Expert Reports (Tab 13).

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33. Kroll misstates the shareholders' ledgers provided by UPS as showing only shares held as at August 25, 1977 and December 16, 1996. In fact, these are the dates that the UPS Canada shares were issued to UPS. The officer's certificate of Mr. Ferreira and the share certificates filed along with it demonstrate that the shareholder's register remained correct as at June 16, 2004.
34. Canada compounds this error by Kroll by stating that the reference to UPS' beneficial ownership of UPS Canada's shares in an Assistant Secretary's Certificate demonstrates that UPS is not the registered owner. In fact, there is no inconsistency. In this case, UPS is both the registered and the beneficial owner.⁹
35. Kroll then refers to the 10K report of United Parcel Service, Inc. dated December 31, 1999 filed with the *US Securities and Exchange Commission*. The annex to that filing correctly lists both UPS and UPS Canada as subsidiaries of United Parcel Service, Inc. That listing contains both direct and indirect subsidiaries of United Parcel Service, Inc. and is therefore perfectly consistent with the statements in the Investor's Memorial describing United Parcel Service, Inc. as the parent of UPS and UPS as the owner of UPS Canada.¹⁰
36. The Kroll report and Canada's Counter-Memorial also reflect a fundamental misunderstanding of a merger transaction involving the Claimant in November 1999.¹¹ Prior to that date, UPS owned all of the shares of United Parcel Service, Inc., which in turn owned all of the shares in a company called UPS Merger Subsidiary, Inc.. On October 25, 1999, the shareholders of UPS approved a merger of UPS with UPS Merger

⁹ Witness Statement of Joseph Amsbary dated July 29, 2005 at para. 6.

¹⁰ Witness Statement of Joseph Amsbary at para. 12.

¹¹ Witness Statement of Joseph Amsbary at paras. 7 - 9.

Subsidiary Inc.. That merger resulted in United Parcel Service, Inc. owning all of the shares of UPS which continued as an existing corporation. The merger did not result in any change in the ownership of the shares of UPS Canada. UPS Canada remained a wholly owned subsidiary of the Claimant, UPS (i.e. United Parcel Service of America, Inc.).¹²

37. Kroll makes reference to ownership returns filed by UPS Canada with Statistics Canada for the years 1997 through 2002. These returns list UPS as the ----- until 2000, but then identify United Parcel Service, Inc. as the----- These Ownership Returns were prepared internally by UPS Canada and reflect a clerical error.¹³ Although United Parcel Service, Inc. was the indirect owner of UPS Canada after 2000, the -----remained UPS. These returns have been re-filed and the inadvertent mistake has been corrected.¹⁴ Thus, there is no question that the Claimant owns and controls UPS Canada.

¹² Witness Statement of Joseph Amsbary at para. 9.

¹³ Witness Statement of Joseph Amsbary at paras. 13-18.

¹⁴ See re-filed Ownership Returns at Reply Schedule of Documents (Tab U420).

II. CANADA POST'S COMPETITION WITH UPS CANADA

38. In its Memorial, the Investor demonstrated that the Canadian courier market is characterized by competition between Canada Post and a small number of foreign-owned companies, including UPS Canada.¹⁵ This competitive relationship between Canada Post and UPS Canada is central to the “like circumstances” analysis in NAFTA Article 1102.

39. While acknowledging that Canada Post and courier companies both deliver messages and parcels, Canada asserts that they are nonetheless “very different entities”. Canada Post’s operations purportedly “focus on universal service in the pick up and delivery of mail across Canada, at the expense of optimum profit, speed and reliability”.¹⁶ However, the repeated invocations of Canada Post’s alleged Universal Service Obligation by Canada’s witnesses cannot mask the reality disclosed in Canada Post’s business plans and marketing documents. These documents reveal an organization which has the same “focus” on competing in the courier market as its competitors. This focus has led Canada Post to provide the same or very similar services to the same customers as its competitors, both directly and through its Purolator subsidiary. These services include competitive services for imports of packages into Canada.

A. Canada Post’s Own Documents Demonstrate Its Focus on Courier Services

40. Canada Post’s Annual Report reveals the importance of courier services to Canada Post. In its Annual Report, Canada Post’s own courier services (i.e. those that are not provided through Purolator) are categorized as “Physical Distribution”.¹⁷ For the Canada Post

¹⁵ Investor’s Memorial at para. 113.

¹⁶ Canada’s Counter-Memorial at para. 58.

¹⁷ Canada Post Annual Report 2004 “Canada Post Segment” at 21, Investor’s Schedule of Documents (Tab U419).

segment alone (i.e. excluding Purolator and other subsidiaries), physical distribution revenues represent the second largest source of revenue for the corporation, after its letter mail services, which are referred to as communications services in its Annual Report. Letter mail is part of Canada Post's exclusive privilege and therefore not subject to competition. Thus, in the realm of competitive services, physical distribution services are Canada Post's largest source of revenue.

41. ----- Professor
Fuss, a distinguished economist at the University of Toronto, reviewed these documents in great depth in his Expert Report filed with the Memorial.¹⁸ -----

42. Canada Post marketing and advertising documents clearly show that it holds itself out to the public as a courier company. One example is Xpresspost, which was launched and

¹⁸ See Investor's Memorial. See also Reply Report of Melvyn Fuss at paras. 148-164, 179-200, 213-215, 224-232, 240-243, 256-258.

¹⁹ See Investor's -----
1. ----- 29);
2. ----- (Tab U144);
3. -----
4. ----- (Tab 245);
5. -----
6. ----- (Tab U160).

²⁰ See, for examp -----
1. ----- (Tab U206);
2. -----
3. ----- (Tab U160); and
4. ----- (Tab U200).

marketed as a cost-effective alternative to couriers for sending time sensitive documents and packages.²¹ Canada Post has also made improvements to Xpresspost expressly to meet the needs of courier customers.²²

43. The Canada Post Mandate Review also concluded that Canada Post had switched its focus from its traditional USO services to courier services. Earlier competitive activities were either defensive, intended primarily to protect letter mail from rival means of communication, or ancillary to the core letter mail service.²³ Now, Canada Post activities represent an aggressive pursuit of the Canadian courier market. The Mandate Review noted this fact, and agreed that Canada Post's courier operations were aggressive price leaders.²⁴
44. The Post Office Department historically provided various services that overlapped to some degree with those of private businesses. However, the nature, extent, and intensity of postal involvement in competitive fields have changed dramatically since 1981 when the Post Office Department was replaced by Canada Post.²⁵
45. In his Expert Report, filed on behalf of Canada, Robert Campbell describes how recent developments, such as technological change in the communications field and

²¹ Canada Post Annual Report 1993-1994 at 3, Investor's Schedule of Documents (Tab U470).

²² Canada Post 1999/2000 to 2003/2004 Corporate Plan referring to Xpresspost changes at 2 "[T]o better meet the speed, reliability, security and ease-of-use needs of **courier customers**" [emphasis added], Investor's Schedule of Documents (Tab U471).

²³ Canada Post Mandate Review at 20, Investor's Schedule of Documents (Tab U79).

²⁴ Canada Post Mandate Review at 33.

²⁵ Canada Post Mandate Review at 19.

globalization have created new competition between Canada Post and private couriers.²⁶ Canada was not participating in the courier industry to a similar extent when postal services were provided by the Post Office Department.²⁷

46. Canada Post has been responsive to the initiatives of the courier industry, not their forerunner. UPS Canada opened for business in Canada in 1975.²⁸ Canada Post did not begin to aggressively market Priority Courier until 1987/88.²⁹
47. In the early 1990s, UPS Canada introduced additional time sensitive express courier services.³⁰ Canada Post then followed suit with its Xpresspost service,³¹ a rebranded version of Canada Post's Special Delivery service, designed to compete with courier products. Also during this time frame, Canada Post acquired Purolator.
48. UPS does not take issue with Canada Post's involvement in competitive services *per se*. Its participation in earlier non-monopoly initiatives is also not at issue. UPS takes issue with the manner in which Canada Post participates in the courier industry and Canada's failure to provide a level playing field for Canada Post's competitors. This unfair competition belies Canada's claims that Canada Post is not "focused" on providing courier services.

²⁶ Report of Robert Campbell at paras. 65-66, Canada's Brief of Affidavits and Expert Reports (Tab 5). As the report of Robert Campbell addresses issues that overlap with those considered in the report of James Campbell filed with the Investor's Reply, each expert will be referred to by both first and last names.

²⁷ Report of Robert Campbell at para. 56.

²⁸ Witness Statement of Alan Gershenhorn at para. 10.

²⁹ Report of Robert Campbell at para 97. Although Priority Courier was introduced as Priority Post in 1979, Professor Campbell explains on behalf of Canada that it was not made a "priority" until 1987/88 when an "aggressive" approach was taken to the physical distribution market.

³⁰ Witness Statement of Alan Gershenhorn at paras. 21 and 23.

³¹ Canada Post Annual Report 1993-1994 (Tab U470); Canada Post News Release dated June 27, 2000 (Tab U473).

B. Canada Post's Courier Services Are the Same As UPS Canada's

49. Canada essentially admits that Purolator and UPS Canada are in like circumstances.³² However, it attempts to differentiate Canada Post's internal courier services from those of UPS Canada. These efforts rely on both Canada Post's alleged Universal Service Obligation and a series of purported differences between Canada Post's (non-Purolator) services and those of UPS Canada. While the full implications of Canada Post's delegated governmental authority to provide universal service are discussed in Part III below, it is important to note that this does not differentiate Canada Post's courier services from those of UPS Canada. These services are for all intents and purposes the same as those of UPS Canada.

50. -----

51. -----

³² See Part One, section C, immediately following this section.
³³ Affidavit of Francine Conn at para. 67, Canada's Brief of Affidavits and Expert Reports (Tab 6).
³⁴ Affidavit of Francine Conn at para. 70. Canada has refused to provide the documents referred to by Ms. Conn.

52. Canada also refers to a series of factors which purportedly differentiate Canada Post's services from UPS Canada's. These purported differences are either non-existent, immaterial or irrelevant:

a. *Nature of Goods*: Canada fails to provide any documentary evidence for its allegation that courier goods are somehow different from postal ones.³⁵

³⁷ The first allegation is spurious.

These attempts to distinguish Canada Post from UPS Canada fail.

⁴⁰ Moreover,

³⁵ Canada's Counter-Memorial at para. 140-141; Affidavit of Bill Henderson at para. 10, Canada's Brief of Affidavits and Expert Reports (Tab 17).

³⁶ Affidavit of Bill Henderson at para. 10; Canada's Counter-Memorial at para. 140.

³⁷ Canada's Counter-Memorial at para. 141; Affidavit of Bill Henderson at para. 10.

³⁸ Affidavit of Bill Henderson at para. 10.

³⁹ See, for example, Expert Report of Melvyn Fuss at paras. 124-131.

⁴⁰ See, for example, Expert Report of Melvyn Fuss at paras. 124-131; Reply Statement of Alan Gershenhorn at para. 2.

Canada Post relies on its “single mail pipeline” for processing *all* of its products, regardless of size or type.⁴¹ -----

- b. *Knowledge of Identity of Sender and Contents of Goods*: This type of knowledge is only relevant for imports, which are discussed below. Canada Post requires a bill of lading or manifest for its courier items, which include Priority Courier, Xpresspost, and Expedited Parcel products.⁴² This is true for Canada Post’s domestic courier services as well as its international ones, such as Xpresspost-USA and Expedited Parcel;⁴³
- c. *Track and Trace*: Canada alleges that the ability of couriers to track and trace from point of origin through to destination distinguishes their products from postal ones. This is manifestly incorrect. -----

- d. *Speed of Delivery*: Canada alleges that courier transit times cannot be matched by Canada Post. In fact, the delivery times for next day services are very similar or identical,⁴⁵ and those for second day or later services are identical,⁴⁶

⁴¹ Canada’s Counter-Memorial at paras. 154-161.

⁴² See Priority Courier, Xpresspost, Expedited Parcel excerpts from Postal Guide, Investor’s Schedule of Documents (Tab U484).

⁴³ See, for example, Expedited Parcel-USA, Xpresspost-USA. The Xpresspost-USA and Xpresspost-International documentation is not entitled a “bill of lading”, but it requires information about the sender and addressee and a customs declaration as would a bill of lading (Tab U484).

⁴⁴ Expert Report of Melvyn Fuss at paras. 132-136.

⁴⁵ Expert Report of Melvyn Fuss at paras. 110-113.

⁴⁶ Expert Report of Melvyn Fuss at paras. 132-136.

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- e. *Contractual Relationship*: Canada's claim that the contractual relationship between couriers and their clients somehow distinguishes a courier shipment from a postal shipment is misleading. The Postal Guide contains an entire chapter on the terms and conditions of the postal relationship, which is akin to a contractual relationship.⁴⁷ Canada Post's courier items are explicitly subject to these General Terms and Conditions,⁴⁸ and
- f. *Population Densities*: Canada argues that couriers are different because they focus on highly populous areas, while Canada Post must deliver to every address in Canada. Both Canada Post and UPS Canada deliver to all points in Canada.⁴⁹ Canada has provided no evidence to support its claim that there is a material difference in deliveries of competitive products by population density.

53. Canada Post courier services are the same as those of UPS Canada. The overwhelming majority of the goods they handle are the same. Both companies offer pick up and drop off service options. Canada Post's courier products equally require knowledge of identity of sender and contents of goods. Both Canada Post and UPS Canada provide track and trace abilities. Delivery times for each company are very similar or identical, and both Canada Post and UPS Canada deliver to all points in Canada.

C. Canada Has Admitted Purolator Is in Like Circumstances

54. In its Counter-Memorial, Canada repeatedly admits that Purolator is in like circumstances with UPS Canada. These admissions consider UPS Canada and Purolator to be the same kind of entity. For example:

⁴⁷ Chapter 8 Postal Guide, Investor's Schedule of Documents (Tab U485).

⁴⁸ See, for example, Canada Post Postal Guide 2005, Section C, Chapter 2, *Priority Courier* (Tab U484).

⁴⁹ Expert Report of Melvyn Fuss at para. 72.

The fact that **couriers like Purolator or the Complainant** [*sic*] can trace goods from pick-up to delivery is one of the reasons customers may choose the services offered by these companies over most of the services offered by Canada Post.⁵⁰

Attempts to synergize the two corporations [Canada Post and Purolator] have met with only limited success, as a result of differences between the operations, facilities and customer base of a courier company as opposed to Canada Post. **Purolator's operations, like those of the Claimant**, are structured to maximise speed and reliability within highly populated areas.⁵¹

The fact that Purolator is in like circumstances with UPS Canada is clearly not in dispute.

55. Given these admissions, Canada has tried to separate Purolator from Canada Post by calling it a “separate corporate entity” that deals at arms-length with Canada Post.⁵² This characterization is flawed. -----

a. -----

b. -----

c. -----

d. -----

----- and

⁵⁰ Canada’s Counter-Memorial at para. 144 [emphasis added].

⁵¹ Canada’s Counter-Memorial at para. 191 [emphasis added].

⁵² Canada’s Counter-Memorial at para. 187; Affidavit of -- -- at paras. 2-4.

⁵³ Canada’s Counter-Memorial at footnote 140, Affidavit of -- -- at para. 4.

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- e. Canada Post requires Purolator to “take every reasonable step” to exploit synergies within the Canada Post Group of companies.⁵⁴
56. These mechanisms of control and direction by Canada Post require the Tribunal to treat Canada Post and Purolator as part of the “Canada Post Group”, as Canada Post refers to them in its Annual Report.⁵⁵ It is immaterial that Purolator’s “day-to-day” management is separate from Canada Post. Many subsidiaries have independence in their day-to-day operations. Purolator courier services are still Canada Post services.
57. Professor Fuss provides the pertinent example of General Motors Corporation and its wholly-owned subsidiary, Saturn Corporation.⁵⁶ Saturn Corporation is a separate legal entity. However, Saturn cars are just another brand of General Motors Corporation, like Pontiac or Buick. Canada Post owns the overwhelming majority of Purolator’s shares and therefore maintains economic control. It can determine the optimal extent of independence and vary this extent when necessary. Thus, Purolator’s courier products are ultimately controlled by Canada Post.
58. Purolator services and Canada Post services are sold through the same retail network. Indeed, Canada Post offers some of Purolator’s courier services in its post offices and retail outlets. Mr. Henderson provides a list of the extensive arrangements between Purolator and Canada Post, including the sale of stamps at Purolator retail outlets, electronic services, and joint tendering. These services conflate the offerings of the two companies and appear to consumers as merely different brands of the same company.

⁵⁴ Affidavit of Bill Henderson at para. 5-7.

⁵⁵ CPC Annual Report 2004, “Our Business”, at 20, Investor’s Schedule of Documents (Tab U419).

⁵⁶ Reply Report of Melvyn Fuss at para. 46; Such ownership is stated clearly in General Motors’ 10-K Filing with the Securities and Exchange Commission, dated March 16, 2005 (Tab U481).

D. Economic Analysis of Competition Between Canada Post and UPS Canada

59. In its Memorial, the Investor summarized the expert report of Professor Fuss of the University of Toronto. -----

60. In its Counter-Memorial, Canada relies on the report of Professor Schwindt and a mere footnote in the report of Professor Kleindorfer to take issue with the analysis of Professor Fuss. Professor Schwindt ----- and advances criticisms that are inconsistent with his own prior submissions to the Competition Bureau. Professor Kleindorfer’s comments were properly relegated to a footnote in his report as they are not material to the analysis. In particular:

a. *Misunderstanding of the Legal Test:* -----
-----⁷ That is because Professor Schwindt misunderstood the legal test that applies in this arbitration. As outlined in the Fuss Reply Report, -----
-----⁵⁸ The NAFTA Tribunal Award in *S.D. Myers v. Canada* established that the concept of “like circumstances” in NAFTA Article 1102 requires an examination of the sector in which the investors compete, and that the word “sector” broadly includes “economic sector” and “business sector”.⁵⁹ This test is based on the jurisprudence of the World Trade Organization

⁵⁷ Expert Report of Richard Schwindt at 2, Canada’s Brief of Affidavits and Expert Reports (Tab 34).

⁵⁸ Reply Report of Melvyn Fuss at paras. 6-12.

⁵⁹ *S.D. Myers v. Canada*, First Partial Award, November 13, 2000, 2000 *WL* 34510032; 40 *I.L.M.* 1408 (2001), paras. 250-251, Investor’s Book of Authorities (Tab 4).

(“WTO”), and is consistent with analysis of the WTO Appellate Body in *Japan - Taxes on Alcoholic Beverages*.⁶⁰ As explained by Professor Fuss, the relevant economic sector is the sector in which establishments produce competitive products in the sense that customers are prepared to substitute among them.⁶¹ This legal test has a clear meaning to economists. -----
----- - In his Reply Report, Professor Fuss points out that, in any case, he analyzed the economic sector that corresponds to North American Industry Classification System 492110.⁶²

b. *Inconsistency with Professor Schwindt’s Prior Submissions:* -----

-----⁶³ In his Reply Report, Professor Fuss demonstrates that in spite of the numerous flaws with Professor Schwindt’s representations, -----

Moreover, Professor Schwindt never rebuts the conclusion that Canada Post and UPS Canada compete with one another. In fact, to do so would be inconsistent with Professor Schwindt’s own conclusions in a 1993 study submitted to the

⁶⁰ See the discussions in *Japan-Taxes on Alcoholic Beverages* –AB-1996-2- Report of the Appellate Body [1996] WTOAB2, October 4, 1996, Investor’s Schedule of Documents (Tab U336).

⁶¹ Reply Report of Melvyn Fuss at para. 9.

⁶² Reply Report of Melvyn Fuss at para. 23.

⁶³ Expert Report of Richard Schwindt at 5, Reply Report of Melvyn Fuss at paras. 24-33.

Competition Bureau on behalf of Canada Post.⁶⁴ -----

c. *The Kleindorfer Footnote*: Canada quotes at length from a footnote of Professor Kleindorfer -----

----- Professor Fuss rightly corrects Professor Kleindorfer -

-----⁶⁷

61. Finally, Canada also completely misrepresents the conclusions of the Fuss Report. Canada alleges that -----

⁶⁴ See CPC Competitive Impact Analysis (Tab U413).

⁶⁵ See CPC Competitive Impact Analysis, at 4-5, 39-44, 73, Investor's Schedule of Documents (Tab U413).

⁶⁶ See CPC Competitive Impact Analysis at 73.

⁶⁷ Reply Report of Melvyn Fuss at paras. 51-52.

-----⁶⁸ This
statement is simply wrong.

62. -----

E. Competition for Import Services

1. Canada Post's Partnership with the US Postal Service

63. Canada maintains that Canada Post does not compete with UPS Canada for delivery from the United States to Canada. In its Counter-Memorial, Canada criticized the Investor's characterization of Canada Post's delivery of USPS courier services as "joint production".⁷⁰ Canada relies on the Expert Report of Professor Schwindt to argue:

⁶⁸ Canada's Counter-Memorial, para 135.

⁶⁹ Expert Report of Melvyn Fuss at para. 11.

⁷⁰ Canada's Counter-Memorial at paras. 136-137, 335.

⁷¹ Expert Report of Richard Schwindt at 7; Canada's Counter-Memorial at para. 136.

64. This is a flawed rebuttal. Professor Fuss rightly maintains that the service is indeed joint in the sense that both courier segments are required to deliver the product.⁷² Moreover, Professor Schwindt's example suffers from gross oversimplification. Canada Post/USPS courier services do not exist in a hierarchy of production.⁷³ In Professor Schwindt's example, the tire is clearly an intermediate input, while the automobile is the finished product. For Canada Post/USPS courier services, the services are jointly required to complete delivery, but each is a complete service on its own.

65. In its Counter-Memorial, Canada insists that Canada Post does not provide services to US customers through USPS or together with USPS.⁷⁴ However, Canada Post does not passively await USPS packages. Rather, Canada Post actively markets its presence in the US market.

66. In July 1997, Canada Post launched "-----"

----- :

67. -----

⁷² Reply Report of Melvyn Fuss at paras. 34-35.

⁷³ Reply Report of Melvyn Fuss at paras. 34-35.

⁷⁴ Canada's Counter-Memorial at para. 654.

⁷⁵ Canada Post Sales News dated July 1997 at 5 (Tab U482).

⁷⁶ Canada Post Sales News at 5 [emphasis added].

68. Canada Post’s website lists only two postal administrations as partners: USPS and La poste.⁷⁸ The partnership relationship between Canada and the United States is exemplified by joint initiatives and mutual benefit. As Professor Fuss notes, Canada Post is compensated for the completion of deliveries that originate with the USPS.⁷⁹ Indeed, one of the reasons Canada Post competes for delivery of US packages is because of their impact on its revenues. Each time a US shipper sends goods via the USPS to Canada, Canada Post receives lucrative terminal dues. In the late 1990s, Canada Post and USPS opted to conclude a bilateral agreement, the terms of which were considered “commercially sensitive”.⁸⁰ In 2003, Canada Post realized net income in the amount of \$253 million, which included a \$118 million settlement of terminal dues with foreign postal administrations.⁸¹ Thus, payments from foreign postal administrations represented almost half of Canada Post’s annual income.

2. Canada Post Divisions Dedicated to Postal Imports

69. Canada Post has an entire department and staff dedicated to international business

⁷⁷ Canada Post Sales News at 5.

⁷⁸ Reply Report of Melvyn Fuss at para. 37 and footnote 17.

⁷⁹ Reply Report of Melvyn Fuss at para. 40.

⁸⁰ Reply Report of Melvyn Fuss at paras. 40-41.

⁸¹ Highlights of 2003 Annual Report (Tab U445).

development.⁸² This *International Business Development* Department is led by its own general manager. One of the major objectives of this Department is to facilitate the shipment of goods from foreign countries into Canada, via the post, for delivery to the Canadian addressee by Canada Post. Canada Post's International Business Development department actively tries to "grow [their] business in the Canadian catalogue market".⁸³

70. Canada Post's International Business Development department emphasizes that the market in Canada for the postal shipment of catalogue purchases is "underdeveloped", and that Canada Post "wants to drive this business, because both Canada Post and our catalogue customers have a lot to gain from it."⁸⁴ Canada Post refers to "the huge potential increase in deliveries [by Canada Post] to customers who place orders from catalogues."⁸⁵
71. Canada Post has another division called *Borderfree* that works with US retailers to walk them through the complexities of the Canadian market.⁸⁶ The objective of Canada Post's *Borderfree* Division is to enable US firms to mail goods to Canadian online purchasers through USPS for delivery by Canada Post.⁸⁷

⁸² Canada Post's *Performance Magazine*, (January/February 2003), at 21 (Tab U435). See also *Performance Magazine* (October 1999), at 23 which referred to the name of Canada Post's department at that time as "International Business" department (Tab U415).

⁸³ Canada Post's *Performance Magazine* (October/November 2004), at 15 (Tab U436).

⁸⁴ Canada Post's *Performance Magazine* at 15. See also Affidavit of Jane Elliott, para. 12 on the growth of US mail order firms such as Lands' End, Eddie Bauer, and L.L. Bean in shipping to Canada.

⁸⁵ Canada Post's *Performance Magazine* at 15.

⁸⁶ "J.C. Penney Seeks to Net Canadians", *Globe and Mail* July 25, 2005, Investor's Schedule of Documents (Tab U418).

⁸⁷ "Canada Post Borderfree Announces New Capabilities - Only Provider Offering Complete Marketing Service for Untapped Canadian Market", from Canada Post Borderfree Web site, 01/07/2005 (Tab U447).

Canada Post has also played its part in enticing U.S. e-tailers, said Paulina Sazon, marketing manager at Canada Post's Borderfree division. It works with U.S. retailers, trying to help them ease their way into what can be a complex Canadian market, she said. It walks them through the duty and tax laws, shipping practices and marketplace idiosyncrasies.

Canada Post's research has found that there could be room for \$15-billion worth of Internet and catalogue business for U.S. retailers in Canada, she said.⁸⁸

72. There is no doubt that Canada Post's partnership with its *Borderfree* Division was designed to be profitable.⁸⁹ Again, this contradicts Canada's claims that it does not compete for shipments into Canada and that it does not partner with USPS to complete these deliveries. Canada Post admits that:

Every one per cent increase in U.S. direct-to-home marketing and e-commerce business means significant increases in revenues for Canada Post in catalogue distribution and parcel delivery.⁹⁰

3. Canada Post Marketing Initiatives and Partnerships with US Shippers

73. Canada Post has far too many marketing initiatives and joint arrangements with US shippers to claim that it does not compete with UPS Canada for shipments of goods into Canada. -----

-1

There is considerable evidence of this competition:

⁸⁸ *Globe and Mail*, July 25, 2005 (Tab U418).

⁸⁹ Canada Post's *Performance Magazine* (January/February, 2003) article entitled "New Partnership Streamlines US Web Shopping" at 21 (Tab U435).

⁹⁰ Canada Post's *Performance Magazine* article entitled "New Partnership Streamlines US Web Shopping" at 21, columns 2-3.

⁹¹ -----

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- a. Canada Post recently announced that its *International Business Development* Department has entered into a partnership arrangement with Lands' End - one of the largest mail order shippers based in the US.⁹² This partnership allows Lands' End to sell and ship its products from the United States into Canada via the post. Canada Post anticipates that this partnership will lead to "understanding their business [of clients like Lands' End] has helped us learn what we need to do to grow our own business in the Canadian catalogue market;"⁹³
 - b. In 2003, Canada Post's letter carriers delivered a glossy Canada Post advertising brochure *Get Easy Access to Major US E-tailers* to the doors of thousands of Toronto homes. This brochure lists seven major US retailers that have partnered with Canada Post to encourage Canadians to purchase goods online and by catalogue from the US. The delivery of these goods will be completed by Canada Post.⁹⁴
 - c. Canada Post recently partnered with Abacus Canada to help US firms "Canadianize" their websites.⁹⁵ This partnership will permit participating websites to convert the cost of the US Goods into Canadian dollars for Canadian purchasers; and
 - d. Canada Post regularly publishes a glossy advertising booklet entitled "Canadian Connexions", designed to solicit the business of foreign (particularly US) business shippers.⁹⁶

⁹² Canada Post's *Performance Magazine* (October/November 2004), at 15 (Tab U436).

⁹³ *Canada Post's Performance Magazine* at 15.

⁹⁴ Canada Post Ad, undated, "Get Easy Access to Major U.S. E-tailers!" (Tab U437).

⁹⁵ Press release dated May 24, 2005 regarding the launch of Abacus Canada (Tab U443).

⁹⁶ See "Canadian Connexions" (Tab U444).

4. Canada Post Competes with UPS Canada for Delivery of US Imports

74. Canada Post actively solicits and obtains the business of US shippers, at the expense of UPS Canada.⁹⁷ As set out in the Fuss Reply Report, Canada Post is well-positioned to influence the competitive marketplace. It can influence the price by negotiating profitable terminal dues arrangements, varying the quantity of a service for its portion of the delivery, thereby affecting the quality-adjusted price, and improving the competitive position of a joint product through open communication with its partner, USPS.⁹⁸

75. This kind of activity contradicts Canada’s Counter-Memorial, which creates the impression that Canada Post merely waits passively for packages to arrive in Canada from foreign countries, from shippers that Canada Post does not even know.⁹⁹ -----
----- by encouraging shippers from anywhere in North America to ship goods into Canada via the post.

76. -----

⁹⁷ See Canada Post’s *Performance Magazine’s “MiniMag”* (undated), at 8 (Tab U438) , which refers to Lands’ End as a “delivery customer” of Canada Post.

⁹⁸ Reply Report of Melvyn Fuss at para. 43.

⁹⁹ Canada’s Counter-Memorial, paras. 670, and 382.

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¹⁰¹ Statement of Lisa Paré at para. 32. See also Investor’s Schedule of Documents (Tab U272).

----- UPS offers US shippers its *UPS Standard* product, which is an inexpensive courier service that travels by ground from the US, and takes a number of days to reach the Canadian addressee. As a result, Canada Post is in like circumstances to UPS Canada with respect to competition for this business.

III. THE USO DOES NOT JUSTIFY UNFAIR TREATMENT OF COMPETITORS

77. Canada Post is not merely a monopoly and a state enterprise competing in the courier market. It is a governmental monopoly that, under the *Canada Post Corporation Act*, has been delegated a wide range of governmental authority over postal services. Canada Post's powers to grant or deny access to a network created from public funds and a state-enforced monopoly are just as much of an exercise of governmental authority as the power to grant licenses or approve commercial transactions.
78. Contrary to Canada's submissions, the delegation of governmental authority to provide "basic customary postal service" to Canada Post does not entitle Canada Post to provide competitive advantages to its own courier services. Rather, it creates a special obligation on Canada to ensure that Canada Post exercises its governmental powers in a non-discriminatory manner consistent with the requirements of national treatment in NAFTA Article 1102.
79. Canada's discussion of the Universal Service Obligation ("USO") and the reasons for granting Canada Post a monopoly and other privileges does not address many of the central issues in dispute. There is no dispute that Canada may grant Canada Post a monopoly over letter mail. There is also no dispute that the universal provision of basic customary postal services can be a valid public policy objective for Canada to pursue. Instead, the dispute arises out of the unusual and inappropriate manner in which Canada has delegated special powers related to universal service to Canada Post. In particular:
- a. Canada has failed to define any USO for Canada Post. Contrary to Canada's submissions, neither international treaties nor Canadian legislation specify Canada Post's USO. The USO is whatever Canada Post says it is;

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- b. The failure to define the USO makes it impossible to determine the resulting burden, if any, on Canada Post. Canada Post is given great powers without any clear responsibilities. This has led to a situation in which Canada Post's monopoly powers and other privileges can be abused for its own private purposes;
- c. Even if there were a burden on Canada Post from its USO, such a burden would not justify the preferential treatment of Canada Post's courier services. Most other industrialized countries impose much more clearly defined and burdensome USOs on their postal operators, yet also recognize that their governmental postal monopolies must be supervised by independent regulators to ensure that competitors are treated fairly. Canada has failed to do so.

A. Canada Has Delegated Governmental Authority to Canada Post

80. Canada Post is a governmental monopoly that has been delegated a broad range of governmental authority over postal services. Canada has delegated governmental authority to Canada Post to define public policy relating to universal service. In its Counter-Memorial, Canada admits that the *Canada Post Corporation Act* merely establishes the "overall commitment" to the USO.¹⁰² The *Canada Post Corporation Act* only requires Canada Post to "have regard to" various policy objectives. It does not define the USO or even impose a true *obligation* to provide universal service. By virtue of the powers granted to Canada Post under the *Canada Post Corporation Act*, Canada grants Canada Post full governmental authority to determine the scope and nature of universal service. In its Counter-Memorial, Canada confirms that:

[T]he detailed implementation of the universal service obligation [*sic*] is found in Canada Post's regulations, policies and practices.¹⁰³

¹⁰² Canada's Counter-Memorial at para. 85.

¹⁰³ Canada's Counter-Memorial at para. 85.

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81. Pursuant to section 19 of the *Canada Post Corporation Act*, Canada Post is delegated governmental authority to make these regulations. Thus, Canada Post exercises its delegated governmental authority to define and implement universal service through such regulations, policies and practices. There is no doubt that Canada Post performs the governmental function of deciding what universal service means.
82. Canada Post's regulation-making powers are highly unusual. They include the power to define the scope of its exclusive privilege by changing the definition of "letter" and the power of fixing rates of postage. Cabinet approval for these regulations is deemed to be given within sixty days. Moreover, Cabinet cannot propose any of its own regulations on these matters. It can only reject regulations by Canada Post.¹⁰⁴ Canada's own expert, Robert Campbell, has described Canada Post's regulatory practice of obtaining price increases for letter mail as having become a "trivial ritual".¹⁰⁵
83. In its Counter-Memorial, Canada alleges that the Canadian case law cited in the Investor's Memorial stands for "only very narrow propositions".¹⁰⁶ This is incorrect. These four Canadian 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. In particular, these decisions show that Canada Post remains part of the Government of Canada even when it is engaging in the supply of competitive services.¹⁰⁷

¹⁰⁴ See *Canada Post Corporation Act*, s. 19(1), 20(5), Investor's Schedule of Documents (Tab U218). Cabinet's regulatory-making power is limited to materials for the blind and for Members of Parliament. See *Canada Post Corporation Act*, s. 19(3), 35-36.

¹⁰⁵ Robert Campbell, *The Politics of Postal Transformation* at 293, Investors Schedule of Documents (Tab U498).

¹⁰⁶ Canada's Counter-Memorial at para. 93.

¹⁰⁷ Investor's Memorial at paras. 63 and 65; *Canadian Daily Newspaper Assn. v. Canada Post Corp.* [1995] 3 F.C. 131, [1995] F.C.J. No. 945 (T.D.), Investor's Book of Authorities (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.), Investor's Book of

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84. The Canadian case law also confirms that the definition and implementation of universal service is left entirely to Canada Post. Canada Post has substantial discretion with respect to the manner in which it chooses to provide postal services.¹⁰⁸ Contrary to Canada's assertion that the USO is a burden, these cases show that Canada Post is free to reduce the scope of its customary postal services while it aggressively pursues expansion in the competitive courier market.
85. The two additional Canadian cases cited in Canada's Counter-Memorial do not stand for any contrary proposition.¹⁰⁹ Both cases were actions in which Canada Post enforced its monopoly powers against competitors. The courts observed that Canada Post was granted these powers for the purpose of providing universal service. They did not define the scope of any obligation to provide universal service.
86. Canada Post is more governmental in nature than other state enterprises and monopolies. Professor Robert Campbell, on behalf of Canada, describes the corporatization of Canada Post as follows:

Compared to some other progressive regimes, the government retained a significant degree of influence.¹¹⁰

Authorities (Tab 69); *Re City of Nepean and Canada Post Corp.* (1986), 57 O.R. (2d) 297, Investor's Book of Authorities (Tab 71); *Rural Dignity of Canada v. Canada Post Corp.*, [1991] F.C.J. No. 33 (T.D.), upheld on appeal, (1992), 88 D.L.R. (4th) 191 (F.C.A.), Investor's Book of Authorities (Tab 75).

¹⁰⁸ *Canadian Daily Newspaper Association*, Investor's Book of Authorities (Tab 68); *Canadian Union of Postal Workers*, Investor's Book of Authorities (Tab 69); *City of Nepean*, Investor's Book of Authorities (Tab 71); *Rural Dignity of Canada*, Investor's Book of Authorities (Tab 75).

¹⁰⁹ Canada's Counter-Memorial at paras. 91 and 92.

¹¹⁰ Report of Robert Campbell at para. 90.

While describing Canada Post as fitting within the “public” model of postal organization, Robert Campbell also acknowledges that it has elements of both the “market” and “mercantilist” models. He describes the “mercantilist” model as the policy of building the postal operator into a “national champion”.¹¹¹ Such a policy is completely antithetical to the liberalizing framework of NAFTA and its national treatment obligation. It is these “mercantilist” aspects of Canada’s policies towards Canada Post that are in dispute in this arbitration.

87. Together with this Reply, the Investor has filed the expert report of Mr. James Campbell, an attorney specializing in international and comparative laws relating to postal regulation and who has consulted for governments, postal operators and courier companies. James Campbell notes that Canada Post lies outside of the broad postal policy contours of modern postal regimes in the industrialized world. In Canada, unlike many other industrialized countries, there is no clear boundary between the authority and responsibility of Cabinet and that of Canada Post.¹¹² For example, Canada’s witnesses repeatedly refer to unwritten “informal directives” from the Minister even though the Minister has never used the directive power in the *Canada Post Corporation Act*.¹¹³ Thus, it is unclear to what extent postal services in Canada result from Cabinet decisions and to what extent they result from Canada Post independently.

B. Canada’s Reliance on the Universal Postal Union Is Misplaced

88. In its Counter-Memorial, Canada dwells at great length on the nature of the Universal Postal Union (“UPU”), seeking to find a definition of the USO stemming from the UPU.

¹¹¹ Report of Robert Campbell at 8.

¹¹² Expert Report of James Campbell at para. 75.

¹¹³ Affidavit of Gordon Ferguson at para. 72 at Tab 11 of Canada’s Brief of Affidavits and Expert Reports.

Canada's statements about the UPU are strewn with errors and inaccuracies. Canada mischaracterizes the origins of the UPU and obscures the nature of its decisions. Canada misstates several key provisions of the Acts of the UPU, including the scope of the USO. In so doing, Canada overstates the content of its UPU obligations. Finally, Canada relies on various UPU provisions, but fails to mention that it has entered reservations to those same provisions. Together, these errors and inaccuracies paint an entirely misleading picture of the UPU and the USO.

89. Contrary to Canada's assertions in its Counter-Memorial, the UPU was not created to promote or protect universal postal service.¹¹⁴ Rather, the UPU was created to overcome the limitations of a patchwork of bilateral postal treaties dealing with rights of transit. Canada repeatedly confuses rights of transit with universal service.

90. The primary accomplishment of the *Universal Postal Convention* of 1874 was to secure a harmonized right of transit for international mail.¹¹⁵ The UPU originally established a set of rules for the exchange of mail between postal administrations. Its objective was contained in Article 1 of the UPU Constitution:

The countries adopting this Constitution shall comprise, under the title of the Universal Postal Union, a single postal territory for the reciprocal exchange of letter-post items. Freedom of transit shall be guaranteed throughout the entire territory of the Union.¹¹⁶

91. Thus, the only specific legal obligation imposed on member countries was to guarantee freedom of transit. Furthermore, the extent to which member countries were required to establish delivery networks for postal items depended entirely on the interpretation of the

¹¹⁴ Canada's Counter-Memorial at para. 69; Report of Robert Campbell at para. 17; Expert Report of James Campbell at para. 23.

¹¹⁵ Expert Report of James Campbell at para. 23.

¹¹⁶ UPU Constitution, Article 1, Canada's Book of Authorities (Tab 1).

phrase “single postal territory”. In its Counter-Memorial, Canada fails to mention that the UPU has declared this phrase to be figurative rather than legal. The UPU made this declaration at the 1994 Seoul Convention, stating that the phrase must be figurative because “strictly speaking, there is no single postal territory covering all the states and territories which compose the UPU”.¹¹⁷

92. Contrary to Canada’s submissions, the Universal Service Obligation is a very recent phenomenon. As James Campbell explains, the UPU did not oblige member countries to provide universal service until the Beijing Congress in 1999 and the resulting *Universal Postal Convention* which came into force on January 1, 2001.¹¹⁸ Prior to 1999, the UPU explicitly disclaimed any effect on the national postal legislation of member countries. Furthermore, member countries did not provide universal postal service at the time of the UPU’s creation. Leading countries such as the United Kingdom and the United States did not achieve universal service until the 20th century. Even in the mid-1990s, only one-third of national postal administrations provided delivery in rural areas five days per week.¹¹⁹
93. The Tribunal should also note that the UPU is not a disinterested source of international law. The decisions of the UPU have been substantially influenced by the financial interests of national postal operators, as well as by public interest considerations.¹²⁰ In its Counter-Memorial, Canada refers to the UPU’s social and cultural objectives but fails to mention that the UPU is also concerned with protecting and promoting the financial

¹¹⁷ UPU Constitution, Article 1, Commentary 1.1. An identical notation appeared in the official versions of the Constitution following the 1979, 1984, and 1989 congresses.

¹¹⁸ Expert Report of James Campbell at para. 27.

¹¹⁹ Expert Report of James Campbell at para. 32.

¹²⁰ Expert Report of James Campbell at para. 24.

viability and commercial success of national postal operators. In fact, UPU activities during the fifteen years preceding the 1999 Beijing Congress reflected an institutional preoccupation with improving the capacity of national postal monopolies to compete with private courier companies.

94. Finally, Canada fails to mention that the already-limited scope of UPU obligations is further reduced by many countries' use of the reservation and declaration mechanism. As James Campbell notes, in recent years countries have freely used reservations and declarations to opt out of legislative provisions that are inconsistent with national legislation or with other international treaties.¹²¹ Canada is no exception to this trend, having registered multiple reservations. Despite the fact that it has registered at least 24 reservations to the 1999 UPU Convention and Regulations, Canada omits to mention the reservation mechanism in its Counter-Memorial.

C. The Universal Postal Union Does Not Define the USO

95. Contrary to Canada's submissions, the Acts of the UPU do not define or specify Canada Post's USO. Canada mischaracterizes the burden, if any, imposed by the UPU. The Acts of the UPU do not impose specific obligations on member countries.
96. The USO contained in Article 1 of the 1999 *Universal Postal Convention* is so flexible that any burden of compliance on Canada is minimal. The UPU does not define the USO, nor does it prescribe its components for member countries. It merely provides broad, voluntary indications. Article 1 reads:

In order to support the concept of the single postal territory of the Union, member countries shall ensure that all users/customers enjoy the right to a universal postal service involving the permanent provision of quality basic postal services at all points in their territory, at affordable prices.¹²²

¹²¹ Expert Report of James Campbell at para. 26.

¹²² UPU Convention (1999), Letter Post Manual, Section A, Article 1, Canada's Book of Authorities (Tab 3).

97. In July 2001, following the adoption of the universal service provision by the Beijing Congress, the UPU released the Memorandum on Universal Postal Service Obligations and Standards (“UPU Memorandum”).¹²³ Its purpose was to compile information about the content of USO service and quality standards for member countries.¹²⁴
98. Canada fails to mention that the UPU Memorandum is not a source of international law, and therefore is not binding. Instead, Canada cites selective excerpts from the UPU Memorandum as if it was bound by the broad suggestions contained therein. Canada also misstates the guidelines contained in the UPU Memorandum.
99. Like the Acts of the UPU, the UPU Memorandum describes the USO in very flexible terms and establishes a very narrow scope for USO products. It specifically disclaims any authority to dictate the scope of universal service to member countries. It makes absolutely clear that the UPU interprets the provisions of Article 1 of the 1999 *Universal Postal Convention* with great flexibility. It expressly allows for differences between member countries. For example, the UPU Memorandum describes the USO in the following terms:
- It is not very easy to define which components of the letter post should form part of the Universal Postal Service, given that most countries have divergent views on this subject.¹²⁵
100. The UPU Memorandum notes that in some member countries the USO covers a wide range of letter post products, while in others it is limited to ordinary letters weighing up to

¹²³ UPU Memorandum, Canada’s Schedule of Documents (Tab 3).

¹²⁴ UPU Memorandum at 2, 35.

¹²⁵ UPU Memorandum at 16, s.3.1.1.

20 grams.¹²⁶ Indeed, the only requirement of the USO contained in the UPU Memorandum is only that member countries should provide for the collection and delivery of 20 gram letters at all points in their territories.¹²⁷ It does not require member countries to provide universal service for other letter post items such as direct mail or publications, nor does it require parcel service. It clearly states that daily delivery of universal postal service is *not* a general obligation of member countries.¹²⁸ The UPU Memorandum reiterates that prices should be affordable, but it does not require that rates for universal service should be uniform throughout the member country.

101. A careful reading of Canada's Counter-Memorial further reveals just how difficult it has been for Canada to derive a USO definition from the 1999 UPU Convention.¹²⁹ In particular:

- a. Instead of citing the UPU Memorandum, which describes the USO in very flexible terms, Canada cites the Commentary on Article 1 of the UPU Convention.¹³⁰ This Commentary was added by International Bureau staff and does not reflect any consensus among member countries;¹³¹
- b. Canada describes the service obligations of transit mail as if they pertained to the USO.¹³² Canada states that the postal administrations are required to forward

¹²⁶ UPU Memorandum at 16, s.3.1.1.

¹²⁷ Expert Report of James Campbell at para. 43.

¹²⁸ See "*Implementation of the Beijing Postal Strategy*", Beijing Congress at 6; Expert Report of James Campbell at para. 26.

¹²⁹ Expert Report of James Campbell at para. 42.

¹³⁰ Canada's Counter-Memorial at para. 449; Expert Report of James Campbell at para. 42.

¹³¹ Expert Report of James Campbell at paras 13 and 42.

¹³² Canada's Counter-Memorial at para. 450.

postal items “always by the quickest routes and the most secure means”, without noting that this provision pertains to transit mail, not universal service; and

- c. Canada incorrectly asserts that the USO “applies to all mail items, including both letter post and parcels”.¹³³ However, the UPU Memorandum explicitly states that national collection and delivery of parcels is not required by the UPU Convention:

*A second possible component of the Universal Postal Service is postal parcels, even though this service is not part of the Universal Postal Service in all member countries but only in a slight majority of them [emphasis added].*¹³⁴ ...

102. Canada then alleges that the “real definition” of the USO is not derived from Article 1 of the UPU Convention, but rather from the 400 pages of detailed regulations.¹³⁵ This is patently untrue. In his Expert Report, James Campbell observes that the phrase “universal postal service” appears only in Article 1 of the UPU Convention, and must be interpreted in light of that limiting factor.¹³⁶ In fact, the other provisions of the UPU Convention and the 400 pages of detailed regulations do not impose any additional Universal Service Obligation on Canada:

- a. The other rules contained in the UPU Convention and its Regulations apply only to international mail, which represented a very small share of the mail;¹³⁷
- b. The vast majority of the rules related to international mail are optional by their terms. For example, the provisions related to terminal dues and express mail

¹³³ Canada’s Counter-Memorial at para. 451.

¹³⁴ UPU Memorandum at 17, s.3.1.2.

¹³⁵ Canada’s Counter-Memorial at para. 75.

¹³⁶ Expert Report of James Campbell at para. 50.

¹³⁷ Expert Report of James Campbell at para. 52.

service (“EMS”) provide that administrations may regulate these areas on the basis of bilateral agreements.¹³⁸ In fact, Canada Post has negotiated specific bilateral terminal dues and EMS agreements with the United States;¹³⁹

- c. Canada could have exempted Canada Post from the burdensome elements of these rules by means of a reservation, and has done so in several instances.¹⁴⁰ For example, Canada cites Article 7, which imposes rules for charges for international postal services, as part of the burden imposed by the UPU.¹⁴¹ However, Canada has filed a reservation that permits it to collect postal charges “other than those provided for in the Regulations”. Similarly, Canada refers to the obligations imposed by rules pertaining to terminal dues and air conveyance dues, yet Canada has filed reservations to both of these provisions;¹⁴² and
- d. The majority of the costs associated with the rules on international mail are normal costs of doing business with international partners.¹⁴³ Such provisions do not create a burden on Canada Post as they are merely normal business practices that any private postal supplier would perform in the absence of a treaty.

¹³⁸ See UPU Convention (1999), Articles 47(8) and 61; Expert Report of James Campbell at para. 41.

¹³⁹ See Postal Convention Between Canada and the United States of America, Article 16, Investor’s Book of Authorities (Tab 149); EMS Agreement between Canada and US, Investor’s Book of Authorities (Tab 4).

¹⁴⁰ Expert Report of James Campbell at para. 54, footnote 38.

¹⁴¹ Canada’s Counter-Memorial at para. 77(b).

¹⁴² Canada’s Counter-Memorial at para. 77(i), Protocol to UPU Convention ss.24, 25.

¹⁴³ Expert Report of James Campbell at para. 43.

**D. Canadian Law Does Not Implement the Universal Postal Convention or
Otherwise Define the USO**

103. Contrary to Canada's submissions, Canadian legislation does not define or specify Canada Post's USO. In Canada, treaties must be implemented by legislation to have effect in domestic law.¹⁴⁴ Neither the text nor the substance of the UPU Convention have been incorporated into domestic law. All of the laws and regulations cited by Canada predate the USO obligation contained in the 1999 UPU Convention. Thus, these statutes cannot be the implementing legislation for the UPU Convention. Accordingly, the UPU Convention has no validity in Canadian law and does not impose binding obligations on Canada Post.
104. Canada relies on Canadian legislation to define the USO, but this legislation predates the entry into force of the 1999 *Universal Postal Convention* by twenty years. Canada relies on the *Canada Post Corporation Act*, Regulations, and Canada Post policies and practices for the content of its USO. However, the *Canada Post Corporation Act* and the Regulations made thereunder date back to 1981. Canada has not made any changes to the *Canada Post Corporation Act* in response to the 1999 UPU Convention that created the USO.
105. In any case, the *Canada Post Corporation Act* does not mention "universal service", much less formally define the concept. Similarly, none of the fifteen regulations made thereunder mention "universal service", much less formally define it. The *Canada Post Corporation Act*'s requirement that Canada Post shall provide "basic customary postal service" is known as a statutory service requirement rather than a universal service requirement.¹⁴⁵

¹⁴⁴ *AG for Canada vs. AG for Ontario (Labour Conventions)* [1937] WL 25550; [1937] A.C. 326; *Pfizer Inc. v. Canada (T.D.)*, Court File No. T-667-99, [1999] 4 F.C. 441; [1999] F.C.J. No. 1122, *Investor's Book of Authorities* (Tabs 148 and 170, respectively).

¹⁴⁵ Expert Report of James Campbell at para. 70.

106. Aside from Canadian law, Canada is itself unsure of the content of its USO. This uncertainty is evidenced in the various definitions of the USO provided throughout the course of this arbitration. -----

----- Now, in its Counter-Memorial, Canada defines its USO to include express letter services.¹⁴⁷

107. All that the Investor can discern from Canada's discussion of its USO is that the obligation imposed by the 1999 UPU Convention is indeed a flexible one. Canada's own definition of its USO is inconsistent and sometimes contradictory. Such inconsistency is only possible as a result of the vagueness surrounding the USO in Canada's national legislation.

E. The Content of Canada Post's USO, If Any, Is Meaningless Compared to Other Industrialized Countries

108. Canada's failure to define the USO makes it impossible to determine the resulting burden, if any, on Canada Post. In modern postal regulation, an USO is a legal provision in which a superior legal entity requires an inferior legal entity, under threat of penalty, to provide a "minimum range of services of specified quality ... for the benefit of all users, irrespective of their geographic location".¹⁴⁸ In a legal sense, it is impossible to have a USO unless there is a definition of universal service and a government that requires a national postal administration to provide the services in question.

¹⁴⁶ Canada's Answers to Interrogatories, Question 257, Investor's Schedule of Documents (Tab U290).

¹⁴⁷ Canada's Counter-Memorial at para. 68.

¹⁴⁸ Expert Report of James Campbell at para. 60, European Postal Union Directive 1997/67/EC, recital 11 (Tab U285).

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109. As James Campbell sets out in his Expert Report, most industrialized countries have concluded that the national post office should be structurally separated from government and managed in a commercial manner. The complement of permitting a national postal administration to act in a commercial manner is that the government must define precisely the minimal level of national postal service required of the national postal administration.¹⁴⁹ In the absence of a defined USO, it is impossible to ensure fair competition between the postal monopoly and its competitors in non-monopoly markets.
110. The widespread practice of industrialized countries is to provide a clear indication of what the USO entails. Although the precise instrument or definition that establishes the USO varies among industrialized countries, each of them has established a basis for such legal authority. Moreover, there is similarity among these documents. In Appendix D to his Expert Report, James Campbell provides examples of the USO contained in these national documents. They range from licenses in the United Kingdom, to regulations in Australia, to ordinances in Germany. Canada lacks any equivalent legal authority for the USO.
111. These countries also provide detailed definitions of the USO. In the European Union, the definition of USO includes scope of service, access, quality of service, and user rights.¹⁵⁰ In Australia, the USO is essentially limited to monopoly services. In New Zealand, the USO includes scope of service, access, quality of service, and stamp prices. For these latter two countries, the USO is less onerous than in European Union member states, but it is nonetheless, defined in significant detail. Canada's failure to define its USO means that Canada Post is effectively granted monopoly powers without any clear responsibilities.

¹⁴⁹ Expert Report of James Campbell at para. 61.

¹⁵⁰ Expert Report of James Campbell at para. 88.

F. Canada Post's USO, If Any, Is Not Burdensome

112. Although Canada's failure to define its USO has made it difficult to determine precisely the resulting burden on Canada Post, it is nonetheless apparent that any USO of Canada Post is not nearly as burdensome as its Counter-Memorial suggests.
113. Canada's claim that Canada Post is subject to a burdensome USO in national law is unsubstantiated. The source, content, and object of the USO in Canadian law are indiscernible. As a result, it is unclear the extent to which the postal services actually provided result from discretionary decisions, and the extent to which these postal services are required by law. It remains also unclear which entity - Cabinet or Canada Post - is subject to the USO. Given the inability to identify the source, content, or object of the USO in Canadian law, it is impossible to determine the extent of the burden that Canada alleges is imposed on Canada Post.
114. In any case, the USO is not the burden that Canada makes it out to be. In order to demonstrate that the USO contained in Article 1 of the UPU Convention is a significant cost burden for Canada Post, Canada must demonstrate that Canada Post and its competitors would not voluntarily deliver to every address in Canada at affordable rates. The obligation imposed by the UPU Convention is very flexible. It does not require daily delivery or uniform rates. UPS Canada delivers to every address in Canada even though it does not enjoy the economies of scale and scope resulting from a governmental monopoly. Canada has not demonstrated that Canada Post would not provide the same services as it does now without a USO.

G. The Burden of the USO, If Any, Does Not Justify Preferential Treatment of Courier Services

115. To the extent that the USO is a burden on Canada Post, it receives numerous advantages from the Government of Canada to offset that burden. These measures are not at issue in

this arbitration, but they demonstrate both the governmental nature of Canada Post and the advantages that Canada Post receives in return for fulfilling the USO:

- a. Canada Post is exempt from paying any provincial income taxes in each of the ten Canadian provinces where it carries on business. This exemption reduces its effective income tax rate by between 4 to 7 per cent in nine of the ten provinces.¹⁵¹ Canada Post is also exempt from paying corporate capital taxes in the various provinces of Canada that impose such a tax;
- b. Canada Post is exempt from paying real property taxes on any of the lands and buildings that it owns throughout Canada. Pursuant to the *Payments in Lieu Of Taxes Act* of Canada, Canada Post has the legal right to “negotiate” the payment of a sum, “in lieu of real property taxes,” with each municipality in which a Canada Post building is located.¹⁵² These negotiated sums will ordinarily be *less* than the amount of taxes that would be charged to a company such as UPS, if UPS had owned the same property. Canada Post is one of the largest landowners in Canada;
- c. Canada Post is exempt from paying land transfer taxes,¹⁵³ and
- d. Canada Post is one of the largest corporations in Canada, but it only became subject to pay Canadian federal income tax for the very first time in 1994, and

¹⁵¹ Canada Post “*Ensuring Universal Service at Affordable Rates*”: June 1996, UPS document no. 5148-5175 at s.2.09 (Tab U78). This document also suggest that in the 10th province, Quebec, the exemption actually increases Canada Post’s effective income tax rate by 1 %.

¹⁵² See *Payments in Lieu of Taxes Act*, Investor’s Book of Authorities (Tab 146).

¹⁵³ *Land Transfer Tax Act* of Ontario, section 2(8), and section 29(1) of the *Interpretation Act* of Ontario. Land transfer tax is charged on the purchase price of the land and building. The higher the price, the more land transfer tax is payable by the purchaser. See Investor’s Book of Authorities (Tab 154).

capital gains tax in 1996.¹⁵⁴

116. In his Expert Report, James Campbell demonstrates that countries with more clearly defined and burdensome USOs still take measures to ensure competitors are treated fairly. In fact, all industrialized countries surveyed, except for Canada, have adopted a regulatory framework for postal services that establishes restraints on unfair competition.¹⁵⁵

117. In modern postal regulation, the objective of independent regulation is two-fold: to ensure the fairness and quality of universal service; and to prevent the public postal operator from competing unfairly against private companies. It is obvious that a commercially-oriented national postal administration cannot be entrusted with responsibility for these objectives because it has a contrary incentive. In the words of the Government of France:

[A]n increasing number of States have considered they could no longer be “judge and party” and have chosen to separate public authority responsibilities from operational functions both organically and functionally.¹⁵⁶

118. All surveyed countries that have a postal monopoly also have an independent regulator of the monopoly. There is a consensus among industrialized countries that the issues posed by competition between national postal administrations and private courier companies require postal operators to maintain cost accounts using a method defined by an impartial body (legislative or regulatory) and overseen by an independent regulator.¹⁵⁷

¹⁵⁴ Canada Post “*Ensuring Universal Service at Affordable Rates*”: June 1996, UPS document no. 5148 - 5175, at 5162 (Tab U78).

¹⁵⁵ Expert Report of James Campbell at para. 78.

¹⁵⁶ UPU, Council of Administration GT 1.1 1996.1 Doc. 4. Para. 13, Investor’s Schedule of Documents (Tab U572).

¹⁵⁷ Expert Report of James Campbell at para. 119 and 144.

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119. In the European Union, the European Postal Directive requires each Member State to designate “one or more national regulatory authorities for the postal sector that are legally separate from and operationally independent of the postal operators”.¹⁵⁸ Even the United States, which has not yet undertaken all of the elements of postal reform, has established an independent regulatory agency called the Postal Rate Commission.¹⁵⁹ Contrary to Canada’s allegations, UPS does not demand that Canada follow the model of the US Postal Rate Commission. Instead, this model is simply an example of the many forms of independent regulation around the world that are absent in Canada.
120. Canada is alone in the fact that it has a postal monopoly, yet refuses to undertake modern postal reform.¹⁶⁰ There is no clear boundary between the authority and responsibility of Cabinet and that of Canada Post. Canada has failed to adopt a formal, transparent, objective definition of universal service. Canada has provided no indication of its intention to repeal the postal monopoly. Finally, Canada has failed to provide for independent regulation.¹⁶¹
121. Canada’s repeated invocations of a nebulous USO cannot justify its preferential treatment of courier services. Many industrialized countries have clearly defined USOs that impose significant burdens on their governments and national postal administrations. These countries still take measures to ensure competitors are treated fairly. Canada cannot opt out of fair competition rules on this basis.

¹⁵⁸ Directive 1997/67/EC Article.22, submitted with the Expert Report of James Campbell.

¹⁵⁹ Expert Report of James Campbell at para. 108.

¹⁶⁰ Expert Report of James Campbell at para. 115.

¹⁶¹ Expert Report of James Campbell at para. 113.

IV. THE COMPETITIVE ADVANTAGES OF CANADA POST'S NETWORK

122. As a result of its monopoly and related privileges, Canada Post has developed a vast network which no competitor can replicate. Canada Post gives its competitive services access to the network to take advantage of economies of scale and scope. Conversely, Canada Post rarely gives access to UPS Canada and, when it does, it never gives access on terms as favorable as those it gives to its own competitive services.

123. In its Counter-Memorial, Canada provides an inaccurate and incomplete description of Canada Post's network and the competitive advantages that Canada Post's competitive services receive from access to that network. Much of Canada's description of the network is contradicted by its own comments elsewhere in the Counter-Memorial and those of its experts.

A. Canada Post's Infrastructure Derives from Its Monopoly

124. Contrary to Canada's claims,¹⁶² UPS never alleged that Canada Post's Monopoly Infrastructure was *exclusively designed* for the delivery of the monopoly product. UPS refers to Canada Post's infrastructure as the Monopoly Infrastructure because the size and scope of the infrastructure *derives* from its monopoly.¹⁶³ Canada admits that the infrastructure is characterized by economies of scale and scope¹⁶⁴ and could not be

¹⁶² Canada's Counter-Memorial at para. 149.

¹⁶³ See Investor's Memorial at para. 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 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." 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."

¹⁶⁴ Canada's Counter-Memorial at para. 155: "... Canada Post is entitled to take advantage of economics of scope and scale to improve its operating efficiency and customer service."

sustained if Canada Post did not have an exclusive privilege.¹⁶⁵

**B. Canada Post's Competitive Services Benefit from the Monopoly
Infrastructure**

125. Both Canada and its economics experts admit that Canada Post's competitive services use the Monopoly Infrastructure¹⁶⁶ and enjoy the benefits of its economies of scale and scope.¹⁶⁷ Canada's bald claims that the infrastructure is more of a burden than a benefit to its competitive services¹⁶⁸ is unsubstantiated and contradicted by the statements of its own experts. As explained by Canada's expert Professor Cooper:

¹⁶⁵ See, for example, Report of Michael Crew at para. 13, Canada's Brief of Affidavits and Expert Reports (Tab 9): "the 'exclusive privilege' ... is a critical method of funding the USO;" Report of Paul Kleindorfer at para 50 of Canada's Brief of Affidavits and Expert Reports (Tab 20): "For products in the reserved area of the PO, such as letter mail below the reserved area threshold ... competition is prohibited in order to assure a viable USO"; Affidavit of Francine Conn at para. 7: "The exclusive privilege is necessary in order for Canada Post, like other postal administrations, to ensure the viability of its operations in relation to various social and policy obligations, including the universal service obligation."

¹⁶⁶ See Canada's admissions and a description of the access enjoyed by Canada Post's competitive services in Chapter III of Part Two of the Investor's Memorial at pages 46 - 62.

¹⁶⁷ Canada's Counter-Memorial at para. 155: "... Canada Post is entitled to take advantage of economics of scope and scale to improve its operating efficiency and customer service." See also comments from Canada's economic witnesses. For example, Report of Paul Kleindorfer at para. 46: "It is important to emphasize that it is efficient for both parcels and letter mail to provide contributions to cover the fixed costs of the USO network. *Both products use the network and both products profit from economies of scale and scope driven by the fixed costs and ubiquity of the network* [emphasis added];" Expert Report of John Panzar at 3, Canada's Brief of Affidavits and Expert Reports (Tab 29): "My conclusions are as follows: Canada Post's participation in competitive markets is consistent with its statutory mandate ... [this] conclusion is based upon the nature of *efficient industry configurations* in cases in which there are cost complementarities (scope economies) between monopoly and competitive services;" Report of Michael Crew at para. 65, Tab 9 of Canada's Brief of Affidavits and Expert Reports: "... scale and scope economies provide contributions to overhead justifying a PO's activity in competitive markets ..."; see also Report of Michael Bradley in s.3(A), Canada's Brief of Affidavits and Expert Reports (Tab 3).

¹⁶⁸ For example, see Canada's Counter-Memorial at para 150: "... the universal service obligation is not a privilege or a competitive advantage. It is an onerous domestic and international obligation that, has not "enabled" Canada Post to develop and maintain a delivery network, but rather, has required substantial investment and requires ongoing costs for its fulfilment;" at para. 165: "Canada Post's authority to place its mail boxes on public property is, from a strictly business perspective, more of a burden than a benefit;" at para. 166: "One measure of CPC's burden is the extra outlets it is obligated to operate."

C. The Operation of Canada Post's Monopoly Infrastructure

126. While the size and scope of Canada Post's network derive from its exclusive privilege, the network also developed to deliver competitive products such as parcels. Indeed, Canada goes to great lengths to point this out when arguing that the title "Monopoly" Infrastructure is inappropriate.¹⁷⁰

127. After stressing the importance of competitive products in the development of the network, Canada then contradicts itself and argues that the network is inappropriate for use by competitors. -----

-----¹⁷¹ Canada argues that the differences in induction and delivery of its products imply that its infrastructure is inappropriate for courier company products.¹⁷²

¹⁶⁹ Report of Robin Cooper at 24, Canada's Brief of Affidavits and Expert Reports (Tab 7).

¹⁷⁰ Canada's Counter-Memorial at para. 149.

¹⁷¹ -----

----- Canada's Counter-Memorial at para. 141.

¹⁷² Canada says Canada Post's "induction points are usually small buildings, lower capacity vehicles and mail boxes. Unlike couriers like UPS of America Inc., Canada Post's core market is therefore small products. Canada Post is effectively restricted from moving large volumes of large parcels of freight because of this limited collection capacity." Canada's Counter-Memorial at para. 160.

128. Canada's reversal is unjustified. Canada Post's network is suited to the delivery of products by courier companies. Canada understates the importance of small item delivery to courier companies like UPS Canada and understates the importance to Canada Post of higher weight and volume delivery.

129. -----
----- and a significant percentage are inducted through drop-offs at boxes, retail stores or authorized shipping outlets. This percentage would be even higher if UPS Canada had access to the same extensive retail network that Canada Post is able to sustain as a result of its monopoly.¹⁷⁴

130. In addition to understating the importance of drop-off induction and residential delivery to UPS Canada, Canada understates the importance of larger volume delivery to Canada Post. Many of Canada Post's competitive services offer scheduled pick-up and some also offer "on-call" pick up.¹⁷⁵ Indeed, Canada Post's own brochure says that businesses with a minimum volume of packages, combining both monopoly and courier services, qualify for a daily pick-up service.¹⁷⁶ -----

¹⁷³ Reply Witness Statement of Alan Gershenhorn at para. 4.

¹⁷⁴ Reply Witness Statement of Alan Gershenhorn at para. 2.

¹⁷⁵ Reply Witness Statement of Alan Gershenhorn at para. 3. See also Expert Report of Melvyn Fuss at paras. 39-46.

¹⁷⁶ Xpresspost brochure at 2283, Investor's Schedule of Documents (Tab U10).

¹⁷⁷ Reply Witness Statement of Alan Gershenhorn at para. 3.

D. Purolator's Discriminatory Access to the Monopoly Infrastructure

131. Canada hardly attempts to argue that UPS Canada enjoys the same access to the Monopoly Infrastructure as Priority Courier, Xpresspost and other Canada Post competitive services because it cannot. -----
----- but cannot claim that UPS Canada enjoys access on the same terms. While Canada occasionally says that its ----- Canada provides no evidence to support these bald statements.¹⁷⁸

132. Evidently accepting that Canada Post does not give UPS Canada access on the same terms as services such as Priority Courier and Xpresspost, Canada instead concentrates on arguing UPS Canada enjoys the same access as Purolator. Canada even fails at this task.

133. -----

134. -----

-----ial at para. 124: -----

¹⁷⁹ See, for example, Canada's Counter-Memorial at para. 191.

¹⁸⁰ Canada's Counter-Memorial at para. 189.

----- Comparing the access, and terms of access, enjoyed by Purolator with that enjoyed by UPS Canada demonstrates that Canada's claim is groundless.

135. Canada Post gives Purolator extensive access to its network, including the following areas:

a. *Sale and Use of Stamps:* Canada Post allows customers to buy stamps at Purolator centers,¹⁸² and pay for Purolator products with stamps and meters;¹⁸³

b. *Sales at Retail Outlets:* All Canada Post outlets sell Purolator's domestic and international products. -----

c. -----

d. -----

¹⁸² Affidavit of Francine Conn at para. 53.

¹⁸³ See Canada Post Canada Postal Guide, October 2000, Section D, Chapter 1, Page 1 (D12891) Investor's Schedule of Documents (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), at AA00467, Investor's Schedule of Documents (Tab U290).

¹⁸⁴ Affidavit of Francine Conn at paras. 32 - 37.

¹⁸⁵ Affidavit of Francine Conn at paras. 50 - 51.

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e. -----

f. *Access to Delivery Boxes:* Canada Post allows Purolator packages to be deposited in its Post Office (“PO”) boxes.¹⁹⁰ Canada Post authorizes its letter carriers to use a master key to open apartment and community mail boxes to deposit Purolator products if no signature is required;

g. -----

¹⁸⁶ See Canada’s Interrogatory answers to Investor’s Information Request to Canada dated April 25, 2003, question 122(d), AA00441, Investor’s Schedule of Documents (Tab U290).

¹⁸⁷ Affidavit of Bill Henderson at paras. 25 - 28.

¹⁸⁸ Affidavit of Bill Henderson at para. 25.

¹⁸⁹ Affidavit of Bill Henderson at para. 28.

¹⁹⁰ See, for example, letter from Midlake Post Office to PO Box Holders of February 15, 2000: “Due to Canada Post regulations effective March 1st, 2000, we will only accept Priority Post and Purloater [*sic*] deliveries for our Postal Box customers. All other courier companies will be refused [*sic*] 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, Investor’s Schedule of Documents (Tab U146).

¹⁹¹ Affidavit of Francine Conn at para. 58.

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- h. *Bills:* Canada Post includes Purolator services on its letter mail bills.¹⁹² Canada Post will not provide monopoly services to customers who have not paid their bill; and

 - i. *Advertisements:* Canada Post advertises Purolator services in the same advertisements for its monopoly services¹⁹³ and Purolator advertisements are delivered with letter mail and without stamps.

136. -----

-----¹⁹⁵

137. Canada has provided none of this information. During the document production stage of

¹⁹² See, for example, Canada Post document, “Discover Shipping Solutions That Travel The World”, P74-8 (Tab U57) in which Canada Post indicates that consumers will “get only one bill for all your shipping within Canada, across the border, around the globe.”

¹⁹³ See, for example, Canada Post document, “Around the world with Canada Post”, P69-11 (Tab U576) in which Canada Post advertises Purolator International and Xpresspost USA.

¹⁹⁴ Generally, see Canada’s Counter-Memorial at para. 191. Specifically, in regard to Purolator’s:

- ----- Francine Conn at para. 53;
- -----

- ----- see: Affidavit of Francine Conn at para. 57.

¹⁹⁵ Supplementary Expert Report of Howard Rosen dated August 6, 2005 (Tab 23).

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-
- b. *Sales at Retail Outlets:* Canada Post forbids its franchised offices and outlets from selling competing courier companies' services.²⁰¹ Canada claims that Canada Post genuinely offered UPS Canada access to its retail stores to sell its products.²⁰² Canada is incorrect.

Canada Post merely initiated discussions with UPS Canada following a previously undisclosed informal government directive to offer access to the network. -----

----- Geoffrey Bastow, who negotiated on behalf of UPS
Canada, -----

²⁰¹ See Investor's Memorial at para. 154 and the documents referred to there.
²⁰² Canada's Counter-Memorial at para. 170.
²⁰³ Affidavit of Francine Conn, Exhibit K.
²⁰⁴ Witness Statement of Geoffrey Bastow at para. 5.
²⁰⁵ Witness Statement of Geoffrey Bastow at para. 6.

c. -----

d. -----

e. -----

f. *Access to Delivery Boxes:* UPS Canada cannot deliver to Post Office,²⁰⁷ apartment or community mail boxes.²⁰⁸ Canada claims UPS Canada has equal access because there is nothing preventing it from agreeing with apartment owners to construct separate mailboxes for its products.²⁰⁹ As explained by Mr. Gershenhorn in his Reply Witness Statement, UPS Canada does not have such equal access:

Apartment owners are expected to have mail boxes for letter mail and Canada Post will not usually need to negotiate with them for this. Once mail boxes are installed, Canada Post has the exclusive right to deposit competitive service products in them. By contrast,

²⁰⁶ Reply Statement of Alan Gershenhorn at para. 10.

²⁰⁷ Canada's Interrogatory answers to Investor's Information Request to Canada, question 228(c), AA00404-AA00468 at AA00465, Investor's Schedule of Documents (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 1st, 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, Investor's Schedule of Documents (Tab U146).

²⁰⁸ Canada's answer to question 227(c), Investor's Interrogatories (page 61); Investor's Schedule of Documents (Tab U290); See also decision of Justice Cullen, Federal Court of Canada, June 1995, file T-2075-93, Investor's Book of Authorities (Tab 68).

²⁰⁹ Canada's Counter-Memorial at para. 184.

apartment owners are reluctant to construct separate boxes for courier items and such agreements are, in my opinion, rare. Even where they do exist, they need to be negotiated, are more restrictive and more costly.²¹⁰

- g. ----- - *Bills and Advertisements*: UPS Canada has not been offered access to any of these aspects of the network infrastructure.

E. Canada Post's Discriminatory Offer of Access to Interlining

139. Purolator is the only courier company, other than Canada Post's own physical distribution services, that enjoys access to many different aspects of Canada Post's network. Only Purolator enjoys access to Canada Post's retail, collection, transportation and delivery services discussed above. This fact alone raises serious doubts regarding Canada's claims that Purolator's access is at "market rates." If there was truly a market rate, then one would expect to see other courier companies accessing the network at these market rates.
140. The only example offered by Canada of a courier company other than Purolator accessing Canada Post's network is for interlining and distribution services. This is the only aspect of the network where competitors such as Federal Express and, on a few occasions, contractors or affiliates of UPS Canada, enter into agreements with Canada Post.
141. Canada suggests that UPS Canada's lack of use of interlining and distribution services demonstrates a lack of interest by UPS Canada in accessing its network. Canada's argument is wrong for two reasons. First, UPS Canada does have an interest in accessing other parts of Canada Post's network but has never been offered such access.²¹¹ Second, Canada's own evidence demonstrates that even the access for interlining and distribution services is on discriminatory terms.

²¹⁰ Reply Statement of Alan Gershenhorn at para. 7.

²¹¹ Reply Statement of Alan Gershenhorn at para. 8.

142. An outright denial of access is simply an extreme case of a discriminatory offer of access. It is access at an infinite price.²¹² Canada admits that Canada Post's interlining services are offered to competitors at "market prices." At the same time, Canada Post allows its own competitive services to access this network not at "market prices" but just for a contribution that need only exceed incremental cost. The same types of courier services are charged different prices simply because the service is provided by Canada Post itself.

²¹² Expert Report of David Sappington at para. 11.

V. CANADA POST'S DISCRIMINATORY LEVERAGING OF THE NETWORK

143. Together with its Memorial, the Investor filed the expert report of Dr. Kevin Neels, an economist with extensive experience in postal and regulatory matters. Dr. Neels explained that Canada Post's monopoly allowed it to capture economies of scale and scope that are not equally available to its competitors, thereby providing it with a competitive advantage in non-monopoly markets.

144. Canada has retained a number of different experts to critique Dr. Neels' report. None of these experts dispute his conclusion that Canada Post's monopoly allows it to benefit from economies of scale and scope. -----
-----²¹³ Instead, these experts insist that, as a matter of economic efficiency and sound business practice, Canada Post should exploit these economies.

145. However, Dr. Neels did not argue that the economies of scale and scope from the Monopoly Infrastructure should be wasted. Instead, he explained 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".²¹⁴ Such equal treatment of competitors could be achieved by charging its own competitive services arm the market price for access to the Monopoly Infrastructure.

146. After reviewing Canada Post's documents, Dr. Neels concluded that Canada Post does not provide equal treatment. Instead, it merely attempts to avoid the technical definition

²¹³ See quote from Report of Robin Cooper at para. 24, Appendix B, section "Economic Advantage".

²¹⁴ Expert Report of Kevin Neels at para. 45.

of cross-subsidization, which is a necessary but not a sufficient condition for equal treatment of competitors. Dr. Neels further observed that Canada had not produced documents that would be responsive to UPS' document request relating to cross-subsidization and the few documents that were produced raised serious questions about whether Canada Post was even meeting this minimum standard.²¹⁵

147. Given that Canada Post clearly does not even attempt to meet the equal treatment standard, Canada has retained a number of experts to critique the equal treatment standard, sometimes in language that descends to the level of *ad hominen* attacks on Dr. Neels.²¹⁶ These attempts fail. Dr. Neels has provided a lengthy and thorough rebuttal of his critics. His Reply Report is supplemented by the Expert Report of Professor David Sappington, an eminent economist who confirms that Dr. Neels' conceptual framework reflects widely-accepted economic theory. In addition, Robert Cohen, a former Director of the US Postal Rate Commission, confirms that Canada has refused to produce reasonably available documents and that those documents that have been produced raise serious questions that Canada Post is not even meeting the incremental cost test for cross-subsidization.
148. Canada attempts to resolve this dispute simply by retaining multiple experts to make the same points. However, a better approach to choosing between the different experts is to examine whether their assumptions are consistent with the factual record before this Tribunal. As demonstrated below, Canada's economic experts share a number of factual assumptions that are inconsistent with Canada's own evidence, including:

²¹⁵ Expert Report of Kevin Neels at paras. 15 and 16.

²¹⁶-----

- a. assuming that Canada's policy objective is to maximize economic welfare regardless of how these gains are distributed between USO and non-USO consumers. Canada states its objective is solely to fund the USO;
- b. assuming the sole issue is cross-subsidization and thereby ignoring equal treatment;
- c. assuming Canada Post's managers act solely to maximize profits. Canada states that they pursue various social objectives;
- d. assuming that Canada Post has an efficient network. The record demonstrates otherwise; and
- e. assuming that Canada Post is subject to pure price cap regulation. The present arrangement cannot be characterized in this manner.

149. The equal treatment standard is also more consistent with established regulatory practices than the test employed by Canada's economists. As Canada has never subjected Canada Post's accounting methodology to independent outside scrutiny, it is not surprising that it reflects a very narrow view of cross-subsidization that would not be accepted by any regulator with a mandate to ensure fair competition. Finally, even Canada's own test does not appear to have been met given Canada's failure to disclose the underlying documents and the highly ambiguous statements of its own witnesses.

A. The Issue Is Equal Treatment Not Cross-Subsidization

150. Canada devotes much of its Counter-Memorial to the issue of cross-subsidization. Canada explains that cross-subsidization occurs when a company offering both monopoly

and competitive services subsidizes the competitive services through the monopoly services. Canada also correctly identifies that the traditional narrow economic test for cross-subsidization is to determine if the competitive services are paying the long run incremental cost of their use of the network that also provides monopoly services. None of this is in dispute.

151. Canada then claims that UPS is trying to replace the traditionally accepted test for cross-subsidization with its own “equal treatment” test. UPS is doing no such thing.

152. -----
----- By focusing on “equal treatment”, UPS is merely requiring Canada to meet a different test than the cross-subsidization test for a different context. UPS is merely requiring Canada to meet a test of fairness in competition by a governmental monopoly that differs from the standards applied to some private monopolies in contexts such as anti-trust law. This fairness test recognizes Canada’s own stated public policy goals and the different incentives faced by a Crown Corporation such as Canada Post.

153. Canada can ensure that Canada Post’s competitive services receive no competitive advantage through their exclusive access to the Monopoly Infrastructure. One way would be for Canada Post’s competitive services to pay a sum to use the network that equates to the competitive advantage gained. This sum would necessarily be greater than incremental cost.²¹⁷ Since incremental cost is the technical test for cross-subsidization,

²¹⁷ UPS is, therefore, not arguing that costs should be *fully* distributed as some of Canada’s economics experts incorrect imply. See, for example, the extensive discussion of “fully distributed costing” in the Report of Michael Bradley at 9 - 16 and of “full absorption costing” in the Report of Robin Cooper at 16 - 20. Similarly, UPS is not arguing that the equal treatment test be used as a test for entry, as suggested by the Report of Michael Bradley at 33, Report of Robin Cooper at 34 - 35, and Expert Report of John Panzar at 49. See Dr. Neels’ response to these suggestions and a rejection of the claim that equal treatment prevents entry into profitable industries at paras. 18 - 49 of Expert Reply Report of Kevin Neels.

Canada must show more than just that Canada Post does not cross-subsidize to show that it provides equal treatment.

154. In this way UPS is not attempting to *replace* the cross-subsidization test. UPS is merely holding Canada to a different standard for a different purpose. This standard addresses the competitive advantages while retaining the economies of scale and scope. It ensures that the full benefits of the network are received by monopoly or USO consumers in accordance with Canada's stated policy objectives.

B. Equal Treatment Reflects Widely-Accepted Economic Theory

1. The Economic Rationale for Equal Treatment

155. Dr. Neels' analysis does not lack "foundation in economic theory" and is not "fundamentally contrary to regulatory practice," as Canada claims.²¹⁸ Indeed, Professor Sappington confirms that Dr. Neels' analysis reflects widely-accepted economic theory.
156. Professor Sappington is eminently qualified to make this assessment. He is the Lanzillotti-McKethan Eminent Scholar in the Warrington College of Business at the University of Florida and sits on the editorial boards of five leading economic journals. He previously served on the board of the *American Economic Review*, one of the world's preeminent economics journals.
157. Professor Sappington is an expert on regulatory economics. In addition to serving on the editorial board of the leading journal in this area, the *Journal of Regulatory Economics*,

²¹⁸ See, for example, Canada's claim at para. 273 of its Counter-Memorial that "Mr. Neels' "equal treatment" approach has no foundation in economic theory and is fundamentally contrary to regulatory practice." See Reply Report of Kevin Neels' response at paras. 13-17.

he was Chief Economist at the US Federal Communications Commission and has appeared before several national regulatory authorities.

158. Professor Sappington draws from his extensive experience and expertise to endorse Dr. Neels' analysis. Professor Sappington says that "[c]ross subsidization and unequal treatment are two distinct concepts. The absence of cross-subsidization does not imply equal treatment of competitors."²¹⁹ He also concludes that Dr. Neels' critics "have incorrectly portrayed Dr. Neels' recommendation for ensuring equal treatment as a cross-subsidy standard."²²⁰
159. Professor Sappington begins his report by explaining that, to an economist, the national treatment standard in NAFTA Article 1102 can be readily interpreted to require, at a minimum, symmetric treatment of industry participants. Symmetric treatment is consistent with, not contrary to, the objective of economic efficiency:

Absent such symmetric treatment, the most efficient and the most innovative service providers can be precluded from serving customers. Consumers suffer as a result, as they are denied the benefits of lower prices, greater product variety, and higher service quality that flow naturally from the competitive process and that free trade agreements like the NAFTA promote.²²¹

160. Professor Sappington then gives a simple numerical example of how a monopoly postal operator that scrupulously avoids cross-subsidization can still make it impossible for an unaffiliated shipper to compete successfully with an affiliated shipper. It does so by charging discriminatory prices for access to a key service that the monopoly provides, such as valued space in retail establishments. The affiliated shipper could be a subsidiary of the postal operator (such as Purolator) or simply the competitive services arm of the

²¹⁹ Expert Report of David Sappington at para. 7.

²²⁰ Expert Report of David Sappington at para. 7.

²²¹ Expert Report of David Sappington at para. 8.

postal operator (such as Canada Post's physical distribution arm). The result of the discriminatory treatment is that the unaffiliated shipper cannot compete successfully even though it is the most efficient provider of a final service.²²²

161. Professor Sappington goes on to say:

----- -23

162. He also says:

2. The Assumptions of Canada's Economists Contradict Its Stated Policy Objectives

163. The conclusions of the economics expert reports filed by Canada, which Canada quotes in its Counter-Memorial, are all based on an incorrect understanding of the facts. After these false assumptions are corrected, the reports say nothing to undermine Dr. Neels' or Professor Sappington's conclusions.

164. The passage from Professor Panzar's Report, from which Canada quotes, is based on two misunderstandings of the facts.²²⁵ -----

²²² Expert Report of David Sappington at para. 10.

²²³ Expert Report of David Sappington at para. 7.

²²⁴ Expert Report of David Sappington at para. 7.

²²⁵ Canada's Counter-Memorial at para. 278.

----- As explained above, Dr. Neels is doing no such thing.

165. ----- Dr.
Neels' welfare criteria, i.e. what he assumes to be Canada's policy objectives, are
precisely the criteria identified by Canada in its Counter-Memorial. -----

166. Canada's Counter-Memorial explains that Canada Post offers competitive services to
reduce the cost of the services it is purportedly obliged to offer under its USO. Canada
entitles one of the sections in its Counter-Memorial, "Canada Post Must Provide
Competitive Services to Fund The Universal Service Obligation."²²⁸ Canada's Counter-
Memorial quotes Francine Conn as saying:

167. Similarly, Canada's Counter-Memorial says that "[t]he primary public policy objective of
the postal service is to provide an affordable, domestic ... postal service to all addresses in

²²⁶ Expert Report of John Panzar at 44, quoted in Canada's Counter-Memorial at para. 278.

²²⁷ Expert Report of John Panzar at 44.

²²⁸ Canada's Counter-Memorial at page 37.

²²⁹ Canada's Counter-Memorial at para. 104; Affidavit of Francine Conn at para. 5.

Canada ...²³⁰ To best reduce the costs of USO services through its provision of competitive services, Canada Post must maximize the contribution such competitive services make to defraying the cost of the network.²³¹ -----

168. -----

169. Professor Cooper's comments are also replete with factual misunderstandings. Three of his four conclusions simply address Canada Post's ability to cross-subsidize, not equal treatment. His one conclusion that vaguely relates to the equal treatment standard is also premised on a misunderstanding. -----

-----³³ The issue before the Tribunal is whether Canada fulfils its NAFTA obligation to provide equal treatment and not the economic consequences of fulfilling those objectives. Regardless, Dr. Cooper is not correct when he says that equal treatment would reduce Canada Post's economic performance. Dr. Neels demonstrates that Dr. Cooper has relied on examples in which Canada Post is the inefficient supplier and should not be providing the service. In

²³⁰ Canada's Counter-Memorial at para. 68.

²³¹ Expert Report of David Sappington Report at para. 36; Reply Report of Kevin Neels at 17-22.

²³² Canada's Counter-Memorial at para. 124.

²³³ Report of Robin Cooper at Appendix B, quoted in Canada's Counter-Memorial at para. 280.

addition to likely increasing Canada Post’s efficiency, equal treatment would certainly increase the efficiency of the postal industry because it would ensure that the most efficient suppliers are not excluded from the market.²³⁴

170. Professor Kleindorfer also does not appear to have been fully informed of the facts when making the assumptions upon which his conclusions rely. -----

Professor Kleindorfer is obviously unaware that Canada’s stated welfare criteria, identified above, is not to maximize social welfare, subject to a certain constraint, but to maximize the welfare of the users of USO services. Professor Kleindorfer also appears to be unaware that Canada does not formulate the USO as a binding constraint on Canada Post, but merely one of its possible policy objectives.²³⁶

3. Canada’s Economists Mistakenly Assume Canada Post Maximizes Profit

171. Professor Kleindorfer claims that the “incentives are aligned” in the postal industry for Canada to provide equal treatment merely by leaving Canada Post with discretion to decide access.²³⁷ Professor Kleindorfer’s claim is based on the false assumptions that Canada Post maximizes profits and is subject to an effective price cap.

172. Canada’s Counter-Memorial demonstrates that Professor Kleindorfer’s assumption that Canada Post maximizes profits is incorrect. In its Counter-Memorial, Canada repeatedly

²³⁴ Expert Report of David Sappington at para. 8; see also Reply Expert Report of Kevin Neels at paras. 22 - 44.

²³⁵ Report of Paul Kleindorfer at para. 67, quoted in Canada’s Counter-Memorial at para. 281.

²³⁶ Report of Paul Kleindorfer at paras. 2 and 4.

²³⁷ Report of Paul Kleindorfer at para. 26.

attempts to distinguish Canada Post from UPS Canada because Canada Post pursues social objectives that are inconsistent with profit maximization. For example, Canada says the operations of Canada Post “focus on universal service in the pick up and delivery of mail across Canada, *at the expense of optimum profit, speed and reliability.*”²³⁸

173. Canada even refers to the 1995 report of Canada’s Auditor General to make the same point:

Corporations in the private sector operate with the understanding that maximizing shareholder wealth is the major priority. However the primary objective for public sector entities is not as clear cut. Many Crown Corporations are required to achieve self-sufficiency while at the same time meeting public policy objectives.²³⁹

174. Even Canada’s witnesses and experts, apart from Professor Kleindorfer, continually stress that Canada Post pursues social objectives inconsistent with profit maximization.

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175. Dr. Kleindorfer’s fellow economic expert, Dr. Crew, explains that Crown corporations, generally, do not maximize profits. He says that “since most POs are public enterprises, the profits they are allowed to earn are effectively restricted.”²⁴¹ Dr. Crew also describes a Crown corporation as a “middle ground between a government department and a private enterprise” and observes that Canada can direct Canada Post’s activities “to take into account over-riding public policy objectives.”²⁴²

²³⁸ Canada’s Counter-Memorial at para. 58 [emphasis added].

²³⁹ Quoted in Canada’s Counter-Memorial at para. 100.

²⁴⁰ Affidavit of Douglas Meacham at para. 101, Canada’s Brief of Affidavits and Expert Reports (Tab 27).

²⁴¹ Report of Michael Crew at para. 49.

²⁴² Report of Michael Crew at para. 70. See also Robert Campbell at 8:

CPC is linked to and embedded in the society that it has been designed to serve. Its role combines multiple

5. Canada’s Economists Mistakenly Assume Canada Post’s Network Is Efficient

178. In a footnote in his report, Dr Panzar acknowledges that -----
-----²⁴⁵ This would occur for the simple
reason that -----

----- -46

179. As Professor Sappington demonstrates, the record in this case raises serious doubts about Dr. Panzar’s assumption that inefficient network design is only a “theoretical possibility”.
In particular:

- a. Canada Post is aware that letter mail volume is declining due to electronic substitution and values expansion into competitive markets to prevent potential layoffs;²⁴⁷
- b. The *Canada Post Corporation Act* mandates that Canada Post consider a broad range of social objectives that create broad discretion for excess capacity in the network;²⁴⁸ and
- c. -----

²⁴⁵ Expert Report of John Panzar at footnote 7.

²⁴⁶ Expert Report of David Sappington at para. 13.

²⁴⁷ e.g. Report of Paul Kleindorfer at para. 12; The Press Release to the Multi-Year Policy Framework Agreement explicitly recognized the threat of electronic substitution and Canada Post’s rigid labour cost structure (Tab U480).

²⁴⁸ Expert Report of David Sappington at para. 16.

²⁴⁹ Expert Report of David Sappington at para. 44.

6. Canada's Economists Have Repeatedly Mischaracterized Dr. Neels' Report

180. Canada's Counter-Memorial quotes at length from a number of criticisms by Canada's economists of Dr. Neels' report. As set out in the lengthy and thorough Reply Report of Dr. Neels, most of these criticisms are of statements that were never made in his first report. Dr. Neels' critics have simply attacked a straw man of their own imagination. They offer examples that reflect implausible situations, assume perverse behavior by Canada Post or reflect incorrect reasoning.²⁵⁰

C. Equal Treatment Is Consistent with Widely-Followed Regulatory Practice

181. The broad economic support for equal treatment is reflected in international practice. After reviewing the cost accounting practices of regulators in many industrialized countries, James Campbell concludes:

... all countries [except Canada] have concluded that a public postal operator that operates in both noncompetitive and competitive markets should be required to charge prices for competitive products, either individually or collectively, at a level that covers not only incremental costs but also a reasonable share of common overhead costs.²⁵¹

182. James Campbell's comments reinforce the view that equal treatment is a widely used standard of fairness and not the extreme standard Canada's Counter-Memorial makes it out to be. The regulatory requirement to exceed incremental cost by some reasonable measure is a simple mechanism for implementing the concept of equal treatment.²⁵² None of the surveyed countries rely solely on -----

²⁵⁰ Reply Expert Report of Kevin Neels at para. 4.

²⁵¹ Reply Expert Report James Campbell at 119.

²⁵² Reply Expert Report of Kevin Neels at paras. 3, 78, 113 and Annex A.

D. Canada Post Does Not Even Meet Its Own Cross-Subsidy Tests

183. UPS has demonstrated above that Canada has failed to treat UPS Canada as equally as it treats Canada Post's competitive services -----

----- Contrary to Canada's claim in its Counter-Memorial, Canada is not treating UPS Canada equally simply if Canada Post's monopoly services are not cross-subsidizing its competitive services. Yet, Canada even fails to meet the low test it sets for itself.

184. Canada has refused to provide sufficient documents to determine if Canada Post was or was not cross-subsidizing. Those documents produced do not reveal either the details of Canada Post's methodology or the application of that methodology. The few documents submitted by Canada reveal that both the methodology used by Canada Post to declare it is not cross-subsidizing and the application of that methodology are flawed.

185. -----

²⁵³ Expert Report of Kevin Neels at paras. 87 - 109.

186. Canada Post's actions are:

... consistent with the actions of a firm that views its costing system principally as a potential source of regulatory constraint, and that desires to keep the percentage of its costs that are attributed to products relatively low and stable, so as to provide it with relatively large and relatively consistent reported contribution margins for its various product groupings.²⁵⁴

187. Neither Canada's Counter-Memorial, nor the reports on which it relies, provide reliable evidence to disturb this conclusion.

1. Canada Has Not Produced Reasonably Available Information Regarding Its Annual Cost Study

188. Canada presents evidence from Canada Post's former auditors. -----

-----²⁵⁵

189. Neither Dr. Cooper, nor Canada's other expert witnesses, actually opine on whether particular Canada Post competitive services are cross-subsidized by Canada Post's monopoly services. The most that these experts offer is that competitive service *groupings*, rather than individual products, are not cross-subsidized. -----

-----²⁵⁶ Mr. Price of Canada Post says the Competition Bureau found that Canada Post has not cross-subsidized Canada Post's "competitive services *group* or any market *grouping* of competitive services."²⁵⁷

²⁵⁴ Expert Report of Kevin Neels at para. 109.

²⁵⁵ Report of Barry Lalonde (ACS) at 3, Canada's Brief of Affidavits and Expert Reports (Tab 23) [emphasis added].

²⁵⁶ Report of Barry Lalonde (ACS) at 3 [emphasis added].

²⁵⁷ Affidavit of Bill Price at para. 43, Canada's Brief of Affidavits and Expert Reports (Tab 31) [emphasis added].

190. Conclusions on product groupings provide no evidence on the cross-subsidization of specific products. Cross-subsidized products can be grouped with non-subsidized products to produce a positive contribution to the group.

191. -----

192. For example, in supporting Canada Post’s costing methodology, Dr. Cooper says:

193. The documents described by Dr. Cooper fall within the scope of the UPS document request, but were not produced. Given that Dr. Cooper referred to these documents without attaching them as Exhibits to his report or filing them in the record, the Investor

²⁵⁹ Report of Robin Cooper at 53, Appendix B.

²⁶⁰ Reply Report of Kevin Neels at paras. 46-48.

²⁶¹ Report of Robin Cooper at 15.

²⁶² Report of Robin Cooper at 22.

wrote to Canada to once again request the documents. Despite this, Canada still refused to produce -----
-----Canada's position is that the Tribunal should just take Canada Post's word without allowing UPS to test its veracity.

194. In response to the allegations of Canada and Dr. Cooper that the UPS request for documents underlying its ACS was overly burdensome, UPS has filed the expert report of Robert Cohen. Mr. Cohen is a former Director of the US Postal Rate Commission. He observes that

195. As little as Canada's produced documents reveal about Canada Post's cost allocations, Canada's experts provide even less. Dr. Cooper simply bases his conclusions on the beliefs of Canada Post management. He says:

196. -----

²⁶³ Expert Report of Robert Cohen at para. 15.

²⁶⁴ Report of Robin Cooper at 51, Appendix B.

²⁶⁵ Report of Robin Cooper at 56.

2. **The Methodology Used by Canada Post**

197. -----
When applied by the USPS, Dr. Bradley's methodology has been severely criticized by the US postal regulator, the Postal Rate Commission. For example, in a 1998 decision,²⁶⁷ the Commission explicitly rejected Dr. Bradley's testimony, in which he advocated reducing the allocation to specific products from 96.7% of the mail processing labour costs to 77%.
198. In rejecting Dr. Bradley's testimony, the Commission specifically criticized Dr. Bradley's methodology. The Commission said it "would be willing to accept and to rely upon the [Bradley] tests if witness Bradley's testimony satisfied common and accepted standards for econometric practice. However, it is the Commission's opinion that it does not."²⁶⁸ The Commission went on to say that "Witness Bradley's model lacks a firm basis in economic theory"²⁶⁹ and:

[t]he amount of data that is removed [by Bradley from his analysis] is extraordinary. ... More than 22 percent of the original sample is discarded! ... It is evident ... that his [data] scrubbing introduces a substantial selection bias that tends to depress his volume variabilities."²⁷⁰

²⁶⁶ Report of Robin Cooper at 2.

²⁶⁷ United States of America Postal Rate Commission, Opinion and Recommended Decision Vol. 1, Investor's Schedule of Documents (Tab U578) Docket No. R97-1 decision (issued May 11, 1998).

²⁶⁸ Docket No. R97-1 at para. 3033, Investor's Schedule of Documents (Tab U578).

²⁶⁹ Docket No. R97-1 at para. 3039, Investor's Schedule of Documents (Tab U578).

²⁷⁰ Docket No. R97-1 at paras. 3045 and 3046, Investor's Schedule of Documents (Tab U578).

199. In Canada, there is no independent regulator, such as the Postal Rate Commission, to ensure the appropriateness of Dr. Bradley’s methodology. Canada Post’s auditors assume the validity of Dr. Bradley’s methodology in giving their limited opinions.²⁷¹

200. Canada’s experts not only fail to demonstrate that Canada Post’s monopoly services do not cross-subsidize its competitive services, -----

- 72

201. -----

- 73

E. Canada’s Failure to Ensure Equal Treatment Has Caused Harm to UPS

202. The harm caused to UPS by Canada’s failure to ensure equal treatment is easily seen through three steps. Neither Canada’s Counter-Memorial, nor the Kroll Report on which it relies, undermines the validity of any of these steps:

- a. By failing to require Canada Post’s competitive services to contribute a sum --
----- --to the Monopoly Infrastructure, Canada
has not treated UPS Canada equally. -----
-----Canada’s

²⁷¹ Reply Expert Report of Kenneth Dye at paras. 3-5.

²⁷² Reply Expert Report of Kevin Neels at para. 35.

²⁷³ Expert Report of Robert Cohen at paras. 16-19.

failure to ensure equal treatment has reduced Canada Post's competitive services' costs by at least the sum they should be paying -----

Given that what is at issue here is Canada Post's competitive services paying too few costs, it is perplexing how Canada can criticize Mr. Rosen of LECG for assuming "-----" ²⁷⁴ Canada's criticism of Mr. Rosen for -----
----- ⁷⁵ is equally invalid - -----

- b. Through these lower costs, Canada Post's competitive services charge lower prices and, therefore, take market share that could otherwise have gone to UPS Canada.

----- ⁷⁶ and

- c. UPS Canada's reduced market share has reduced the profits and, therefore, harmed UPS.

²⁷⁴ Canada's Counter-Memorial at para. 542 and response in para. 11(e) of Expert Report of Howard Rosen, March 22, 2005: "If CPC were required to fully allocate its operating costs on a market rate basis between its Postal Monopoly and Courier Services, its Courier Service costs would increase and the price of its Courier Services would increase accordingly."

²⁷⁵ Canada's Counter-Memorial at para. 553.

²⁷⁶ It is, therefore, inappropriate for UPS Canada's independent valuator's, LECG, to also comment on this as Canada suggests at para. 543 of its Counter-Memorial. See para. 11(b) of Expert Report of Howard Rosen, March 22, 2005: "In the conduct of our analysis, we have assumed the following: 'CPC provides non-monopoly courier and small package delivery services (the "Courier Services") which compete with UPS Canada and other courier companies' services and UPS Canada and CPC compete in the same economic sector for the same market share.'"

----- It is unnecessary for LECG to
further scrutinize these already audited statements, as Canada seems to suggest.

UPS needs only show that it suffered some harm from Canada's measure. That harm exists if UPS Canada would have made the profit from shipping one extra courier item but for Canada's measure. UPS would not need to build any extra capacity to ship one extra item. Regardless, UPS' existing market capitalization of US\$80 billion provides the resources and capability to service the incremental volume in Canada.²⁷⁷

²⁷⁷ Reply Report of Howard Rosen at page 6.

VI. LACK OF SUPERVISION OF CANADA POST'S DISCRIMINATORY CONDUCT

203. Canada Post benefits from a state-guaranteed monopoly and broad discretion with respect to postal policy. In its Memorial, the Investor explained that Canada had granted these extraordinary powers without any regulation or supervision that would ensure that they were not abused by Canada Post to gain advantages over its competitors. This combination of extraordinary powers without independent regulation is highly unusual both in Canada and the rest of the industrial world. Every single one of the many independent reviews of Canada Post's business conduct has warned the government that this lack of regulation has led to unfair competition, yet each of these warnings has gone unheeded.

204. Canada's response confuses the issue of lack of regulatory control or administrative supervision of Canada Post's exercise of its special legal privileges with the issue of corporate governance or with other forms of regulation that have nothing to do with its monopoly. Government supervision of corporate by-laws or regulation under the *Official Languages Act* or *Privacy Act* is simply not relevant to the issues in dispute. On the few occasions that the regulatory or administrative measures cited by Canada are relevant, they do not come close to meeting Canada's obligation to *ensure* that Canada Post's powers are not exercised in a discriminatory manner.

A. Canada's Lack of Supervision of Canada Post's Discriminatory Conduct Is Not Consistent with International Practices

205. In its Memorial, the Investor referred to Professor Robert Campbell's statement, with respect to Canada Post's monopoly powers, that "This complete absence of third party regulation of a public postal corporation is unique in the industrial world."²⁷⁸ Canada has now retained Robert Campbell as an expert witness and he has filed a report on its behalf.

²⁷⁸ Robert Campbell, *The Politics of the Post* at 352, Investor's Book of Authorities (Tab 64).

This report is highly inconsistent with his earlier writings including those written only a few years before his retainer by Canada Post.

206. In his previous writings, Robert Campbell wrote that Canada's regulatory regime is poorly designed, deliberately opaque, fragmented, ad hoc, confusing and inappropriate; that Canada should adopt third-party regulation; and that the 1999 Framework Agreement is tentative, incomplete, and insubstantial. In his Report for Canada, he now claims the opposite.
207. In order to avoid any suggestion that Robert Campbell has been quoted out of context, relevant excerpts from his previous writings are reproduced at length below. UPS' claim that Canada Post is effectively unregulated or poorly supervised with respect to its delegated governmental authority is entirely consistent with Robert Campbell's earlier writings as the following passages reveal:
- a. *This is particularly evident in the absence of an intelligent or reformed regulatory regime, which is perhaps the most striking lacuna in the two decades' experience of postal reform.* The Canadian case provides an excellent case study of how a poorly designed regulatory and governance environment generates weaker than optimal performance and inhibits postal development. As will be seen below, *the regulatory environment and process appears to be deliberately opaque and fragmented, to allow political control to be perpetuated in a surreptitious way. ... As a result, the Canadian regulatory regime is as informal and incoherent as it is inhibiting and political;*²⁷⁹
 - b. *The regulatory environment that was created [by the Canada Post Corporation Act] was highly informal and ad hoc;*²⁸⁰
 - c. The Conservative period, though, comprised a job only half done. The Post was corporatized and commercialized to a great extent. But this was carried out as an act of political will, in an informal and ad hoc manner without a formal process or regulatory pattern then or for the future. The Post was quasi-regulated, partially by competition and partially by the minister. The latter "looked the other way" to the extent that the Post continued to perform to the government's expectations and to

²⁷⁹ Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor's Schedule of Documents (Tab U498).

²⁸⁰ Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor's Schedule of Documents (Tab U498) at 279.

improve financially. *Thus, the Post as a “monopoly” was substantially unregulated.* The *Canada Post Corporation Act* - particularly its social objectives - was more or less ignored. No formal regulatory environment tracked CPC’s actions and performance. There were no operational criteria against which to judge CPC’s performance - save for the minister’s direct wishes. This was not a stable regulatory situation.;²⁸¹

- d. *The regulatory environment is fragmented, informal, and ad hoc. In this context, [Canada Post President] André Ouellet functions much more like minister of a department than as the president of a crown corporation;*²⁸²
- e. As noted, the *Canada Post Corporation Act* established a “gazetting” system for price changes. *Section 20 of the Act provided the public with a sixty-day period to respond to CPC’s announcement of a proposed price increase, and offered another sixty days for the minister to decide whether to accept the Post’s recommendation for a price increase - given the public input that has been received. This system had deteriorated to a trivial ritual by the time the Liberals returned to office.* There had been substantial public input regarding the price changes of January 1982, February 1983, and June 1985... But once the public developed a sense that the results were preordained, it lost interest in the process. ... *The regulatory practice of the gazetting of price increases had evolved, in effect, into a simple process of ministerial approval;*²⁸³

208. In its Counter-Memorial, Canada quotes at length from Robert Campbell’s vitriolic criticisms of the report of the Canada Post Mandate Review chaired by George Radwanski.²⁸⁴ In his 2002 book, however, Robert Campbell approved of many aspects of the Mandate Review and claimed that many of its suggestions were ignored for purely political reasons:

- a. Finally, the [Mandate Review] report illustrated the glaring weaknesses in the postal regulatory and governance structures, which Radwanski urged the government to strengthen bureaucratically

²⁸¹ Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor’s Schedule of Documents (Tab U498) at 282-283.

²⁸² Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor’s Schedule of Documents (Tab U498) at 293.

²⁸³ Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor’s Schedule of Documents (Tab U498) at 298.

²⁸⁴ Canada’s Counter-Memorial at paras. 227-228.

and through regulation. However, as we have seen and will see again, *the government chose to ignore this suggestion, precisely because a loose governance and regulatory regime made it easier to direct Canada Post to the national and political project;*²⁸⁵

b. ...There had been an increasing sense that the Canadian postal regime lacked sufficient regulatory formality. *For example, both the Radwanski report...and the TD Securities report had suggested the necessity of appointing some sort of governance or regulatory supervisor. This supervisor would evaluate and track Canada Post's activities against specific targets and expectations set by the government. The government instead determined to maintain the informal and opaque regulatory status quo. It did so precisely for political reasons.* The introduction of regulatory formality would expose the political character of the government's relationship with Canada Post. It would require the political scrutiny of its postal goals as well as some sort of policy-accountability system. An informal, ad hoc regulatory relationship suited government purposes better. It allowed the government to maintain a bargaining and deal-making relationship with CPC, one that evolved in an invisible and stable fashion;²⁸⁶ and

c. The Radwanski report of 1996 concluded: "The corporation is currently beyond any effective control by the government." There is an element of truth in this characterization. Canada Post has a great deal of autonomy within a fragmented, loose, and informal regulatory environment. Traditional or formal controls are indeed lacking, and public-accountability mechanisms are all but non-existent. What this "system" allows, though, is a high degree of ad hoc political manipulation and control.²⁸⁷

209. At paragraph 129 of his Report for Canada, -----
----- Yet, in the conclusion of
his 2002 book, he recommended that Canada adopt third-party regulation:

a. Parliamentary democracies tend to use the dual-authority departmental model (DOFA and DCITA in Australia, Finance and Commerce in New Zealand). However, the newly devised postal regime in the United Kingdom will include an independent third-party regulator. We anticipate that this will become the prevalent model in the future.

We recommend that this approach be given serious consideration and introduced in Canada, for a number of reasons. First, Canada has adopted the national postal model. For this reason, it is imperative that extra precaution be exercised in distancing the government (as shareholder) from regulatory practice. Second, *we anticipate that the exclusive privilege will be maintained in*

²⁸⁵ Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor's Schedule of Documents (Tab U498) at 303 and 304.

²⁸⁶ Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor's Schedule of Documents (Tab U498) at 312.

²⁸⁷ Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor's Schedule of Documents (Tab U498) at 286.

Canada for some time, given the perpetuation of the national model. If so, third-party regulation is needed to set a framework that will assure postal competitors and customers that the restricted area is not being abused. Third, there is a serious deficiency of postal expertise and intelligence in Canada. A third-party regulatory model will force members of the postal-policy community to be more professional and to articulate and defend their interests more precisely and concretely;²⁸⁸

b. ... We recommend following the British example and setting up a small, stand-alone regulatory operation, with a small staff and a limited budget, to exercise what we have called “passive” regulation;²⁸⁹ and

c. In sum, *third-party regulation in the Canadian regime would distance regulation further from the shareholding function, assure citizens and customers of the fairness of the postal regime, give assurance of good postal performance, and increase postal professionalism and understanding.* The regulator would report annually to Parliament and to the minister. This would form the basis for reconsideration and/or reconfirmation of various elements of the contract agreement. There is no need, then, for regulation to be elaborate, assertive, or heavy-handed. The regulatory regime should be designed to ensure a passive approach and a light-handed touch.²⁹⁰

210. Canada’s Counter-Memorial quotes the Report of Robert Campbell at length in an effort to justify its claims that it has exercised regulatory control or administrative supervision over Canada Post’s delegated governmental authority. This defense is built on a foundation of sand. The Report that Robert Campbell has filed for Canada offers opinions that are simply irreconcilable with his own writings.

211. In order to provide independent confirmation that Canada’s lack of regulation of its postal monopoly is indeed inconsistent with international practices, UPS asked international postal regulation expert James Campbell to survey the practices of industrialized countries such as the European Union, the United States, Australia and New Zealand. James Campbell concludes that Canada is the only country to maintain a monopoly

²⁸⁸ Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor’s Schedule of Documents (Tab U498) at 425.

²⁸⁹ Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor’s Schedule of Documents (Tab U498) at 426.

²⁹⁰ Robert Campbell, *The Politics of Postal Transformation* at 274 [emphasis added], Investor’s Schedule of Documents (Tab U498) at 427.

without independent regulation: “(1) to ensure the fairness and quality of universal service and (2) to prevent the public postal operator from competing unfairly against private companies”.²⁹¹

212. All countries surveyed by James Campbell, other than Canada, have concluded that adequate supervision of a postal operator that operates in both monopoly and non-monopoly markets requires transparent oversight of accounting rules by an independent regulator and not just the postal operator’s own auditors. Similarly, all countries surveyed, other than Canada, have concluded that fairness to competitors requires more than just contributions from competitive services that exceed incremental costs. Some reasonable contribution to overhead costs over and above incremental costs is also required.²⁹²

B. Canada Has Repeatedly Ignored Its Own Independent Reviews of Canada Post

213. In its Memorial, the Investor identified the following events which demonstrate that Canada is aware that Canada Post is engaging in unfair competition and has chosen to turn a blind eye:
- a. the decision to remove regulatory supervision by the Canadian Transportation Commission from the draft legislation to establish Canada Post;
 - b. the refusal to follow the 1984 Neilson Task Force recommendation to regulate Canada Post in the same manner as telecommunications providers;

²⁹¹ Expert Report of James Campbell at para. 98.

²⁹² Expert Report of James Campbell at para. 146-147.

- c. the refusal to follow the 1985 Marchment Committee recommendation to establish a permanent Postal Services Review Board;
- d. the elimination of the Postal Services Review Committee after its November 1989 report found that Canada Post was cross-subsidizing its competitive services;
- e. the April 1997 decision to disregard the formal finding of the Canada Post Mandate Review that Canada Post was engaged in cross-subsidization and unfair competition; and
- f. the April 1997 decision to ignore confidential advice from TD Securities Inc. that, if Canada chose to allow Canada Post to remain in competitive services, it should establish an independent regulator to prevent cross-subsidization and other abuses of the exclusive privilege.²⁹³

214. In its Counter-Memorial, Canada has only addressed two of these reports. First, with respect to the Postal Services Review Committee (“PSRC”), Canada has stated that “Contrary to the Claimant’s assertions, the PSRC was given only modest review powers and only the authority to make recommendations to the Government. The Progressive Conservative Government of the time preferred a *deregulated* environment” [emphasis added].²⁹⁴

215. This admission that Canada Post operated in a deregulated environment in 1989 is startling. Canada now claims that Canada Post is regulated, but there has been no

²⁹³ Investor’s Memorial at 74-86.

²⁹⁴ Canada’s Counter-Memorial at para. 223.

substantive change in the regulatory environment since 1989. Furthermore, UPS did not assert that the PSRC had anything other than modest review powers. It merely pointed out that the PSRC's finding of cross-subsidization was ignored by the government.

216. -----

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217. Mr. Radwanski's conclusions were the same as those of the PSRC and were based on recommendations from a staff seconded from other government departments. Canada criticizes Mr. Radwanski for hiring staff rather than relying on an "inexpensive" steering committee.²⁹⁶ Canada offers no reasons for why this expensive staff's conclusions on Canada Post's unfair competition were incorrect.²⁹⁷

218. Instead of offering a reasoned critique of the findings of the PSRC and the Mandate Review, Canada relies on vague and unsubstantiated comments by Robert Campbell that the Mandate Review shocked Canada Post and the postal community. As set out above, Robert Campbell's views today are not consistent with his writings prior to this arbitration.

²⁹⁵ Canada's Counter-Memorial at para. 226. See also Introduction section to the Mandate Review, Investor's Schedule of Documents (Tab U49).

²⁹⁶ Canada's Counter-Memorial at para. 227.

²⁹⁷ Later in its Counter-Memorial, Canada quotes a statement from the Competition Bureau that findings of cost misallocation, in and of themselves, do not suffice to demonstrate cross-subsidization. However, Mr. Radwanski did not base his conclusions solely on instances of cost misallocation. Rather, in light of Canada Post's refusal to produce all available information, Mr. Radwanski drew an inference of cross-subsidization from the limited available information. See Mandate Review at 19-48, Investor's Schedule of Documents (Tab U79).

219. Canada also expends considerable effort attacking the Mandate Review's recommendations regarding the abolition of the exclusive privilege and the sale of Purolator, relying again on Robert Campbell and the *TD Securities Report's* rejection of these recommendations. However, neither the abolition of the exclusive privilege nor the sale of Purolator are at issue in this arbitration. The dangers of unfair competition and the need for a regulator were confirmed by the very *TD Securities Report* on which Canada relies for its criticisms of the Mandate Review.

C. Cabinet Approval of Domestic Letter Mail Price Increases Does Not Prevent Unfair Competition

220. All of the prices for Canada Post's competitive services are completely deregulated. However, in its Counter-Memorial and expert reports, Canada relies on a purported "price-cap" on basic domestic letter mail resulting from a 1999 Framework Agreement to assert that it ensures, through regulatory control of basic letter mail prices, that Canada Post does not engage in unfair competition. The assertion does not withstand scrutiny.
221. There is nothing in the documents announcing the purported "price cap" to suggest it was introduced as a measure to regulate Canada Post's unfair competition. Nor does the prevailing regime possess the characteristics necessary for it to have such an unintended effect.
222. On January 18, 1999, the Government of Canada and Canada Post Corporation announced a *multi-year* policy framework that "established service, productivity and performance *targets*" for the corporation so that it "will be able to develop in an *increasingly competitive* domestic and international environment."²⁹⁸

²⁹⁸ "Multi-Year Policy Framework Established for Canada Post," Press Release, Government of Canada and Canada Post, January 18, 1999, Investor's Schedule of Documents (Tab U480). [emphasis added]

223. According to the 1999 Press Release, the policy framework proposes:

a financial management regime with appropriate targets for key business indicators, such as operating income, return on equity, dividend policy, and capital structure and leverage, while establishing challenging financial performance targets for the next five to seven years.

224. As part of this budgeting and planning exercise, Canada Post proclaimed that increases on the rate for basic domestic letter mail would be limited to: (a) only annually in early January and (b) no more than 66.67% of the Consumer Price Index. On January 29, 2000, Canada Post made a regulation codifying this policy with Cabinet approval.²⁹⁹ Although the 1999 Press Release refers to the submission of minimum service standards for Cabinet approval, no regulation of letter mail service standards has been adopted. Canada Post admits that it has set its own current service standards for letter mail.³⁰⁰

225. Canada's expert, Robert Campbell, now alleges that the 1999 Framework Agreement strengthened the regulatory environment. Canada has refused to produce a copy of the Agreement in response to UPS' document request, so it is difficult for UPS to comment on it.³⁰¹ However, Robert Campbell's 2002 book largely dismisses this document as inconsequential:

- a. If compared to the contract and service agreements between Post and government in Scandinavia and Australasia, it would pale in comparison. *The Framework Agreement is not really a plan or a manifesto but a policy paper*, although it does establish a kind of financial-management regime;³⁰²

²⁹⁹ See "Regulatory Impact and Analysis Statement, Investor's Schedule of Documents (Tab U483).

³⁰⁰ Affidavit of Francine Conn, Exhibit E.

³⁰¹ The Agreement falls within the scope of UPS document request 247. See the Investor's Schedule of Documents (Tab U294).

³⁰² Robert Campbell at 285.

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- b. *The Framework Agreement is the least public-service or contractual agreement of any examined in this study.* To begin with, the agreement is all but invisible. *The document is difficult to find and has not been published or distributed in a public way.* It has not been set out on any public platform. *The agreement contains no mechanisms for regular follow-up or for public reporting regarding CPC's performance against the standards or expectations of the agreement. The document is sparsely written and has little substance, background, or explanation.* Its array of targets and goals is limited and focused almost exclusively on financial targets. There is no elaboration of the components of the universal postal system or expectations about performance targets. There are few measures of productivity, service, and performance other than the most aggregated or general financial targets;³⁰³
- c. *First, the agreement represents the bare-minimum guidance provided by the government to project the impression of a regulatory framework. Second, the Framework Agreement is simply a spiced-up version of the status quo. It excludes the possibility of creating regulatory momentum to advance the framework between 1999 and 2004. ... Third, the framework fits the government's desire to maintain an informal regulatory and governance structure that will allow it to bargain with and use CPC for its political objectives.* In sum, the Liberals have maintained but not deepened a commercial orientation to postal policy while increasing their political command of the area. But the government has done little to adjust the governance environment to assist CPC in meeting product, technological, and international competition;³⁰⁴
- d. *With respect to process and evaluation, the Framework Agreement contains no accountability mechanisms or process, no evaluation expectations (save at the end of five years), and little mention of service standards and expectations;*³⁰⁵ and
- e. At the end of the Mandate Review process, the government and Canada Post adopted a Framework Agreement that appears to have been constructed in the spirit of the above discussion. *However, the Framework Agreement - which took years to produce - is a slender, tentative, and incomplete documents that is more akin to a policy framework or set of financial expectations than anything else.* It combines qualitative statements and wishes with quantitative financial goals, soft targets, and statements of service intent. Compared to documents such as New Zealand's Statement of Corporate Intent and Deed of Understanding, Canada's Framework Agreement looks like a set of preliminary or rough notes. Indeed, we recommend that the New Zealand pattern be adopted.³⁰⁶

³⁰³ Robert Campbell at 312 to 313.

³⁰⁴ Robert Campbell at 313.

³⁰⁵ Robert Campbell at 329.

³⁰⁶ Robert Campbell at 424 to 425. Campbell recommends that Canada prepare more elaborate contracts between the government and CPC. He goes on to recommend that regulatory department work with CPC to construct a Service Charter which "could be produced for a longer time-frame and include a range of targets, including delivery speed and rates of performance, delivery times, the extent of the network, conditions for subsidy of service activity (if any), retail outlets (total number and composition), formulas for closing retail outlets and changing Universal Service Obligations, and so on".

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226. Canada repeatedly refers to the 1999 Framework Agreement and the 2000 regulation as adopting a “price cap” for letter mail that deters unfair competition by Canada Post. However, there is no true price cap and, even if there were, it would do little to ensure fair competition. In particular:
- a. there is nothing in the 1999 Press Release or the 2000 Canada Post Regulatory Impact Analysis Statement that refers to the price cap as serving to ensure fair competition. This is an *ex post* rationale served up for the first time in this arbitration;³⁰⁷
 - b. the purported price cap is little more than a financial planning process for a five to seven year period. It is part of a series of budgetary and operating targets that are akin to the planning process that any unregulated private sector firm would present to its controlling shareholder.³⁰⁸ As explained in the expert reports of Dr. Neels and Professor Sappington, the effectiveness of a price cap depends both on it being “chiseled in stone” with no possibility for review and on the ability of the regulated firm to earn unlimited profits. The documents surrounding the introduction of the “price cap” specifically disclaim any intention to allow Canada Post to earn unlimited profits and it is difficult to conceive of such a situation being permitted given Canada Post’s social objectives.³⁰⁹ A price cap that is part of a financial planning process that sets target rates of return has none of the characteristics needed to render it effective;³¹⁰

³⁰⁷ “Multi-Year Policy Framework Established for Canada Post”, January 18, 1999, Investor’s Schedule of Documents (Tab U480); 2000 Regulatory Impact Analysis Statement, Investor’s Schedule of Documents (Tab U483).

³⁰⁸ “Multi-Year Policy Framework Established for Canada Post” (Tab U480).

³⁰⁹ Expert Report of David Sappington at paras. 23-26.

³¹⁰ Reply Report of Kevin Neels at paras. 9-17 and 58-66.

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- c. Nor does the *Canada Post Corporation Act* permit a true price cap. Cabinet has no authority to impose an indefinite price cap on Canada Post. Instead, Canada Post regulates its own prices. Canada Post is free to propose a new regulation and there is no evidence to show that Cabinet would reject it;³¹¹
- d. The purported price cap applies only to increases in *domestic basic* letter mail not exceeding 30 grams and not to all of Canada Post's exclusive privilege services.³¹² There is no price cap for domestic letter mail over 30 g and not exceeding 500 g (the maximum limit of the exclusive privilege). There is no price cap for United States or international letter mail, regardless of weight. Since 2000, Canada Post has repeatedly obtained approval to raise prices for international letter mail. The price increases have been many times greater than the rate of inflation. Addressed ad mail is not subject to any regulation even though it is part of the exclusive privilege. Even basic domestic letter mail prices may be effectively increased by reducing service standards, thereby increasing the true price,³¹³ and
- e. in any event, as set out in the expert report of Professor Sappington, even a true price cap would do little to ensure fair competition.³¹⁴

D. The Competition Bureau Does Not Regulate Discriminatory Conduct

227. In its Statement of Defence and Counter-Memorial, Canada has relied heavily on the fact that Canada Post is subject to the *Competition Act* in the same manner as private firms.

³¹¹ s.19(1) of the *Canada Post Corporation Act*, Investor's Schedule of Documents (Tab U218).

³¹² *Letter Mail Regulations*, ss. 3(4), (5) and Schedule in Investor's Schedule of Documents (Tab U483).

³¹³ See Increases in International and US Letter Mail Charts, Investor's Schedule of Documents (Tab U575).

³¹⁴ Expert Report of David Sappington at para. 23-26 and 29-33.

In its Memorial, the Investor explained that the mandate of the Competition Bureau does not extend to measures that ensure fair competition between a state-enforced monopoly exercising delegated governmental authority and its foreign competitors. The Investor referred to the Competition Bureau's own submission to the Canada Post Mandate Review which recommended that, in the event that the exclusive privilege was not abolished, Canada should consider a variety of regulatory measures to restrict Canada Post's incentives to cross-subsidize its competitive products. It also cited statements made by senior Competition Bureau officials that the Bureau's investigation into Canada Post's acquisition of Purolator was limited to technical issues of merger analysis and did not give Canada Post a "clean bill of health".³¹⁵

228. Canada has not addressed these prior statements in its Counter-Memorial. Instead, Canada and its witnesses have incorrectly attempted to cast the Competition Bureau into a regulatory role that it has repeatedly declined to perform. For example, in his Affidavit submitted on behalf of Canada, Gordon C. Ferguson, a former senior official of Canada Post, asserts that

Canada Post, like other corporations in Canada, is **regulated** by the Competition Bureau which administers and enforces the federal *Competition Act* to promote and maintain fair competition among Canadian firms. [emphasis added]³¹⁶

229. In fact, the Competition Bureau does not have any such regulatory mandate. This has been emphasized repeatedly by senior Competition Bureau officials in a number of public statements. In 1994, the then head of the Bureau has explained:

At the outset, it is important to note that *competition law is fundamentally different in approach and application from direct economic regulation of specific industries*. Unlike regulation, the *Competition Act* is a general law of general application, which cuts across all sectors of the economy from transportation to the manufacture of shoes; and from petroleum products to the information highway.

³¹⁵ Investor's Memorial, at paras. 260-266.

³¹⁶ Affidavit of Gordon Ferguson, para. 93, Canada's Brief of Affidavits and Expert Reports (Tab 11).

Also unlike economic regulation, competition law does not involve prior approval of business conduct. Competition authorities do not regulate levels of service, quality, prices or profits. Rather, they seek to provide a framework within which these outcomes can be freely determined by competitive market forces.³¹⁷

230. This sharp distinction between competition law and regulation has been drawn by another senior Bureau official, pointing out that competition policy is the antithesis of regulation:

Many of you might think of the Competition Bureau as a regulatory agency. That is certainly understandable, since in many ways the *Competition Act* and the Prohibition Order, by prohibiting certain types of anti-competitive conduct, appears to be regulating business behaviour. **However, competition policy is actually the antithesis of regulation. Unlike regulation, competition law does not involve prior approval for a course of business conduct. The Competition Bureau does not regulate levels of service, quality, prices or profits. Rather, the Bureau is an investigative agency whose purpose is to ensure that these outcomes are determined by competitive market forces.**³¹⁸ [emphasis added]

231. In summary, the Competition Bureau does not act as a regulator of Canada Post. The Bureau treats Canada Post like any other corporation operating in the Canadian economy.
232. The limits of the Bureau's role are illustrated in the Affidavit of Richard Annan filed on behalf of Canada. Mr. Annan explains that an analysis of predatory pricing or abuse of dominant position by the Competition Bureau will be limited to circumstances in which the dominant firm seeks to recoup lost profits once rivals have been disciplined or left the market and that cross-subsidization in and of itself is not an anti-competitive act.³¹⁹ In this case, UPS does not allege that Canada Post will raise prices after disciplining its competitors. It alleges that Canada Post keeps the prices of courier services low

³¹⁷ George Addy, Speech to the Board of Directors of the Canada Ports Corporation on September 27, 1994, entitled "*The Competition Act and the Canadian Transportation Sector in the 1990s*", Investor's Schedule of Documents (Tab U486).

³¹⁸ Harry Chandler [then Deputy Director of Investigation and Research (Criminal Matters)], speech to the 1998 Annual Conference and Trade Show of the Canadian Real Estate Association on September 27, 1998 entitled "*Closing the Deal: Ten Years after the Real Estate Prohibition Order*", Investor's Schedule of Documents (Tab U487).

³¹⁹ Affidavit of Richard Annan at paras. 23 and 33, Canada's Brief of Affidavits and Expert Reports (Tab 1).

indefinitely through the discriminatory leveraging of its monopoly. Canada Post does not seek to increase its profits, but rather to expand into new markets solely for the purpose of keeping its workforce employed in light of the decline in letter mail volume.

233. In its Counter-Memorial, Canada asserts that “As described in the Affidavit of Richard Annan, many of the Claimant's allegations are allegations of anti-competitive conduct.”³²⁰ This is a misleading characterization of Mr. Annan’s evidence who expressly states the contrary:

However, in order to determine, if, in fact the allegations made by UPS raise issues under the *Act* would require a detailed factual examination. Such an examination is beyond the mandate of this Affidavit.³²¹

234. In any event, in this arbitration, UPS is not alleging that Canada’s measures constitute anti-competitive conduct *per se*, but rather that Canada has violated NAFTA Article 1102, both directly and through Canada Post’s exercise of its delegated governmental authority, by providing competitive advantages to Canada Post that are not equally available to UPS. Mr. Annan does not purport to offer any opinion on this issue.
235. Under NAFTA and WTO jurisprudence, the analysis of whether two firms are “in like circumstances” or supplying “like products” will overlap with factors examined in antitrust market definition, but it will not be identical to them.³²² Similarly, an analysis of whether a state has offered a foreign firm the “equality of competitive opportunities” mandated by the national treatment obligation necessarily involves some analysis of competitive dynamics in a given economic sector. This analysis may overlap with issues examined by competition authorities, but it does not mean that international trade and investment disputes are the same as competition law disputes.

³²⁰ Canada’s Counter-Memorial, para. 203.

³²¹ Affidavit of Richard Annan, para. 3.

³²² This is explained in the Fuss Reply Report at paras. 6-11, which discusses the overlapping but different approaches under NAFTA / WTO jurisprudence and Canadian competition law.

236. The very limited role played by the Competition Bureau is also evident from a review of the Bureau's previous investigations of Canada Post. As acknowledged by Canada's expert Mr. Annan, the Competition Bureau only considered cross-subsidization in the technical sense of pricing below long run incremental cost.³²³ It did not consider the fairness of the incremental cost standard in the manner of most postal regulators.
237. The restricted nature of the Competition Bureau's investigations stands in stark contrast to the role of postal regulators in Europe, the United States and Australia, surveyed by Mr. James Campbell. As set out in his Expert Report, even though each of these jurisdictions have strong competition laws, they also have postal regulators that perform a very different additional function. These postal regulators review both the compliance of the postal operator with its Universal Service Obligation and the fairness of its rates (including rates for competitive services).³²⁴ In assessing the fairness of the postal operator's rates for competitive services, these regulators determine both the appropriate cost standard (having unanimously rejected incremental cost as a sufficient standard) and whether costs are in fact being allocated to competitive services in a manner that meets the designated standard. The Competition Bureau performs none of these functions nor does it pretend to do so.

E. The Audit Opinion Is "Meaningless Window Dressing"

238. When the Minister responsible for Canada Post rejected the recommendations of both the Mandate Review and the *TD Securities Report* regarding the potential remedies for Canada Post's unfair competition, she announced that Canada Post would hence forth include a statement from its auditors in its annual report confirming that it is not cross-

³²³ Affidavit of Richard Annan, para. 34.

³²⁴ Note that while Australia does regulate its post office through the Australian Competition and Consumer Commission (ACCC), the ACCC has been given special powers to act as a postal regulator that are supplementary to its general role as a competition authority. See Expert Report of James Campbell at para. 106.

subsidizing.³²⁵ This statement by the auditors is neither regulatory control nor administrative supervision, let alone sufficient to ensure that Canada Post does not use its delegated governmental authority in a discriminatory manner. It is a mere public relations exercise by Canada Post.

239. There is no law, regulation or formal Ministerial directive to Canada Post to perform the Annual Cost Study. At best, it is one of the “informal directives” repeatedly referred to by Canada which carries no formal sanction for non-compliance. Nor is there any evidence that there is administrative supervision by Canada of the Annual Cost Study beyond the Minister’s press release that Canada Post’s auditors should make a statement about the ACS in Canada Post’s Annual Report.
240. If this Tribunal finds that reliance on the auditors’ opinion is administrative supervision, it is certainly not supervision that can ensure that Canada Post does not unfairly exploit its monopoly to the detriment of competitors. The former Auditor General of Canada, Kenneth Dye, has described the statements issued by Raymond Chabot Grant Thornton, Canada Post’s auditors since 1999/2000, as “mere window dressing”. Nothing in Canada’s Counter-Memorial disturbs this conclusion.³²⁶ The auditor’s opinion on the ACS does not opine on the validity of the cost methodology in the ACS.
241. Mr. Dye did remark that the reliance by Canada Post’s previous auditors, KPMG, on the work of Dr. Michael Bradley was not in accordance with audit guidelines as Dr. Bradley had a direct contractual relationship with Canada Post. In its Counter-Memorial, Canada has disclosed that Dr. Bradley’s direct relationship with Canada Post began in 1999. Prior to that date, Dr. Bradley’s relationship was indirect, his retainer being with KPMG or its predecessor. While Canada makes much of this fact, it is only relevant to whether KPMG

³²⁵ See April 1997 announcement filed with Investor’s Memorial, Investor’s Schedule of Documents (Tab U95).

³²⁶ Expert Report of Kenneth Dye at paras. 21-31.

followed audit guidelines in statements made in the Annual Reports prior to 1999, a period of time largely outside the relevant period of this arbitration. It does not change the fact that KPMG was not performing an independent review of the validity of Dr. Bradley's methodology.³²⁷

242. Dr. Bradley's work for Canada Post is based on the very same methodology that he developed for the United States Postal Service.³²⁸ In the United States, the Postal Rate Commission routinely reviews Dr. Bradley's work and has required significant changes to be made to his methodology. Canada Post's auditors cannot perform any such function nor does KPMG's representative purport to have done so in his letters filed by Canada.³²⁹ It is likely for this reason that KPMG's successors watered down the statements filed in Canada Post's Annual Reports to the point that they provide very little assurance.³³⁰

F. Corporate Governance Is Not the Issue

243. In light of the absence of regulatory control or administrative supervision of the exercise of Canada Post's delegated governmental authority in a manner that ensures compliance with Canada's NAFTA obligations, Canada has attempted to confuse the issues before this Tribunal. In paragraph 201 of its Counter-Memorial, it has provided a laundry list of purported regulation of Canada Post. The list is neither regulatory control nor administrative supervision. Nor does it have anything to do with ensuring compliance with Canada's obligations to treat US investors in like circumstances no less favorably than Canada Post.

³²⁷ Reply Report of Kenneth Dye at para. 3.

³²⁸ Report of Michael Bradley at 2.

³²⁹ Reply Report of Kenneth Dye at para. 3.

³³⁰ Expert Report of Kenneth Dye at paras. 21-31.

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244. Much of Canada's laundry list consists of the normal functions that a sole shareholder would exercise in a private corporation such as appointing the Board of Directors and the President; authorizing borrowing; approving the sale of substantial assets; approving corporate by-laws; and appointing the auditors.
245. Other examples relate to the requirement of financial self-sufficiency, such as involvement in the corporate planning and budgeting process. Again, this would not be unusual in a private corporation. In any event, there is no allegation that Canada Post is not subject to a budget constraint. UPS does allege, however, that Canada Post's lack of clear profit maximization objective and its need to balance various amorphous policy considerations create incentives to price below incremental costs that do not exist in private firms. As set out in Chapter V above, Canada has repeatedly acknowledged that Canada Post does not have a profit maximization objective and its policy objectives are vague and undefined.
246. Canada acknowledges that Canada Post has never been subject to a formal Ministerial directive. Instead, Canada relies on vague "informal directives" of which it attaches only one example in a press release. By definition, an informal directive is not legally binding on Canada Post and does not clearly lay down any obligation. Such a non-transparent system can hardly qualify as a regulatory control or administrative supervision, let alone ensure fair treatment of competitors.
247. With the exception of the domestic letter mail pricing regulations and the *Competition Act*, the only laws and regulations cited by Canada are either completely irrelevant ones (such as the *Official Languages Act* and the *Privacy Act*) or the regulations granting the various legal privileges whose unfair exploitation is at issue in this case. As set out earlier in this Chapter, neither the domestic letter mail pricing regulations nor the *Competition Act* ensure that Canada Post does not abuse its governmental privileges at the expense of its competitors.

VII. PREFERENTIAL CUSTOMS TREATMENT OF POSTAL IMPORTS

248. In its Memorial, the Investor demonstrated that Canada has failed to meet its national treatment and international law standard of treatment obligations with respect to customs measures.³³¹ UPS did not ask for UPS Canada to be treated the same as Canada Post in all respects, recognizing that there were legitimate reasons for distinguishing between postal and courier imports. However, UPS did demand that the differences in the treatment be no less favorable to UPS Canada than Canada Post. It identified two sets of measures that resulted in less favorable treatment for UPS Canada in its competition with Canada Post in the market for express package and parcel imports as they bore no relationship to the rationale for the creation of different postal and courier streams:

a. *measures related to fees and charges for the performance of the same customs compliance procedures.* In particular:

i. UPS Canada is charged cost recovery fees for the services of customs officers and for electronic data interchange while Canada Post is not;

ii. UPS Canada is required to perform materials handling tasks for Canada Customs while Canada Post is paid to perform the same tasks; and

b. *measures related to the systematic lack of enforcement of customs laws in the postal stream relative to the courier stream.* In particular:

i. the exemption of postal imports from the need for brokerage services;

ii. the delegation of customs enforcement tasks to Canada Post; and

³³¹ Investor's Memorial at paras. 267-338 and 582-585.

iii. the failure to levy fines, penalties and interest against Canada Post.³³²

249. The Investor's Memorial filed evidence that the systematic lack of enforcement of customs laws in the postal stream resulted in Canada Post's failure to collect duties and taxes. This evidence included a carefully controlled study of 450 identical shipments performed by an independent expert, Mr. James Nelems (the "Nelems Study"). This failure to collect duties is known in the market place and results in the loss of business for UPS Canada.³³³

250. In its Counter-Memorial, Canada has raised the following defences:

- a. Canada allegedly does not take any measures relating to Canada Post because customs treatment is provided by Canada Customs to foreign postal administrations and not to Canada Post,³³⁴
- b. Canada Post and UPS Canada are not in like circumstances because it is impossible to compare the customs treatment between postal imports brought in by Canada Post and courier imports brought in by UPS Canada,³³⁵
- c. Canada does not provide treatment less favorable to UPS Canada because all

³³² The Investor's Memorial also referred to Canada's granting of additional time to Canada Post to remit duties and taxes, its exemption of Canada Post from various bonding requirements and from Goods and Services Tax on its handling fees. In light of the complexity of some of the defences raised by Canada in regard to these measures in its Counter-Memorial, the Investor has chosen not to challenge these measures in this Reply. It has done this solely to narrow the issues in dispute for the Tribunal and this decision does not represent an admission that these measures comply with NAFTA.

³³³ Investor's Memorial, paras. 330-338

³³⁴ Canada's Counter-Memorial at paras. 646-655.

³³⁵ Canada's Counter-Memorial at paras. 656-696.

courier companies receive the same treatment³³⁶ and, in any event, the treatment for courier imports is not less favorable than treatment for postal imports;³³⁷ and

- d. Canada denies that the Nelems Study is evidence of a systematic lack of enforcement of its customs laws in the postal stream.³³⁸

251. This section demonstrates that, contrary to Canada's Counter-Memorial:

- a. Canada's customs measures relate to Canada Post, which handles postal imports before they go to Customs;
- b. While there may be differences, or similarities, between customs measures relating to postal and courier imports, Canada Post and UPS Canada are still in like circumstances regarding parcel and package imports;
- c. Canada provides treatment less favorable to UPS Canada than provided to Canada Post as follows:
- i. Customs charges cost recovery fees to UPS Canada while not charging similar fees to Canada Post. At the same time, Customs pays handling fees to Canada Post for services that UPS Canada must perform for free;
- ii. Customs fails to levy fines, penalties and interest against Canada Post;
- iii. Canada exempts postal imports from brokerage requirements; and

³³⁶ Canada's Counter-Memorial at para. 697.

³³⁷ Canada's Counter-Memorial at paras. 698-703.

³³⁸ Canada's Counter-Memorial at paras. 366-375

- iv. Canada Customs fails to properly assess duties and taxes on postal imports.

252. Canada has also raised certain limitation period defences and alleged that the *Postal Imports Agreement* falls within the procurement exception under NAFTA Article 1108(7).³³⁹ These issues will be addressed in the discussion of these respective defences in the legal argument in Part III, Chapters III (B) and VI(G) of the Reply.

A. Customs Measures Apply To Canada Post and UPS Canada

253. Canada asserts that foreign postal administrations, and not Canada Post, are the recipient of the customs measures taken by Canada for postal imports. Canada states “this is not treatment accorded to Canada Post but to inbound foreign mail. Canada Post only presents inbound foreign mail to customs on behalf of the foreign postal administration or the sender.”³⁴⁰

254. It is interesting to note that Canada has unsuccessfully raised similar arguments before the WTO. The WTO have rejected these arguments.. For example, in the *Canada - Periodicals* case,³⁴¹ Canada claimed its measure was directed at “advertising” (which as a service was not covered by the GATT agreement but under the GATS) rather than magazines (which would fall under the GATT). The panel held that even if the GATS might apply, what was important was that the measures affected competitive opportunities of foreign and imported magazines (goods). Thus, the measure related to goods and to services.

³³⁹ Canada’s Counter-Memorial at paras. 704-709.

³⁴⁰ Canada’s Counter-Memorial at para. 646; see also, paras. 641, 651, 652.

³⁴¹ *Canada - Periodicals, Dispute Settlement Panel Report, WT/DS 31/R* 14 March 1997 at paras. 5.17 - 5.27, Investor’s Book of Authorities (Tab 66).

255. The process of customs inspection of postal imports demonstrates that the customs inspection of postal imports is jointly undertaken by Canada Post and Customs. Customs has responsibility to inspect all imports of goods into Canada.³⁴² Customs delegated responsibly to Canada Post to do the preliminary steps of customs inspection of mail, the identification of which items require primary customs inspection, through the terms of the *Postal Imports Agreement*. Under the terms of Annex C and section 4.1 of the *Postal Imports Agreement*,³⁴³ Canada Post sorts the incoming postal imports and provides Customs only with materials that contain goods. Customs is not authorized to generally open mail that does not contain goods under the *Customs Act*. Only then does Customs commence its primary and secondary inspection procedure for postal imports containing goods.
256. Canada Post first receives all imported mail in Canada. As Canada points out,³⁴⁴ Canada Post is obliged to present all mail containing goods to Canada Customs for inspection under subsection 42(1) of the *Canada Post Corporation Act* which provides:

All mail arriving in Canada from a place outside Canada that contains or is suspected to contain anything the importation of which is prohibited, controlled or regulated under the Customs Act or any other Act of Parliament shall be submitted to a customs officer.

This statutory duty is confirmed by paragraph 18 of Customs Memorandum D5-1-1.³⁴⁵

³⁴² *Customs Act*, section 12, Investor's Schedule of Documents (Tab U383).

³⁴³ *Postal Import Agreement* at s.4.1, Investor's Schedule of Documents (Tab U66).

³⁴⁴ Canada's Counter-Memorial at para. 346.

³⁴⁵ Customs Memorandum D5-1-1, Customs International Mail Processing System, Canada Customs and Revenue Agency, dated September 23, 2002. Appendix H to the Affidavit of Brian Jones, Canada's Brief of Affidavits and Expert Reports and Investor's Schedule of Documents (Tab U253).

The Affidavit of Hal Tobias, relied upon by Canada, admits that Canada Post sorts postal imports before they are first inspected by customs.³⁴⁶

257. In addition, the Investor relies on the Expert Report of Denise Polesello, a former Manager of Canada Customs' Postal, Courier / LVS and Casual Refund Programs for imported goods. Ms. Polesello states that Canada Post sorts the mail pursuant to Annex C of the *Postal Imports Agreement* before Customs conducts its inspection.³⁴⁷
258. Canada states that Canada Post takes control of international mail when it is "exchanged" at one of Canada's three International Mail Exchange Offices ("IMEO").³⁴⁸ In some instances, Canada Post takes control of the international mail before arrival at a Canada Post facility designated as an IMEO. For example, Canada Post takes letter mail coming from the United States (by truck) or Greenland (by boat) at a series of 11 transborder exchange point offices at border locations.³⁴⁹ None of these exchange points are located within an IMEO. Without inspection, Canada Post inducts such mail directly into its postal infrastructure for delivery without inspection.
259. Whether Canada Post obtains this treatment as an agent or as principal is simply irrelevant. The test is whether the customs measures that relate to Canada Post result in more favorable treatment than the measures that relate to UPS Canada.

³⁴⁶ Of course, Mr. Tobias needed not to admit this point, as the terms of the *Postal Imports Agreement* are very clear in this regard. In the Affidavit of Hal Tobias at para. 27 states that the Canadian Courier Association made a submission to the Canadian House of Commons Standing Committee on Consumer and Corporate Affairs and Government Operations stating that "Canada Post has permission to conduct a form of primary sortation before presentation to Customs personnel".

³⁴⁷ Expert Report of Denise Polesello at para. 19.

³⁴⁸ See Affidavit of Brian Jones at para. 54; Expert Report of Denise Polesello at paras. 18-21

³⁴⁹ See Appendix C to Memorandum D5-1-1, Customs International Mail Processing System, September 23, 2002 set out as Exhibit H to Affidavit of Brian Jones, Canada's Brief of Affidavits and Expert Reports and Investor's Schedule of Documents (Tab U253).

260. Just as customs measures apply to Canada Post, they also apply to UPS Canada regardless of whether it is acting as principal or agent for UPS. It is UPS Canada, not UPS, that:
- a. is charged for the provision of customs services and electronic data interchange;
 - b. performs materials handling tasks for Canada Customs;
 - c. pays fines, penalties and interest for failure to comply with customs procedures.³⁵⁰

B. UPS Canada and Canada Post Are in Like Circumstances

261. Canada asserts that UPS Canada and Canada Post are not in like circumstances because they operate under two different systems. In its Counter-Memorial, Canada goes to great length to describe, in great detail, the differences in the customs treatment of postal mail imports through Canada Post and courier imports through UPS Canada (and other courier companies).³⁵¹
262. UPS does not take issue with the customs measures applied to letter mail not containing goods which is within the exclusive privilege of Canada Post. However, various Canada Customs measures including those contained in the *Postal Imports Agreement* apply to all “mailable matter”. This term is not limited to monopoly letter mail but refers to all material sent from a foreign postal administration.

³⁵⁰ Witness Statement of Lisa Paré at paras.16-29

³⁵¹ Canada’s Counter-Memorial at paras. 656-696.

263. The *Postal Imports Agreement* explicitly covers Express Mail Services (EMS) and EMS/Priority Courier products, which are not part of the Canada Post letter mail monopoly and which compete with UPS and UPS Canada products. The *UPU Convention* describes EMS products as:

EMS shall be the quickest postal service by physical means and, in relations with administrations which have agreed to provide this service, **EMS takes priority over other postal items.**³⁵²

The treatment of EMS is currently undertaken pursuant to bilateral agreements with other postal administrations.³⁵³ However, EMS has been expressly excluded from the scope of both the current and the revised *Kyoto Convention*.³⁵⁴ Canada's attempt to justify its preferential treatment by reference to this agreement fails.

264. Canada Customs also gives preferential treatment to the non-EMS courier products of foreign postal authorities such as the US Postal Service's "Global Priority Mail", which is a courier package that is delivered in Canada within three to four days of mailing from the US.³⁵⁵ Both Canada Customs and Canada Post process global priority mail packages as soon as they arrive in Canada, on a priority basis.³⁵⁶

265. Finally, Canada Customs preferential treatment also applies to parcels that are imported through Canada Post from the US and other destinations. These parcel services compete

³⁵² Article 61(1), *UPU Convention* at Tab 3 of Canada's Book of Authorities [emphasis added].

³⁵³ In his Affidavit, Marcus Harding refers to Article 11 of the *UPU Convention* together with the EMS Standard Multilateral Agreement, as the basis of the EMS obligation. Mr. Harding is referring to the 2004 *UPU Convention*, which is not yet in effect and will not be until January 1, 2006. See footnotes 5 and 6 in the Affidavit of Marcus Harding, Canada's Brief of Affidavits and Expert Reports (Tab 16).

³⁵⁴ Expert Report of James Campbell at para. 153.

³⁵⁵ United States Postal Service's Products & Services, Investor's Schedule of Documents (Tab U489).

³⁵⁶ United States Postal Service, Global Priority Mail, Investor's Schedule of Documents (Tab U490).

with UPS and UPS Canada basic parcel import services such as UPS Standard.³⁵⁷ Canada has made an issue of the fact that: “Canada Post does not provide services to US customers through USPS (US Postal Service) or together with USPS. Canada Post merely delivers mail within Canada after it is released by Customs pursuant to Canada’s treaty obligations.”³⁵⁸ Canada re-emphasizes the point further by writing:

In no sense does Canada Post through USPS offer a product to US customers in competition with the Claimant, UPS Canada or both. Therefore, the Claimant’s argument that it is in like circumstances because it is in competition with Canada Post must fail.”³⁵⁹

For the reasons set out in Part Two, Chapter II of this Reply, Canada’s assertions in this regard are completely false. There is considerable evidence of the fact that Canada Post competes extensively in the US (with UPS and others) for shipments of goods into Canada.

266. Although the *Kyoto Convention* does provide for simplified customs treatment of parcels from foreign postal administrations, nothing in this Convention requires or recommends preferential treatment of such parcels over similar items conveyed by private operators.³⁶⁰ Whatever may be the similarities or differences between the customs treatment of postal mail imports and courier imports, Canada Post and UPS Canada are in like circumstances in that they both compete in the market for imports of parcels and packages that are outside the scope of the letter mail monopoly.

³⁵⁷ Expert Report of Melvyn Fuss at paras. 251-258.

³⁵⁸ Canada’s Counter-Memorial, para. 654.

³⁵⁹ Canada’s Counter-Memorial, para. 691.

³⁶⁰ Expert Report of James Campbell at para. 151.

C. Canada Provides Treatment Less Favorable

267. Canada has placed great emphasis on the existence of a separate regime for mail, including express delivery products handled by Canada Post, and for express delivery products *not* handled by national postal services, including those of UPS Canada that compete with products handled by Canada Post. On this basis, Canada argues that UPS Canada is not receiving any less favorable treatment than other courier companies subject to the same customs measures for courier imports and, as an aside, suggests that courier companies, as a group, do not receive any less favorable treatment than Canada Post.
268. The fact that UPS Canada may receive the same treatment as other courier companies is not an answer to whether UPS Canada has received less favorable treatment than Canada Post in breach of NAFTA Article 1102. There is no dispute that Canada Customs has the statutory duty to carry out the enforcement of the customs laws of Canada. From the perspective of duties and tax enforcement, it should make no difference whether the goods to be inspected come into Canada as postal imports or courier imports. Similarly, when the same customs compliance procedures are performed, it should make no difference whether they are being performed in one stream rather than the other.

1. Canada Customs Charges UPS Canada Fees for Services Supplied to Canada Post for Free

269. UPS Canada pays “cost recovery fees” to Canada Customs each year, for the provision of Customs officers on the premises of UPS Canada for the purpose of providing certain permission for the release of many such imported packages.³⁶¹

³⁶¹ For example, if Canada Customs demands to examine a particular package imported by UPS into Canada, UPS Canada can be charged cost recovery fees by Canada Customs for providing an officer to perform such an examination at a UPS facility in Canada.

270. While UPS does not dispute this feature of the Courier/LVS system, it was not aware that Canada Customs would refrain from applying its own cost recovery regulations against Canada Post. As a result, UPS Canada has been placed at a competitive disadvantage to Canada Post, with whom it competes for the business of delivering imported packages in Canada.

271. Canada's Counter-Memorial states that UPS Canada is assessed these cost recovery fees under contract with Canada Customs, when Customs officers provide services at UPS premises *outside* of the "core business hours" of 7:00 to 18:00.³⁶² Yet certain contracts prepared and imposed by Canada Customs upon UPS Canada³⁶³ stipulate that UPS Canada is obliged to pay cost recovery fees to Canada Customs whether or not the services are provided to UPS outside of "core business hours" (7:00 to 18:00), or during core business hours.

272. -----

----- ---- ----- Canada Post pays no cost recovery fees whatsoever for the valuable services of these Canada Customs officers.³⁶⁵

³⁶² Canada's Affidavit of Brian Jones, para. 83. Both UPS Canada and Canada Post provide office space for Customs officials on their respective premises.

³⁶³ See, for example, contract between UPS Canada and Canada Customs dated April 23, 2003 for UPS' bonded warehouse building in Hamilton, Ontario: Investor's Schedule of Documents (Tab U280). UPS Canada has followed a practice of expressly signing these Canada Customs contracts under protest, since it has no choice but to sign and to pay the cost recovery fees in order to ensure that the services of Customs officers will continue to be provided to it.

³⁶⁴ Canada Customs, Mississauga Int-----

Schedule of Documents (Tab U449). See also Canada's Counter-Memorial, para. 672.

³⁶⁵ *General Accounting Office Report: US Postal Service: Competitive Concerns About Package Link Services*, June 5, 1998, Investor's Schedule of Documents (Tab U115).

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273. Canada suggests that UPS Canada receives special services from Canada Customs officers so as to enable UPS Canada to meet its morning delivery time guarantees for courier packages.³⁶⁶ Yet Canada Customs officers also provide expedited treatment to courier packages sent into Canada (for delivery by Canada Post) via the various courier products from foreign postal administrations around the world.³⁶⁷
274. Contrary to Canada's assertion in its Counter-Memorial,³⁶⁸ the same regulations that oblige UPS Canada to pay cost recovery fees to Canada Customs, are also applicable to Canada Post.
275. The *Special Services (Customs) Regulations* of Canada have been promulgated under the *Customs Act*. That *Act* is expressly applicable to the Federal Crown in Canada.³⁶⁹ Section 3(2) of these *Regulations* exclude certain types of "special services" from the ambit of the special services fees, such as examination by Customs officers of documentation at any time of military aircraft, vehicles, or vessels belonging to Canada's Department of National Defence.³⁷⁰ There is no such exemption for services rendered by Customs officers to another Crown entity, such as Canada Post.³⁷¹

³⁶⁶ Canada's Counter-Memorial, para. 669.

³⁶⁷ *Postal Imports Agreement* at Section 9.6 and Annex C2. See also Affidavit of Marcus Harding, paras. 38-39. The courier packages sent to Canada by foreign postal monopolies for delivery by Canada Post are referred to as "EMS" packages.

³⁶⁸ Canada's Counter-Memorial, para. 644.

³⁶⁹ Section 3(2) of the *Customs Act* of Canada, Investor's Schedule of Documents (Tab U383).

³⁷⁰ Section 2(2) of the *Special Services Customs Regulations*, and section 38 in the Guidelines and General Information attached thereto, in Canada Customs Memorandum D1-2-1, Investor's Schedule of Documents (Tab U91).

³⁷¹ In addition, the Deputy Minister could have fixed certain hours for the provisions of services by Customs officers at Canada Post facilities pursuant to section 3(1)(a), thereby in effect exempting Canada Post from the ambit of the *Regulations*, but he has not done so. See Investor's Schedule of Documents (Tab U91).

276. Canada's Counter-Memorial suggests that (notwithstanding the failure of Canada to exempt Canada Post from the *Special Services (Customs) Regulations*), Canada Post is not bound by those *Regulations*. The reason offered is that Canada Customs is simply performing its "statutory functions"³⁷² at Canada Post premises, as they relate to goods imported into Canada via the post.
277. However, Canada cites no authority to support the proposition that there exists a specific statutory obligation to have Canada Customs officers perform their "functions" *at any or all of the relevant Canada Post facilities that handle imported packages*.³⁷³ Canada Customs has simply elected to place a certain number of officers (of its choosing) in those specific locations, and has elected to refrain from assessing any cost recovery fees against Canada Post - in violation of the *Special Services Regulations*.
278. Canada's Counter-Memorial also acknowledges that Canada Customs uses a computer-based technology to facilitate Customs' processing of postal imports, known as PICS.³⁷⁴ While specific information processed by PICS may be different from the CADEX Electronic Data Interchange used by UPS Canada, this does not explain why only UPS Canada should be charged the costs associated with such technology. In both cases, computer connections are established to exchange information.

³⁷² Canada's Counter-Memorial at para. 644.

³⁷³ Para. 656 of Canada's Counter-Memorial acknowledges that Canada Customs has national security objectives regarding the admissibility of goods into Canada via the mail, as well as via courier. Therefore, if Canada Customs did in fact have a specific statutory obligation to perform its functions at Canada Post's five buildings that receive imported packages, Canada Custom would also have a similar statutory obligation at UPS' buildings in Canada that receive imported courier packages. This would not absolve UPS Canada from paying cost recovery fees to Canada Customs; nor would it absolve Canada Post.

³⁷⁴ Canada's Counter-Memorial at para. 361.

279. The *Kyoto Convention* does not prohibit or preclude Canada Customs from charging cost recovery fees to a postal monopoly such as Canada Post.³⁷⁵ Nor does the fact that information regarding courier packages is available in advance of customs clearance explain this different treatment.

280. In view of the foregoing, Canada's assertion that "The treatment accorded to UPS Canada under the Courier/LVS Program is no less favorable than the treatment accorded to international mail..."³⁷⁶, cannot be maintained. Canada Customs has simply failed or refused to apply the laws of Canada against Canada Post.

2. Canada Customs Pays Canada Post for "Services" That UPS Canada Must Supply for Free

281. The collection of duties and taxes by Canada Post is a "*governmental function*".³⁷⁷ Canada's Counter-Memorial states that Canada Post is paid to perform this function:

Canada Post is authorized under the *Postal Imports Agreement* to perform, on behalf of Customs, a *governmental function* (i.e. collect duties and taxes-- --- would otherwise be performed by Customs. For these services, Canada Post receives --- for each dutiable/taxable m-- - ---
----- Canada Post on behalf of Customs,- -----

³⁷⁵ Canada's Counter-Memorial, para. 459.

³⁷⁶ Canada's Counter-Memorial, para. 698.

³⁷⁷ See also A-----

³⁷⁸ Canada's Counter-Memorial, para. 709 [emphasis added].

282. Canada refers to the \$5.00 fee as a “handling fee”.³⁷⁹ For duties and taxes on imported packages, UPS Canada collects its own “handling fee” from its Canadian addressees.

283. The Investor’s Memorial has already set out how UPS Canada is obliged to provide certain comparable services to Canada Customs officers, for no payment whatsoever, regardless of whether duties/ taxes are actually assessed against the package.

284. -----

285. In the case of EMS packages, Canada Post is entitled to seek expedited customs processing from Canada Customs. -----

286. Canada has not provided any reliable information on the number of EMS / Priority courier mail processed under the *Postal Imports Agreement*. -----

287. Under the *Postal Imports Agreement*, all EMS packages are given priority screening by Customs. -----

-----The *Postal Imports Agreement* also gives

³⁷⁹ Affidavit of Janice Elliot at para. 33, quoting a Canadian House of Commons Notice. See also Affidavit of Brian Jones at para. 177. This fee is not charged if no duties or taxes are payable, see *Fees in Respect of Mail Regulations*, section 4(a), Investor’s Schedule of Documents (Tabs U57 and U406).

³⁸⁰ See *Postal Imports Agreement*, Section 9.1, of Investor’s Schedule of Documents (Tab U66). See also Affidavit of John Cardinal at para. 18 of Canada’s Brief of Affidavits and Expert Reports (Tab 4).

³⁸¹ See Affidavit of John Cardinal at para. 19.

Canada Post the discretion in identifying which non-EMS postal imports are to be inspected by Customs³⁸² and in which priority. As a result, it is up to Canada Post's discretion to elevate the speed of customs processing, if it so chooses to any non-EMS postal imports, which then result in -----
----- and a \$5.00 handling fee from the addressee.

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

288. Canada's Counter-Memorial acknowledges that not all the differences in treatment (by Canada Customs) of UPS Canada and Canada Post, arise out of the *Postal Imports Agreement*.³⁸³ Canada Customs' decision to refrain from levying fines and penalties against Canada Post for violations of the *Customs Act* and regulations, but to levy fines/penalties against UPS Canada for the same infractions, is one such instance.
289. Penalties imposed upon UPS Canada for infractions in the "courier stream" comprise:
- a. Non-reporting of an imported package to Canada Customs: \$1,000 for goods over \$1,600; \$100 for goods valued less than \$1,600,³⁸⁴
 - b. Unlawful removal of an imported package from UPS Canada's warehouse: \$1,000 for the first instance or 5% of the value for duty (VFD) whichever is greater; \$2,000 for the second instance or 10% of the VFD, whichever is greater; and for the third instance \$3,000 or 20% of the VFD, whichever is greater; and

³⁸² *Postal Imports Agreement* at section 4.1(i).

³⁸³ Canada's Counter-Memorial, para. 643.

³⁸⁴ Administrative Monetary Penalty System (AMPS). Investor's Schedule of Documents (Tab U546).

- c. Late accounting for the goods by UPS to Canada Customs: \$100 for the first instance, \$500 for the second instance; and \$1,000 for the third instance.³⁸⁵

290. -----

----- 88 -----

291. Rather, both Canada Post and UPS Canada are bound by law to comply with the *Customs Act* by refraining from releasing goods for delivery prior to receiving the approval of Canada Customs.³⁸⁹ In fact, any instance by either Canada Post or UPS Canada of releasing such imported goods prior to Customs approval, is a specific offence under the *Customs Act*.³⁹⁰ -----

³⁸⁵ Letter of February 24, 1998 from Laurie Bratina, Director, Import Process Division of Canada Customs to Bernard Unger of US General Accounting Office (GAO): Investor's Schedule of Documents (Tab U469). See also Section 33.1 of the *Customs Act*. See Investor's Schedule of Documents (Tab U383).

³⁸⁶ Investor's Memorial, para. 321.

³⁸⁷ Canada's Reply to Interrogatories, questions 51 and 53 (Tab U290).

³⁸⁸ Section 3(2) of the *Customs Act* stipulates that this Act applies to Her Majesty in right of Canada (the Government of Canada), Investor's Schedule of Documents (Tab U383).

³⁸⁹ Section 31 of the *Customs Act*.

³⁹⁰ Section 160(1) of the *Customs Act*.

³⁹¹ Canada's Reply to Interrogatories, questions 51 and 53. Investor's Schedule of Documents (Tab U290).

292. -----

-----³⁹² This allegation is not accurate.

293. First, Canada Post unloads packages and then Canada Customs stores a backlog of hundreds of thousands of imported packages in its warehouses for many days, until Canada Customs officers are ready to examine them.³⁹³ Second, like UPS Canada, Canada Post is fully capable of committing inadvertent infractions of the *Customs Act* by releasing imported goods, prior to the goods being cleared and released by Canada Customs.

294. -----

295. -----

----- It states:

³⁹² Canada's Reply to Interrogatories, questions 51 and 53.

³⁹³ See UPS Reply herein under the heading of "*Canada Post is Exempted from Posting Bonds*". In particular, commercial goods valued at more than \$1600 must be stored by Canada Customs even longer, until the addressee or a hired broker secures their release.

³⁹⁴ Toronto International Mail Processing Centre, *Questions and Answers*, at Investor's Schedule of Documents (Tab U448).

296. Since Canada Customs does not station any of its officers at Canada Post's buildings in the Canadian cities of Halifax, Regina and Edmonton, -----

----- No penalties would be assessed by Canada Customs against Canada Post for any such infractions.

297. There is no provision of Canadian law that permits Canada Post to circumvent customs inspection for mail containing goods.³⁹⁶

298. -----

-----³⁹⁷ Neither the *Customs Act* nor regulations create such an exemption in favor of Canada Post for committing such an infraction. Furthermore, the *Postal Imports Agreement* does not provide for any financial or other remedies if Canada Post fails to comply with the provisions of that agreement except for the right to terminate the agreement.³⁹⁸

³⁹⁵ E-mail dated April 7, 2000 re: 'Customs Issues' from Louis Young to Malcolm Tait et al of Canada Customs , Investor's Schedule of Documents (T-----ms'

----- Investor's Schedule of Documents (Tab U455).

³⁹⁶ Expert Report of Denise Polesello at para. 21.

³⁹⁷ Undated Canada Customs document , Investor's Schedule of Documents (Tab U469), at Section 5, "Penalties".

³⁹⁸ *Postal Imports Agreement* at para. 18.1

299. Canada Customs is also “involved in the process” of examination, clearance and release of certain packages from the UPS Canada warehouses that store such imported goods.³⁹⁹ Canada does not suggest that this involvement of Canada Customs exempts UPS Canada from paying any fines or penalties for releasing such packages for delivery - prior to obtaining approval from Customs.

4. Canada’s Exemption of Canada Post From Brokerage Requirements

300. One particularly important difference in enforcement is the requirement for courier imports to have a customs broker while postal imports of goods (under \$1600 in value) do not require a customs broker.⁴⁰⁰ Canada relies upon the Affidavit of Larry Hahn who establishes this particular rule. Mr. Hahn states that:

With the exception of travellers coming to Canada and postal imports valued under \$1600, all modes of importing goods into Canada, including the Courier/ LVS programme, are serviced by customs brokers.⁴⁰¹

301. UPS relies upon the Expert Report of Allan Cocksedge, a former Assistant Deputy Minister of Customs Operations, to compare the benefits arising to Canada Post from the operations of the dual postal and courier import streams. Mr. Cocksedge states that:

The two streams are motivated by the different origins of the packages. However, the two streams share the same goal and the same obligation, which is to move packages through the customs system in compliance with Canadian customs legislation.

³⁹⁹ Especially packages valued at more than \$1600, Investor’s Schedule of Documents (Tab U94).

⁴⁰⁰ Canada’s Counter-Memorial at para. 416. A broker can be required for a postal import only in the case of a re-assessment of duty or tax set out in a form E-14, issued for postal imports or for postal imports of goods valued above \$1600. A broker is never required for postal imports under \$1600 during Customs’ primary or secondary inspection.

⁴⁰¹ Affidavit of Larry Hahn at para 13.

The only substantive difference between the two streams is the point at which information is gathered. For courier imports, this information is gathered when the sender brings the parcel to the courier office. For postal imports, this information is gathered when the parcel is submitted to Canada Customs by Canada Post for primary and secondary inspection. In both cases, the relevant information is collected, and therefore both streams should result in similar compliance rates.⁴⁰²

302. Canada could have created a process which was competitively neutral, which ensures equality of competitive opportunities. Former Customs Assistant Deputy Minister Allan Cocksedge states in his Expert Report that the requirement of having a broker is not a relevant issue to differentiate between customs and postal imports. He states:

Regardless of stream, Canada Customs must rate items in the same manner, assess duties and taxes according to the same laws, and collect those duties and taxes. It is irrelevant that a customs broker acts as an intermediary in the courier stream. The obligation remains the same to comply with Customs legislation.⁴⁰³

303. Canada Post obtains a clear advantage in that it is able to handle imports of goods through an import process that does not require customs brokers. When reviewing the benefits to Canada Post of being exempted from the requirement to use customs brokers for postal imports of goods under \$1600 in value, Allan Cocksedge states:

In particular, the fact that inspection is performed directly by Customs officers saves Canada Post the requirement to report on behalf of the importer through the hiring of a customs broker. This difference in treatment places UPS Canada at a comparative disadvantage.⁴⁰⁴

304. On occasions, Canada Post uses Purolator to clear non-EMS courier products from foreign postal administrations on an expedited basis.⁴⁰⁵ Just as Canada Post handles both expedited and non-expedited items, UPS Canada also handles non-expedited imports through its UPS Standard service. However, it does not have the option of using the

⁴⁰² Expert Report of Allan Cocksedge at paras. 8 - 9.

⁴⁰³ Expert Report of Allan Cocksedge at para. 10 .

⁴⁰⁴ Expert Report of Allan Cocksedge at para 13.

⁴⁰⁵ Expert Report of Denise Polesello at para. 23.

postal stream in such cases. Mr. Cocksedge continues by looking at whether benefits under the postal imports stream could be made available to UPS. On this issue, he concludes:

Private courier companies are not allowed to choose which of the two streams to use for customs processing. Private courier companies must use the courier stream. UPS also has non-urgent items that it delivers by UPS Standard. It does not have the option of processing these non-urgent items through the less costly postal stream.

There is no reason that access to treatment by Canada Customs in a manner similar to the postal customs stream inspection process could not be made available for non-urgent parcel and package imports handled by entities other than Canada Post.⁴⁰⁶

305. There is no question that Canada Post obtains a benefit from the special exemption granted to it that does not require customs brokers to attend to postal imports. No program exists under Canada law that permits UPS Canada and other Canada Post competitors to have access to a similar customs import stream that does not require the intervention of a customs broker for non-urgent parcel and package imports.

D. Canada's Failure to Properly Inspect Postal Imports.

306. Regardless of the differences between packages imported into Canada via the postal stream, or by courier, UPS Canada and Canada Post have *the same obligations* under Canadian domestic law to collect, pay and remit to Canada Customs the proper amount of Canadian import duties, taxes, and provincial sales tax that are exigible on each package imported into Canada.⁴⁰⁷ These obligations to collect import duties and taxes exist independently of the processing streams.
307. Under Canadian customs law, duties and taxes are assessed at the identical dollar amount, based upon the identical tariff classification of the goods whether they are imported

⁴⁰⁶ Expert Report of Allan Cocksedge at paras. 14 - 15.

⁴⁰⁷ *Customs Act* of Canada, and in particular s. 58.

through the postal system or through a courier like UPS Canada. Canada's failure to enforce its own laws puts UPS Canada at competitive disadvantage to Canada Post on the importation of packages into Canada.⁴⁰⁸

308. In its Counter-Memorial, Canada cites a number of differences between the postal import system and the courier system. For example, Canada mentions that the sender of foreign goods into Canada via UPS is known to UPS, whereas the sender of foreign goods into Canada via the post is not known to Canada Post.⁴⁰⁹ In fact, Canada Post knows, or should know, the following from the CN22 or CN23 forms affixed to the incoming mail: the exporter, the addressee and the description of the goods.
309. Also Canada asserts that Canada Post is well suited to collect duties and taxes at the door of each Canadian addressee.⁴¹⁰ Canada does not offer any evidence to suggest that other persons such as UPS Canada may not be suitable for this task especially since Canada Post engaged a private contractor to provide the services it agreed to provide to Canada Customs under the *Postal Imports Agreement*.
310. According to Canada, "the lack of reliable and accurate information about the exporter, the importer and the contents of the mail items moving around the world and the absence of a party accepting legal liability for the import transaction necessitates the intervention of (Canada) Customs officers to assess duties and taxes in respect of goods imported as mail."⁴¹¹

⁴⁰⁸ See Investor's Memorial, para. 338.

⁴⁰⁹ Canada's Counter-Memorial, paras. 670, and 380-381.

⁴¹⁰ Canada's Counter-Memorial, para. 707.

⁴¹¹ Affidavit of Brian Jones, para. 90. See also Canada's Counter-Memorial, paras. 961, and 673.

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311. While Customs claims to intervene, Customs is omitting to perform its job of determining the origin of the goods, tariff classification, and value for duty of the goods pursuant to the *Customs Act*.⁴¹² As a result, when Canada Post delivers an imported package to the door of a Canadian addressee, there are often no Canadian duties or taxes for Canada Post to collect.
312. Canada suggests that “there is no evidence” that Canada Post is failing to collect the requisite duties and taxes. The real question is whether there is any evidence that Canada Customs is failing to assess the requisite duties and taxes on postal imports packages that compete with UPS products.
313. Canada writes that: “In order to ensure that prohibited goods do not enter Canada and to rate and assess duties and taxes on those goods, (Canada) Customs, therefore, must physically examine every mail item containing or suspected of containing goods.”⁴¹³ According to Canada: “...Customs has designed the International Mail Processing System in such a manner that the Customs Officers are on site within Customs Mail Centres and to inspect each individual mail item...”⁴¹⁴
314. Canada Customs officers must perform this tedious *manual* rating task for each and every package under \$1600, one package at a time. This need for Canada Customs officers to perform a “physical inspection of the goods” by “looking at each and every item of mail,”⁴¹⁵ is highly onerous considering the huge volume of imported packages that are presented to Canada Customs officers for examination each year.⁴¹⁶

⁴¹² *Customs Act*, section 58.

⁴¹³ Canada’s Counter-Memorial, para. 660.

⁴¹⁴ Canada’s Counter-Memorial, para. 662.

⁴¹⁵ Canada’s Counter-Memorial, para. 963.

⁴¹⁶ See Canada’s Answer to Investor’s Interrogatories, question 36, of Investor’s Schedule of Documents (Tab 290).

315. Canada writes that: “The volumes of international mail arriving annually are large...Each year, approximately 400 million mail items arrive in Canada in a continuous flow, six days a week. -----

316. -----

a. -----

b. -----

c. -----

d. -----

e. ----- and

f. -----⁴¹⁹

⁴¹⁷ Canada’s Counter-Memorial, para. 336. See also e-mail from Bill Fitzmorris of Canada Customs to Bertin Picard dated September 18, 2002, re: “Mail Volumes”, Investor’s Schedule of Documents (Tab U455).

⁴¹⁸ E-mail message dated March 14, 2000 from Denise Polesello of Canada Customs to Regine Clement re: “Update to Q’s and A’s by UPS”, Investor’s Schedule of Documents (Tab U459).

⁴¹⁹ -----

317. These statistics, provided by Canada, mean that Canada Customs may be permitting -----
----- to be imported into Canada by the
post, *without assessment of duties and taxes.*⁴²⁰ Many of these packages would properly
attract such import duties and taxes.

318. These statistics are consistent with a memo dated May 20, 2003 from a senior official at
Canada Customs head office in Ottawa, which -----

-----⁻²¹

319. ----- were referred for
secondary examination for formal assessment of Canadian duties/taxes by Canada
Customs officers.⁴²² -----

320. An affidavit filed by Canada refers to the role of Canada Customs officers on imported
mail/packages, and states: "This is significant in the establishment of a distinct customs

⁴²⁰ ----- (but certainly not all) released free of duties/taxes would likely be
classified as "gifts" under \$60, or packages under \$20 on which no duties/taxes are payable.

⁴²¹ Memo dated May 20, 2003 from Brian Brimble, Interim Director General, Operations Policy for Canada
Customs to Allan J. Cocksedge re: "Postal Examination Statistics ", Investor's Schedule of Documents (Tab U453)
[emphasis added].

⁴²² "Secondary examination" is the place where Canada Customs assesses duties/taxes on postal imports: *Statement
of Defense*, para. 74. At "Primary examination" the goods may be released to Canada Post for delivery that are
considered duty free and non-taxable, or goods under \$20 in value, or gifts under \$60 dollars. These items may be
stamped 'Cleared Customs' and released to Canada Post: Postal Operational Review Report of Canada Customs
dated May 8, 1997, Appendix "A", Investor's Schedule of Documents (Tab U454).

process applicable to mail items as officers are required to render determinations on 100% of transactions.”⁴²³

321. -----

322. These statistics demonstrate that the number of imported packages (arriving at Canada Post) that were actually assessed at secondary examination by Canada Customs, -----

----- 424

323. -----

⁴²³ Affidavit of Darwin Satherstrom at para. 23, Canada’s Brief of Affidavits and Expert Reports (Tab 33).

⁴²⁴ The contract between Adminserv Canada and Canada Post signed May 17, 1999 states in Schedule “B” (description of the project) clause 3.1.1 that when Adminserv assists Canada Customs at secondary inspection, approximately 28% of the total volume that reaches secondary inspection will be released to Canada Post for delivery, *free of Canadian duties/taxes*: Investor’s Schedule of Documents (Tab U449).

⁴²⁵ Affidavit of John Cardinal at para. 21.

324. -----

325. -----

326. At the commencement of the operation of the *Postal Imports Agreement*, Canada
Customs and Canada Post -----

327. -----

⁴²⁶ Expert Statement of Denise Polesello at para. 29.

<u>Date</u>	<u>Amounts</u>
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-----	-----
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-----	-----

328. -----

<u>Date</u>	<u>Amounts</u>
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Canada has not provided UPS with more recent figures than are set forth above.

329. Canada imposes a seven per cent goods and service tax (“GST”) on goods imported into Canada, regardless of whether the goods are for commercial or non-commercial use⁴²⁹

⁴²⁷ Canada’s Reply to Interrogatories at question 14(l), regarding Annex “E”, Part B of the *Postal Imports Agreement*.

⁴²⁸ Canada’s Reply to Interrogatories at question 14(h), regarding Annex “E”, Part A of the *Postal Imports Agreement*.

⁴²⁹ There is an exception for gifts under \$60, or non-gifts under \$20.

and whether its imported through the courier “stream” or postal “stream”.⁴³⁰

330. The GST is by far the largest component of duties and taxes revenues collected by both Canada Post, and by UPS Canada, on packages imported into Canada.⁴³¹ UPS Canada charges GST to its customers on the value of imported packages delivered by it in Canada. As a result of the failure by Canada Customs/Canada Post to charge duties and taxes ----- UPS Canada customers pay considerably more money in taxes to import packages than do Canada Post customers.⁴³²

331. Canada alleges that Canada Post collects the GST from Canadian customers as agent of Canada Customs, whereas UPS Canada does not act as agent of Customs when collecting GST from its customers.⁴³³ UPS replies that this difference does not absolve Canada Post/Canada Customs of the need to collect the GST from customers in the first place on imported packages.

⁴³⁰ Affidavit of Janice Elliott at para. 8: “As GST applied to all goods imported into Canada, including goods imported through the postal or courier streams, Customs officials were required to assess and collect the GST on those imported goods.”

⁴³¹ According to Canada Customs Memorandum D5-1-1 at 17, clause 26: “The GST is applied to most mail items imported into Canada at the time of importation and is calculated on the item’s value for tax purposes, which is the total of the foreign dollar value converted to Canadian funds, plus any duties that apply.” (Tab U94). “You have to pay GST on most goods you import into Canada. This is to make sure the imported goods are taxed in the same way as those sold or provided in Canada. We calculate GST on the mail item’s duty-paid value. This is the total value converted to Canadian funds, plus any duties that apply”: Canada Customs guide entitled “Importing Non-Commercial Goods by Mail”, Investor’s Schedule of Documents (Tab U1).

⁴³² UPS customers are obliged to pay the 7% GST, plus a further fee to UPS for its services in collecting and remitting the GST to Canada Customs. Whereas, when Canada Customs fails to assess any GST (and other duties) on packages imported via the post, the Canadian addressee not only avoids paying the 7% GST, but is also not charged the usual \$5.00 handling fee by Canada Post. The \$5.00 handling fee is only charged when Canada Post actually collects GST or Canadian import duties on the package.

⁴³³ Canada’s Counter-Memorial, para. 709.

332. None of Canada's provinces has the authority to collect its own provincial sales taxes on postal imports. Rather, Canada Customs has the sole authority to collect the provincial retail sales tax on all non-commercial postal imports valued at over \$20,⁴³⁴ for all nine of Canada's 10 provinces.⁴³⁵

333. The same Canadian laws that oblige Canada Post to collect provincial sales tax from its customers on imported packages, also apply to UPS Canada. UPS Canada charges the applicable provincial sales taxes to its customers when it delivers imported packages to them in Canada.

334. ----- Canada Post for delivery, without being assessed with any Canadian duties and taxes. This means that Canada Customs also fails to assess the Canadian recipients of those packages with the relevant *provincial sales taxes*. Once again, Canada Customs/Canada Post's failure to charge provincial sales taxes on imported *postal* packages on a consistent basis, places UPS Canada at a competitive disadvantage.⁴³⁶ An affidavit filed on behalf of Canada accurately states, with respect to large shippers from the US to Canada, that "...in an industry where net profit margins are typically in the order of 7 - 8% of sales, these differences are critical."⁴³⁷

335. Furthermore, even Canada Customs acknowledges that the international rules of the Universal Postal Union and the *Kyoto Conventions* (referred to by Canada at great

⁴³⁴ *Canada Post Postal Guide*, April 2001, entitled "*Customs Requirements*", Investor's Schedule of Documents (Tab U456).

⁴³⁵ The 10th province, Alberta, does not impose any provincial sales tax.

⁴³⁶ The provincial sales taxes charged to UPS Canada's customers (but often not assessed by Canada Customs against Canada Post's customers) is in addition to the 7% GST charged to UPS' customers. The provincial sales tax is usually about 8% per cent (or more) of the value of the goods, depending upon the particular province of Canada in which the addressee resides.

⁴³⁷ Affidavit of Janice Elliott, para. 14.

length), do not absolve it of the obligation to assess Canadian duties and taxes,⁴³⁸ and that “individual inspections of mail items will continue to be necessary...”⁴³⁹

E. The Nelems Study Demonstrates Canada’s Systematic Failure To Enforce Customs Laws In The Postal Stream

336. In its Counter-Memorial,⁴⁴⁰ Canada asks the Tribunal to give no weight to the Customs import study prepared by James Nelems (“Nelems Study”) filed by UPS.⁴⁴¹ Canada criticizes the Nelems Study as being based on incorrect factual foundations and the result of an erroneous application of statistical methodology.⁴⁴²

337. UPS submitted the Nelems Study in support of the proposition that packages shipped from the U.S. to Canada are highly more likely to attract duties and/or taxes if they were sent via UPS than via USPS/Canada Post. Notwithstanding Canada’s allegations, these conclusions remain valid.

1. Allegation of Erroneous Application of Statistical Methodology

338. Canada claims that the Nelems Study erroneously applied statistical methodology, relying on the Expert Report of Dr. Shirley E. Mills it has submitted (“Mills Report”). The main criticism of Dr. Mills is that the Nelems Study used a *t*-test when it should have used a *z*-test.⁴⁴³

⁴³⁸ Affidavit of Brian Jones, at para. 130. See also Canada’s Counter-Memorial, para. 457.

⁴³⁹ Affidavit of Brian Jones, at para. 130.

⁴⁴⁰ Canada’s Counter-Memorial at paras. 372-375 and 958-969.

⁴⁴¹ Expert Report of James Nelems.

⁴⁴² Canada’s Counter-Memorial at para. 373.

⁴⁴³ See, in particular, see Affidavit of Shirley Mills at para. 30.

339. In response to this criticism, UPS has filed a reply by Mr. Nelems (“Reply Report of Nelems”). In his Reply Report, Mr. Nelems clarifies that, while he incorrectly referred to the statistical analysis used in his study as being a *t*-test, the study had, in fact, used a *z*-test.⁴⁴⁴
340. UPS has asked Dr. Anindya Sen, a Professor of Economics and Statistics, to evaluate the criticisms in the Mills Report. In response to the criticism about the incorrect use of the *t*-test, Dr. Sen confirms that the Nelems Study had, in fact, used a *z*-test and he was able to independently confirm the conclusions of the Nelems Study. In response to Dr. Mills, Dr. Sen states:

Using her recommendations, I employed a conventional text book form of the *z* test [footnote 2]. The results of these tests are quite conclusive. Specifically, the results show: (1) a statistically significant difference in the proportion of packages charged duty and GST by Canada Post and UPS; and (2) also the fact that the proportions of packages charged duty and GST by UPS is higher than the corresponding proportions charged by Canada Post. Furthermore, based on the level of significance employed (1%), I would expect similar results 99 times from 100 similarly generated samples. [footnote 3].⁴⁴⁵

341. According to the Expert Report of Dr. Sen, he was also able to confirm the results of the Nelems Study using the more sophisticated analysis of a multivariate regression model.⁴⁴⁶
342. Since the alleged erroneous application of statistical methodology is the central criticism of Dr. Mills, it is surprising that she did not conduct independently the tests done by Dr. Sen. If she had, her own approach would have confirmed the results of the Nelems Study.⁴⁴⁷ These attacks are totally without merit and should be disregarded.

⁴⁴⁴ Reply Expert Report of James Nelems at paras. 11-12.

⁴⁴⁵ Expert Report of Prof. Anindya Sen. at para. 46.

⁴⁴⁶ Expert Report of Prof. Anindya Sen at paras. 47-53.

⁴⁴⁷ Expert Report of Prof. Anindya Sen at paras. 35 and 58; Reply Expert Report of James Nelems at para. 15.

2. Alleged Misunderstanding of the Proper Tariff Classification

343. Canada claims that the Nelems Study failed to take into account the most appropriate and beneficial tariff classification for the shipments under study, misunderstanding the basis on which goods are determined to be either commercial or casual goods⁴⁴⁸. According to the Affidavit of Darwin Satherstrom, commercial samples are entitled to duty-free entry into Canada because they were probably considered by Canada Customs to be “casual” and not commercial goods and therefore Customs correctly did not assess duties and taxes on postal imports.⁴⁴⁹.
344. UPS asked Darrell Pearson, a lawyer specializing in Canadian customs law with over 22 years of experience in this area, to review the Affidavit of Darwin Satherstrom.⁴⁵⁰ Mr. Pearson has reviewed the affidavit of Mr. Satherstrom and has concluded that the items shipped in the Nelems Study properly attracted both duties and GST taxes.⁴⁵¹ Based on his review of each of the shipment made in the Nelems Study, Mr. Pearson concludes that none of the shipments qualified for duty free treatment and confirms the validity of the conclusions about dutiable and taxable goods used in the Nelems Study.⁴⁵²
345. UPS also asked Denise Polesello to review Mr. Satherstrom’s Affidavit. Ms. Polesello has over 23 years of experience with Customs Canada including being Manager of Canada Custom’s Postal, Courier/LVS and Casual Refund Programs. Ms. Polesello has

⁴⁴⁸ Canada’s Counter-Memorial at para. 375(a) and (e).

⁴⁴⁹ Affidavit of Darwin Satherstrom at paras. 14-27.

⁴⁵⁰ Witness Statement of Darrell Pearson at para. 2 and his curriculum vitae at Appendix A therein.

⁴⁵¹ Witness Statement of Darrell Pearson at para. 38.

⁴⁵² Witness Statement of Darrell Pearson at paras. 21-38.

extensive experience in interpreting and applying the *Customs Act*, *Customs Tariff* and *Excise Tax Act*, court jurisprudence, international agreements, administrative agreements and over 60 pieces of legislation administered by Customs.⁴⁵³

346. Ms. Polesello agrees with the conclusion of Mr. Pearson, namely, that none of the shipments in the Nelems Study in issue qualified for duty and/or tax free treatment.⁴⁵⁴

3. Alleged Restricted Purpose of Nelems Study

347. Canada suggests that “at best”, the Nelems Study could only be contrasting the self-assessment of duties and taxes by UPS Canada with the determinations and assessments of Customs officers.⁴⁵⁵ This criticism misses the purpose of the Nelems Study, namely, whether there is a difference in the collection of duties and/or taxes on shipments sent from the U.S. to Canada via USPS/Canada Post and UPS. It misses the point that the study accepts as given the existing policies and practices for the assessment and collection of duties and/or taxes for items imported from the U.S. via USPS/Canada and via UPS.⁴⁵⁶
348. Also, Canada suggests that UPS Canada has no legal obligation to “collect” customs duties and that it is wrong to say that UPS Canada is “highly compliant”. This criticism also misses the point. From the perspective of the shipper and consignee, shipping via USPS/Canada Post and via UPS are alternatives and what is at issue is whether there is

⁴⁵³ Expert Report of Denise Polesello at paras. 4 and Appendix A.

⁴⁵⁴ Expert Report of Denise Polesello at para. 13.

⁴⁵⁵ Canada’s Counter-Memorial at para. 375(b).

⁴⁵⁶ Reply Expert Report of James Nelems at para. 17.

any difference in the collection of duties and/or taxes.⁴⁵⁷ In any event, it is absurd to say that UPS Canada does not have a legal obligation to collect duties or taxes. UPS Canada has a duty to comply with Canadian laws, as does Canada Post. UPS Canada is subject to fines and penalties if it fails to comply with Customs laws.

4. Alleged Seasonality Issues

349. Canada suggests that the Nelems Study is flawed because of seasonality issues, citing in support the Affidavit of Darwin Satherstrom and Mills Report.⁴⁵⁸ The essence of this criticism is that Nelems Study did not address the seasonality issues relating to end of the year holidays.

350. The Nelems Study took account of the potential impact of the Christmas period and thus avoided making shipments after December 3, 2004.⁴⁵⁹ This was confirmed by Mr. Nelems in his Reply Report.⁴⁶⁰ While seasonality could be a theoretical problem, neither Mr. Satherstrom nor Dr. Mills provide any statistical analysis of the impact of the so-called seasonality issues on the validity of the conclusions in the Nelems Study. Their criticisms are pure speculation.

5. Alleged Irrelevance of Time Frame of Nelems Study

351. Canada questions the validity of the Nelems Study on the grounds that it was conducted

⁴⁵⁷ Reply Report of James Nelems at para. 19.

⁴⁵⁸ Canada's Counter-Memorial at para. 375(d); Affidavit of Darwin Satherstrom at para 28; Affidavit of Shirley Mills at para. 11.

⁴⁵⁹ Expert Report of James Nelems at Appendix I at 3.

⁴⁶⁰ Reply Expert Report of James Nelems at para. 20.

outside the relevant time frame of the arbitration.⁴⁶¹ The Investor's position is that the impugned conduct occurred during the relevant period of the Claim and continues to this day.⁴⁶²

⁴⁶¹ Canada's Counter-Memorial at para. 375(f).

⁴⁶² Investor's Memorial at para. 492-500.

**VIII. PUBLICATIONS ASSISTANCE PROGRAM REQUIREMENTS FAVOR
CANADA POST**

352. The *Publications Assistance Program* subsidizes the distribution of a broad range of Canadian weekly newspapers and magazines to communities across Canada. The laudable objectives of the program are well canvassed in both Investor's Memorial⁴⁶³ and Canada's Counter-Memorial.⁴⁶⁴

353. UPS accepts the value of these objectives and only objects to the manner in which Canada implements the *Publications Assistance Program*. Canada has discriminated against courier companies, like UPS Canada, by restricting the benefits of the *Publications Assistance Program* to publishers who use Canada Post to deliver their publications. Canada can implement the *Publications Assistance Program* to fulfill its policy objectives and also fulfill Canada's NAFTA obligations. Removing the restrictions to allow publishers the freedom to use a carrier would not undermine the policy objectives of the *Publications Assistance Program*.

354. -----

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⁴⁶³ Investor's Memorial at para. 347.

⁴⁶⁴ Canada's Counter-Memorial at paras. 292 - 295.

⁴⁶⁵ Canadian Business Press Submission, December 2002 at 15 (R263(b)-3) (Tab U9).

355. Investor’s Memorial quoted other industry bodies supporting a choice of carrier.⁴⁶⁶ The conclusion that the industry supports a choice of carrier is not altered by Canada’s vague, unsupported assertion that “[r]epresentations from the industry were generally supportive of Canada Post’s involvement in the delivery of the *Publications Assistance Program*.”⁴⁶⁷

356. -----

357. Canada has provided no justification for its discrimination. Canada provides no evidence to support its bald claim that its exclusive deal with Canada Post allows it to “negotiate more favorable rates for mailing Canadian publications than would otherwise be possible.”⁴⁷⁰ Furthermore, there is no evidence that Canada attempted to secure the best rates by inviting UPS Canada and other delivery companies the opportunity to bid for work. If Canada is so sure that Canada Post provides the best deal it should declare its arrangement with Canada Post to be a procurement and be prepared to defend the deal in NAFTA Chapter 10 proceedings.

⁴⁶⁶ See the comments of industry associations at para. 353 of Investor’s Memorial.

⁴⁶⁷ Canada’s Counter-Memorial at para. 301.

⁴⁶⁸ Alan Gershenhorn, former President of UPS Canada, explains that UPS has “some significant accounts with publishers, including McGraw-Hill and Harper-Collins, for whom it delivers books to retailers, businesses and schools” and at least one account with a magazine publisher, Reply Witness Statement of Alan Gershenhorn at para. 13.

⁴⁶⁹ Reply Witness Statement of Alan Gershenhorn at para. 12.

⁴⁷⁰ Canada’s Counter-Memorial at para. 302.

358. Canada's attempted justification through Canada Post's governmental role in the implementation of the *Publications Assistance Program* is specious. Canada spends much of its Counter-Memorial attempting to avoid responsibility for Canada Post's actions by saying it is an independent commercial entity and now seeks to avoid responsibility for its discriminatory action because Canada Post contributes to the fund like any other government department.

359. Canada also defends its conduct because Canada Post acts as a trustee of public funds.⁴⁷¹ The McCarthy Tétrault Report did not even mention this as a reason to retain Canada Post as the exclusive carrier under the *Publications Assistance Program* because there are a myriad of ways to ensure beneficiaries of the program spend the funds appropriately.⁴⁷² For example, Canada can establish program accounts at courier companies just like it does with Canada Post.

A. Canada's Discriminatory Application of the Publications Assistance Program Has Harmed UPS

360. -----

----- There is nothing inherent in the delivery of publications to suggest that UPS Canada would not make the same profit it makes delivering these publications as it makes delivering other materials.⁴⁷⁴

⁴⁷¹ Canada's Counter-Memorial at para. 302.

⁴⁷² See The McCarthy Report, section C: "The Funding Process" at 30, Investor's Schedule of Documents (Tab U402).

⁴⁷³ Reply Witness Statement of Alan Gershenhorn at para. 13.

⁴⁷⁴ See LECG's Reply Report at page 6 for confirmation UPS Canada profits from delivering materials other than publications. There is, therefore, no foundation to Canada's claim at para. 552 that UPS has failed to prove it would profit from the additional market share it would enjoy if the *Publications Assistance Program* funds were not

361. Neither Canada's Counter-Memorial, nor the Kroll Report on which it relies, disrupts the conclusion that Canada's discriminatory operation of the *Publications Assistance Program* harms UPS. Canada implicitly claims that Canada Post would be the cheapest carrier of periodicals, even without the *Publications Assistance Program*, because periodical delivery is chiefly to households. The percentage of deliveries to households is irrelevant to UPS Canada's loss of the opportunity to deliver to retailers. Besides, Canada even fails to provide any evidence to support its claim that most periodical delivery is to households.⁴⁷⁵

distributed solely through Canada Post.

⁴⁷⁵ Canada's Counter-Memorial at para. 551. Canada refers to paras. 292 - 295 of its Counter-Memorial to support this assertion. The only relevant part of paras. 292 to 295 says "Because of high subscription sales and low newsstand sales in Canada, ..." There are no documents to support this assertion.

PART THREE: THE LAW

I. OVERVIEW OF LEGAL ARGUMENT

362. UPS is an investor of the United States that has made substantial investments in Canada. As a result, UPS is entitled to expect that Canada will abide by its obligations under NAFTA to treat UPS and UPS' Canadian investments no less favorably than it treats Canadian investors or investments in like circumstances. It is also entitled to expect that its investments will receive fair and equitable treatment in accordance with international law. Canada's failure to respect these treaty obligations, and to take measures to ensure that Canada Post does as well, entitles UPS to seek compensation under the procedures established in NAFTA.

363. In its Counter-Memorial, Canada raises a series of preliminary objections to UPS' rights to enforce its claims. These objections are either based on flawed factual premises, contorted interpretations of procedural rules or misstatements of UPS' claims. In particular:

- a. UPS owns UPS Canada, so there is no issue of standing;
- b. No time bar applies as all claims relate to measures that are still in effect and continuously breach NAFTA or, in other cases, arose within any limitation period;
- c. UPS has met the minimal harm requirement necessary at this stage of the arbitration;
- d. The issues involving the *Postal Imports Agreement* and the *Publications Assistance Program* do not involve procurement, subsidies or cultural measures.

UPS is not complaining about being denied the opportunity to bid on the *Postal Imports Agreement* or that publishers are subsidized. It is complaining that the *Postal Imports Agreement* is evidence of differences in customs procedures for otherwise like circumstances and that an administrative requirement penalizing publishers for choosing competitors of Canada Post has been imposed on a legitimate program. Further, these exceptions and exemptions are affirmative defences that must be proven by Canada, not jurisdictional objections; and

- e. The Investor's claim was properly amended to include subsequent actions by Canada Post relating to Fritz Starber that resulted from the original claim. Canada's arguments to the contrary reveal its highly formalistic interpretations of legal rules and its complete disregard for established precedents.

364. Canada Post is an investment of Canada that competes against UPS Canada in the courier market, both directly and through Purolator. This competitive relationship between these domestic and foreign economic interests creates a national treatment obligation on Canada to ensure an equality of competitive opportunities between UPS Canada and Canada Post. Canada has failed to do so.

365. Contrary to Canada's allegations, UPS is not challenging "the direct and natural result" of a creation of a monopoly nor the decision of that monopoly to exploit economies of scale and scope. There is nothing "natural" about the manner in which Canada Post competes. On the contrary, the claim results from the following combination of factors that has created an extraordinary set of circumstances:

- a. The monopoly is also a state enterprise competing in non-monopoly markets;
- b. The monopoly also forms part of the machinery of the government, having been granted its monopoly along with broad discretion to pursue various vaguely

defined policy objectives. It is therefore either an organ of the state or a governmental monopoly exercising delegated governmental authority;

- c. There are economies of scale and scope between the monopoly and non-monopoly markets that create a network that no private firm can replicate;
- d. The governmental monopoly chooses to exploit these economies of scale and scope in a manner that favors its own competitive services and its own subsidiary over other competitors; and
- e. There is no regulatory control, administrative supervision or other measure to ensure that the governmental monopoly does not do so.

366. Canada's attempts to distance itself from Canada Post's discriminatory conduct also fail. Canada's discussion of the meaning of "treatment" attempts to circumvent previous NAFTA rulings rejecting Canada's interpretations of the NAFTA Article 1101 requirement that there be "measures relating to" investments. Canada also ignores a series of GATT and WTO rulings rejecting its arguments that claims involving state enterprises must be limited to special rules or that the operations of these enterprises involve purely commercial conduct and not an exercise of governmental authority.

367. As Canada acknowledges in its Counter-Memorial, discriminatory intent is not a necessary condition for a finding of a violation of national treatment. The inquiry is an objective one into the nature of the competitive relationship between the foreign and domestic economic interests. The measures may have been motivated by a *bona fide* relevant public policy objective, but this fact alone cannot excuse their discriminatory effect. Nor do vague and repeated invocations of "public policy" become any more persuasive when they are cloaked with international treaties that do not mandate the measures complained of.

368. The UPS claim also involves breaches of well-established rules of customary international law. There is a wealth of precedent in customary international law for the proposition that public authorities must enforce laws equally with respect to both nationals and aliens,⁴⁷⁶ which Canada has failed to do by allowing Canada Post to avoid collecting duties and taxes. Fundamental collective bargaining norms have also become part of customary international law and UPS has the standing to claim for damages where the failure to respect them has harmed its investment. The retaliation of public authorities against foreigners who seek to assert their legal rights is also a breach of a recognized rule of customary international law, which Canada Post performed when it refused to entertain the Fritz Starber bid as a result of the NAFTA claim.

⁴⁷⁶ For example, Bin Cheng refers to the International Court of Justice's decision in the *Anglo-Norwegian Fisheries* case that held that "The principle of good faith requires that every right be exercised honestly and loyally. Any fictitious exercise of right for the purpose of evading such a rule of law or contractual obligation will not be tolerated. Such an exercise constitutes an abuse of right, prohibited at law." Bin Cheng, *General Principles of Law* (1987) at 132-134, Investor's Book of Authorities (Tab 26).

II. TREATY INTERPRETATION AND ADVERSE INFERENCES

A. The Role of Other International Treaties

369. In its Counter-Memorial, Canada correctly points out that relevant rules of international law applicable in the relations between the parties may be taken into account in the interpretation of NAFTA.⁴⁷⁷ Canada then ignores this principle when arguing for an interpretation of the national treatment obligation in a manner that is inconsistent with well-established GATT and WTO jurisprudence.⁴⁷⁸

370. Canada refers to this rule of treaty interpretation in an attempt to imply that its measures are somehow sanctioned by the *Acts of the UPU* or the *Kyoto Convention*. Canada admits, however, that neither of these treaties conflict with NAFTA.⁴⁷⁹ It is a well-established rule that, in the absence of a conflict, a party with two separate treaty obligations must comply with both of them.⁴⁸⁰ Even if there were a conflict, the requirements of NAFTA would prevail.⁴⁸¹ As a result, nothing in these other treaties excuses non-compliance with NAFTA.

371. In any event, there is nothing in either the *Acts of the UPU* or the *Kyoto Convention* that somehow excuses any of the specific measures at issue in this case:

- a. As discussed at length in Part Two of this Reply, the Universal Service Obligation does not justify the measures relating to Canada Post's discriminatory leveraging of its monopoly;

⁴⁷⁷ Canada's Counter-Memorial, para. 442 citing Article 31(3) of the *Vienna Convention on the Law of Treaties*.

⁴⁷⁸ See Canada's attempts to distinguish GATT and WTO jurisprudence at paras. 606-614 of its Counter-Memorial.

⁴⁷⁹ Canada's Counter-Memorial, para.441, Canada's Book of Authorities (Tabs 1-4 and 7).

⁴⁸⁰ Article 30 (iv) of the *Vienna Convention*.

⁴⁸¹ NAFTA Article 103(2).

- b. The *Kyoto Convention* mandates that Customs laws be enforced in international postal traffic for goods destined for that territory.⁴⁸² The Investor is complaining that Canada is not doing so;

- c. The *Kyoto Convention* does not apply to Express Mail Service. While it does create simplified rules for parcel imports, these rules are not at issue in this case. Nothing in either the original *Kyoto Convention* or the revised one (which has not yet entered into force) prevents customs authorities from treating courier shipments in a competitively neutral manner;⁴⁸³ and

- d. None of the specific impugned measures of Canada Customs in this case are in accordance with the Standards and Recommendations of the *Kyoto Convention* cited by Canada. Canada refers to these as the basis for the creation of separate postal and courier streams, the use of joint “Customs/post offices”, the practice of permitting collection of duties and taxes upon delivery and the use of “administrative arrangements” between Canada Customs and Canada Post.⁴⁸⁴ It is merely certain specific administrative arrangements made between Canada Customs and Canada Post, as compared to the arrangements made between Canada Customs and couriers, that are at issue.

372. Canada’s reliance on these treaties is simply an attempt to add the luster of international legitimacy to a series of measures that do not otherwise have any proper policy justification. There are no provisions in either the *Acts of the UPU* or the *Kyoto Convention* that shed light on the meaning of obligations in NAFTA.

⁴⁸² Annex F.4 of the *Kyoto Convention*, 1973, Canada’s Counter-Memorial, para. 457, Canada’s Book of Authorities (Tab 7).

⁴⁸³ Expert Report of James Campbell at para. 151.

⁴⁸⁴ Canada’s Counter-Memorial at paras. 457-462.

B. Canada's Failure to Provide Documents Permits This Tribunal to Make Adverse Inferences

373. In its Memorial, the Investor established that the Tribunal should take adverse inferences with respect to refusals by Canada to produce documents relating to the following areas of the Investor's claim, amongst others:

- a. Canada Post's Annual Cost Study;
- b. Purolator's Use of the Monopoly Infrastructure;
- c. Canada Post's Use of the Monopoly Infrastructure; and
- d. Canada's Supervision of Canada Post.

374. In its Counter-Memorial, Canada has compounded the unfairness to UPS of its refusal to produce relevant documents by having its witnesses and experts repeatedly refer to and rely upon such documents without attaching them as exhibits to their affidavits or filing them elsewhere in the record. For example:

- a. *Annual Cost Study*: Numerous witness refer to various aspects of Canada Post's Annual Cost Study even though the particulars of this Study have not been produced.⁴⁸⁵

⁴⁸⁵ See, e.g., Affidavit of Charlie Lavoie, paras.10-13; Affidavit of Jason Hergert, para.6; Report of Robin Cooper at 9, 22, 28; Letter of Barry Lalonde (Neels) dated May 2, 2005 at para.5; Report of Barry Lalonde (ACS) dated May 12 at 8-9; Report of Michael Bradley at 39.

b. *Purolator*: -----

c. *Supervision*: Mr. Ferguson claims that the Cabinet supervises Canada Post through “informal directives” from the Minister responsible for Canada Post and through a multi-year framework agreement that led to a price cap. Only one example of an “informal directive” is attached and it has nothing to do with fair competition. The Framework Agreement is not attached even though it was responsive to the Investor’s Information Request.⁴⁸⁹

375. Canada argues that the Tribunal should not take adverse inferences based on Canada’s failure to produce relevant evidence. Canada states that the main inferences requested by the Investor should not be made because the documents in question “...are not within Canada's control and are irrelevant to the arbitration.”⁴⁹⁰ There is simply no basis for this sweeping denial.

376. Canada also argues that it has provided justifications for its refusal to produce. The Tribunal has already ruled repeatedly that Canada’s justifications are insufficient. In

⁴⁸⁶ Affidavit of Bill Henderson at paras.22, 28.

⁴⁸⁷ Supplementary Report of Howard Rosen.

⁴⁸⁸ Investor’s Information Request to Canada (Tab U294)

⁴⁸⁹ Affidavit of Gordon Ferguson at paras. 72 and 102.

⁴⁹⁰ Canada’s Counter-Memorial at para. 485.

particular, it has expressly stated that confidentiality and Cabinet privilege concerns do not justify the refusal to produce otherwise relevant documents.

377. Finally, Canada argues that the adverse inference should not be drawn unless there is a prima facie case and the Tribunal is unable to base its decision on other grounds. The Investor agrees that there are other grounds on which the Tribunal could base a decision in favor of the Investor. However, it would not be consistent with principles of procedural fairness to make findings of fact on these issues in favor of Canada without having given the Investor access to all the documents relevant to these issues.
378. Nonetheless, given that the Counter-Memorial discloses that certain facts are no longer in dispute, it is possible to narrow the findings of fact for which an adverse inference can be drawn. These findings are set out below.

1. Annual Cost Study

379. In its Memorial, the Investor argued that the following adverse inference should be made regarding the Annual Cost Study:
- 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 incremental or a fair contribution to covering the costs of basic postal services.⁴⁹¹

380. In response, Canada argues in its Counter-Memorial that the documents requested by the Investor are irrelevant.⁴⁹² Based on the statements of Dr. Cooper,⁴⁹³ Canada states that the

⁴⁹¹ Investor's Memorial at para. 401.

⁴⁹² Canada's Counter-Memorial at para. 486.

⁴⁹³ Canada's Counter-Memorial at para. 487.

Investor's document requests were simply impossible to fulfill and were overly broad. Both Canada and Dr. Cooper are incorrect.

381. The document requests made by the Investor were reasonable and made with respect to specific types of documents that are common in the preparation of cost studies prepared by postal operators, such as the USPS. As stated by Dr. Neels:

382. Based on the witness statements of Professors Bradley and Cooper, to whom Canada apparently provided the documents and information requested by the Investor,⁴⁹⁵ the information reviewed by them appears to have been directly relevant to the conclusions made by them, and relied upon by Canada in its Counter-Memorial. As noted by Dr. Neels:

Given the incompleteness of the Canada's responses to UPS's information requests, one aspect of their testimony that I evaluated carefully while reviewing their reports was what they reviewed and relied upon in forming their opinions. It appears that these opinions are based in part upon documents and information that I and other witnesses for UPS have not had the opportunity to evaluate..."⁴⁹⁶

383. Mr. Cohen, a costing expert who worked for both the U.S. Postal Service and the U.S. Postal Rate Commission, reviewed Canada's productions. -----

⁴⁹⁴ Neels Reply at para. 40. Also see paras. 36-43.

⁴⁹⁵ Canada's Counter-Memorial at para. 487: "Professor Bradley's explanations of the methodology and Professor Cooper's review of its application present a complete picture of the facts."

⁴⁹⁶ Neels Reply Report at para. 44. Also see paras. 45-52.

384. Despite the fact that simple fairness and the equality of the parties requires production, Canada has refused to produce probative documents related to the Annual Cost Study reviewed by Professors Bradley and Cooper. Only two conclusions can be made by the Tribunal in response to these refusals:

- a. first, the documents requested by the Investor do exist and Canada is not producing them for review by the Investor's experts for fear of providing information disadvantageous to its defence; or
- b. second, the documents do not exist and the conclusions that have been made by Professors Bradley and Cooper have no basis and should be completely discounted by the Tribunal as having no weight.

385. Canada takes a further opportunity to misstate the Investor's position with respect to cross-subsidization by stating that "With respect to incremental contribution, the Claimant has explicitly argued that absence of cross-subsidization is irrelevant to Article 1102."⁴⁹⁸ As addressed elsewhere in this Reply Memorial, the Investor has made no such argument. It has simply stated that the avoidance of cross-subsidization is a minimum condition for equal treatment, not an irrelevant consideration. Cross-subsidization automatically entails unequal treatment. The Investor has produced sufficient evidence

⁴⁹⁷ Expert Report of Robert Cohen at para.15.

⁴⁹⁸ Canada's Counter-Memorial at para. 486.

that demonstrates a strong *prima facie* argument that Canada is misstating the allocation of costs in the Annual Cost Study. Since Canada has refused to rebut such evidence, it is entirely appropriate for this Tribunal to find Canada Post's courier services do not make either an incremental or a fair contribution to covering the costs of basic postal services.

2. Purolator's Access to Infrastructure

386. In its Memorial, the Investor argued that the following adverse inference should be made about use of the Canada Post infrastructure:

- 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.⁴⁹⁹

387. In its Counter-Memorial, Canada denies that this inference should be made on the grounds that the Investor's original request was vague and that there is more than enough evidence available on which the Tribunal can rule.⁵⁰⁰

388. The requests made by the Investor were clear and precise and any accusations of vagueness by Canada is mere rhetorical bluster. -----

----- Such a failure to produce documents will support the Tribunal's conclusions that:

⁴⁹⁹ Investor's Memorial at para. 401.

⁵⁰⁰ Canada's Counter-Memorial at para. 492.

⁵⁰¹ For example, see the Affidavit of William Henderson at paras. 22, 28 and 29 which confirms Purolator's use of Canada Post infrastructure.

- a. Purolator obtains its access on terms that are more favorable than those granted to its competitors;
- b. -----
-----⁻⁰² and
- c. the manner in which third parties receive access to the Canada Post infrastructure is not as transparent and fair as Canada has alleged.⁵⁰³

3. Canada Post's Courier Services' Access to Infrastructure

389. In its Memorial, the Investor argued that the following adverse inference should be made:

- 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.⁵⁰⁴

390. Again, Canada incorrectly argues that such an adverse inference should not be made because the original requests were "phrased in vague terms" and not sufficiently specific.⁵⁰⁵ Information regarding the access of Priority Courier and Xpresspost to the Canada Post infrastructure goes to the heart of the Investor's claims against Canada. As

⁵⁰² Canada's Counter-Memorial at paras. 44, 135, 170, 187-191 and 886.

⁵⁰³ -----

⁵⁰⁴ Investor's Memorial at 401.

⁵⁰⁵ Canada's Counter-Memorial at para. 492.

stated in the relevant document requests, the Tribunal should make the following inferences for documents not produced:

- a. Canada Post owned or leased buildings and facilities that are used 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;⁵⁰⁶ and
- b. Canada Post's competitive services (for example, Priority Courier, Xpresspost, Expedited Parcel and Regular Parcel) have not paid the incremental cost of using the Canada Post infrastructure.⁵⁰⁷

4. Supervision

391. In its Memorial, the Investor argued that the following adverse inference should be made regarding Canada's failure to supervise Canada Post:

⁵⁰⁶ See Investor's Memorial at Footnote 185 which references Document Request No. 209, to which Canada refused to provide any documents: "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". For further examples of access of these products to the Canada Post infrastructure, see Investor's Memorial at paras. 144-177.

⁵⁰⁷ Based on t----- d

----- See Investor's Memorial at paras. 190-197. As noted in the Investor's Memorial, at Footnote 250, in the Investor's Information Request to Canada No. 82, the Investor sought all documents relating to the Annual Cost Study (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, Investor's Book of Authorities (Tab 15); Direction of the Tribunal Concerning Document Production dated August 1, 2003 at paras. 1, 2, Investor's Book of Authorities (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 (Tab U155).

- 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.⁵⁰⁸

392. In response, Canada has argued that the Affidavit of Gordon Ferguson explains how the Government supervises Canada Post, and that the documents already provided "speak for themselves."⁵⁰⁹ As discussed elsewhere in this Reply, the evidence provided by Canada allows this Tribunal to make the exact opposite conclusion - that Canada could have, but did not, supervise Canada Post. This is a critical distinction which Canada fails to address.

393. Canada has permitted Canada Post to effectively regulate itself. Canada has allegedly used, by its own admission, "informal" directives to supervise Canada Post. If any of these informal directives related to the issues in dispute, Canada should have produced them.⁵¹⁰ It has not, and accordingly the Tribunal can only conclude, by way of adverse inference, that such supervision was not with respect to the use of Canada Post's monopoly powers against competitors.

394. Canada, through the evidence of Mr. Ferguson and others, puts particular reliance on the fact that Canada and Canada Post concluded the Multi-Year Framework Agreement and

⁵⁰⁸ Investor's Memorial at para. 401.

⁵⁰⁹ Canada's Counter-Memorial at para. 489.

⁵¹⁰ The fact that Canada has produced one example of such an informal directive suggests that it would certainly be able to provide further examples. See Canada's Reply to Investor's Motion On Canada's Failure to Produce Certain Documents, Investor's Schedule of Documents (Tab 156). See also Affidavit of Gordon Ferguson at para. 72, Canada's Brief of Affidavits and Expert Reports (Tab 11).

the resulting price cap.⁵¹¹ However, Canada continues to deny production of that Agreement despite the particular emphasis its economic experts place on it with respect to the establishment of the alleged “price cap” through that Framework Agreement.⁵¹²

395. Moreover, Canada has provided access to the Framework Agreement to its expert Professor Robert Campbell, for the purposes of his second book, who described it as:

- a. “a tentative, incomplete, and insubstantial document”;⁵¹³
- b. “the least public-service or contractual agreement of any examined in this study”;
- c. “all but invisible”;
- d. “sparsely written [with] little substance, background, or explanation”;⁵¹⁴ and
- e. “a spiced-up version of the status quo”.⁵¹⁵

396. Given that Canada Post regulates its own prices, subject only to Cabinet approval, it cannot be said to be under any form of true “price cap”. The failure to produce the Framework Agreement and other Cabinet documents relating to Canada Post’s monopoly powers leads to the inference that Cabinet has not adopted a policy of refusing any further price increases. If necessary, the Tribunal should make an inference that the purported “price cap” does not restrain unfair competition by Canada Post as, amongst other things, Cabinet has not committed itself to refuse further price increases.

⁵¹¹ Canada’s Counter-Memorial at paras. 110, 196, 210 (bullets 4 and 11) and 280; Affidavit of Gordon Ferguson at para. 102; Report of Robin Cooper at Appendix B; Report of Paul Kleindorfer at paras. 53-62.

⁵¹² Canada’s Counter-Memorial at para. 233: “The Framework, as discussed in greater detail in the Affidavit of Gordon Ferguson, established service, productivity and financial performance targets for Canada Post, and provided for a rate-capping mechanism for basic lettermail.” Also see: Report of Michael Bradley at 46, fn 32; Report of Robert Campbell at para. 130; Affidavit of Francine Conn at paras. 62-63; Report of Robin Cooper at 44; Report of Michael Crew at 17, para. 72; Report of Paul Kleindorfer paras. 34 and 46; and Expert Report of John Panzar at 53. See Neels Reply Report at paras. 58-66 for discussion of the price cap issue.

⁵¹³ Robert Campbell, *The Politics of Postal Transformation* at 413, Investor’s Schedule of Documents (Tab U498).

⁵¹⁴ Robert Campbell, *The Politics of Postal Transformation* at 312 to 313.

⁵¹⁵ Robert Campbell, *The Politics of Postal Transformation* at 313.

397. With respect to the alleged supervision of Canada Post by the Competition Bureau, it is clear that the Bureau is not a regulator and does not ensure fair competition.⁵¹⁶ Nor does the evidence disclose any detailed independent analysis by the Competition Bureau of Canada Post's Annual Cost Study. The Bureau appears to have been content to rely on Canada Post's own consultants in its investigations. Such an approach may very well have been sufficient given its limited mandate. However, as the Bureau officials have themselves stated, Canada Post cannot rely on them for "a clean bill of health".⁵¹⁷
398. Canada's failure to produce the requested documents from the Competition Bureau is simply confirmation that the Competition Bureau has not engaged in supervision to ensure that Canada Post does not leverage its network in a discriminatory manner.

⁵¹⁶ Canada's Counter-Memorial at para. 490: Canada states that it "has produced evidence of actual instances where the Competition Bureau examined the commercial behaviour of Canada Post." However, as shown by the Investor, these "actual instances of oversight" are no such thing. See Investor's Memorial at paras. 260-266.

⁵¹⁷ Canada Post Mandate Review, *The Future of Canada Post Corporation*, (1996) Chapter 3 at 13 (Tab U79)

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III. CANADA'S PRELIMINARY OBJECTIONS ARE GROUNDLESS

399. Canada's preliminary objections confuse jurisdictional issues, procedural matters and exceptions or exemptions. Canada bears the burden of proving the exceptions or exemptions from the national treatment obligation and these will be addressed in the discussion of that obligation. The remaining issues are procedural and are addressed in this chapter.

A. UPS Is an Investor from the United States

400. Canada asserts that UPS has not proved that it is an Investor of a Party. For the reasons set out in Chapter I of Part Two of this Reply, there is no question that UPS is an Investor from the United States of America, which owns and controls investments in Canada. Accordingly, Canada's argument should be dismissed.

B. The Investor's Claim Is Within NAFTA's Time Limits

1. The Investor's Claims Arising from Canada's Continuing Acts Are Within NAFTA's Time Limits

401. NAFTA Article 1116(2) provides that an investor must first make its claim within three years of the time that it "first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage." The Investor's claims are consistent with Article 1116(2) because the measures in dispute were either maintained or first occurred after April 19, 1997, three years before the claim was made. Thus, the Investor claimed within three years of knowledge of the alleged breaches.

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402. It is undisputed that Canada's retaliation against Fritz Starber, in breach of Article 1105, occurred on December 5, 2001. It is, therefore, undisputed that the Investor became aware of this breach after April 19, 1997. It is also undisputed that the Investor became aware of Canada's breach of Article 1105, by denying its workers core labour standards, after April 19, 1997.
403. The parties also do not dispute that the remainder of Canada's measures which breach its NAFTA obligations are still in force today. Consequently, the Investor's claim in regard to these breaches cannot be time barred. Regardless of when these measures were first implemented, claims arising from acts that still continue cannot be time barred.
404. International law accepts that in continuing an action inconsistent with international law, a state is taken to repeat that action every day and, therefore, commits a separate breach of international law every day. The claimant becomes aware of this separate breach every day and, therefore, cannot be time barred while the state continues to breach its obligation.
405. International decisions unanimously support this interpretation. For example, in the *De Becker* case, the European Commission on Human Rights said:

when the Commission receives an application concerning ... a permanent state of affairs ... the problem of the six months [limitation] period specified in Article 26 can arise only after this state of affairs has ceased to exist; whereas in the circumstances, it is exactly as though the alleged violation was being repeated daily thus preventing the running of the six months period.⁵¹⁹

406. Similarly, the International Law Commission ("ILC") has said:

in the case of a 'continuing' wrongful act, however, this *dies [a quo]* of the time limit can be established only after the end of the time of commission of the wrongful act itself.⁵²⁰

⁵¹⁹ *Yearbook of the European Convention on Human Rights*, 2 (1958-9), at 244, Investor's Book of Authorities (Tab 150).

⁵²⁰ ILC Report on its 30th Session (1978), n. 428, Investor's Book of Authorities (Tab 151).

407. In its Memorial, the Investor referred to *Peter Blaine v. Jamaica*, *Neville Lewis v. Jamaica*, *Kevin McDaid, Hilton v. UK* and *Montion v. France* in support of the conclusion that time limits only run from the end of a continuing act. In *Peter Blaine v. Jamaica* and *Neville Lewis v. Jamaica*, the Inter-American Commission on Human Rights addressed an argument that the claim was time barred under Article 46(b) of the *Inter-American Convention on Human Rights*. That Article provides that a petition must be presented within six months from the date of the final domestic judgment complained of. The Commission noted that Article 38 of the Convention said where no such judgment has been issued because it has not been possible to exhaust internal remedies, then the petition must be presented within a reasonable period of time from the state act complained of.⁵²¹ The Commission decided that the claim was not barred under either time limit because the impugned state act was still continuing. The Commission said:

As the foregoing claims concern a set of alleged conditions ... and a set of norms and consequences which continue to apply and unfold ... their admissibility is not barred by the six-months rule.⁵²²

408. While Canada says the *Peter Blaine v. Jamaica* and *Neville Lewis v. Jamaica* decisions are “inapplicable”⁵²³ to NAFTA Article 1116(2), Canada’s precise objection to their authority is hard to understand. Canada says the decisions are inapplicable because the relevant treaty at issue in those cases contained two provisions containing time limits.⁵²⁴ It

⁵²¹ *Peter Blaine v. Jamaica*, Case 11.827, Report No. 96/98, Inter-Am. C.H.R. at para 50; *Neville Lewis v Jamaica* Case 11.825, Report No. 97/98, Inter-Am. Court of Human Rights OEA/Ser.L/V/II.95 Doc. 7 rev at 327 (1998) at para. 50, Investor’s Book of Authorities (Tabs 84 and 74, respectively).

⁵²² *Peter Blaine v. Jamaica* at para. 52, Investor’s Book of Authorities (Tab 84). *Neville Lewis v. Jamaica* at para. 52, Investor’s Book of Authorities (Tab 74): “As the foregoing claims concern sets of norms and consequences, respectively, which continue to apply and unfold, their admissibility is not barred by the six month rule.”

⁵²³ Canada’s Counter-Memorial at footnote 504.

⁵²⁴ Canada says (at footnote 504):

The Claimant’s authorities from outside the NAFTA context are also inapplicable. *Peter Blaine v. Jamaica*

is impossible to determine how this fact affects the authority of the tribunal's comments on the effect of a continuing act on those time limits. At another point, Canada says the decisions are inapplicable because "the prescription period at issue did not apply only because a different limitations rule applied."⁵²⁵ The passage quoted above demonstrates that this is untrue. The tribunal found that the claim was not time barred because the state's impugned act still continued.

409. The *Kevin McDaid, Hilton v. UK* and *Montion v. France* decisions all addressed the application of the time limit in the *European Convention on Human Rights*. That Convention says that the claim must be presented within six months of the final domestic decision denying remedies.⁵²⁶ In *Kevin McDaid*, the tribunal said:

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 ... Where there is no remedy available, the six month period runs from the date of the act or decision complained of.⁵²⁷

and *Neville Lewis v. Jamaica* were decided under a treaty providing for two prescription periods: six months for matters that have been subject to a final judgement at the domestic level, and a "reasonable period of time" for matters that are still ongoing, but for which it is impossible to exhaust local remedies. The six-month rule in the European cases cited at footnote 542 also refers specifically to the date of a "final decision."

⁵²⁵ Canada says at para. 45 of its Counter-Memorial: "The Claimant cites a human rights case as an example of an international tribunal finding that prescription periods 'do not apply where the allegations concern a continuing situation.' In fact, the case was decided under a procedure with two separate rules - one for 'continuing situations' and one for situations that had already been resolved domestically. Thus the prescription period at issue did not apply only because a different limitations rule applied."

⁵²⁶ Article 26 of the Convention states: "The Commission may only deal with the matter after all domestic remedies have been exhausted, according to the generally recognized rules of international law, and within a period of six months from the date on which the final decision was taken".

⁵²⁷ *Kevin McDaid and Others v the United Kingdom*, ECHR Application No. 25681/94, 9 April 1996 at 3, Investor's Book of Authorities (Tab 82). See also *Hilton v UK*, ECHR Application No. 12015/86, 6 July 1988 at 12 and 13, Investor's Book of Authorities (Tab 112): "... in accordance with constant case-law the "final decision" for purposes of the six months rule must normally be regarded as the date of the acts or decisions complained of where there exists no domestic remedy in respect of the complaint." See also *Montion v. France*, ECHR Application No. 11192/84, 14 May 1987 at 4, Investor's Book of Authorities (Tab 130): "...lorsqu'il n'existe pas de voie de recours interne, l'acte ou la décision incriminés doivent eux-mêmes être normalement considérés comme la décision interne

410. All three cases applied this rule to consider if the claims were time barred because six months had run from the date of the act or decision complained of. All three found that the claims were not barred because the acts complained of still continued and the six months could only run from the end of the act.⁵²⁸
411. Canada claims that these three cases are inapplicable because, on their face, the time limit in question ran from a final decision of domestic courts.⁵²⁹ Once again, it is impossible to understand Canada's point. Presumably, Canada seeks to distinguish the decisions because they considered a time limit which ran from a different event to the time limit in NAFTA Article 1116(2). Yet, regardless of the event triggering the running of the time limit, the effect of the continuing nature of the event on the time limit is the same. Furthermore, the tribunals clearly said that they were actually considering the state's impugned action and not the final domestic decision as the triggering event. The three cases are, therefore, perfectly good authority for the proposition for which they were cited by the Investor: time limits only run from the end of a continuing act. A claim impugning an act that is still continuing cannot be time barred.

définitive visée à l'article 26".

⁵²⁸ *Kevin McDavid* at 3, Investor's Book of Authorities (Tab 82), "Insofar as the applicants complain that they are victims of a continuing violation to which the six month is applicable, the Commission recalls that the concept of a "continuing situation" refers to a state of affairs which operates by continuous activities or on the part of the State to render the applicants victims". See *Hilton v. UK* at 13, Investor's Book of Authorities (Tab 112): "The commission further recalls that the six months rule... does not apply to a complaint which concerns a "continuing situation". See also *Montion v. France* at 4, Investor's Book of Authorities (Tab 130): "le delai de six mois ne s'applique pas, ... lorsque le requérant se prétend victime d'une violation continue..."

⁵²⁹ In Canada's Counter-Memorial (at footnote 504) it says:

The Claimant's authorities from outside the NAFTA context are also inapplicable. *Peter Blaine v. Jamaica* and *Neville Lewis v. Jamaica* were decided under a treaty providing for two prescription periods: six months for matters that have been subject to a final judgement at the domestic level, and a "reasonable period of time" for matters that are still ongoing, but for which it is impossible to exhaust local remedies. *The six-month rule in the European cases cited at footnote 542 also refers specifically to the date of a "final decision"* (emphasis added).

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412. In its Memorial, the Investor explained how the *Feldman* NAFTA decision confirms that the time limit in Article 1116(2) only runs from the end of a continuing act.⁵³⁰ Canada chooses not to question the authority of the *Feldman* decision⁵³¹ but, instead, claims that the *Mondev* NAFTA decision says the continuing nature of a breach does not affect the operation of Article 1116(2). The *Mondev* decision says no such thing.
413. The *Mondev* tribunal addressed a claim that the US breached NAFTA through two distinct state actions: first, the state's interference with the claimant's rights in a building project; and second, the state courts' failure to compensate the claimant for that interference. To overcome the problem that the first action occurred well before NAFTA came into force, the claimant alleged that the two actions were part of the same continuing breach. In the obiter passage to which Canada refers, the tribunal was merely saying that such a claim would be time barred because the first act had clearly ended and, therefore, could not be seen as repeated every day. The tribunal makes this distinction through its reference to a "continuing NAFTA claim," rather than a "continuing act."⁵³² Ultimately, the *Mondev* tribunal examined the US' actions occurring within three years of the claim to determine if they were consistent with the US' NAFTA obligations. This is simply what the Investor asks of this Tribunal.
414. Apart from *Mondev*, the only other case upon which Canada relies is the *Case Concerning Certain Phosphate Lands in Nauru*.⁵³³ The precise authority Canada seeks to draw from this case is difficult to discern. The International Court of Justice's decision confirms that time limits only run from the end of the continuing act.

⁵³⁰ Investor's Memorial at para. 495, Investor's Book of Authorities (Tab 8).

⁵³¹ Canada's Counter-Memorial at para. 511.

⁵³² *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award, October 11, 2002, 2002 WL 32841359; 42 ILM 85 (2003) at para. 87, Investor's Book of Authorities (Tab 37).

⁵³³ *Case Concerning Certain Phosphate Lands in Nauru (Nauru v. Australia)*, Preliminary Objections, 1992 ICJ 240 at para. 32, Canada's Book of Authorities (Tab 44).

415. The relevant aspect of that case concerned Australia’s refusal to rehabilitate certain land on the island of Nauru. Canada accepts that Australia’s refusal to rehabilitate was a continuing act and that “Nauru’s claim was not rendered inadmissible by the passage of time” but claims the Court was “prepared to reject the claim for that reason.”⁵³⁴ The paragraph to which Canada refers to support this proposition simply said:

The Court recognizes that, even in the absence of any applicable treaty provision, delay on the part of a claimant State may render an application inadmissible. It notes, however, that international law does not lay down any specific time-limit in that regard. It is therefore for the Court to determine in the light of the circumstances of each case whether the passage of time renders an application inadmissible.⁵³⁵

416. The Court then went on to find the claim was not time barred because Australia’s impugned act still continued. After the paragraph quoted above, the Court goes on to identify that Australia continued to refuse to rehabilitate the land throughout the relations between the two countries and the steps taken by Nauru to seek rehabilitation of the land. The Court then concludes:

... given the nature of relations between Australia and Nauru, as well as the steps thus taken, Nauru’s application was not rendered inadmissible by passage of time.⁵³⁶

The decision simply confirms that claims impugning continuing acts will not be time barred.

417. Both NAFTA and other international tribunals have unanimously found that a state act that still continues cannot be time barred because such a situation does not fulfill the

⁵³⁴ Canada’s Counter-Memorial at footnote 502.

⁵³⁵ *Case concerning Phosphates in Nauru* at para. 32.

⁵³⁶ *Case concerning Phosphates in Nauru* at para. 36.

purposes of limitation articles.⁵³⁷ A state continually acting inconsistently with its international obligations promotes far greater uncertainty than can be generated by allowing a claim for an act that the state repeats every day. Furthermore, while Canada says allowing such claims creates a “prejudice to the respondent from difficulties in establishing the facts,”⁵³⁸ it fails to explain how there can be any such prejudice if the breach continues to generate the relevant facts every day. The Investor’s claims arising from Canada’s continuing acts are, therefore, not time barred.

2. The Investor Only Became Aware of Several Breaches Within Three Years of Its Claim

418. If the Tribunal finds that the time limit in Article 1116(2) can begin while Canada’s acts still continue then the precise time that the Investor became aware of Canada’s breaches becomes important. The Investor only became aware of several breaches after April 19, 1997. In particular:

a. Canada’s Breach of NAFTA Articles 1502(3)(a) and 1503(2) through its failure to take measures to ensure Canada Post did not act inconsistently with Canada’s Chapter 11 obligations

419. The Investor became aware of Canada’s failure to ensure Canada Post did not leverage the Monopoly Infrastructure in a discriminatory way when Canada definitively declared it would not follow any of the recommendations of the Canada Post Mandate Review. Canada had established the Mandate Review in response to allegations Canada Post was inappropriately leveraging the Monopoly Infrastructure. The Mandate Review

⁵³⁷ See paras. 496 and 497 of the Investor’s Memorial.

⁵³⁸ Canada’s Counter-Memorial at para. 510.

subsequently recommended actions Canada should take to ensure Canada Post did not continue to leverage the Monopoly Infrastructure in a discriminatory way.

420. Canada definitively declared it would not follow any of the recommendations of the Mandate Review on April 23, 1997 through the press release of Minister Marleau, the Minister Responsible for Canada Post.⁵³⁹ Minister Marleau's press release said that it "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 ..."⁵⁴⁰
421. It was only at this time that the Investor became aware that Canada failed to ensure Canada Post did not leverage the Monopoly Infrastructure in a discriminatory way. It was, therefore, only at this time that the Investor became aware Canada had breached NAFTA Articles 1502(3)(a) and 1503(2).
422. In incorrectly claiming that this aspect of the Investor's Chapter 15 claim is time barred, Canada says that the Investor "has argued that Canada Post monopoly products cross-subsidize the competitive services" since at least 1989.⁵⁴¹ The Investor's awareness of Canada Post's cross-subsidization does not imply awareness of lack of supervision contrary to Articles 1502(3)(a) and 1503(2). Prior to April 23, 1997, Canada was reviewing possible measures to ensure equal treatment. Canada failed to ensure Canada Post provided equal treatment when it refused to adopt any of the recommendations of the Review.

⁵³⁹ The Investor described in its Memorial at paras. 239 - 244 how the changes announced by Minister Marleau in the April 23, 1997 press release did not implement any of the recommendations of the Review.

⁵⁴⁰ Marleau Outlines Plan for Canada Post, News Release dated April 23, 1997 (Tab U95).

⁵⁴¹ Canada's Counter-Memorial at para. 516.

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- b. *Canada's Breach of NAFTA Articles 1102 and 1105 in Regard to Customs.*

423. Canada takes measures inconsistent with its NAFTA Article 1102 obligation through measures contained in or ancillary to the *Postal Imports Agreement*. Specifically:
- a. Canada Customs pays Canada Post for services it provides under the *Postal Imports Agreement* but which UPS Canada must provide for free;⁵⁴² and
- b. Canada Customs gives Canada Post free access to Customs officers and to the electronic PICS system under the *Postal Imports Agreement*, but charges UPS Canada for the same or similar services.⁵⁴³
424. Canada's claim that the Investor became aware of both the payment to Canada Post and Canada Post's free access to certain Customs services when the *Postal Imports Agreement* was publically announced in 1992 is incorrect.⁵⁴⁴ The June 30, 1992 *Postal Imports Agreement* was an interim understanding consisting of a two paragraph letter sent from the Minister of National Revenue to the President of Canada Post.⁵⁴⁵ The interim agreement did not make any reference to payments from Canada Customs to Canada Post or to access to Customs officers and computer systems. It only referred to "the collection of duties in respect of mail, as agent of the Minister, upon such terms and conditions and during the time period which may be agreed to by the parties."

⁵⁴² Investor's Memorial at paras. 306-315.

⁵⁴³ Investor's Memorial at paras. 291 and 294.

⁵⁴⁴ Canada's Counter-Memorial at para. 518.

⁵⁴⁵ Affidavit of John Cardinal, Exhibit C.

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425. In fact, the Affidavit of John Cardinal describes the June 30th letter as an “agency agreement that eventually became the *Postal Imports Agreement*.”⁵⁴⁶
426. Almost two years later, an actual *Postal Imports Agreement* was executed on March 22, 1994, between Canada Post and Customs. The Affidavit of John Cardinal describes that “protracted negotiations of specific terms and conditions” took place regarding this agreement over the nearly two year period.⁵⁴⁷ While Canada seeks to rely on the public announcements surrounding the 1992 Agreement, it has failed to identify a single public notice saying Canada Customs would pay Canada Post for the services it provided under the *Agreement*⁵⁴⁸ or that Canada Post would receive free access to Customs officers or the PICS system.⁵⁴⁹
427. Canada breached NAFTA Article 1105 through its failure to enforce customs laws in good faith. The Investor became aware of this breach after seeing the documents filed in this arbitration.

c. *Canada’s Breach of Article 1102 Through Its Implementation of the Publications Assistance Program*

428. Canada acted in a manner inconsistent with NAFTA Article 1102 when it adopted the current form of the *Publications Assistance Program*. Canada concedes that the current

⁵⁴⁶ Affidavit of John Cardinal at para. 13.

⁵⁴⁷ Affidavit of John Cardinal at para. 14.

⁵⁴⁸ Neither of the sources, to which Canada refers at footnote 518 to support its claim the Investor knew of the payments at that time, refers to Canadian Custom’s payments to Canada Post. See the third reading of Bill C-74, Canada’s Book of Authorities (Tab 21). The Edmonton Journal article simply refers to the \$5 fee that Canada Post collects from customers, Canada’s Schedule of Documents (Tab 29).

⁵⁴⁹ Neither of the sources, to which Canada refers at footnote 515 to support its claim the Investor knew of the payments at that time, referred to Canada Post’s free use of the PICS system. See question No. 363 in the House of Commons Debates, Canada’s Schedule of Documents (Tab 50). Also see Affidavit of Donald Martin at paras. 42 and 44, Canada’s Brief of Affidavits and Expert Reports (Tab 26).

form of the Program was adopted after April 17, 1997. Canada says that “[t]he Program, in its current form, results from the 1996 review and the [30 June] 1997 World Trade Organization decision.”⁵⁵⁰

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430. Canada incorrectly argues that the Investor became aware of the breach before the post-WTO case restructuring of the *Publications Assistance Program* because Canada Post was always the exclusive carrier for publishers.⁵⁵² The time at which Canada Post became the exclusive carrier of publications in Canada is irrelevant. It is the *Publications Assistance Program* requirements, in the form created after the June 1997 WTO decision, and the Memoranda of Agreement, which constitute Canada’s breach of NAFTA Article 1102. The Investor, therefore, could only have become aware of those breaches after the post-1997 restructuring and, therefore, within three years of filing its claim.

C. The Investor Is Entitled to Bring Its Claim Under Article 1116

431. The Investor has brought this NAFTA claim under Article 1116 which provides that an investor of a Party may bring a claim on its own behalf on the grounds that “the investor

⁵⁵⁰ Canada’s Counter-Memorial at para. 297.

⁵⁵¹ Fizet Statement at para. 16.

⁵⁵² Canada’s Counter-Memorial at para. 522.

has incurred loss or damage”. Article 1117 provides that an investor of a Party may bring a claim on behalf of an enterprise that the investor owns or controls on the grounds that “the enterprise has incurred loss or damage”.

432. Canada alleges that the UPS claim should have been brought under Article 1117 rather than Article 1116 on the basis that the loss or damage was incurred by “the enterprise” and not by “the Investor”. Canada states that the vast majority of claims appear to allege loss or damage to UPS Canada.⁵⁵³ Canada asserts that such damage may only be recoverable under a NAFTA claim made under Article 1117.
433. In its Memorial, the Investor explained that it properly brought its claims under Article 1116 as harm to UPS Canada also results in “loss or damage” to UPS.⁵⁵⁴ Canada acknowledges that the *Pope & Talbot* tribunal confirmed the Investor’s position.⁵⁵⁵ It offers no reasonable basis for its remark that the *Pope & Talbot* tribunal was wrong. Nor does Canada address the numerous bilateral investment treaty cases cited in the Memorial that confirm that damage to an enterprise owned by an investor results in damage to the investor through the diminution in value of the investor’s shares.
434. In the alternative, should this Tribunal find that the Investor should have filed under NAFTA Article 1117, the Tribunal should grant leave to permit the Investor to amend its claim to come under NAFTA Article 1117.
435. In this regard, Canada asserts that, as neither UPS Canada nor Fritz Starber has filed its written consent, this results in an absolute bar to the Tribunal’s jurisdiction to hear an

⁵⁵³ Canada’s Counter-Memorial at para. 524.

⁵⁵⁴ Investor’s Memorial at para. 502.

⁵⁵⁵ Canada’s Counter-Memorial at para. 530. *Pope & Talbot v. Canada*, UNCITRAL Arbitration Proceedings, Damages Award, May 31, 2002 at para. 80, *WL* 32824211, Investor’s Book of Authorities (Tab 38).

Article 1117 claim.⁵⁵⁶ That assertion by Canada is absurd. Given that the claim was filed under Article 1116, the Investor supplied written waivers for Fritz Starber and UPS Canada.⁵⁵⁷ Should the Tribunal deem it necessary, these waivers can also be treated as the required consents necessary for the purpose of NAFTA Article 1117.

436. In *Ethyl Corp. v. Canada* the tribunal determined that it had jurisdiction despite the investor's failure to provide a written waiver of rights to other dispute settlement procedures, as required by NAFTA Article 1121.⁵⁵⁸ The same conclusion should apply to a consent as to a waiver.

437. Canada further asserts that the Investor cannot claim losses allegedly suffered by its US subsidiaries.⁵⁵⁹ However, that assertion by Canada must be read in light of the statements made in the tribunal's Award on Jurisdiction:

In terms of the jurisdictional provisions of articles 1101 and 1116, UPS, to recover damages, would have to establish at the merits stage that the damage was suffered either by it or by one or more of its investments "in" Canada. (There is of course no question about UPS Canada.) The evidence may - or may not - establish that any damage suffered by the US Subsidiaries may properly be attributed to UPS itself or that those Subsidiaries, as investments of UPS, were "in" Canada.⁵⁶⁰

438. Therefore, the Investor may properly claim to the extent that the loss or damage suffered by the Investor's US subsidiaries may be attributed to the Investor itself.

⁵⁵⁶ Canada's Counter-Memorial at paras. 534 and 535.

⁵⁵⁷ See Fritz Starber waiver at Investor's Schedule of Documents (Tab U574).

⁵⁵⁸ *Ethyl Corp. v. Canada*, Award on Jurisdiction, June 24, 1998, 1998 WL 34334636; 38 I.L.M. 700 (1999), Investor's Book of Authorities (Tab 50).

⁵⁵⁹ Canada's Counter-Memorial at para. 525.

⁵⁶⁰ *United Parcel Service of America Inc. v. Government of Canada*, Award on Jurisdiction, November 22, 2002, 2002 WL 32824213 at para. 121.

D. The Investor Has Established Harm

439. Together with its Memorial, the Investor submitted the report of Howard Rosen of LECG Canada Ltd⁵⁶¹ (the “Rosen Report”), which demonstrated that the Investor suffered damage and that such damage suffered was caused by Canada’s breach of the NAFTA.
440. Ross Hamilton and Ian Wintrip of Kroll Lindquist Avey provided Canada with a report (the “Kroll Report”) which provides commentary on the Rosen Report. The Kroll Report does not provide an analysis or conclusion as to whether or not the Investor has suffered even one dollar of harm⁵⁶² as a result of the alleged breaches.⁵⁶³ Rather, the Kroll Report is restricted to commentary on the assumptions and methodology employed in the Rosen Report.
441. LECG has reviewed the comments in the Kroll Report and has provide a reply report (“Reply Rosen Report”). The Reply Rosen Report concludes that the Kroll Report is so replete with flaws and inappropriate and incorrect conclusions that it fails to alter any of the opinions of the Rosen Report.
442. The Kroll Report reaches its conclusions on the premise that the basis for the assumptions and analyses contained in the Rosen Report are unreasonable. However, the Kroll Report does not provide any analysis to indicate why the basis for the assumptions and analyses in the LECG Report are unreasonable. Nor could it reasonably do so as these assumptions are based on the opinions of economists that have qualifications in different fields of expertise from those of Kroll. The commentary contained in the Kroll Report is not

⁵⁶¹ Reply Expert Report of Howard Rosen, LECG Canada, (Tab 22).

⁵⁶² Harm is defined as economic damages equal to or greater than one dollar.

⁵⁶³ Reply Expert Report of Howard Rosen at para. 3.

expert evidence. Rather, it is a judgment on the validity of expert evidence that is solely within the purview of the arbitration Tribunal.

443. Indeed, much of the Kroll Report is merely a reiteration of Canada's liability defenses with respect to each of the alleged breaches. In the event that the Tribunal were to find a breach of any provision of NAFTA, the Kroll Report would provide no assistance to the Tribunal with respect to the harm caused by such a breach. It simply assumes away the very facts that would lead to liability.

E. The Fritz Starber Claim Is Admissible

444. For the same reasons explained in its Memorial,⁵⁶⁴ the Investor's claim in regard to Canada Post's retaliatory denial of Fritz Starber's bid is admissible. Canada simply ignores these reasons when reiterating the same objections to the admissibility of the claim that it made in its Statement of Defense. Canada does not explain how:

- a. forcing the Investor to file a separate claim fulfils NAFTA's objective to "create effective procedures ... for the resolution of disputes;"⁵⁶⁵
- b. its argument is consistent with the *Pope & Talbot* tribunal's decision that a claim regarding retaliation to the NAFTA claim was admissible;⁵⁶⁶ or
- c. its argument is consistent with the *Ethyl* decision that the procedural requirements in NAFTA Articles 1119 and 1120 can be dispensed with when the six month

⁵⁶⁴ Investor's Memorial at paras. 482 - 491.

⁵⁶⁵ NAFTA Article 102(e).

⁵⁶⁶ *Pope & Talbot Inc. v. Canada*, UNCITRAL Arbitration Proceedings, Award on the Merits of Phase 2, April 10, 2001, 2001 WL 34776948 at para. 171, Investor's Book of Authorities (Tab 7).

period has elapsed.⁵⁶⁷ It also ignores the fact that further NAFTA Article 1128 consultations were held after the filing of the Revised Amended Statement of Claim.

⁵⁶⁷ *Ethyl Corporation* at para. 84, Investor's Book of Authorities (Tab 50).

IV. CANADA BREACHED CHAPTER 11 THROUGH CANADA POST'S ACTIONS

A. Summary

445. Canada is responsible for Canada Post's actions under both Chapters 11 and 15 of the NAFTA. Under the customary international law of state responsibility, captured in the ILC's *Articles on State Responsibility*, a state is responsible for all of the actions of its organs while those organs act in their official capacity. Canada Post is an organ of Canada and, therefore, Canada is responsible for all Canada Post's actions taken in its official capacity.

446. In its Counter-Memorial, Canada accepts that it would be responsible for Canada Post's actions if Canada Post was an organ of the state. Canada claims it is not responsible for Canada Post's actions because Canada Post is a Crown Corporation and, Canada alleges, Crown Corporations cannot be organs.⁵⁶⁸ Canada made a similar argument before the WTO *Periodicals* Panel when it claimed that Canada Post's pricing of periodicals was not attributable to Canada because it was not governmental. Just as the WTO Panel rejected Canada's argument,⁵⁶⁹ this Tribunal must reject Canada's argument now. Canada's argument has no foundation in international law. States are responsible for the actions of Crown Corporations just as they are responsible for the actions of other state organs. Canada Post is an organ of Canada and Canada is responsible for all its actions taken in its official capacity.

⁵⁶⁸ Canada's Counter-Memorial at para. 792: "Canada Post is not part of the formal structure of the government of Canada as are, for example, the government of a province or territory, parliament, and courts of a Party. Canada Post is a Crown Corporation, in other words a separate legal entity owned by the government of Canada, that has been granted a monopoly on Letter mail. As such, it is not subject directly to the obligations in Chapter 11, although these obligations may be applicable to it to the extent set out in Chapter 15."

⁵⁶⁹ *Canada - Periodicals, Dispute Settlement Panel Report*, WT/DS 31/R 14 March 1997 at para. 5.33 - 5.34, Investor's Book of Authorities at (Tab 66). See discussion in the Investor's Memorial at para. 749.

B. States Are Responsible for the Acts of Organs, Including Crown Corporations

447. Article 4 of the *ILC Articles on State Responsibility* says that the “conduct of any State organ shall be considered an act of that State under international law...” Article 4 reflects the principle of the unity of the state which ensures that, regardless of how a state chooses to organize itself, it will be responsible for the acts of its various components, or organs. The official commentary to Article 4 reinforces this principle by confirming that any natural or legal person can be an organ. The commentary says:

The reference to a “State organ” covers all the individual or collective entities which make up the organization of the State and act on its behalf.⁵⁷⁰

The commentary goes on to reinforce:

[t]he term “person or entity” ... used in article 4 ... is used ... 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.⁵⁷¹

448. The official commentary to Article 4 of the *ILC Articles*, therefore, reinforces that any entity, Crown Corporation or otherwise, can be an organ of the state if it is sufficiently part of the state. International jurisprudence confirms this conclusion by finding that Crown Corporations are state organs, even if they perform commercial functions. For example, in *Salini v. Morocco*, the tribunal hearing a bilateral investment treaty claim held that all the acts of a corporation 80% owned by the state were attributable to the

⁵⁷⁰ J. Crawford, *ILC Articles on State Responsibility* at 94, Investor’s Book of Authorities (Tab 3).

⁵⁷¹ J. Crawford, *ILC Articles on State Responsibility*, at 98-99, Investor’s Book of Authorities (Tab 3).

state.⁵⁷² Similarly, in *Hertzberg and others v. Finland*, the United Nations Human Rights Committee found that Finland was responsible for all the acts of the Finnish Broadcasting Company, a corporation of which it owned 90%.⁵⁷³

449. These decisions of international tribunals, the *ILC Articles* and the commentary to the *ILC Articles* all confirm that Canada Post's status as a Crown Corporation is irrelevant to determining whether it is an organ of Canada.

C. Canada Post Is an Organ of Canada

450. In 1981, Canada reorganized the way it operated postal services. Prior to the reorganization, Canada operated its postal services through a government department called the Post Office Department. Canada then transferred responsibility for postal services to Canada Post Corporation. Canada Post was corporatized but it was not privatized. Canada Post is still part of the Canadian government because:

- a. Canada says Canada Post is part of the government;
- b. Canada Post retained the Post Office Department's government functions;
- c. Canada Post is exempt from paying tax because it is part of the Government;

⁵⁷² *Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, July 23, 2001, 2001 WL 34774212 at paras. 33 - 35, Investor's Book of Authorities at (Tab 152). That corporation built, managed and operated public utilities, such as highways.

⁵⁷³ *Hertzberg and Other v. Finland-Human Rights Committee*, Communication No. CCPR/C/15/D/61/1979, April 2, 1982, [1982] UNHRC 8, Book of Authorities (Tab 153) at para 9.1: "in considering the merits of the communication, the Human Rights Committee starts from the premise that the State party is responsible for actions of the Finnish Broadcasting Company (FBC), in which the State holds a dominant stake (90 per cent) and which is placed under specific government control."

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- d. Canada Post is controlled by Canada; and
 - e. Canada Post deals with Canadian Government departments as a Government department.

1. Canada Says Canada Post Is Part of the Government

451. The second paragraph 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.

By directing that states are responsible for the acts of entities that they designate as an organ, Article 4 protects legitimate expectations. By designating an entity as an organ, a state creates the legitimate expectation in those dealing with that entity that the state will be responsible for the entity's actions. Article 4 says that, after designating an entity as an organ, the state cannot then avoid responsibility by denying the entity is part of the state.

452. Canada creates legitimate expectations that it takes responsibility for the actions of Canada Post by designating Canada Post as an organ of the state. The *Canada Post Corporation Act* says Canada Post is “an institution of the Government of Canada”⁵⁷⁴ and is “an agent of Her Majesty in right of Canada.”⁵⁷⁵

453. Canadian courts have confirmed that Canada Post is an organ of the state under Canadian law. The Federal Court of Canada has declared that Canada Post is part of the government's “decision-making machinery” and that Canada Post's decisions are subject

⁵⁷⁴ *Canada Post Corporation Act*, s.5(2)(e).

⁵⁷⁵ *Canada Post Corporation Act*, s.23.

to the Federal Court's jurisdiction to review government action.⁵⁷⁶

454. The Canadian Minister responsible for Canada Post publically confirmed Canada Post's role as an organ of the government, saying "[t]he 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."⁵⁷⁷

455. Canada has even designated Canada Post as a part of the Canadian state for the purposes of NAFTA. Canada says that Canada Post is part of the Canadian state under the procurement provisions of NAFTA Chapter 10.⁵⁷⁸ According to the *ADF* tribunal, the listing of an entity in the Chapter 10 Annex with respect to procurement reflects acceptance of its status as an Article 4 organ.

456. After concluding that an entity listed in that Annex was an organ of the US, the *ADF* tribunal said that:

[t]he view taken above by the Tribunal is in line with the established rule of customary international law that acts of all its governmental organs and entities and territorial units are attributable to the State and that that State as a subject of international law is, accordingly, responsible for the acts of all its organs and territorial units."⁵⁷⁹

While the tribunal made these comments in the context of considering if the Commonwealth of Virginia was a part of the state, there is nothing in the tribunal's

⁵⁷⁶ See the discussion of the *Canadian Daily Newspaper Association*, Investor's Book of Authorities (Tab 68) and *Rural Dignity of Canada*, Investor's Book of Authorities at (Tab 75) cases in Investor's Memorial at para. 419.

⁵⁷⁷ See speech of Minister Marleau dated October 8, 1996, Investor's Schedule of Documents (Tab U80).

⁵⁷⁸ NAFTA Article 1001 and Annex 1001.1a-2 says that Chapter 10's procurement obligations apply to Canada Post.

⁵⁷⁹ *ADF Group Inc. v. United States of America*, ICSID Case No. ARB(AF)/00/1, Award, January 9, 2003, 2003 WL 2408323 at para 166, Investor's Book of Authorities (Tab 95).

comments excluding their application to the other entities declared part of the state in Chapter 10, including Canada Post.

2. Canada Post Retained the Post Office Department's Government Functions

457. Canada Post retained the same responsibilities as the old government department. It retained the exclusive privilege to deliver letter mail.⁵⁸⁰ It also received authority for delivering parcels in competition with private courier companies.⁵⁸¹ Canada Post retained the responsibility to provide these monopoly and competitive services in order to fulfill social and policy goals. As Canada explains:

Canada Post's services, both those provided under the exclusive privilege and those offered in commercial markets, are provided to ensure that Canada Post meets its social and policy obligations, including the universal service obligation.⁵⁸²

458. In addition to pursuing its alleged USO, Canada Post also:

- a. "promotes the recognition and advancement of English and French in Canada by ensuring that all of its communications with the public are conducted in both languages;"⁵⁸³
- b. "allows visually impaired persons and institutions for the visually impaired to mail specific items for the visually impaired free of postage;"⁵⁸⁴

⁵⁸⁰ Robert Campbell, *The Politics of the Post*, at 50.

⁵⁸¹ Canada's Counter-Memorial at para. 56: "Like the Post Office Department before it, Canada Post offers limited services under an exclusive privilege and a variety of services that are open to competition."

⁵⁸² Canada's Counter-Memorial at para. 104. See also the Affidavit of Francine Conn at para. 5.

⁵⁸³ Canada's Counter-Memorial at para. 102.

⁵⁸⁴ Canada's Counter-Memorial at para. 103.

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- c. “facilitates communication between Canadians and their government by requiring that Canada Post provide free mailing privileges to Members of the House of Commons and the Senate, the Parliamentary Librarian and the Governor General;”⁵⁸⁵ and
 - d. “provide[s] a discounted mailing rate to libraries that send books to other libraries, to persons who are disabled, “shut-ins”, or receive books-by-mail service because they are living in remote locations of Canada;”⁵⁸⁶

These are all government functions.

3. Canada Post Is Exempt from Paying Tax Because It Is Part of the Government

459. Tax legislation confirms Canada Post’s status as a state organ by exempting Canada Post from paying various taxes because of its government status. Canada Post is exempt from paying:
- a. goods and services tax under the *Excise Tax Act* because Canada Post is supplying a government service;⁵⁸⁷

⁵⁸⁵ Canada’s Counter-Memorial at para. 103.

⁵⁸⁶ Canada’s Counter-Memorial at para. 103.

⁵⁸⁷ *Excise Tax Act*, R.S.C. 1985, c. E-15, Part IX, Division I, section 123(I); Division II, section 165(3); Schedule VI, Part X, Investor’s Book of Authorities at (Tab 59).

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- b. provincial income taxes,⁵⁸⁸
 - c. corporate capital taxes in the various provinces of Canada that impose such a tax;
 - d. real property taxes on any of the lands and buildings that it owns throughout Canada,⁵⁸⁹ and
 - e. land transfer taxes.⁵⁹⁰

460. In addition, Canada Post is one of the largest corporations in Canada, but it only became subject to pay Canadian federal income tax for the very first time in 1994, and capital gains tax in 1996.⁵⁹¹

4. Canada Post Is Controlled by Canada

461. Canada retained the same control over the new corporation that it exercised over the Post Office Department. Canada owns all of Canada Post's shares,⁵⁹² appoints all its Board

⁵⁸⁸ Canada Post "*Ensuring Universal Service at Affordable Rates*": June 1996, Investor's Schedule of Documents (Tab U78). This document also suggest that in the 10th province, Quebec, the exemption actually increases Canada Post's effective income tax rate by 1 %.

⁵⁸⁹ See *Payments in Lieu of Taxes Act* at Tab 146 of Investor's Schedule of Documents.

⁵⁹⁰ *Land Transfer Tax Act* of Ontario, section 2(8), and section 29(1) of the *Interpretation Act* of Ontario. Land transfer tax is charged on the purchase price of the land and building. The higher the price, the more land transfer tax is payable by the purchaser, Investor's Book of Authorities (Tabs 154 and 155, respectively).

⁵⁹¹ Canada Post "*Ensuring Universal Service at Affordable Rates*": June 1996, Investor's Schedule of Documents (Tab U78).

⁵⁹² Short-term filing under s. 121 *Competition Act*, Notifiable Transactions (R248B-19) at Appendix A-6, p.36, 459, Investor's Schedule of Documents (Tab U59).

members,⁵⁹³ and can issue formal and “informal” directives to it.⁵⁹⁴ The *Canada Post Corporation Act* gave Canada Post the power to pass a wide range of regulations, including those defining the extent of its exclusive privilege over letters and the rates of postage.⁵⁹⁵ Cabinet approval of these regulations is deemed to be given within 60 days.⁵⁹⁶ While Cabinet approval is necessary, Cabinet is not permitted to impose its own regulations on these matters.

5. Canada Post Deals with Canadian Government Departments As a Government Department

462. Canada Post’s dealings with Canadian departments are those of another government department and not of an independent commercial entity. The 1992 *Interim Postal Imports Agreement* is a good example. Canada provides the Agreement as evidence of what it claims is a multi-year contract for Canada Post to collect millions of dollars in customs duties. An independent commercial entity would not enter into such a contract without hundreds of pages of detailed terms. Yet, the operative Agreement is only one paragraph long and in it Canada Post promises to provide the services “on such terms and conditions and for such period of time as may be later agreed to.”⁵⁹⁷

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⁵⁹³ *Canada Post Corporation Act*, s. 6, Investor’s Schedule of Documents (Tab U218). Section 10(1) of the *Act* provides that the Board directs the exercise of Canada Post’s powers.

⁵⁹⁴ Article 22(1) of the *Canada Post Corporation 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.” Canada’s Counter-Memorial at para. 201.

⁵⁹⁵ *Canada Post Corporation Act*, s.14(1), s.19(1)(d).

⁵⁹⁶ *Canada Post Corporation Act*, s.20(5).

⁵⁹⁷ *Interim Postal Imports Agreement*, June 30, 1992. See Affidavit of John Cardinal at para. 13.

D. Canada Post As an Agent of Canada

464. If the Tribunal concludes that Canada Post is not an organ of the State, then Canada Post’s actions at issue in this case are still attributable to Canada as the actions of an agent of the state. Article 5 of the *ILC Articles on State Responsibility* provides that the actions of an entity empowered to exercise elements of governmental authority are attributable to the state when the entity acts under that authority.⁶⁰⁰

465. The Investor explained in its Memorial⁶⁰¹ how the sources identified in the official commentary to Article 5 indicate if an action is governmental. As discussed therein, and in the discussion of Canada’s breach of Chapter 15 in Chapter VII of Part Three of this Reply, these services confirm Canada Post’s actions at issue in this case are attributable to Canada.

⁵⁹⁸ Affidavit of Bill Fizet at para. 17.

⁵⁹⁹ Affidavit of Bill Fizet at para. 13.

⁶⁰⁰ 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.

⁶⁰¹ Investor’s Memorial at paras. 737 - 756.

**V. CHAPTER 15 DOES NOT LIMIT CANADA'S RESPONSIBILITY UNDER
CHAPTER 11**

A. Summary

466. Canada accepts that if Canada Post is an organ of the state then Canada is responsible for its actions under the NAFTA Chapter 11.⁶⁰² Canada also accepts that states can be responsible under customary international law for the acts of state-designated monopolies and state enterprises, such as Canada Post, when they act as agents of the state.⁶⁰³ Canada claims, however, that Chapter 15 of the NAFTA replaces the customary international law of state responsibility for the actions of state agents. Canada says that by addressing the conduct of the state designated monopolies and state enterprises in Chapter 15, the NAFTA drafters implicitly withdrew from Chapter 11 any state responsibility for monopoly or state enterprise actions as agents of the state.

467. Canada made a similar argument before a GATT Panel in 1988. In *Canada - Provincial Liquor Boards (EEC)*, Canada argued that a GATT provision similar to NAFTA Articles 1502(3)(a) and 1503(2) also withdrew states' responsibility under the other GATT provisions for monopoly and state enterprise conduct. The GATT Panel categorically rejected Canada's argument.⁶⁰⁴ Canada's arguments are as baseless now as they were in 1988. Just like its argument that Canada Post is not a state organ, Canada's argument on the relationship between NAFTA Chapters 11 and 15 is inconsistent with international law and the clear text of NAFTA.

⁶⁰² Canada's Counter-Memorial at para. 792.

⁶⁰³ Canada's Counter-Memorial at paras. 808 and 813.

⁶⁰⁴ *Panel Report on Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, L/6304 - 35S/37, adopted March 22, 1988, Investor's Book of Authorities (Tab 156).

B. The Relationship Between NAFTA Chapters 11 and 15

468. Both Canada and the Investor have recognized that monopolies and state enterprises present specific dangers to the free flow of trade and investment that agreements, like the NAFTA, attempt to facilitate.⁶⁰⁵ Canada recognizes these dangers in its Counter-Memorial, saying that “[b]ecause the NAFTA Parties recognized the potential for monopolies and state enterprises to distort trade, they provided certain obligations governing their conduct.”⁶⁰⁶
469. The NAFTA drafters responded to these dangers of trade and investment distortion in NAFTA Chapter 15. Article 1501 obliges the NAFTA Parties to take measures preventing anti-competitive conduct by private firms with no governmental status. Articles 1502 and 1503 oblige the Parties to prevent state-designated monopolies and state enterprises, respectively, from engaging in certain conduct. NAFTA Articles 1502(3)(a) and 1503(2) oblige the Parties to prevent state-designated monopolies and state enterprises, respectively, from acting inconsistently with the Party’s NAFTA obligations under certain circumstances.
470. A state acts inconsistently with its obligations under NAFTA Article 1502(3)(a) if:
- a. the monopoly acts inconsistently with the state’s obligations under Section A of NAFTA Chapter 11;
 - b. the monopoly acts under delegated authority;

⁶⁰⁵ See Investor’s Memorial at para. 723; Canada’s Counter-Memorial at para. 793.

⁶⁰⁶ Canada’s Counter-Memorial at para. 793.

- c. that authority is governmental;
- d. that authority was delegated in connection with the monopoly good or service; and
- e. the state failed to ensure, through regulatory control, administrative supervision or the application of other measures, that the monopoly took those actions.

471. A NAFTA Party is required under Article 1503(2) to conduct a state enterprise in the same manner, except the state enterprise must act consistent with both Section A of Chapter 11 and Chapter 14 and the authority need not be delegated in connection with any good or service.

472. The Investor explained in its Memorial,⁶⁰⁷ and Canada accepted in its Counter-Memorial,⁶⁰⁸ that NAFTA Articles 1502(3)(a) and 1502(3) are similar to Article 5 of the *ILC Articles on State Responsibility*. The *ILC Articles*, finalized several years after NAFTA was drafted, are commonly accepted as representing the customary international law on state responsibility.

473. Article 5 of those Articles provides the circumstances under which a state is internationally responsible for the acts of entities to which it has delegated specific governmental authority. Such entities are commonly known as state agents. The similarity between Articles 1502(3)(a) and 1502(3) and Article 5 of the *ILC Articles* provides potential for overlap between responsibility under Chapter 15 and under the customary international law of state responsibility. The same action of a monopoly or state

⁶⁰⁷ Investor's Memorial at paras. 738 - 740.

⁶⁰⁸ Canada's Counter-Memorial at para. 808.

enterprise, acting as agent for the state, could also generate a breach of Articles 1502(3)(a) or 1502(3) and a breach of NAFTA Chapter 11.

474. While there is potential for overlap between obligations in NAFTA Articles 1502(3)(a) and 1503(2) and the responsibility of the state for acts of its agents, there is even more potential for overlap in the responsibility of a state for the acts of a monopoly or state enterprise that is also an organ of the state.⁶⁰⁹ Indeed, this is precisely the overlap presented by the facts of this case. Canada Post, as an organ of the state, has taken measures inconsistent with obligations in Section A of NAFTA Chapter 11. Those same actions establish the basis for Canada's violation of NAFTA Articles 1502(3)(a) and 1503(2).⁶¹⁰

475. The fact that NAFTA Articles 1502(3)(a) and 1502(3) overlap with Articles 4 and 5 of the *ILC Articles* does not make NAFTA Chapter 15 *lex specialis* of the customary international law on state responsibility, as Canada claims.⁶¹¹ A rule can only act as *lex specialis* in regard to a rule on the same subject.⁶¹² Articles 1502(3)(a) and 1502(3) prescribe when an act is inconsistent with the NAFTA and, therefore, do not solely address the subject of state attribution.

⁶⁰⁹ Contrary to Canada's misrepresentation at footnote 793, the Investor has not suggested every state monopoly or enterprise is an organ of the state.

⁶¹⁰ International law recognizes that the same act can violate more than one international obligation under the cumulative principle: see Investor's Memorial at paras. 392 - 394.

⁶¹¹ Canada's Counter-Memorial at paras. 805 - 806.

⁶¹² The commentary to Article 55 of the *ILC Articles on State Responsibility*, to which Canada refers, says at page 307: "For the *lex specialis* principle to apply it is not enough that the same subject matter is dealt with by two provisions ...".

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476. Furthermore, simply because the Chapter 11 obligations and those in Chapter 15 may overlap does not mean that any of those obligations are superfluous as Canada claims.⁶¹³ The Chapters complement each other. In recognition of the unique dangers posed by monopolies and state enterprises to the purposes of NAFTA, Chapter 15 reinforces state responsibility under Chapter 11.
477. Canada wrongly argues NAFTA Chapters 11 and 15 do not complement each other but that Chapter 15 replaces Chapter 11 obligations regarding state responsibility for the actions of monopolies and state enterprises.⁶¹⁴ Canada's interpretation of the relationship between the chapters is flawed on every level. Fundamentally, Canada essentially argues that the Chapter 15 provisions, which are designed to enhance state responsibility, actually reduce that responsibility.
478. In the absence of any expressly stated intention of the Parties to limit their international responsibility, such a limitation should not be presumed. By limiting state responsibility for the actions of monopolies and state enterprises, Canada's interpretation simply encourages states to transfer authority to those entities to avoid responsibility.
479. Canada provides no textual support for its effort to reduce state responsibility for the actions of monopolies and state enterprises. Neither Chapter 15, nor Chapter 11, nor any NAFTA provision provides that states are not responsible under Chapter 11 for the actions of monopolies and state enterprises. Neither the Canadian *Statement on Implementation*, nor the US *Statement of Administrative Action* suggest such a limitation.
480. There are, indeed, provisions within NAFTA which explicitly restrict state responsibility. For example, Chapter 10 of NAFTA limits state responsibility under NAFTA's

⁶¹³ Canada's Counter-Memorial at footnote 793.

⁶¹⁴ Canada's Counter-Memorial at paras. 11, 744, 757, 758, 789 - 795 and 809.

procurement obligations only to federal level governments or to specifically listed provincial and state government entities. Thus, in the area of procurement, state responsibility has been explicitly limited by the wording of the NAFTA.

481. Canada had ample opportunity to specify reservations and exceptions to its NAFTA obligations in NAFTA Article 1108 and Annexes I and II. Article 1108 provides exceptions to Chapter 11 applicable to all the NAFTA Parties and, in Annexes I and II, the individual NAFTA Parties listed individual industries exempted from certain NAFTA obligations. Neither NAFTA Article 1108, nor Annexes I and II, absolve the NAFTA Parties of responsibility under Chapter 11 for the actions of monopolies and state enterprises. Canada clearly thought about monopolies and state enterprises during the drafting of the Annexes,⁶¹⁵ but chose not to exclude monopoly and state enterprise actions from the scope of Chapter 11.
482. Canada's interpretation is inconsistent with NAFTA Article 1108. That Article excludes certain forms of state enterprise conduct such as procurement, subsidies and grants from certain Chapter 11 obligations.⁶¹⁶ If NAFTA Chapter 11 does not apply to the actions of state enterprises, as Canada alleges, then there would be no need for the NAFTA drafters to exclude these forms of state enterprise conduct from specific Chapter 11 obligations in this way.

⁶¹⁵ See, for example, Canada's exclusion of measures restricting ownership in certain of its state enterprises from the scope of Article 1102 in NAFTA Annex I.

⁶¹⁶ NAFTA Article 1108(7) says that 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, NAFTA 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.

483. The negotiating history of NAFTA also provides no support for Canada. There is no suggestion that monopolies and state enterprises are excluded from Chapter 11 in the publically released negotiating history to Chapter 11. The negotiating history of Chapter 15 also provides no support to this effect. There is no public negotiating history available for NAFTA Chapter 15. The Investor requested the negotiating history and Canada refused to provide it without explanation.⁶¹⁷ The only inference open to the Tribunal is that the negotiating history of Chapter 15 provides no support for Canada's argument that Chapter 15 replaces the NAFTA Parties' responsibility for the actions of monopolies and state enterprises.

484. Canada's interpretation is also inconsistent with GATT jurisprudence. GATT Panels have considered the relationship between a provision specifically addressing the conduct of state enterprises and the rest of the treaty through their consideration of GATT Article XVII. Similar to Articles 1502(3)(a) and 1503(2) of NAFTA, GATT Article XVII states that a Contracting Party acts inconsistently with its GATT obligation when state enterprises act inconsistently with the GATT Contracting Party's obligations under other provisions in the agreement. Paragraph (1)(a) of GATT Article XVII says:

Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

485. In *Canada - Provincial Liquor Boards (EEC)*,⁶¹⁸ Canada argued that GATT Article XVII has much the same meaning as it now seeks to ascribe to NAFTA Chapter 15. The Panel described Canada's argument in the following way: "In Canada's view, the clause

⁶¹⁷ Canada provided the negotiating history of Chapter 11 but failed to produce the material of Chapter 15 that was equally under its control. See Investor's Document Request, Investor's Schedule of Documents (Tab U294).

⁶¹⁸ *Canada - Provincial Liquor Boards (EEC)*, Book of Authorities (Tab 156).

indicated that the activities of marketing boards which did purchase and sell were governed by Article XVII and did not need to be in accordance with other provisions of GATT.”⁶¹⁹ The Panel rejected this argument, finding that Canada breached other provisions of the GATT through the actions of its marketing board, despite the existence of Article XVII.⁶²⁰

486. The *Canada - Provincial Liquor Boards (EEC)* decision shows that Canada has a history of trying to contort obligations contained in international trade agreements to restrict its state responsibility for actions taken by monopolies and state enterprises. Canada’s arguments today have as little support as they did then.

487. Rather than replacing the obligations set out in NAFTA Chapter 11, NAFTA Chapter 15 supplements them. Chapter 15 provides specific circumstances in which a state is responsible for the conduct of a monopoly or state enterprise, regardless of the responsibility of the state under Chapter 11 and the established customary international law of state responsibility.

⁶¹⁹ *Canada - Provincial Liquor Boards (EEC)* at para. 3.38, Book of Authorities (Tab 156).

⁶²⁰ *Canada - Provincial Liquor Boards (EEC)* at para. 4.27.

VI. CANADA BREACHED ITS NATIONAL TREATMENT OBLIGATION

488. In its Memorial, the Investor explained that the essence of national treatment is the protection of equality of competitive opportunities between the domestic and foreign economic interests defined in the treaty.⁶²¹ These interests are typically defined to be products, services, intellectual property rights or investments. The analysis requires, as a first step, the determination of a competitive relationship between the interests, then a determination of whether there is equality of competitive opportunities within this relationship.
489. Canada opposes the Investor's interpretation of the national treatment obligation in Chapter IV of its Counter-Memorial. It advocates a subjective and narrow construction of national treatment replete with extensive public policy exceptions not contained within the NAFTA obligation. This interpretation is contrary to established precedents under NAFTA Chapter 11 as well as decades of GATT and WTO jurisprudence.
490. In this Chapter of the Reply, the Investor will:
- a. provide a brief summary of Canada's interpretation of national treatment;
 - b. contrast this interpretation with the well-established meaning of national treatment in GATT, WTO and NAFTA jurisprudence;

⁶²¹ The following cases have referred to the notion of equality of competitive opportunities in the context of goods, services and intellectual property rights, respectively. See *United States- Section 337 of the Tariff Act of 1930* (Report by the panel adopted on 7 November, 1989) (L/6439-365/345), January 16, 1989 at paras. 5.11 and 5.13, Investor's Book of Authorities (Tab 13); *European Communities- Regime for the Importation, Sale and Distribution of Bananas* AB-1997-3, 9 September, 1997 (Appellate Body Report) at para. 78, Investor's Book of Authorities (Tab 14); *United States - Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R, Report of the Appellate Body AB-2001-7, signed December 19, 200 at para 258, Appellate Body Report, Investor's Book of Authorities (Tab 145).

- c. address the meaning of the words “like circumstances”;
- d. address the meaning of the words “treatment no less favorable”;
- e. discuss the role of discriminatory intent and public policy in the context of this analysis;
- f. apply this legal framework to the national treatment measures at issue; and
- g. address the scope of the exceptions and exemptions invoked by Canada.

A. Canada’s Subjective and Inconsistent Interpretation of National Treatment

491. Canada begins by stating that NAFTA Article 1102 must be interpreted according to the rules set out in Article 31 of the *Vienna Convention*.⁶²² The Investor agrees. However, Canada then proceeds to ignore each and every one of these rules:

- a. *Interpretation in Good Faith in Accordance with Ordinary Meaning*: Canada picks meanings of the words “treatment” and “like circumstances” out of thin air. It then presents these meanings to the Tribunal as if they were self-evidently true, notwithstanding the repeated decisions of international tribunals to the contrary.
- b. *Context*: Canada ignores the fact the national treatment obligation appears throughout the NAFTA and the WTO agreements which were negotiated concurrently with NAFTA. It purports to distinguish the applicability of the WTO

⁶²² Canada’s Counter-Memorial at para. 428.

jurisprudence on the grounds that the words “like circumstances” have a different meaning from the WTO language of “like goods”, “like services” and “like service providers”. As discussed in part C of this Chapter, Canada’s approach is directly contrary to the representations of all three NAFTA Parties made to the Panel in the NAFTA Chapter 20 state-to-state arbitration, *In the Matter of Cross Border Trucking Services*.⁶²³

- c. *Object and Purpose*: Nowhere in Canada’s discussion of national treatment is there any mention of the objects and purpose of the NAFTA listed in the preamble of the agreement and Article 102, including the objective of promoting “conditions of fair competition in the free trade area”.⁶²⁴ Canada’s statement that the national treatment obligation prevents nationality-based discrimination simply begs the question of how that discrimination is to be determined. There is a well-established objective test for the determination of nationality-based discrimination that does not depend on the highly subjective factors identified by Canada.
- d. *Special Meaning*: Canada summarily dismisses the suggestion that national treatment is a “term of art” in international trade and investment law.⁶²⁵ It offers no reasons for doing so, even though the Investor’s Memorial demonstrated how the term had been used in international treaty practice for decades before the NAFTA was negotiated.

⁶²³ *In the Matter of Cross-Border Trucking Services* (Secretariat File No. USA-Mex-98-2008-01) Final Report of the Panel, February 6, 2001, Investor’s Book of Authorities (Tab 106).

⁶²⁴ NAFTA Article 102(b).

⁶²⁵ Canada’s Counter-Memorial at para. 576. Indeed, the *Methanex* tribunal accepted that the term “like products” used in the GATT national treatment obligation for goods constituted a “term of art” under the Vienna Convention. (*Methanex* Final Award, Part IV, Chapter B at para. 29. Book of Authorities (Tab 171)). If the “like products” sub-test is a term of art, then certainly it stands to reason that the term “national treatment” must also be considered to be a term of art as well under the *Vienna Convention*.

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492. After referring to *Vienna Convention* principles, Canada contends that the Investor has not identified the “treatment” at issue. This is merely another attempt to repackage Canada’s unsuccessful arguments that this Tribunal adopt a restrictive view of the notion of a “measure”.⁶²⁶ Treatment is merely the result of a measure relating to an investment. The Investor described the measures at great length in its Memorial.⁶²⁷
493. Canada then accepts that a consideration of whether the investors or investments compete in the same economic sector is a relevant consideration, indeed, the “beginning” of a determination of like circumstances.⁶²⁸ It also accepts that discriminatory intent is not required for there to be a violation of national treatment. Measures can violate the national treatment obligation even if motivated by legitimate non-discriminatory public policy purposes.⁶²⁹
494. However, Canada also asserts that “like circumstances” can be extended beyond considerations of the competitive relationship to **any or all** differences between the investors or investments being compared.⁶³⁰ Such an approach would make the national treatment obligation highly unpredictable in its application. It would result in a situation of considerable insecurity both for governments and investors, who would be left guessing which differences or similarities between investors and investments any given tribunal might pick out in a given case and how they would be weighed. It would also undermine the trade liberalizing objectives of the NAFTA.

⁶²⁶ See Canada’s Counter-Memorial at paras. 588-594. See Canada’s Memorial on Preliminary Objections to Jurisdiction of February 14, 2002 at paras. 125-135.

⁶²⁷ See Investor’s Memorial at 153-159

⁶²⁸ See Canada’s Counter-Memorial at para. 596.

⁶²⁹ See Canada’s Counter-Memorial at para 616.

⁶³⁰ See Canada’s Counter-Memorial at paras. 597 and 615.

495. Canada then places its own constraining condition on the view that “like circumstances” can include a broad if not limitless range of matters: the elements or circumstances that can be considered are the ones “relevant” to the treatment being complained of in a particular case.
496. Canada however goes on to list a huge inventory of differences between Canada Post and UPS Canada that have nothing to do with the *less favorable* treatment second step test of national treatment of which UPS is complaining. While some of these differences may explain *some* kinds of *non-identical* treatment of UPS Canada and Canada Post, they do not explain or justify the *less favorable* treatment.
497. The Investor is not demanding to be treated identically to Canada Post in all respects. The Investor’s complaint is specific and limited to a carefully identified and circumscribed set of measures that result in less favorable treatment in the courier market.

B. The Well-Established National Treatment Test

498. When the NAFTA was negotiated, national treatment had been an established “cornerstone” obligation of international trade law for almost half a century in the case of trade in goods governed by the GATT. At the same time, national treatment was also being written into the new WTO Agreements, in the areas of services and intellectual property rights.
499. The WTO has been faced with having to interpret the national treatment concept beyond the area of trade in goods into other areas such as the “new” areas of services and the

protection of intellectual property rights. In every case, they have relied consistently on the concept of equality of competitive opportunities as it has evolved in the GATT.⁶³¹

500. Contrary to the statements by Canada,⁶³² NAFTA arbitral tribunals have taken the GATT and WTO practice and jurisprudence on national treatment as an essential point of departure in interpreting the NAFTA.⁶³³ This is not surprising as there is a substantial overlap between these treaty disciplines. Thus, there is a WTO agreement on Trade-Related Investment Measures, the supply of services by means of a commercial presence is both an investment and a mode of supply under the General Agreement on Trade in Services (“GATS”),⁶³⁴ intellectual property rights are both an investment covered by NAFTA Chapter 11 and receive the benefit of national treatment in the agreement on Trade-Related Intellectual Property Rights (“TRIPS”).⁶³⁵

501. Equality of competitive opportunities requires a judgment as to how the measures complained of affect a **competitive relationship** in the marketplace. Therefore, the first step in the analysis is to determine the existence of a competitive relationship. The next step is to determine whether the Party’s measures have had a systematic less favorable

⁶³¹ *Japan - Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, October 4, 1996, pages 26-28, Investor’s Book of Authorities (Tab 79); *EC Asbestos* (Appellate Body Report) WT/DS135/AB/R, para. 97, Investor’s Book of Authorities (Tab 135).

⁶³² Canada’s Counter-Memorial at paragraphs 577-578.

⁶³³ See *S.D. Myers v. Canada*, First Partial Award, November 13, 2000; 2000 WL 34510032; 8 ICSID Rep. (2000); 40 I.L.M. 1408 (2001) at para. 244, Investor’s Book of Authorities (Tab 4). See also *Pope & Talbot Inc. v. Canada*, Award on the Merits Phase 2, April 10, 2001; 2001 WL 34776948 at para. 45, Investor’s Book of Authorities (Tab 7). See also *In the Matter of Cross-Border Trucking Services*, Investor’s Book of Authorities (Tab 106).

⁶³⁴ See Article 16 of The General Agreement on Trade in Services (GATS), Investor’s Book of Authorities (Tab 77). See generally the WTO agreement on Trade-Related Investment Measures (TRIMs) Investor’s Book of Authorities (Tab 176).

⁶³⁵ See generally WTO agreement on Trade-Related Intellectual Property Rights (TRIPS), Investor’s Book of Authorities (Tab 158).

effect on the competitive relationship between the “like” foreign interests and their domestic counterparts.⁶³⁶

502. This objective approach to the national treatment obligation creates security and predictability for both governments and private firms. Thus, from the perspective of governments, the requirement of equality of opportunities, rather than equality of results, implies that not every distinction between “likes” creates less favorable treatment. Individual outcomes where one transaction has a better result for the domestic interest over the like foreign product or interest do not necessarily establish less favorable treatment.
503. Conversely, while differences in the treatment of “likes” can be acceptable, they must not result in “treatment less favorable”.⁶³⁷ In this case, for example, Canada could provide customs treatment of competing postal and courier imports through different postal and courier streams as long as this treatment does not systematically provide competitive advantages to postal over courier imports.⁶³⁸
504. Within this framework of equality of competitive opportunities, both discriminatory intent and *bona fide* public policy objectives can be relevant but not determinative considerations. Canada has misrepresented the Investor’s position when it states that the Investor attempted to demonstrate that the *S.D. Myers* and *Pope & Talbot* cases were wrongly decided or that the competitive relationship is the *sole* factor to be examined.⁶³⁹

⁶³⁶ See *EC-Asbestos*, Appellate Body Report, at para. 100, Investor’s Book of Authorities (Tab 135).

⁶³⁷ *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS/161/AB/R, WT/DS169/AB/R, Appellate Body Report, signed December 2, 2000 at para. 135, Investor’s Book of Authorities (Tab 159).

⁶³⁸ Expert Report of Allan Cocksedge at paras. 6-15.

⁶³⁹ Canada’s Counter-Memorial at para. 579

Both of these tribunals considered intentions and public policy objectives as part of an examination of the competitive relationship between the parties. They did not conduct a subjective, open-ended inquiry in the manner advocated by Canada.

505. The Investor’s Memorial simply stated that, once a *prima facie* breach of national treatment had been established within the equality of competitive opportunities framework, the respondent bears a strict burden of invoking narrow policy exceptions to excuse a finding of liability.⁶⁴⁰ This approach is consistent with both NAFTA and WTO jurisprudence. Canada cannot meet the burden of demonstrating that its measures are *justified* by the public policy goals that it advances. As a result, it relies solely on its good intentions in adopting the measures.

C. The Determination of “Like Circumstances”

506. The NAFTA Chapter 11 national treatment obligation defines national treatment as no less favorable treatment of investors or investments of another NAFTA party “in like circumstances” to a domestic investor or investment:

Article 1102: National Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than 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.

507. Canada alleges that the first step in the analysis of the national treatment obligation is to

⁶⁴⁰ See Investor’s Memorial at para. 531

identify a “treatment” of an investor. This is not logically correct. To determine whether an investor or investment of an investor of another NAFTA Party has been treated less favorably than a domestic investor or investment, in like circumstances, it is necessary to begin from an examination of like circumstances. Normally, before one can consider if a competitive relationship has been disrupted by governmental measures,⁶⁴¹ one must first determine that there *is* a competitive relationship and *what* it is.

1. The Vienna Convention Factors Confirm That “Like Circumstances” Involves a Competitive Relationship

508. In its Memorial, the Investor demonstrated that NAFTA Investor-State arbitral tribunals have consistently come to the conclusion that “like circumstances” entails a determination of whether the investor or investment of the other NAFTA party *competes in the same market or economic sector* with the domestic investor or investment that is alleged to be treated more favorably.⁶⁴² This approach to national treatment situates investment disputes within the wider context of international economic law, which has been unified by the notion of equality of competitive opportunities.

⁶⁴¹ In the *Pope & Talbot* case, the tribunal began its own analysis with observations on the disruption of the competitive relationship (treatment) rather than on “likeness”. *Pope & Talbot* is an example of a case where there was an issue of whether the disruption in the competitive relationship could be attributed to the governmental measures as opposed to extrinsic events. The event disrupting the competitive relationship may also render the investments “unlike” in the sense that the marketplace has changed. In a case like *Pope & Talbot*, the inquiry into the disruption of the competitive relationship and the inquiry into its existence and nature may thus be largely intertwined, and not separable into a first step analysing likeness and a second step examining “treatment.”

⁶⁴² See paras. 522 and 523 of the Investor’s Memorial citing *Pope & Talbot Inc. v. Canada*, UNCITRAL Arbitration Proceedings, Award on the Merits of Phase 2, April 10, 2001, *WL* 34776948 at para. 78, Investor’s Book of Authorities (Tab 7); *S.D. Myers v. Canada*, First Partial Award, November 13, 2000, *WL* 34510032; 8 *ICSID Rep.* (2000); 40 *I.L.M.* 1408 (2001) at paras. 250 and 251, Investor’s Book of Authorities (Tab 4); and *Marvin Feldman v. Mexico* ARB (AF) /99/1 Award December 16, 2002, 42 *I.L.M.* 625 (2003), Investor’s Book of Authorities at paras. 170-172 (Tab 8).

509. In its Counter-Memorial, Canada spends considerable effort rejecting the application of WTO cases. The fundamental basis for this argument is a textual one. Canada alleges:

The Parties did not use the terms “like products”, “like service providers” or even “like investors”. The text of Article 1102 may easily be contrasted with GATT Article III. [which refers to “like products”].⁶⁴³

510. Canada’s textual argument is wrong. All three NAFTA Parties have agreed that the words “like circumstances” in NAFTA have the same meaning as words such as “like service providers” in the GATS or other WTO agreements. This was confirmed in the NAFTA Chapter 20 state-to-state arbitration on *Cross Border Trucking*, in which Canada intervened in support of a claim by Mexico that the United States had simultaneously violated the national treatment obligations in the investment and the services chapters of NAFTA. The NAFTA obligation of national treatment for trade in services contains the very same “like circumstances” language as Article 1102:

Article 1202: National Treatment

1. Each Party shall accord to service providers of another Party treatment no less favorable than that it accords, *in like circumstances*, to its own service providers.

511. All three NAFTA parties confirmed that the phrase “like circumstances” in Article 1202 had the same meaning as “like services and service providers” which in turn was not “substantively different” from the use of “like circumstances” in bilateral investment treaties:

The Panel, in interpreting the phrase “in like circumstances” in Articles 1202 and 1203, has sought guidance in other agreements that use similar language. *The Parties do not dispute that the use of the phrase “in like circumstances” was intended to have a meaning that was similar to the phrase “like services and service providers” as proposed by Canada and Mexico during NAFTA negotiations.* Also, the United States contends, and Mexico does not dispute, that the phrase “in like circumstances” is not substantively different from the phrase “in like situations” as used in bilateral investment treaties.⁶⁴⁴

⁶⁴³ Canada’s Counter-Memorial at para. 608

⁶⁴⁴ *In the Matter of Cross-Border Trucking Services*, Investor’s Book of Authorities (Tab 106).

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512. Thus, the words “like circumstances” in NAFTA Chapters 11 and 12 have the same meaning as “like investors” or “like services and service providers”. The latter phrase appears in Article XII of the GATS. The WTO Appellate Body has held that the analysis of these terms in the GATS focuses on the same factors as those that inform the analysis of trade in goods in the GATT.⁶⁴⁵ Canada would reject this well developed analytical framework in favor of meaningless dictionary definitions of the word “circumstances” that provide no guidance as to what circumstances are relevant.⁶⁴⁶
513. Canada alleges that it is free to ignore the established analytical framework as the WTO Appellate Body itself observed in the *EC-Asbestos* case that the word “like” can have different meanings in the same Article.⁶⁴⁷ Canada overstates the meaning of the Appellate Body’s comment. While observing some textual differences between GATT Article III:2 and Article III:4, the Appellate Body applied the same approach to both Articles. Indeed, when faced with much more significant textual differences between the GATT and the national treatment obligation in the TRIPS agreement, the Appellate Body still followed the same approach. It did so as national treatment is a “fundamental principle of the world trading system as a whole.”⁶⁴⁸
514. Canada then relies on a document from the UNCTAD as evidence that the context of the investment obligations is different. The Investor cited the UNCTAD document as evidence that a wider range of transactions are subject to investment disciplines than trade in goods disciplines as they cover suppliers of both goods and services operating behind

⁶⁴⁵ *EC- Bananas*, Appellate Body Report at para. 221, Investor’s Book of Authorities (Tab 14).

⁶⁴⁶ Canada’s Counter-Memorial at para. 598.

⁶⁴⁷ Canada’s Counter-Memorial at paras. 580-581.

⁶⁴⁸ *US-Section 211 Omnibus Appropriations Act* of 1998 at para. 233, Appellate Body Report, Investor’s Book of Authorities (Tab 145),

the border.⁶⁴⁹ Canada agrees. It then argues that this fact somehow narrows the scope of NAFTA Article 1102 by necessitating a more restrictive view of the universe of firms in like circumstances. This statement does not make sense. Either Canada agrees that national treatment disciplines in investment treaties are broader than in trade treaties or it does not. Under Canada's interpretation, investment obligations would be narrower than those in trade treaties.

515. Next, Canada refers to the breadth of the NAFTA Article 1139 definition of investment and argues that, since it includes "land, stocks, loans and a variety of other items that do not offer products and may not compete in the marketplace", the economic sector test would be inapplicable. While these items do not compete by themselves, landowners, stockholders and lenders do compete in an economic sector.
516. Canada's attempts to distinguish the applicability of WTO law to NAFTA Chapter 11 on the basis of a different "context" is also inconsistent with the *Cross Border Trucking* decision. In finding that the United States' measures violated Chapter 11, the Panel referred to "long-established doctrine under the GATT and WTO" including the principle that national treatment in goods is interpreted to protect expectations regarding competitive opportunities.⁶⁵⁰ Both the *S.D. Myers* and the *Pope & Talbot* Investor-State tribunals also repeatedly invoked principles of WTO law in their decisions. These tribunals used the jurisprudence appropriately to illuminate the meaning of obligations within the NAFTA, following the customary international law recourse to sources of interpretation in the *Vienna Convention on the Law of Treaties*.⁶⁵¹ As the *Methanex*

⁶⁴⁹ UNCTAD, *National Treatment* (New York: United Nations, 1999) at 8-9, Investor's Book of Authorities (Tab 10)

⁶⁵⁰ *In the Matter of Cross Border Trucking* at para.289, Investor's Book of Authorities (Tab 106).

⁶⁵¹ Canada has admitted the applicability of the *Vienna Convention* as expressing the customary international law rules of interpretation in paragraph 428 of its Counter-Memorial.

tribunal pointed out, the usefulness of such jurisprudence will actually depend on an identification in the first instance of the relevant language in the NAFTA itself, which is the subject of interpretation.⁶⁵² The mere invocation of GATT/WTO jurisprudence does not and cannot excuse the imperative of fidelity to the NAFTA's text.

517. Finally, in its discussion of the objects and purpose of the provision, the Counter-Memorial states “Canada accepts that Article 1102, GATT Article III and GATS Article XVII share a broad purpose of preventing nationality-based discrimination”.⁶⁵³

2. Determining the Existence of a Competitive Relationship

518. The WTO Appellate Body has approached the issue of “likeness” as fundamentally one of determining the *existence* and *nature* of the competitive relationship between the imported and domestic products at issue. While leaving open the door to other possible relevant criteria, the Appellate Body has approved an approach to “likeness” that tests for the closeness of the competitive relationship based upon physical characteristics, end uses, consumer habits and tastes, and customs classifications of the products being compared.⁶⁵⁴

519. The *S.D. Myers* tribunal cited the WTO Appellate Body’s decision in *Japan - Alcoholic Beverages* at the outset of its “like circumstances” analysis. It then determined that “like circumstances” involves a determination of whether the non-national investor is in the same “economic sector” as the national investor. It determined that the investor and its investment were “in like circumstances” with the relevant Canadian operators as they

⁶⁵² *Methanex*, Final Award, Part IV, Chapter B. Investor’s Book of Authorities (Tab 171).

⁶⁵³ Canada’s Counter-Memorial at para.614

⁶⁵⁴ *Japan-Taxes on Alcoholic Beverages*, Appellate Body Reports at 22, Investor’s Book of Authorities (Tab 79).

provided the same services and were in a position to attract customers by offering more favorable prices and extensive experience.⁶⁵⁵

520. The factors mentioned by the WTO Appellate Body and the *S.D. Myers* tribunal for the determination of the existence of a competitive relationship are often considered in competition law analysis. For this reason, Canada has tried to characterize this claim as an international competition law claim and accused the Investor's expert, Professor Fuss, of not following competition law guidelines rigorously.⁶⁵⁶ Canada misunderstands the relationship between these analyses.
521. The definition of relevant markets is often broader in international trade cases as they relate to the elimination of measures that impair the potential to compete and not merely practices of private firms that suppress competition. For example, in *Korea - Taxes on Alcoholic Beverages*, the panel concluded that market definitions for GATT purposes are often broader than relevant markets for antitrust purposes:

Trade law generally, and Article III in particular, focuses on the promotion of economic opportunities for importers through the elimination of discriminatory governmental measures which impair fair international trade. Thus, trade law addresses the issue of the potentiality to compete. Antitrust law generally focuses on firms' practices or structural modifications which may prevent or restrain or eliminate competition. ***It is not illogical that markets be defined more broadly when implementing laws primarily designed to protect competitive opportunities than when implementing laws designed to protect the actual mechanisms of competition.*** In our view, it can thus be appropriate to utilize a broader concept of markets with respect to Article III:2, second sentence, than is used in antitrust law.⁶⁵⁷ [emphasis added]

⁶⁵⁵ *S.D. Myers* at paras. 244, 250, 251.

⁶⁵⁶ Canada's Counter-Memorial at para 129.

⁶⁵⁷ *Korea - Taxes on Alcoholic Beverages* (Panel Report) WT/DS75/R; WT/DS84/R, September 17, 1998, paragraph 10.8, Investor's Book of Authorities (Tab 78). The panel in *Chile - Taxes On Alcoholic Beverages*, WT/DS87/R, WT/DS110/R, June 15, 1999, s.7(c), at 163 concurred, Investor's Book of Authorities (Tab 90).

522. In its Counter-Memorial, Canada relies on a number of minor differences between Canada Post's courier services and those of UPS Canada or between their networks. Canada does not demonstrate how any of these differences are sufficiently material to affect the competitive relationship between the parties.

D. The Determination of "Treatment No Less Favorable"

523. In its Memorial, the Investor reviewed WTO cases explaining that the essence of the obligation to accord "treatment no less favorable" was "equality of competitive opportunities". It reviewed the WTO cases demonstrating that this was an objective test, applicable to both *de jure* and *de facto* measures, and served to guarantee that foreign economic interests received the best treatment given to domestic interests. It also demonstrated how previous NAFTA Chapter 11 tribunals had adopted the same approach.⁶⁵⁸

524. In its Counter-Memorial, Canada complains that the Investor has not properly identified the "treatment" at issue. These contentions essentially repeat previous failed attempts to challenge this and other claims for not identifying the "measures relating to" investments. In its discussion of the meaning of "treatment", Canada rejects an interpretive approach that is consistent with established international economic law in favor of a purportedly textual approach. It then adds new requirements that are not to be found anywhere in the text of Article 1102. Canada then advances an interpretation of "no less favorable" which would require a highly unpredictable inquiry into the subjective motivations behind a measure.

⁶⁵⁸ Investor's Memorial at 183-189.

1. Measures Relating to Investments Result in “Treatment”

525. In its Memorial, the Investor noted that one requirement of the national treatment test was that treatment must be “with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments”.⁶⁵⁹ This requirement does impose some restrictions on the claiming investor. For example, the *Methanex* tribunal found that the treatment must be with respect to investments and not, for example, the downstream sale of goods. The *Methanex* tribunal refused the Investor’s attempts to circumvent this requirement through GATT/WTO jurisprudence.⁶⁶⁰
526. The UPS claim satisfies the requirement that treatment must be “with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments because:
- a. Canada’s failure to provide equal treatment regarding the Monopoly Infrastructure is with respect to the expansion, management, conduct and operation of UPS Canada’s courier services. Canada Post’s vast network, such as valuable retail space, is a key input in the supply of courier services that cannot be replicated by private firms. By denying UPS Canada access to this key input used in the operation of its business, or offering it on less favorable terms, Canada Post affects the expansion, management, conduct and operation of UPS Canada’s business;
 - b. Canada’s denying UPS Canada the ability to deliver publications subject to the *Publications Assistance Program* prevents UPS Canada expanding into that market; and

⁶⁵⁹ Investor’s Memorial at 189.

⁶⁶⁰ *Methanex v. United States*, Final Award, Part IV, Chapter B, Investor’s Book of Authorities (Tab 171)

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- c. Canada's prejudicial operation of its customs system affects the conduct and operation of UPS Canada.

527. As Canada rightly agrees, the requirement that treatment be "with respect to the establishment, acquisition, expansion management, conduct, operation, and sale or other disposition of investments" is a broad statement.⁶⁶¹ Yet, after recognizing the breadth of the statement, Canada then goes on to add a further requirement that does not appear anywhere in the text of NAFTA Article 1102. Canada alleges that the treatment must be of the foreign investor or the foreign investor's investments in the territory of the Party.⁶⁶²

528. NAFTA Article 1102 does not require treatment with respect to the foreign investor or their investments. Instead, it requires that foreign investors or their investments be accorded treatment no less favorable than accorded to Canadian investors or investments "with respect to the establishment [*etc.*] of investments". It does so in order to prohibit the host state not only from imposing disadvantages on the foreign investor and its investment, but also from conferring competitive advantages exclusively on their domestic competitors. Its purpose is to prohibit the state from favoring "national champions" at the expense of foreign competitors.

529. The only basis cited by Canada for its definition of treatment is NAFTA Article 1101 which reads:

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; ...

⁶⁶¹ Canada's Counter-Memorial at para. 589.

⁶⁶² Canada's Counter-Memorial at para. 589.

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530. NAFTA Article 1101 demonstrates that Chapter 11 does not apply to “treatments”, but to “measures relating to” foreign investors or foreign investments. When a measure relates to foreign investors or foreign investments, it accords “treatment”. Thus, although measure is a defined term in Article 201, there is no definition of “treatment”. Treatment is simply what the measure accords.
531. In its Memorial, the Investor noted the broad definition of “measures” in Article 201 and in the jurisprudence considering it. It then listed the specific measures that were impugned and explained how they “related to” UPS or its investments. In response to Canada’s objection that the measures did not “relate to” UPS or UPS Canada, the Investor reviewed the ordinary meaning of the term, Canada’s *Statement of Implementation*, the *Pope & Talbot* and *GAMI* NAFTA Chapter 11 decisions and the WTO decision in *Indonesia-Automobiles*. All of these supported a meaning of “relating to” as “to affect”.⁶⁶³
532. Canada has not addressed any of these points. Instead, it attempts to achieve the same result indirectly by insisting on “treatment” instead of “measures relating to”. This strategy of denying the existence of treatment when the measures are directed at assisting domestic interests, rather than impairing foreign ones, has been repeatedly attempted in GATT and WTO jurisprudence. In all cases, it has failed:
- a. In *Italy-Agricultural Machinery*, Italy argued that the measure complained of, aid to *purchasers* of agricultural machinery, did not fall within the national treatment obligation in Article III:4 of the GATT because it was not in relation to the machinery itself and the conditions of its sale, etc. The panel rejected this argument, stating that the intention of the drafters was to prevent indirect

⁶⁶³ Investor’s Memorial at 153-163, Investor’s Book of Authorities (Tabs 9, 38, 100 and 57).

protection, which could occur where a government negatively affected the competitive relationship between domestic and imported products through acts that were not directed at the *products* or their conditions of sale etc.⁶⁶⁴

b. In *Bananas*, the European Communities (“EC”) argued that the complained of measures, a license allocation scheme, could not violate national treatment since this scheme was directed exclusively at Banana operators within the EC and did not entail treatment of any imported *product*. The Appellate Body held that since the measure was aimed at cross-subsidizing EC Bananas to the disadvantage of imported Bananas, it fell within Article III:4 even though the measure itself was directed exclusively at *EC persons*.⁶⁶⁵

c. In *FSC 21.5*, the United States argued that its measure, a taxation scheme for American companies, was not within the scope of national treatment under the GATT because it was not “directed toward” either particular categories of imported products or even imported products in general. The Appellate Body rejected this argument, holding that the scope of Article III:4 did not depend on whether the measure was directed at imports, as long as it was a “law, regulation or requirement affecting . . . *internal sale*” etc. of products.⁶⁶⁶

533. Thus, Canada’s arguments that it only treats “mail” or that Canada Post only takes advantage of economies of scale without any treatment of UPS Canada lack any merit. It is merely old wine in new bottles.

⁶⁶⁴ *Italian Discrimination Against Imported Agricultural Machinery*, L/833 - 7S/60, Panel Report, July 15, 1958, 1958 WL 11385, at paras. 6 and 11, Investor’s Book of Authorities (Tab 160).

⁶⁶⁵ *EC -Bananas*, Appellate Body Report at paras. 35 and 211, Investor’s Book of Authorities (Tab 14).

⁶⁶⁶ *United States - FSC 21.5*, Appellate Body Report, January 4, 2002 at para. 208, Investor’s Book of Authorities (Tab 136).

534. In any event, UPS Canada is subject to treatment by Canada within any reasonable meaning of the word. Canada prohibits UPS Canada from obtaining additional volume through mail deliveries. It then authorizes Canada Post to compete against UPS Canada. Canada Post does so by denying it access to the massive network its monopoly allows it to sustain or by granting access on terms that are less favorable than those of Purolator's and Canada Post's courier services. As a result, Canada Post steals business that would otherwise have gone to UPS Canada and robs UPS of a fair return on its investment.

2. The Meaning of "No Less Favorable"

535. NAFTA Article 1102 lists those aspects of investors or investments to which national treatment applies (such as management, conduct, operation acquisition or establishment). Where *differences* in treatment are related to any of those aspects, it is reasonable to presume less favorable treatment.
536. Canada argues that treatment must not only be different, but "less favorable".⁶⁶⁷ This requirement is not in dispute. Once again, there is extensive GATT/WTO jurisprudence on circumstances in which *different* treatment may not result in less favorable treatment. In those situations, however, there is typically a burden on the defending government to show that, even though the treatment is different, it is in *all* respects no less favorable.⁶⁶⁸
537. Just as it is possible that formally different treatment could, in some situations, be no less favorable, it is also possible that, in other situations, formally identically treatment can be less favorable. These are situations of so-called *de facto* discrimination. An example of such discrimination is to be found in the *Canada-Beer* case, a GATT precedent. The panel found that a minimum price requirement for the sale of beer in stores owned by a

⁶⁶⁷ Canada's Counter-Memorial at para.621

⁶⁶⁸ See paras. 532-534 of Investor's Memorial. See *US-Section 337 of the Tariff Act of 1930* at para 5.11, Book of Authorities (Tab 13).

Canadian provincial governmental monopoly violated national treatment, even though the minimum price applied equally to domestic and “like” American beer. The panel noted that the price was set based on the production costs of major *domestic* Canadian beer producers and thus, although applied to both domestic and “like” American beer, constituted less favorable treatment since it denied equality of competitive opportunities to lower cost American beer producers, which could not take advantage of their cost positions in competing with higher-cost Canadian producers.⁶⁶⁹

538. The *Canada-Beer* case illustrates how “less favorable treatment” can be embedded in a neutral rule, applied to both domestic and foreign actors alike. There may have been some Canadian beer producers also disadvantaged by the minimum price, but what mattered to the panel was that the foreign producer of a “like product” was systematically disadvantaged based on a rule that was, on its face, nationality-neutral, applying equally to the foreign product and like domestic products.
539. The *ADF* tribunal confirmed that *de facto* discrimination under NAFTA Chapter 11 would be evaluated in a similar manner, by considering “evidence concerning the *comparative economics* of the situation”.⁶⁷⁰ Canada quotes at length from this case, seeking to extract some requirement of intent-based discrimination. Yet, nothing in the quoted passage supports such an interpretation. On the contrary, it confirms that the inquiry is based on such objective factors as comparative costs of production and other evidence of “the relevant competitive situation”.
540. Unlike *ADF*, this case involves *de jure* discrimination in which there are distinctions that, on their face, apply differently to Canada Post and Purolator than other investors. In addition, this case can hardly be described as one in which the Tribunal does not have

⁶⁶⁹ *Canada-Beer*, February 18, 1992, DS17/R-39S/27 at para. 5.12, Investor’s Book of Authorities (Tab 158).

⁶⁷⁰ *ADF* at para.157, Investor’s Book of Authorities (Tab 95).

evidence of the “comparative economics of the situation”. The Tribunal has extensive expert evidence before it on these matters. Canada’s own experts admit that Canada Post derives a competitive advantage from its monopoly and its ability to capture economies of scale and scope for its exclusive benefit.⁶⁷¹

541. Canada alleges that there can be no less favorable treatment when the foreign investor is damaged by “necessary consequences of a measure that is in the contemplation of the NAFTA”.⁶⁷² This appears to be a suggestion that the conduct of Canada Post complained of is a necessary consequence of the creation of a monopoly. It is not. As explained in the overview of this legal argument, the following special circumstances also apply:

- a. The monopoly is also a state enterprise competing in non-monopoly markets;
- b. The monopoly also forms part of the machinery of the government, having been granted its monopoly along with broad discretion to pursue various vaguely defined policy objectives. It is therefore either an organ of the state or a governmental monopoly exercising delegated governmental authority;
- c. There are economies of scale and scope between the monopoly and non-monopoly markets that create a network that no private firm can replicate;
- d. The governmental monopoly chooses to exploit these economies of scale and scope in a manner that favors its own competitive services and its own subsidiary over other competitors; and

⁶⁷¹ See, e.g. Report of Robin Cooper at 24.

⁶⁷² Canada’s Counter-Memorial at para. 624.

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- e. There is no regulatory control, administrative supervision or other measure to ensure that the governmental monopoly does not do so.

542. Although the NAFTA contemplates actions such as those of Canada Post, it certainly does not view them as “necessary consequences”. Article 1502(3)(d) contemplates that such consequences are unnecessary and contrary to NAFTA. This does not mean that state-to-state arbitration is the only remedy in such cases. As both the *S.D. Myers* and *Pope & Talbot* tribunals have held, measures that violate provisions of NAFTA that are reserved for state-to-state arbitration may also violate provisions that permit investor-state arbitration.⁶⁷³

3. The Investor Is Entitled to the Best Treatment in Jurisdiction

543. In its Memorial, the Investor explained that under 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.⁶⁷⁴ NAFTA Parties cannot, therefore, avoid responsibility under NAFTA Article 1102 by pointing to domestic investors or investments that are treated in the same way as the claiming foreign investor or its investment. Canada has not challenged this interpretation of the NAFTA Article 1102 obligation.

544. The *Methanex* decision confirms this application of NAFTA Article 1102.⁶⁷⁵ The *Methanex* tribunal considered the meaning of Article 1102 in the context of an unfounded

⁶⁷³ See *Pope and Talbot*, Award on measures relating to Investment Motion at para. 19 and *S.D. Myers*, Partial Award at para. 83, Investor’s Book of Authorities (Tabs 54 and 4, respectively).

⁶⁷⁴ Investor’s Claimant’s Memorial at paras. 544 - 548.

⁶⁷⁵ *Methanex* Final Award, August 3, 2005, Investor’s Book of Authorities (Tab 171). The Award was released to the public on August 10, 2005.

claim alleging a widespread conspiracy at the highest levels of the California government. Methanex produced methanol, a key base ingredient in the production of the gasoline additive, MTBE. Methanex scandalously alleged that California Governor, Gray Davis, banned MTBE to exclude Methanex from the market and thereby reward ethanol manufacturers whom it alleged were Methanex' US-based domestic competitors and whom had contributed to the Gray Davis campaign fund. The tribunal found no basis for this aggressive claim.

545. While the tribunal rejected Methanex' claim for a breach of NAFTA Article 1102, it did confirm that the Article entitled them to the best treatment in the jurisdiction. The tribunal said:

... if a component state or province differentiates, as a matter of domestic law or policy, between members of a domestic class, which class happens to serve as the comparator for an Article 1102 claim, the investor or investment of another party is entitled to the most favourable treatment accorded to some members of the domestic class.⁶⁷⁶

546. After concluding that "most favorable treatment" entitled the foreign investor or investment to the best treatment in the jurisdiction, the tribunal applied this principle to help interpret the "like circumstances" requirement of NAFTA Article 1102. The tribunal said that where the investor cannot even show a closely-related local investor or investment receiving better treatment, let alone the best treatment, then there is no further need to explore the satisfaction of the "like circumstances" element. In concluding that NAFTA Article 1102 "is not relevant to this case," the tribunal said: "There is no more or less favourable treatment here. The treatment is uniform, for the ban applies to all MTBE manufacturers."⁶⁷⁷ The tribunal then said:

⁶⁷⁶ *Methanex* Final Award, at 10 of Part IV, Chapter B.

⁶⁷⁷ *Methanex* Final Award, at 10 of Part IV, Chapter B.

Thus, even assuming that Methanex, as a methanol producer, is deemed to be affected, as a legal and factual matter, under NAFTA and international law, by California's ban of MTBE, Methanex's claim under Article 1102 would fail because it did not receive treatment less favourable than United States investors in like circumstances.⁶⁷⁸

547. In confining the domestic investors and investments in "like circumstances" to those most closely related to the claimant investor and their investment, the *Methanex* tribunal relied on the difference in wording between NAFTA Article 1102 and GATT Article III:2. The tribunal noted that GATT III:2 specifically directs that the comparison is with competing products by referring to "directly competitive or substitutable goods." The tribunal said that the NAFTA drafters expressed their intention by not qualifying "like circumstances" with "directly competitive or substitutable."
548. The tribunal appears to have made this decision without being referred to the *Cross Border Trucking* case on this point. In that case, the NAFTA Parties confirmed that "like circumstances" means the same as "like service providers" in the GATS and, therefore, the appropriate local comparators are suppliers of products or services that compete and not merely suppliers of products or services that are most closely related.⁶⁷⁹ Consistent with the NAFTA Parties' confirmation in *Cross Border Trucking*, the *Methanex* tribunal should not have ended its examination of "like circumstances" at the most closely related suppliers but should have examined the suppliers with whom Methanex competed.
549. The *Methanex* tribunal also appears not to have been referred to the numerous other WTO national treatment provisions, which, while not using the GATT Article III:2 language of "directly competitive or substitutable", all use competition as the touchstone for

⁶⁷⁸ *Methanex* Final Award, at 10 of Part IV, Chapter B.

⁶⁷⁹ *Cross Border Trucking*, Investor's Book of Authorities (Tab 106).

comparison of the local and foreign treatment.⁶⁸⁰ Among these provisions, Article 5 of the GATS Annex on Telecommunications also uses “like circumstances” as the touchstone of comparison, just as NAFTA Article 1102 does.

550. In any case, UPS Canada is still in like circumstances with Canada Post under the *Methanex* tribunal’s approach.⁶⁸¹ Canada Post is the domestic company with which UPS Canada is most closely related. -----

⁶⁸⁰ See, for example, the following national treatment provisions that do not contain directly competitive language yet have all been interpreted by the WTO Appellate Body as referring to competitive relationships:

GATT Article III(4)

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable 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.

GATS Annex on Telecommunications

5. Access to and use of Public Telecommunications Transport Networks and Services

Footnote: The term “non-discriminatory” is understood to refer to most-favoured-nation and national treatment as defined in the Agreement, as well as to reflect sector-specific usage of the term to mean “terms and conditions no less favourable than those accorded to any other user of like public telecommunications transport networks or services under like circumstances”.

TRIPS Article 3 - National Treatment

1. Each Member shall accord to the nationals of other Members treatment no less favourable than that it accords to its own nationals with regard to the protection of intellectual property.

Agreement on Government Procurement - Article III - National Treatment and Non-discrimination

1. With respect to all laws, regulations, procedures and practices regarding government procurement covered by this Agreement, each Party shall provide immediately and unconditionally to the products, services and suppliers of other Parties offering products or services of the Parties, treatment no less favorable than:

- (a) that accorded to domestic products, services and suppliers; and
- (b) that accorded to products, services and suppliers of any other Party.

⁶⁸¹ Canada has admitted that Purolator and UPS Canada are in like circumstances: Canada’s Counter Memorial at paras. 144, 191 and 890.

----- UPS
Canada's conclusion is not surprising:

a. -----

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b. Canada Post offers the same services as UPS Canada.⁶⁸⁵ Conversely, the domestic companies that the *Methanex* tribunal found were not in like circumstances did not even produce the same good. Methanex produced methanol, which was a base component to MTBE, which was used as a gasoline additive. The companies that were not in like circumstances were those producing ethanol, which was a gasoline additive like MTBE. Methanex simply produced an input into the good that the impugned domestic companies competed against. Even then, the impugned domestic companies competed with a completely different product.

⁶⁸² See, for example: Canada Post document entitled "International Business," October 1999 at pages 15-16 (R69B-36) (U173); Canada Post document entitled "Distribution Business," 2 October 2000 at page 21 (R69B-37) (U174); and Canada Post document entitled "Distribution Business," October 2001 at pages 14, 15 and 17 (R69B-38) (U200). Fuss Report at para. 179

⁶⁸³ Investor's Memorial at para. 136; Fuss Report at paras. 194-200.

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----- See Fuss Report at 23.

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Fuss Report at 7-9.

E. The Relevance of Discriminatory Intent and Public Policy Objectives

551. In its Counter-Memorial, Canada admits that establishing a violation of NAFTA Article 1102 does not require a demonstration of discriminatory intent. It then suggests that, nonetheless, governments may offer more favorable treatment to competing domestic firms simply if they act for “valid reasons” and do not discriminate on the basis of nationality.⁶⁸⁶
552. Canada’s approach to national treatment simply begs the question of how nationality-based discrimination is to be determined and aims to re-introduce an intent requirement through the back door. Canada’s interpretation of “likeness” would immunize any less favorable treatment of foreign investors from scrutiny simply because the government had accorded that less favorable treatment in a good faith pursuit of certain public policy objectives. Canada acknowledges that the public policy must be “relevant” but does not explain how it becomes so. It acknowledges that the government must act for “valid” reasons, but implies that the validity of these reasons is simply a matter of good faith.
553. None of the jurisprudence cited by Canada excuses less favorable treatment simply because the government is acting to pursue a *bona fide* policy objective. However, contrary to Canada’s straw man characterization of the Investor’s submissions, this does not mean that public policy objectives are not relevant to the inquiry. In fact, public policy objectives may be considered in three different ways:
- a. In certain cases, the absence of any *bona fide* public policy objective can be evidence of discriminatory intent and thereby establish a breach of Article 1102. However, this does not mean that discriminatory intent becomes a necessary condition of such a breach;

⁶⁸⁶ Canada’s Counter-Memorial, at paras.614-617

- b. Public policy issues may need to be considered in evaluating the competitive relationship between the foreign and domestic interests. In these cases, a public policy factor is not a trump card played by the government but simply one of the factors that must be weighed in determining whether there exists a true competitive relationship and whether the equality of competitive opportunities within that relationship has been violated; and
- c. Finally, public policy may serve as an excuse or an affirmative defense for what would otherwise be a violation. Like all excuses or affirmative defenses, the burden of proving the validity of the excuse rests on the party invoking it.

554. After reviewing each of these three scenarios, the Investor will demonstrate how they explain each of the authorities cited by Canada in its Counter-Memorial.

1. Discriminatory Intent As Evidence of a National Treatment Violation

555. A basic confusion in Canada's discussion of the case law in its Counter-Memorial is to misread passages where tribunals are suggesting that evidence of discriminatory intent would be relevant *if* it existed, as actually stating that national treatment is always about "nationality-based discrimination". Canada does not explain how this requirement of "nationality-based discrimination" is consistent with its admission that a violation of national treatment may occur where there is no discriminatory intent.⁶⁸⁷

556. Canada relies on the following non-sequitur: case law that stands for the proposition that discriminatory intent, *where* it exists, is relevant to whether national treatment has been

⁶⁸⁷ See Canada's Counter-Memorial at para. 616.

violated thereby stands for the proposition that national treatment *cannot* be violated unless there is something present called “nationality-based discrimination.” Canada asserts this is true even where the claim is *not* premised on an assertion of discriminatory intent.

557. Canada’s approach is reminiscent of the so-called “aims and effects” approach that has been decisively rejected by the WTO. Regulatory purpose or discriminatory intent was the focus in several GATT cases on national treatment. In the WTO era, the Appellate Body has consistently rejected this way of reading the national treatment obligation in the GATT and the GATS.
558. For example, in the *EC-Bananas* case, which concerned national treatment with respect to trade in services and trade in goods, the EC defended with an argument similar to the one raised by Canada in this case. It claimed that where the government had legitimate public policy reasons for treating economic operators as “unlike,” they should be found to be “unlike” regardless of being in direct competition in the same market⁶⁸⁸. The Appellate Body decisively rejected this argument. It noted that the “aims and effects” argument originated in the use of the words prohibiting measures “so as to afford protection” in GATT Article III:1. It noted that no such language was used in the GATS.⁶⁸⁹ Nor is any such language used in NAFTA Chapter 11.
559. One reason for the WTO’s rejection of an “aims and effects” test is that an overall focus on discriminatory intent directs the adjudicator away from the exact words of the treaty text, which require a distinct consideration of the question of “likeness” and that of “no less favorable” treatment. The Appellate Body noted that Article 31 of the *Vienna*

⁶⁸⁸ *EC-Bananas*, Appellate Body Report at para. 36, Book of Authorities (Tab 14).

⁶⁸⁹ See *EC-Bananas*, Appellate Body Report at para. 241, Book of Authorities (Tab 14).

Convention on the Law of Treaties requires attention to all of the words of an operative treaty provision.⁶⁹⁰

560. Discriminatory intent was also rejected because of the difficulty of ascertaining “intent”. It is very difficult to discern a single motivation behind most public policies in pluralist democracies. Legislative history is often ambiguous or unavailable. This point was also recognized in the context of NAFTA Chapter 11 by the *Feldman* tribunal.⁶⁹¹
561. At the same time, where discriminatory or protectionist intent is *obvious* from the evidence, the WTO Appellate Body has considered it as relevant.⁶⁹² Thus, despite the rejection of “aims and effects” as an *overall* approach to national treatment, the prohibition of invidious, intentional discrimination remains part of the recognized content of the national treatment obligation.
562. Again, NAFTA Chapter 11 tribunals have taken a similar approach. The *S.D. Myers* Partial Award is the clearest example. In that case, the Canadian Minister of the Environment imposed an export ban after being lobbied by a competitor of the American investor and against the advice of her own officials. There was such overwhelming evidence of malicious intent that the tribunal also found a violation of the fair and equitable treatment standard in Article 1105.
563. *To the extent* that they have been concerned with whether invidious intentional discrimination exists, NAFTA tribunals have had to ask whether the government’s

⁶⁹⁰ *Japan-Taxes on Alcoholic Beverages*, Appellate Body Report at 13, Book of Authorities (Tab 79).

⁶⁹¹ See discussion in Investor’s Memorial at para. 546 and *Feldman* at para.183, Investor’s Book of Authorities (Tab 8).

⁶⁹² *Canada - Periodicals*, Appellate Body Report, WT/DS31/AB/R adopted July 30, 1997 at 33 and 34, Investor’s Book of Authorities (Tab 65).

actions were for a legitimate purpose and the way in which the investor's nationality influenced the treatment in question.⁶⁹³

564. Such cases, however, are rare. If the scope of the NAFTA Chapter 11 national treatment obligation were limited to such instances, it would be of only marginal importance in ensuring that expectations of competitive opportunities from the liberalization of investment measures were not undermined through internal policies. Restricting national treatment to situations of intentional discrimination would make national treatment serve only a very marginal role since clear cases of intentional invidious discrimination are prohibited under NAFTA Article 1105.

565. While admitting that national treatment applies to cases where there is no *intent* to discriminate on the basis of nationality, Canada goes on to suggest that nevertheless there must be "evidence of discrimination on the basis of nationality." But, in the absence of a subjective, intent-based approach, it is precisely *through* the objective comparison of the treatment between a *domestic* investor and the investor of *another* NAFTA party who are in "like circumstances" that nationality-based discrimination can be ascertained.

566. In any case, having rejected the requirement of intent, Canada does not provide any clear additional or alternative test for its notion of "nationality-based discrimination." Given that the President of Canada Post has stated that Canada Post is leveraging its network and pursuing synergies with Purolator for the purpose of competing against "large foreign-owned multinationals",⁶⁹⁴ any reasonable test for such discrimination must be satisfied with respect to these measures.

⁶⁹³ See *Pope and Talbot Inc.*, Award on the Merits Phase 2 at para. 78, Book of Authorities (Tab 7); See also *S.D. Myers*, First Partial Award, November 13, 2000 at para. 254, Book of Authorities (Tab 4); *GAMI Investments*, Final Award, November 15, 2004 at para. 114, Book of Authorities (Tab 100).

⁶⁹⁴ Letter from André Oullette to Konrad von Finckenstein dated October 21, 1999, Investor's Schedule of Documents (Tab U139).

2. Public Policy As a Factor in the Competitive Relationship

567. Although the absence of discriminatory intent does not suffice to immunize measures from review for national treatment, public policy factors may be weighed as part of the context in assessing a competitive relationship. This may occur both at the stage of determining the existence of a competitive relationship and at the stage of determining whether there has been equality of competitive opportunities within that relationship.
568. The WTO *Asbestos* case is an example of how policy factors may determine the existence of a competitive relationship. In that case, the Appellate Body was faced with a situation where the products being compared had radically different health effects.⁶⁹⁵ The banned asbestos-containing products were being compared with non-asbestos containing products with the same end uses not banned by France.
569. The Appellate Body found that the different health effects of the products being compared provided a very relevant *context* for analyzing the existence and nature of the competitive relationship. From a final consumer perspective, physical differences between the products in question would be significant as they led to radically different health effects. The final consumer perspective was deemed relevant even though the initial consumer would be a company using the material in construction activities. As intermediate companies would be liable for health problems created by asbestos, this factor needed to be taken into account in determining whether the asbestos and non-asbestos products were in a competitive relationship.
570. Public policy factors may also be examined to determine whether the disruption of the competitive relationship is attributable to the impugned governmental measures. For

⁶⁹⁵ See *EC-Asbestos*, Appellate Body Report at para. 155, Investor's Book of Authorities (Tab 135).

example, intervening events and new developments may themselves disrupt the competitive relationship. Government intervention may be a mere reaction or acknowledgment of a change in the relationship between economic actors that has its real source in extrinsic factors.

571. This logic underlies the NAFTA tribunal ruling in *Pope & Talbot*, where the tribunal found that it was U.S. countervailing duty action that had disrupted the competitive relationship, and thus that the remaining question under national treatment was whether intentional discrimination was somehow involved in the manner in which Canada had reacted to the extrinsic disruptive event.⁶⁹⁶
572. Regardless of whether such public policy factors are treated as part of the analysis of “like circumstances” or of “treatment less favorable”, they are only one factor to be weighed in the evaluation of an equality of competitive opportunities. They do not serve to automatically render two otherwise “like” firms “unlike”, thereby permitting less favorable treatment.
573. In most international trade and investment cases, there will be some public policy rationale for the measure at issue. This does not make the measure immune from scrutiny. For example, discriminatory taxation measures are a staple of WTO national treatment law.⁶⁹⁷ In each such case, the taxes served the valid public purposes of raising revenues necessary for government projects. Yet, it was not the government’s decision to levy taxes that was at issue but rather the discriminatory manner in which the tax power was exercised.

⁶⁹⁶ *Pope & Talbot*, Merits Award, Investor’s Book of Authorities (Tab 7)

⁶⁹⁷ See, for example, *Korea - Alcoholic Beverages*, Investor’s Book of Authorities (Tab 78). See also *Japan - Alcoholic Beverages*, Investor’s Book of Authorities (Tab 79).

574. In this case, Canada Post's exclusive privilege may serve the valuable public purpose of raising revenues to provide universal service. It is not Canada's decision to grant an exclusive privilege that is at issue, but rather Canada Post's discriminatory exercise of its resulting powers.
575. Similarly, if the Tribunal determines that Canada Post has a burden from its universal service obligation, this burden should only be considered as one factor relevant to the competitive relationship between UPS Canada and Canada Post. It does not automatically lead to UPS Canada and Canada Post not being "in like circumstances". The Tribunal will need to enquire whether the existence of a burden on Canada Post from the USO justifies its decision to allow its non-USO services and those of Purolator to access its network on terms more favorable than those granted to competitors. Such an examination would lead to the conclusion that the USO does not justify such action. On the contrary, it requires that competitors be treated equally.
576. An inquiry that treats the USO as merely one factor to be weighed in the evaluation of the competitive relationship is perfectly consistent with the European Court of Justice decision in *Chronopost*, relied on by Canada.⁶⁹⁸ In that case, the Court merely concluded that the evaluation of whether the French postal operator's contractual arrangements with its courier subsidiary were "state aid" required a recognition of the costs of the postal operator's network. It did not find that the French postal operator was exempt from state aid disciplines and it referred the matter back to the authorities for further investigation.
577. Indeed, the *Chronopost* decision demonstrates that an international court with a mandate to assess breaches of rules creating a common economic area will closely scrutinize the

⁶⁹⁸ Canada's Counter-Memorial at paras. 863-866 citing *Chronopost et. al. v. Union française de l'express et. al.* [2003] ECR I-6993, Respondent's Book of Authorities (Tab 50).

arrangements between a monopoly postal operator and its courier subsidiary. It also confirms UPS' allegation that the postal network could "never have been created by a private undertaking".⁶⁹⁹

3. Public Policy As Excuse for Discriminatory Conduct

578. Finally, in some circumstances, a respondent may invoke public policy reasons as an excuse for treatment that would otherwise violate national treatment. As set out in the Investor's Memorial, such an excuse is a narrow exception that must be strictly proven with the burden of proof being on the party relying on it.⁷⁰⁰
579. In the NAFTA Chapter 20 state-to-state arbitration, *In the Matter of Cross Border Trucking*, the Panel considered the phrase "in like circumstances" in NAFTA Article 1202 dealing with national treatment for trade in services. One issue was whether the phrase could properly allow for differential treatment in the manner contemplated by the Article's predecessor provision in the Canada-US Free Trade Agreement. That provision allowed for differences in treatment "no greater than necessary" for a limited list of public policy reasons.
580. The Panel concluded that, although the previous exception to national treatment had been deleted from Article 1202, the phrase "like circumstances" could include such limited exceptions. However, it went on to state that, in light of the trade-liberalizing objectives of NAFTA, "the Panel is of the view that the proper interpretation of Article 1202 requires that *differential treatment should be no greater than necessary for legitimate regulatory reasons such as safety and that such different treatment be equivalent to the treatment accorded to domestic service providers.*"⁷⁰¹

⁶⁹⁹ *Chronopost* at paras. 34-35, Canada's Book of Authorities (Tab 50).

⁷⁰⁰ Investor's Memorial at para. 531

⁷⁰¹ *In the Matter of Cross Border Trucking* at para. 258, Investor's Book of Authorities (Tab 106).

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581. The Panel went on to confirm that when the “in like circumstances” language was being used as an exception, it should be interpreted narrowly in a manner that was parallel to the general exception for trade in goods and services in NAFTA Article 2101. That exception tracks the language of GATT Article XX. Both of these provisions place the onus on the respondent to show that differential treatment is no greater than necessary for a limited list of health, safety and consumer protection reasons.⁷⁰²
582. The general exception in NAFTA Article 2101 does not apply to NAFTA Chapter 11. Instead, the NAFTA Parties used an extensive list of reservations and exceptions from the various obligations. In *S.D. Myers*, however, the tribunal noted that the NAFTA environmental companion agreements created a context where the assessment of “like circumstances” would “take into account circumstances that would *justify* governmental regulations that treat [investors] differently in order to protect the public interest.”⁷⁰³
583. The *S.D. Myers* tribunal’s reference to a justification of differential treatment “in order to protect the public interest” establishes that the burden is on the government to demonstrate the necessity of the discriminatory measures to secure a vital public objective. This is the same approach adopted by other NAFTA tribunals such as *Feldman*⁷⁰⁴ and *Pope & Talbot*.⁷⁰⁵ Thus, contrary to Canada’s Counter-Memorial,⁷⁰⁶ Canada bears the burden of proof of invoking public policy factors as an excuse for differential treatment.

⁷⁰² *In the Matter of Cross Border Trucking* at para. 260, Investor’s Book of Authorities (Tab 106).

⁷⁰³ *S.D. Myers* Partial Award at para.250, Investor’s Book of Authorities (Tab 4)

⁷⁰⁴ *Marvin Feldman*, Award at para. 176, Investor’s Book of Authorities (Tab 8).

⁷⁰⁵ *Pope & Talbot*, Merits Award at para. 78, Investor’s Book of Authorities (Tab 7).

⁷⁰⁶ Canada’s Counter-Memorial at paras. 632.

584. This is a heavy burden as the differential treatment must be “no greater than necessary” and “equivalent to the treatment” accorded to domestic investors. UPS has demonstrated that it is possible for Canada Post to treat UPS Canada no less favorably than Canada Post’s own competitive services. Indeed, such equal treatment contributes to rather than detracts from Canada’s policy objectives. Therefore, Canada cannot meet its burden.

4. The Mere Existence of a Relevant *Bona Fide* Public Policy Objective Does Not Imply Investments Are Not in “Like Circumstances”

585. Canada presents public policy factors as matters that automatically render two otherwise competing firms “unlike”, thereby immunizing their comparative treatment from scrutiny. However, in all of the cases cited by Canada, public policy was only one factor that was to be taken into account in evaluating the competitive relationship between the interests. It was only to the extent that this factor indicated that the equality of competitive opportunities was not violated that any tribunal considered it to be relevant.

586. Canada begins its discussion of the role of public policy factors by referring to the *S.D. Myers* tribunal’s summary of an OECD document stating that an evaluation of “like situations” should “*take into account policy objectives*”.⁷⁰⁷ However, the *S.D. Myers* tribunal went on to quote the OECD document to show precisely how policy objectives should be taken into account, namely “*inasmuch as those objectives are not contrary to the principle of national treatment*”.⁷⁰⁸ Thus, public policy objectives are to be taken into account within the overall framework of a national treatment analysis. They do not automatically justify less favorable treatment.

⁷⁰⁷ Canada’s Counter-Memorial at para. 600 citing *S.D. Myers* Partial Award at para. 248, Investor’s Book of Authorities (Tab 4).

⁷⁰⁸ *S.D. Myers*, Partial Award at para. 248, Investor’s Book of Authorities (Tab 4).

587. Canada then refers to the *Pope & Talbot* decision as evidence that public policy considerations render otherwise competing firms unlike.⁷⁰⁹ Yet the analysis followed by the *Pope & Talbot* tribunal is very different from the one advocated by Canada. The case involved the allocation of export quotas under a scheme adopted by Canada to implement the Softwood Lumber Agreement with the United States. That Agreement was made as a result of countervailing duty actions by the United States that targeted some Canadian provinces but not others. The tribunal did not simply satisfy itself that Canada had taken its measures to implement valid objectives set out in an international treaty. It performed a detailed analysis of how the measures were being implemented and satisfied itself on the evidence that the quota allocations were actually being performed in a manner consistent with that objective.

588. Contrary to the submissions of Canada, the *Pope & Talbot* tribunal did not conclude that it was sufficient for there to be a “relevant” nexus between the measure and the public policy. The tribunal stated that:

Differences in treatment will *presumptively* violate Article 1102(2), unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or de facto, between foreign-owned and domestic-owned firms, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.⁷¹⁰

589. The tribunal’s reference to a *presumption* of a violation demonstrates that, as in the WTO jurisprudence, differences in treatment between firms in the same economic sector shift the burden on respondents to show the treatment is no less favorable. This burden is not met by merely establishing a “reasonable nexus to rational government policies”. The differences in treatment must also not distinguish between foreign and domestic interests,

⁷⁰⁹ Canada’s Counter-Memorial at para. 602.

⁷¹⁰ *Pope & Talbot*, Merits Award at para.78, Investor’s Book of Authorities (Tab 7).

either on their face or *de facto*. In this case, the measures distinguish between Canada Post and other firms “on their face”.

590. Canada also refers to the *Loewen* and the *GAMI* cases. The *Loewen* case involved the outcome of a jury trial involving the investment. The plaintiff was not a competitor of the investment nor was there any suggestion that such competitors systematically received better treatment by the American courts. Unsurprisingly, the tribunal did not find like circumstances.
591. Canada quotes the *Loewen* tribunal as suggesting that NAFTA Article 1102 proscribes only “demonstrable and significant indications of bias and prejudice on the basis of nationality.” Given the context in which this dictum appears, this is nothing more than a restatement of the notion that mere differences in *outcomes* are not enough to establish a violation of national treatment, but rather that the *competitive relationship* between the foreign firm complaining and a domestic investor must be actually prejudiced by the *nature* of the treatment provided.
592. Further, the *Loewen* tribunal framed its remarks as an endorsement of the views of Professor Richard Bilder. In referring to nationality bias as covered by NAFTA Article 1102, Professor Bilder was discussing whether *intentional* discrimination on grounds *other* than nationality was covered by NAFTA Article 1102 and was not opining on whether NAFTA Article 1102 extended *beyond* intentional nationality-based discrimination and in what way. Thus, Professor Bilder’s overall conclusion was not that nationality *bias* must always be proven for NAFTA Article 1102 to be violated but rather that “complaints of bias on grounds other than nationality are more appropriately considered under the provisions of Article 1105.”⁷¹¹

⁷¹¹ Expert Opinion of Richard Bilder submitted to Loewen tribunal at para. 8, Investor’s Book of Authorities Tab 147.

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593. Canada also cites the *GAMI* case as a decision based upon an analysis of the existence of intentional nationality-based discrimination.⁷¹² This is not an accurate reading of this decision. In *GAMI*, the basis of the investor's national treatment complaint was that under a government program to address a crisis in the sugar industry, three of the sugar mills owned by its investment were expropriated while other sugar mills not owned by foreign investors were not expropriated.
594. The investor's claim was interpreted by the tribunal to amount to the notion that this *mere difference in outcomes* constituted a violation of national treatment. *GAMI* had not presented evidence that the difference in *outcomes* could be attributable to *less favorable treatment*, whether intentional or otherwise. *GAMI* had not even formulated its claim in terms of a denial of equality of competitive opportunities, i.e. a distortion of the competitive relationship between investors competing in the same market. *GAMI* presented no evidence that the *criteria* by which Mexico determined what sugar enterprises to expropriate systemically led to less favorable treatment nor any evidence of discrimination in the manner in which the criteria were applied.
595. In sum, the tribunal's ruling in *GAMI* stands for the proposition that a *prima facie* case of national treatment violation cannot be made out by the mere fact of an outcome commercially or financially disadvantageous to the complainant relative to some domestic investor. A *prima facie* case must involve at least some evidence that the commercially or financially disadvantageous outcome results from less favorable treatment, i.e. a distortion in the competitive relationship between the investor and a domestic investor in like circumstances. This is precisely the nature of the UPS claim.

⁷¹² Canada's Counter-Memorial at para. 586.

596. One of the examples used by Canada in its Counter-Memorial is further evidence that even measures related in some way to a *bona fide* public policy objective can violate national treatment. Canada alleges that it is self-evidently true that programs offering privileges to small business or economically depressed areas cannot violate national treatment if their benefits exclude large foreign enterprises.⁷¹³ It uses this example to imply that the Investor's interpretation of national treatment could have pernicious consequences.
597. While programs to assist economically depressed areas would not necessarily result in a violation of equality of competitive opportunities, it is quite possible that they could have such an unintended effect. Each NAFTA Party foresaw this risk and carefully considered reservations for such programs in the NAFTA against their national treatment obligations in NAFTA Article 1102. There was considerable care taken in these reservations to preserve wide public policy freedom for future social policy innovations.
598. For example, Canada took a reservation against existing or future policy measures relating to socially or economically disadvantaged minorities in Annex II-C-8. In Annex II-C-9, Canada took a very broad social policy reservation. This reservation states:

Canada reserves the right to adopt or maintain any measure with respect to the provision of public law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care.

This reservation provided significant public policy flexibility to the Government of Canada within its described sectors.

⁷¹³ Canada's Counter-Memorial at para. 615.

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599. The policies protected by the Annex II-C-8 and II-C-9 reservations demonstrate that Canada understood that, merely because these social policies are well-intentioned and serve valid public purposes, they are not immunized from scrutiny under the national treatment violation. There would have been no need to take such reservations if the interpretation of national treatment now advocated by Canada was shared by NAFTA's drafters.
600. The *Methanex* Final Award confirms that the mere existence of a relevant *bona fide* public policy objective does not imply investments are not in "like circumstances". In *Methanex*, the NAFTA tribunal found that the US took the impugned measure, the ban of the gasoline additive MTBE, for the *bona fide* public policy reason of protecting the environment.⁷¹⁴ Despite this, the tribunal did not consider this public policy objective when addressing the "like circumstances" element of Article 1102.⁷¹⁵ While the tribunal did find that "like circumstances" was narrower than all competing domestic investors and investments, it did not do so because of the measures public policy objectives but through an objective assessment of how the closest market participants were treated.⁷¹⁶

F. National Treatment and the UPS Case

1. Overview

601. UPS' claims concerning national treatment violations are straightforward. The courier market is a competitive sector of the Canadian economy. Both Canada Post and UPS Canada compete in that sector and there is thus the kind of competitive relationship between the two that is envisaged in the meaning of "like circumstances".

⁷¹⁴ *Methanex*, Final Award, Part III, Chapter A at para. 102, Investor's Book of Authorities (Tab 171).

⁷¹⁵ *Methanex*, Final Award, Part IV, Chapter B.

⁷¹⁶ *Methanex*, Final Award, Part IV, Chapter B.

602. There are no exceptional contextual factors that would justify going beyond the existence of the competitive relationship in determining whether Canada Post and UPS Canada are in like circumstances for purposes of this complaint.
603. Canada did not file any relevant reservations or limitations to its NAFTA Article 1102 national treatment obligation, even though the effects of NAFTA on Canadian public enterprise were widely debated and discussed among citizens and governments when NAFTA was being negotiated.
604. Canada determined that it could achieve its policy goals in the postal sector while respecting the requirements of NAFTA in the competitive courier sector. Nothing has changed to make this determination now impossible or unviable. The disturbance in the competitive relationship that the investor complains of cannot be attributed to any intervening external event but rather is directly and wholly attributable to Canada's policy choices.
605. Further support can be found in Canada's approach to its commitments in the *General Agreement on Trade and Services* (GATS). There it has bound the courier sector but left unbound the postal sector. This is evidence of Canada's voluntary decision to operate a public policy-driven postal sector side-by-side a normal competitive market for courier services.⁷¹⁷ Canada itself, by choosing this approach, has created and reinforced the expectation that the courier market will be open to competition based on Canada's international trade and investment obligations.
606. UPS is not challenging this decision of Canada to bifurcate service markets in this way. Nor is the Investor attacking Canada's decision to allow Canada Post to participate in the

⁷¹⁷ Canada's Counter-Memorial at para. 693.

competitive courier market, taking advantage of positive synergies between postal and courier services. It merely challenges the manner in which Canada Post is doing so.

607. The distortion of the competitive relationship between UPS Canada and Canada Post in the courier market is what UPS complains of, and there are simply no reasons why Canada cannot provide treatment no less favorable to UPS Canada *in that market* while attaining its policy objectives in the postal sector. UPS does not expect to be treated identically to Canada Post in all respects.

608. All of the differences in treatment that UPS complains of are explicit: UPS is not making a *de facto* discrimination complaint that identical measures nevertheless lead to less favorable treatment. It complains that Canada Post is explicitly given better treatment by Canada, even though that better treatment may have been well-intentioned.

609. All of the differences in treatment complained of by UPS result in less favorable treatment, i.e. a distortion or the disturbance of the competitive relationship between Canada Post and UPS Canada to the disadvantage of UPS Canada.

2. Analysis of the Impugned Measures

610. UPS has previously established that UPS Canada is an investment of an investor of the United States. Canada has not disputed that Canada Post and Purolator are investments of an investor of Canada. Canada has also essentially admitted that Purolator is in like circumstances with UPS Canada.⁷¹⁸

611. Canada's responsibility for the actions of Canada Post are addressed at length in the Investor's Memorial and this Reply's sections on state responsibility and delegated governmental authority. Thus, the issues to be resolved are as follows:

⁷¹⁸ Canada's Counter-Memorial at paras. 144, 146, 187 and 890.

- a. With respect to the measures of Canada Post:
 - i. Does Purolator receive more favorable treatment with Canada Post than UPS Canada? (Canada has admitted Purolator is in like circumstances).

 - b. With respect to the measures of Canada Post:
 - i. Is Canada Post in like circumstances with UPS Canada?
 - ii. Does Canada Post receive more favorable treatment?

 - c. With respect to the measures of Canada Customs:
 - i. Is Canada Post in like circumstances with UPS Canada?
 - ii. Does Canada Post receive more favorable treatment?

 - d. With respect to the *Publications Assistance Program* restriction:
 - i. Is Canada Post in like circumstances with UPS Canada?
 - ii. Does Canada Post receive more favorable treatment?
612. For each set of measures, UPS has established the existence of a competitive relationship between UPS Canada and Canada Post. In particular:
- a. With respect to the measures of Canada Post, UPS Canada and Canada Post compete directly in all aspects of the delivery of courier services in Canada;

 - b. With respect to the measures of Canada Customs, UPS Canada and Canada Post compete for the importation of parcels and express packages into Canada from the

United States; and

- c. With respect to the *Publications Assistance Program* restriction, UPS Canada and Canada Post compete for the delivery of magazines and newspapers to retailers.

613. Therefore, the next order of inquiry is whether, within these competitive relationships, there has been a denial of equality of competitive opportunities and, if so, whether that differential treatment has been justified by Canada. In all cases, there has been such a denial and the prima facie violation cannot be justified.

- a. *Measures of Canada Post That Provide Competitive Advantages to Purolator*

614. Canada Post has adopted a systematic policy and practice of granting Purolator access to valuable aspects of the vast network that is sustained by Canada Post's monopoly. The policy and practice has resulted in a series of arrangements between Purolator and Canada Post involving:

- a. Sale and use of stamps;
- b. Sales at retail outlets;
- c. -----
- d. -----
- e. -----

f. ----- bills and advertisements.

615. These arrangements between Canada Post and Purolator are measures relating to UPS Canada. They give UPS Canada's largest competitor access to a government-controlled resource. As a result, they are treatment of UPS Canada.

616. The treatment of UPS Canada is systematically less favorable than that given to Purolator. With the exception of interlining and distribution services, UPS Canada has not been offered any of the access to the network granted to Purolator. This fact alone is evidence of differential treatment and creates a burden on Canada to demonstrate that the treatment is no less favorable.

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618. There is no regulatory control, administrative supervision or other measure to ensure that Purolator's access to the benefits of the Monopoly Infrastructure is indeed no more favorable than that which could be obtained by UPS Canada. -----

----- While Purolator may have a separate legal personality and organizational structure, it is controlled by Canada Post and its operations are intertwined with those of Canada Post.

619. When viewed as a whole, the arrangements between Canada Post and Purolator have

⁷¹⁹ See Supplementary Expert Report of Howard Rosen.

systematically denied UPS Canada an equality of competitive opportunity with Purolator. The arrangements allow Purolator to retain the largest market share of any courier in Canada, even when its market share is viewed separately from Canada Post's. Purolator maintains this market share at the expense of UPS Canada.

620. Canada has not offered any public policy rationale for this differential treatment of Purolator nor is there any conceivable excuse for it. It is simply naked discrimination by Canada Post in favor of its affiliate.

b. Measures of Canada Post Providing Competitive Advantages to Its Own Courier Services

621. Canada Post has adopted a systematic policy and practice of operating its network in a manner that accords UPS Canada treatment less favorable than that accorded to Canada Post's own courier services. -----

622. As Canada Post's own competitive services are not provided by a separately-incorporated company, there are no contracts similar to those between Canada Post and Purolator. Instead, the prices at which competitive services access Canada Post's network are implicitly determined by the contributions measured in Canada Post's Annual Cost Study.

623. Canada Post's policy and practice of permitting its competitive services to enjoy access to its network at or below incremental cost accords treatment to UPS Canada. It allows UPS Canada's second largest competitor (after Purolator) to enjoy a competitive advantage not otherwise available to UPS Canada. Canada Post uses this advantage to expand its share of the courier market share at the expense of UPS Canada.
624. Canada's grant of authority to Canada Post to provide universal service does not render Canada Post "unlike" UPS Canada nor does it otherwise suggest that the treatment of UPS Canada is no less favorable. In particular:
- a. Canada Post is not under the burden of a universal service obligation as it is free of any well-defined obligation. Canada Post may vary its service standards as it sees fit. There is no legal instrument that defines the service standards that Canada Post must meet. It is not even clear which products beyond letter mail and basic parcel service are to be provided as universal service. At best, there are only "informal directives" from the Minister that have no legal status;
 - b. To the extent that Canada Post is under any obligation to provide universal service, there is no evidence that the obligation is a material burden. A monopoly service provider free of any service obligation would likely deliver to all points in Canada just as UPS Canada delivers to all points in Canada. Canada has not adduced any evidence of material costs incurred by Canada Post that are not part of the ordinary costs of doing business. The only specific costs identified are not material (e.g. services for the blind and Members of Parliament) and are easily offset by the benefits of a monopoly and other governmental privileges such as exemptions from federal and provincial taxes;
 - c. If Canada Post is under a material burden from a universal obligation, the funding

of such a burden would not excuse a discriminatory exercise of its control over its access to the network. Canada Post can fully exploit the economies of scale and scope deriving from its network by charging its competitive services a price that offsets the competitive advantage of its use of the network. It is common practice throughout the industrialized world for monopoly postal operators with strict universal service obligations to offer competitive services only at contributions well in excess of incremental costs. Regulatory control or other measures serve to ensure that they do so while still fulfilling universal service obligations.

625. As a result, careful consideration of any social obligations or burdens on Canada Post reveals that its policies and practices still distort the competitive relationship between its courier services and those of UPS Canada. Canada Post systematically favors its own courier services at the expense of those of UPS Canada.
626. The universal service obligation does not create a valid public policy excuse for less favorable treatment of UPS Canada. Canada bears the burden of showing that the preferential treatment of Canada Post's courier services is necessary to fulfill its public policy objectives. It has not done so.

*c. Measures of Canada Customs Providing Preferential Treatment to
Canada Post*

627. Canada provides treatment less favorable to UPS Canada than provided to the package and parcel imports handled by Canada Post. Canada Post handles some imported courier imports into Canada through relationships with Purolator, which is required to have customs inspection in the same manner as UPS Canada. In addition, UPS does not take issue with the customs measures applied to letter mail under 30 grams not containing goods which is within the exclusive privilege of Canada Post and is also not subject to

customs inspection or to duties or taxes.

628. Customs measures for postal imports (such as those contained in the *Postal Imports Agreement*) apply to all “mailable matter” and not only to Canada Post letter mail. Thus, Canada Post receives a special mode of treatment for all mail items containing goods handled by Canada Post from a foreign postal administration. Thus, the Investor’s focus with respect to treatment less favorable is upon package and parcel imports handled by Canada Post which are handled through the customs postal imports stream.
629. Canada has attempted to characterize UPS’ claim as being opposed to the maintenance of two different customs inspection streams. The Investor does not take issue with the creation of separate streams for postal and courier products. Rather UPS is concerned about the use of these separate streams in a manner which favors Canada Post in its competitive market operations. Canada could have created a process which was competitively neutral, which ensures equality of competitive opportunities. The Investor concedes that the *mere existence* of two separate regimes does not establish less favorable treatment of UPS Canada. However, in *design and operation* these regimes result in systematically less favorable treatment to UPS Canada with respect to the imports of packages and parcels in competition with Canada Post.
630. Canada’s differential policy affects the competitive opportunities of UPS Canada against Canada Post as follows:
- a. Customs charges cost recovery fees to UPS Canada while not charging similar fees to Canada Post. Canada has no obligation under the *Kyoto Convention* to refrain from charging cost recovery fees to Canada Post with respect to package and parcel imports imported through the mail. The fact that Canada does impose such fees upon UPS Canada and does not upon Canada Post clearly demonstrates

the provision of less favorable treatment to UPS Canada by Customs;

- b. Canada Post does not comply with the types of Customs obligations that are imposed on other competitors in the parcel and package market like UPS and is exempt from the payment of fines, penalties and interest. -----

and

- c. Canada Customs fails to properly assess duties and taxes on postal imports. There is no justification for Canada's failure to carry out Canadian domestic law and properly inspect Postal Imports.

- i. While it has disputed this fact, Canada has delegated authority for primary customs processing to Canada Post by requiring upon Canada Post the obligation to process all postal imports containing goods to Customs through Section 42 of the *Canada Post Act* and the *Postal Imports Agreement*, which establishes that Canada Post is to screen all incoming mail imports to Canada and determine those which are to go to Customs

⁷²⁰ Investor's Memorial at para. 321.

⁷²¹ Canada's Reply to Interrogatories, questions 51 and 53, Investor's Schedule of Documents (Tab U290).

⁷²² Section 3(2) of the *Customs Act* stipulates that this Act applies to Her Majesty in right of Canada (the Government of Canada), Investor's Schedule of Documents (Tab 383).

for inspection. Both Canada Post and Customs are thus responsible for the failures that occur in customs inspection in Canada. Canada Post is primarily responsible for the failure for items to actually be inspected at all by Customs, while Customs is totally responsible for the failure for customs duties to be rated and the failure to assess taxes on goods imported through the postal stream that Canada Post has presented to them. For the purpose of national treatment, it is not necessary for this Tribunal to identify from which organ of the Canadian Government the customs flaws occur, as the conduct is attributable back to Canada in either event under the customary international law principles of state responsibility;

- ii. The Nelems Study has confirmed that the joint Canada Post and Canada Customs postal imports inspections system is flawed with respect to postal imports coming into Canada. Canada simply fails to adequately rate duty and assess taxes to goods imported through the postal stream while taking measures to ensure that UPS Canada properly brings all imported goods to the attention of Customs so that each and every item can be rated for duties and assessed appropriate taxes;

- iii. -----

----- Even after

⁷²³ E-mail dated April 7, 2000 re: 'Customs Issues' from Louis Young to Malcolm Tait et al of Canada Customs, in Canada's restricted binder no. 14 (Tab R232) which states:

that point, there is no evidence submitted by Canada that all postal imports are now being inspected by Customs or that Canada is enforcing the terms of Canadian law against Canada Post to require it to bring all imported mail containing goods to Customs for inspection; and

- iv. The failure of Canada to actually require packages and parcels containing goods which are imported through the postal stream to receive customs inspection while requiring UPS Canada properly to do so, has not provided equality of competitive opportunities to parcel and package imports of UPS Canada.

631. There is no dispute that Canada Customs has the statutory duty to carry out the enforcement of the customs laws of Canada. From the perspective of duties and tax enforcement, it should make no difference whether the goods to be inspected come into Canada as postal imports or courier imports.

632. Canada has not offered any public policy rationale for this differential treatment respecting the enforcement of the Customs and Excise laws of Canada. None of Canada Post's World Customs Organization obligations⁷²⁴ or its asserted social policy objectives are rationally connected to Canada's failure to enforce its own customs laws with respect to goods imported through the postal stream. It is simply naked discrimination by Canada

in Canada's restricted binder no. 14 (Tab R4-232). See Investor's Schedule of Documents (Tab U455).

⁷²⁴ Canada's Counter-Memorial at para. 459.

in favor of postal imports handled by its wholly-owned state organ, Canada Post.

d. The Publications Assistance Program Measure

633. The administrative requirement that the beneficiaries of the *Publications Assistance Program* use Canada Post for their deliveries is a measure that accords less favorable treatment to UPS Canada. Publishers who would be potential customers of UPS Canada can only access their subsidy if they give all of their business to Canada Post. UPS Canada is denied the opportunity of competing for this business on equal terms.
634. This blatant differential treatment was not the result of a competitive process that considered Canada Post's inherent advantages in residential delivery. UPS Canada was simply denied the opportunity of providing the services to publishers that are provided by Canada Post. Publishers and independent advisers have informed Canada that there is no reason to restrict the choice of carrier in such a manner.
635. Canada has not justified the restriction in the *Publications Assistance Program* as necessary to fulfill its stated public policy goals. The fact that Canada Post has chosen, in its governmental capacity, to contribute to the subsidy program should not give it the right to secure the resulting delivery business.

G. The Exceptions Claimed by Canada Do Not Apply to the Measures Related to the *Postal Imports Agreement*

636. Canada claims that the *Postal Imports Agreement* is a procurement or alternatively a subsidy and that accordingly all measures that relate to the *Postal Imports Agreement* are exempted from the obligations of NAFTA Article 1102. The Investor disputes Canada's approach.

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637. The Investor does not complain about any inappropriate tender actually entered into by Canada and Canada Post relating to the *Postal Imports Agreement*. Canada Post raised concerns in the *Dussault* case that if the details of the Postal Import Agreement were made public, there could be a call for a public tender where a foreign investor like UPS could offer a better price for the services than Canada Post.⁷²⁵ While it is true that a transparent public process would likely save Canadian taxpayers money and would be more consistent with the general objectives of the NAFTA, such considerations, are outside of the nature of the investor-state claim brought by UPS to this Tribunal.
638. The *Postal Imports Agreement* started out on June 30, 1992 as an interim understanding consisting of a two paragraph letter sent from the Minister of National Revenue to the President of Canada Post.⁷²⁶ The interim agreement did not make any reference at all to fees or services to be provided by Canada Post to Canada Customs regarding materials handling or customs processing. It only referred to “the collection of duties in respect of mail, as agent of the Minister, upon such terms and conditions and during the time period which may be agreed to by the parties”.
639. In fact, the Affidavit of John Cardinal describes the June 30th letter as an “agency agreement that eventually became the *Postal Imports Agreement*”⁷²⁷. It is very doubtful that this agency agreement could ever be considered as a procurement agreement. To the extent that the Interim *Postal Imports Agreement* was an agreement at all, it was with respect to the collection of assessed duties.

⁷²⁵ *Dussault v. Canada (Customs and Revenue Agency)*, 2003 F.C. 973 at para. 11(5), Canada’s Book of Authorities (Tab 77).

⁷²⁶ This letter was set out as Exhibit C to the Affidavit of John Cardinal.

⁷²⁷ Affidavit of John Cardinal at para. 13.

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643. The meaning of the term “procurement” used in the Article 1108(7)(a) exception was found in the definition of procurement in NAFTA Article 1005 by the *ADF* tribunal⁷³⁰. This definition explicitly excludes from the meaning of the term “procurement” “non-contractual agreements” such as the clearly inter-governmental type of agreement contemplated by the 1992 *Interim Postal Imports Agreement*. Accordingly, the interim *Postal Imports Agreement* cannot be considered to fit at all within the scope of NAFTA Article 1108(7)(a) procurement exception. At best, only the 1994 *Postal Imports Agreement* should be considered by this Tribunal as potentially fitting within the terms of this exception.
644. The purpose of the procurement exception in NAFTA Article 1108(7)(a) requires that the measure sought to be excepted from the national treatment obligation be causally related to the procurement. Canada has merely argued that since a procurement may be involved, everything connected with the *Postal Imports Agreement* is inoculated from Tribunal review. Such an argument cannot be valid or else there would be little effective meaning to the national treatment obligation under the NAFTA as governments would always be able to join a facially discriminatory measure with some minor procurement to exempt the entire measure from international review.
645. The procurement exception in NAFTA Article 1108(7)(a) applies to claims with respect to disputes surrounding procurement. The Investor’s complaints before this Tribunal do not relate to the unequal nature of Canada’s procurement. UPS does not complain that it was denied an opportunity to bid on the services. Instead, the Investor’s complaints relate to the unequal customs treatment granted to Canada Post over UPS Canada. For example, how could the procurement exception ever be used to justify Canada Customs’

⁷³⁰ *ADF v. United States* at para.161, Investor’s Book of Authorities (Tab 95).

failure to properly assess duties and taxes on postal imports while duties and taxes on competitive imports coming through UPS Canada are carefully assessed? In such a circumstance, the Article 1108(7)(a) procurement exception cannot be used to exempt customs treatment violations, but only to questions surrounding the procurement activity *per se*.

646. The procurement exception in NAFTA Article 1108 can only apply to *bona fide* and lawful procurement taken by the Government of Canada. Canada must come to the Tribunal with clean hands.⁷³¹ If the procurement in issue was colourable or illegal, the exception cannot be applied by Canada.

647. Canada contends that the ----- of the \$8 dollar fee constitutes “procurement”, since it is paid by Canada Customs to compensate Canada Post for the data entry and material handling services rendered by Canada Post to Customs officers under the *Postal Imports Agreement*.⁷³² Yet it is odd that if this payment from Canada Customs is truly for procuring important services from Canada Post, -----

648. -----

⁷³¹ In *US - Shrimp/Turtle*, the Appellate Body observed that because of the principle of good faith a state cannot exercise its rights in an abusive manner. Appellate Body Report, *United States - Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, October 12, 1998 at para. 158, Investor’s Book of Authorities (Tab 46).

⁷³² Affidavit of Brian Jones at para. 178, Canada’s Brief of Affidavits and Expert Reports (Tab 19).

⁷³³ Canada’s Counter-Memorial at paras. 362-365.

649. If the *Postal Imports Agreement* were truly a “procurement” agreement, one would expect the *Agreement* to stipulate that the lower the volumes, the less money would be paid by Customs to Canada Post. This is not, however, what ----- *Postal Imports Agreement* provides.

650. -----

⁷³⁴ Canada’s Counter-Memorial at para. 363.

⁷³⁵ Affidavit of John Cardinal at para. 21.

⁷³⁶ Annex “E”, Appendix “B”, of the *Postal Imports Agreement*, Investor’s Schedule of Documents (Tab U66).

⁷³⁷ Canada’s Counter-Memorial at para. 19.

651. It is clear from Canada's argument repeated by the judge in Canadian Federal Court decision in *Dussault*, that Canada is of the view that the alleged procurement process regarding the *Postal Imports Agreement* was problematic under Canadian law. No doubt this is the case as, if the *Postal Imports Agreement* is a procurement, it failed to comply with the requirements for a procurement under Canada's *Financial Administration Act*.⁷³⁸
652. Canada's *Financial Administration Act* required Canada to publish advertisements about any *bona fide* procurement involved in the Postal Import Agreement in 1992. Under the *Governmental Contracts Regulations* in force at the time, such a contract should have been tendered by:
- a. advertising in one or more newspapers; or
 - b. a suppliers list.

The services detailed under the *Postal Imports Agreement* were not advertised in accordance with Canada's own domestic requirements set out in the *Financial Administration Act*.

653. Indeed, Canada's only evidence regarding public knowledge about the agreement comes from the most obscure places. Canada claims that there was public knowledge due to:
- a. An Answer on the Parliamentary Order Paper, published in Hansard, from the Minister of State to a question raised by an Opposition MP in 1992 as to whether Customs was outsourcing jobs which disclosed that Livingston Canada had obtained a contract from Canada Post;⁷³⁹ and

⁷³⁸ *Financial Administration Act*, Investor's Schedule of Documents (Tab U298).

⁷³⁹ Affidavit of Larry Hahn at para. 48.

- b. An explanatory note contained in an amendment to the *Customs Act* on April 29, 1992.⁷⁴⁰

None of Canada's explanations look like the type of normal lawful behaviour that Canada would take with a ----- procurement.

654. Canada asserts that these various fees were made public many years ago at the time of their introduction.⁷⁴¹ However, the news release issued by Canada Post at that time announces only the \$5.00 fee, -----

-----⁷⁴³ and were even withheld from UPS when Canada released a redacted form of the *Postal Imports Agreement* to UPS in 1999 under Canada's *Access to Information Act*.⁷⁴⁴

655. In 1994, Canada was obligated to advertise any tender of the services called for under the *Postal Imports Agreement* under NAFTA Chapter 10 in addition to its obligations under the *Financial Administration Act*. The relevant NAFTA Annex reads as follows:

⁷⁴⁰ Affidavit of Janice Elliot at para. 32. A copy of this document is set out at Exhibit H to her Affidavit. See Canada's Brief of Affidavits and Expert Reports (Tab 10).

⁷⁴¹ Canada's Statement of Defense at para. 92.

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⁷⁴⁴ Investor's Memorial at para. 276.

Annex 1010.1: Publications

**Section A - Publications for Notices of Procurement in Accordance with Article 1010
(Invitation to Participate)**

Schedule of Canada

1. Government Business Opportunities (GBO)
2. Open Bidding Service, ISM Publishing

656. Counsel for the Investor retained the services on an expert Canadian archive search firm, Public History, to find evidence that the services under the *Postal Imports Agreement* were advertised for tender. They report that in fact no such advertisements ever occurred.⁷⁴⁵ Public History researched tenders archived on the Governments MERX tendering system from 1993 - 2005, as well as the Canada Gazette and other relevant publications such as the Globe and Mail online. They concluded their report by stating:

Based on our research, it would appear that Revenue Canada Agency and Canada Post Corporation may have viewed the *Postal Imports Agreement* as an agreement, rather than as a contract, and therefore, it is possible that no supplier list or advertisement were used to publicly tender the relevant customs support services.

657. Canada's failure to advertise the alleged procurement in 1994 and every year thereafter provides evidence that Canada's procurement from Canada Post was either illegal or more plausibly, simply an inter-departmental agreement between various state organs, which is not within the definition of the international law concept of procurement.

2. The *Postal Imports Agreement* Is Not a Subsidy

658. Canada has alleged that the *Publication Assistance Program* is a "subsidy,"⁷⁴⁶ as are

⁷⁴⁵ Letter from Public History to B. Appleton dated August 4, 2005, Investor's Schedule of Documents (Tab U565).

⁷⁴⁶ Canada's Counter-Memorial, para. 634 and 722.

certain payments under the *Postal Imports Agreement*.⁷⁴⁷ As such, Canada contends that those subjects are exempt from the national treatment obligation by virtue of Article 1108(7)(b).

659. Article 1108(7)(b) is an “exception” to the otherwise applicable NAFTA investment national treatment obligations in NAFTA Article 1102. As an exception to the treaty obligation, Canada has the burden of proof, as the party invoking the exception, to show that its measure falls within the scope of the exception.⁷⁴⁸ Along these lines, the *ADF* tribunal has described NAFTA Article 1108(7) as a “defense.”

660. The NAFTA Chapter 20 tribunal in the *Mexico Trucking Services* case noted that fulfilling the purposes of NAFTA implies reading exceptions narrowly such that they do not undermine the fundamental balance of rights and obligations in the treaty.⁷⁴⁹

661. Canada’s attempt to justify its NAFTA inconsistent measures as a subsidy is entirely inadequate. Canada states that:

If the Tribunal agrees with the claimant that payments under the Agreement are not for the procurement of services, then the payments would still be exempt from national treatment as subsidies.⁷⁵⁰

This proposition is footnoted to NAFTA 1108(7)(b).

⁷⁴⁷ Canada’s Counter-Memorial, para. 570.

⁷⁴⁸ *United States - Import Prohibition of Certain Shrimp and Shrimp Products*, Report of the Appellate Body, WT/DS58/AB/R, October 12, 1998 at para. 34, Investor’s Memorial, Book of Authorities (Tab 46).

⁷⁴⁹ *In the Matter of Cross-Border Trucking Services* at para. 219, Investor’s Memorial, Book of Authorities (Tab 106).

⁷⁵⁰ Canada’s Counter-Memorial at para. 570.

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662. This statement is entirely inadequate to plead a defense under the 1108(7)(b) exception. It is not accompanied by any supporting facts concerning the intention, structure and design of the *Postal Imports Agreement*. Nor does Canada offer any legal interpretation of 1108(7)(b) that would support its application to the *Postal Imports Agreement*. This is a mere assertion rather than a defense.
663. Taken on its merits, Canada's assertion that the *Postal Imports Agreement* is a subsidy is simply not credible. Over the years, Canada Post itself has vigorously rejected the characterization of arrangements such as the *Postal Imports Agreement* as subsidies or as containing a subsidization component. Canada's ability to assert the subsidy defense, has been undermined by official statements made on behalf of Canada and Canada Post over the years, to the effect that Canada Post no longer receives any subsidies or financial support from Canada or Canadian taxpayers. For example:
- a. In a written submission made to the Canada Post Mandate Review in 1996, Canada Post responded to critics who alleged that it was receiving substantial subsidies from the government of Canada, as follows:

In their mischaracterization of CPC's financial position, several of CPC's competitors have asserted that it receives subsidies from the government. In fact, CPC has not received any government subsidies since its 1987/88 fiscal year and has paid dividends to the government in the aggregate amount of \$65.2 million since that time. The payments misleadingly referred to as subsidies are those made, on a fee for service basis, for CPC's performance of services for the government, including the delivery of Parliamentary mail and material to the blind free of postage, the delivery of newspapers and Canadian magazines at rates that are subsidized for their publishers and the provision of commercial freight (primarily food) services for remote northern communities at cost. These payments to CPC are no more subsidies than are payments by the government to third parties for other goods and services.⁷⁵¹

⁷⁵¹ Submission to the Canada Post Mandate Review, 1996, Investor's Schedule of Documents (Tab U567).

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- b. Canada Post has also advised the Mandate Review that it *“has not required, directly or indirectly, any taxpayer support.”*⁷⁵²
- c. In a debate in Canada’s House of Commons about Canada Post, a Member of Parliament for the governing party told that House:

In fact, Canada Post has achieved a considerable turnaround in its operations and finances. It is self-sufficient and since 1988 no longer receives appropriations from Government.⁷⁵³

- d. The President and C.E.O. of Canada Post testified at a House of Commons Committee that:

Since 1988, Canada Post has operated without the assistance of the taxpayer’s money. We have operated on a break even basis, earning a profit from operations before special charges...⁷⁵⁴

- e. Canada’s Minister responsible for Canada Post testified at a House of Commons Committee that: *“For the last 10 years, the Canada Post Corporation has not received any public money and we have to make sure it never again becomes a burden for the Canadian taxpayer.”*⁷⁵⁵
- f. The next year, Canada’s Minister responsible for Canada Post testified again to the same effect, that: *“ For the last 10 years, Canada Post has not received any*

⁷⁵² Submission to the Canada Post Mandate Review, 1996. In a further submission dated February 15, 1996 by Canada Post to the Mandate Review, Canada Post wrote: *“... If Canada Post were to cease to provide key competitive services (e.g. courier, admail), the consequences again would be three unattractive options: a very large increase in the basic letter rate; reverting back to substantial cash support from the government...”*, Investor’s Schedule of Documents (Tab U75).

⁷⁵³ John Harvard, MP, *Hansard* , November 27, 1995, Investor’s Schedule of Documents (Tab U568).

⁷⁵⁴ Georges Clermont, president and CEO of Canada Post, at House of Commons Standing Committee of Government Operations, May 29, 1996 , Investor’s Schedule of Documents (Tab U569).

⁷⁵⁵ Canada’s Minister of Public Works and Government Services, at House of Commons Standing Committee, December 2, 1977, Investor’s Schedule of Documents (Tab U570).

*public money. We have to make sure it never again becomes a burden for the Canadian taxpayer.*⁷⁵⁶

- g. Canada Post's chief media spokesman re-stated a similar refrain, as follows:
*"Canadians today pay for the postal services that they use and nothing more. It's a user pay system. And we haven't had any federal funding since 1988."*⁷⁵⁷

There is simply no question that contemporaneous statements from Canada and Canada Post indicate that during the operative time periods, Canada Post was not receiving subsidies from the Government of Canada.

664. The legal meaning of 1108(7)(b) has not been the subject of interpretation by NAFTA tribunals. The NAFTA does not define "subsidy" in the context of Chapter 11 or otherwise within the Agreement. The definition of "subsidy" is a contentious matter in international economic law and policy, which involves many sensitive political economy considerations⁷⁵⁸. While invoking NAFTA 1108(7)(b) as a defense, Canada has not offered any theory as to its meaning. It is not for the investor to cut from a whole cloth a theory of what is covered by the meaning of NAFTA Article 1108(7) subsidy exception, given that Canada has offered no jurisprudential support for its invocation of the exception and that it has the burden of proof.

665. Should the Tribunal permit Canada to advance such a theory at a later point in these proceedings, the investor is entitled to an adequate opportunity to respond in detail.

⁷⁵⁶ Canada's Minister of Public Works and Government Services, at House of Commons Standing Committee on Natural Resources and Government, February 17, 1998, Investor's Schedule of Documents (Tab U571).

⁷⁵⁷ Transcript of radio interview with John Caines, chief media spokesman for Canada Post, on August 31, 2000, Investor's Schedule of Documents (Tab U170).

⁷⁵⁸ Rambod Behboodi, *Industrial Subsidies and Friction in World Trade*, Investor's Book of Authorities (Tab 162).

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666. In any case, should the Tribunal find that Canada's 1108(7)(b) defense has been pleaded adequately to allow its merits to be adjudicated, the investor believes there is a range of considerations that the Tribunal should take into account in the interpretation of 1108(7)(b).
667. The NAFTA does not elaborate any *disciplines* on subsidies but instead by virtue of Chapter 19 of NAFTA the NAFTA Parties reserve the right to maintain their own countervailing duty laws as *unilateral* responses to subsidies. NAFTA Chapter 19 also requires that any changes to domestic countervailing duty laws be consistent with the GATT Subsidies Code or any "successor agreement." The reference to "successor agreement" reflects the fact that when NAFTA was being concluded a comprehensive *WTO Agreement on Subsidies and Countervailing Measures* ("SCM") was being negotiated; the NAFTA drafters clearly anticipated that Canada and the US would be bound by such an agreement, and their domestic laws would have to reflect it.
668. It is by no means clear that the expression "subsidies and grants" in 1108(7)(b) of NAFTA was intended to cover the same measures as the definition of "subsidy" eventually negotiated in the WTO; however, the lack of a definition in NAFTA itself combined with the awareness of NAFTA's drafters of the WTO negotiations suggests that the WTO definition of "subsidy" must at least be one normative reference point in considering the meaning of "subsidy" under 1108(7)(b). Moreover, the definition of "subsidy" in Canada's own domestic law tracks closely that in the WTO SCM Agreement.⁷⁵⁹

⁷⁵⁹ R.S.C. 1985, c. \S-15, s. 2 – Canada Federal Statutes, *Special Import Measures Act*, Gazette Vol 139:13 (June 29, 2005) at Articles 2(1) and (1.6), Investor's Book of Authorities (Tab 163); *Agreement on Subsidies and Countervailing Measures*, WTO at Article 1, Investor's Book of Authorities (Tab 164).

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669. The definition of “subsidy” in the WTO SCM Agreement requires that there be both a “financial contribution” by government and a “benefit” (competitive advantage)⁷⁶⁰ in order for a measure to qualify as a “subsidy.” The meaning of “financial contribution” is defined in Article 1 of the SCM Agreement.
670. The *Postal Imports Agreement* represents an allocation of public functions and their costs as between agencies of the same government (Canada Customs and Canada Post). There is no government intervention in commercial operations or activities. Such arrangements do not correspond to any of the forms of “financial contribution” listed in the SCM Agreement.
671. Finally, the definition of “subsidy” in the WTO SCM Agreement has as its context the *discipline* of subsidies, either through actionability in WTO dispute settlement or through the unilateral remedy of countervailing duties. Where “subsidy” is being defined for purposes of *exemptions* from free trade disciplines, as in NAFTA 1108(7)(b), a strict or narrow approach is appropriate, in light of the purpose and in order to ensure the exemption is not abused in a discriminatory fashion.
672. Thus, in the *Indonesia-Autos* case, a WTO panel rejected Indonesia’s claim that indirect subsidies must be included in the subsidies *exception* to national treatment in GATT Article III:8 because they were included in the definition in the SCM Agreement. The panel held that the purpose of the national treatment obligation would be undermined if the exemption included subsidies that discriminated between imported and domestic

⁷⁶⁰ *Brazil - Export Financing Programme for Aircraft*, WT/L/160/Rev.1, Panel Report, July 26, 2001, 2001 WL 846553 at paras. 5.24-5.29, Investor’s Book of Authorities (Tab 165); Panel Report, *Canada - Measures Affecting the Export of Civilian Aircraft*, April 14, 1999, WT/DS70/R at Section V (Investor’s Memorial, Book of Authorities, Tab 137); Appellate Body Report, *United States - Countervailing Measures Concerning Certain Products from the European Communities*, AB-2002-5, December 9, 2002, 2002 WL 31761829 at paras. 124-127, Investor’s Book of Authorities (Tab 166).

*products.*⁷⁶¹

673. Accordingly, the Tribunal must additionally ensure that the *exemption* of the measure in question on grounds it is a subsidy is consistent with the purposes of NAFTA and does not unduly limit or undermine the cornerstone obligation of national treatment.

H. No Publications Assistance Program Subsidies or Cultural Measures Are at Issue

674. Canada claims that Canada's choice of Canada Post as the exclusive carrier of publications under the *Publications Assistance Program* is not subject to Canada's Article 1101 obligations because it is a subsidy and a cultural measure. Canada has failed to carry its burden of proving either of these defences.

1. Canada's Measure Does Not Fall Within the Cultural Exemption

675. NAFTA Annex 2106 provides that between the US and Canada, "any measure adopted or maintained with respect to cultural industries" is governed exclusively by the Canada-US Free Trade Agreement and, therefore, is not subject to the obligations in NAFTA Chapter 11. Both NAFTA Article 2107 and Article 2012 of the Canada-US Free Trade Agreement define "cultural industries" in the following way:

Cultural industries means persons engaged in any of the following activities:

(a) the publication, distribution, or sale of books, magazines, periodicals or newspapers in print or machine readable form but not including the sole activity of printing or typesetting any of the foregoing;

⁷⁶¹ *Indonesia-Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, Panel Report, July 2, 1998 at para. 14.45, Investor's Book of Authorities (Tab 57).

Canada concedes that the purpose of this cultural exemption is to “realize ... cultural objectives.”⁷⁶²

676. Canada proposes three arguments why the cultural exemption applies to its measure designating Canada Post as the exclusive carrier under its *Publications Assistance Program*. All are without foundation.
677. First, Canada seeks to cast the whole *Publications Assistance Program* as the measure and says “[t]here is no question that the program *as a whole* is a measure ‘with respect to cultural industries’.”⁷⁶³ With respect, it is for the Investor to identify the measure it impugns in this claim. It is Canada’s designation of Canada Post as the exclusive delivery service for publishers benefitting from the *Publications Assistance Program* that is the measure at issue.
678. Canada’s second argument is reflected in the following passage:

How Canada chooses to design or implement its measures with respect to cultural industries in order to realize its cultural objectives is exactly what was meant to be protected from review by the cultural exemption.⁷⁶⁴

Canada argues that it subjectively and exclusively decides what is “with respect to cultural industries” under NAFTA Annex 2106. Under this argument, the extent to which the measure actually realizes the cultural objective is irrelevant if Canada says it realizes that objective.

⁷⁶² Canada’s Counter-Memorial at para. 720.

⁷⁶³ Canada’s Counter-Memorial at para. 720.

⁷⁶⁴ Canada’s Counter-Memorial at para. 720.

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679. Canada argument is contrary to NAFTA's text, objectives and decisions under the Agreement.
680. NAFTA Annex 2106 does not say "any measure *the Parties say* is adopted or maintained with respect to cultural industries," as Canada seems to suggest. The words "with respect to" require Canada to establish that there is an objective connection to the cultural industry.
681. Canada's interpretation is also inconsistent with the careful balance the NAFTA struck between its trade liberalizing objectives and protection of party sovereignty. Allowing a Party to unilaterally remove any measure from scrutiny under the NAFTA simply because it says it is "with respect to" a cultural industry destroys this balance. The NAFTA *US-Cross Border Trucking* tribunal recognized the need to preserve the careful balance created by the Agreement when it stressed the need to interpret exemptions narrowly.⁷⁶⁵ Canada's interpretation is directly inconsistent with this decision.
682. Canada also proposes an argument in the alternative. Canada essentially accepts that "with respect to cultural industries" requires that the measure it seeks to exempt actually helps realize the cultural objectives.⁷⁶⁶ It is for this reason that Canada attempts to explain how designating Canada Post as the exclusive delivery service provider under the *Publications Assistance Program* helps to realize the program's cultural objectives.
683. Canada's alternative argument is equally baseless. In Chapter VIII of Part Two of this Reply, the Investor explains that the reasons Canada proffers for designating Canada Post

⁷⁶⁵ See *In the Matter of Cross-Border Trucking Services* at para. 260 and footnote 234, Investor's Book of Authorities (Tab 106).

⁷⁶⁶ Canada's Counter-Memorial at para. 719: "Furthermore, the program's provision of distribution assistance through Canada Post is in line with the objectives of the program" and at para. 713: "Canada Post's involvement in the *Publications Assistance Program* achieves the program's goals"

as the exclusive service provider under the *Publications Assistance Program* do not help realize the program's cultural objectives in any way.

684. Through the failure of these three arguments, Canada has failed to carry its burden that its designation of Canada Post as the exclusive delivery service provider under the *Publications Assistance Program* falls within the cultural exemption.

2. Canada's Measure Is Not Excluded As a Subsidy

685. Canada breached Article 1102 through the measure of designating Canada Post as the exclusive carrier under the *Publications Assistance Program*. The measure is not a subsidy. Canada's argument that the measure is exempt as a subsidy relies on Canada's subsidization of delivery of publications under the program. This subsidization is not at issue. It is the designation of Canada Post as the exclusive delivery service provider.
686. In its Memorial, the Investor explained how 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.⁷⁶⁷ In *US-FSC*, the Appellate Body accepted that tax relief could be a subsidy,⁷⁶⁸ 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.⁷⁶⁹

⁷⁶⁷ Investor's Memorial at para. 602.

⁷⁶⁸ *United States - Tax Treatment for 'Foreign Sales Corporations,'* ("FSC") Article 21.5 claim, WT/DS108/AB/RW, 14 January 2002 at paras. 190, 194, Investor's Book of Authorities (Tab 136).

⁷⁶⁹ *US - FSC*, Investor's Book of Authorities (Tab 136) at paras. 218 - 222.

687. Canada's attempts to distinguish this authority are misplaced. The different wording between NAFTA Article 1102 and GATT Article III:8 do not affect the principle behind the Appellate Body's decision. The legal principle is that measures that are expressed as conditions on the receipt of some advantage or benefit from the government are to be regarded as regulatory measures that must comply with the national treatment obligation. This remains true regardless of whether the actual advantage or benefit qualifies as a subsidy. The subsidy is not the measure, merely the causal link that encourages discriminatory purchasing by publishers.

VII. CANADA BREACHED ITS OBLIGATIONS UNDER ARTICLES 1503(2)(a) AND 1502(3)

A. Canada Post Acted Inconsistently with Canada's NAFTA Obligations

688. 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 failure to perform customs duties and collect duties and taxes; and
- c. Canada Post's unfair denial of Fritz Starber's bid.

The manner in which these acts breach NAFTA Chapter 11 obligations is fully described in Chapters VI and VIII, respectively, of Part Three of this Reply.

B. Canada Post Acted Under Delegated Authority

689. Canada delegated to Canada Post control over the right and terms of access to the Monopoly Infrastructure through the *Canada Post Corporation Act* and accompanying regulations.⁷⁷⁰ Canada delegated authority to Canada Post to perform its own customs duties and to retain fees paid by mail addressees through the *Customs Act* and the *Postal*

⁷⁷⁰ As explained in detail at paras. 733 - 734 of Investor's Memorial, Canada generally delegated control over the right and terms of access to the Monopoly Infrastructure through Article 14(1) of the *Canada Post Corporation Act*, which gives Canada Post the "sole and exclusive privilege of collecting, transmitting and delivering letters to the addressee thereof within Canada," and Article 19, which gives Canada Post the authority to make regulations for "carrying the purposes and provisions of this Act [including Article 14(1)] into effect." Articles 2 and 57 of the *Canada Post Corporation Act*, the *Mail Receptacles Regulations* and the *Postal Meter Regulations* delegate control over the right and terms of access to specific aspects of the Monopoly Infrastructure, Investor's Schedule of Documents (Tab U218).

*Imports Agreement.*⁷⁷¹ -----

690. The Investor described in its Memorial that there is no requirement that delegation under Articles 1502(3)(a) and 1503(2) be specific or formal. The articles do not prefix the word “delegated” with “formally,” “specifically” or any other kind of adverb. NAFTA Note 44 confirms this ordinary meaning by explaining that the authority can be delegated by a broad range of government acts.⁷⁷²

691. Commentary to Article 5 of the *ILC Articles*, which Canada recognizes as similar to Articles 1502(3)(a) and 1503(2),⁷⁷³ further confirms the ordinary meaning by expressly saying that delegation does not need to be specific.⁷⁷⁴ Principles of state responsibility also confirm the ordinary meaning. It is inconsistent with the purposes of attributing responsibility to states for the actions of agents if the state can escape responsibility simply by delegating responsibility in an informal and vague manner.

692. In light of this authority, Canada’s bald assertion that delegation must be formal and specific must be rejected.⁷⁷⁵

⁷⁷¹ As explained at para. 735 of Investor’s Memorial, 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*, under which Canada Post is delegated authority to perform its own customs duties and to retain fees paid by mail addressees.

⁷⁷² 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.”

⁷⁷³ Canada’s Counter-Memorial at para. 808.

⁷⁷⁴ 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”: Crawford at 102 (Investor’s Book of Authorities at Tab 3). See also the *WTO Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products* Panel decision, Canada’s Book of Authorities (Tab 41). The Panel found that a state board was exercising delegated governmental authority and said “[n]or is our conclusion altered by the fact that the authority thus delegated to the boards offers the boards a certain discretion.”

⁷⁷⁵ Canada’s Counter-Memorial at para. 818.

C. That Delegated Authority Is Governmental

1. Canada Post Always Acts Under Governmental Authority

693. In its Memorial, the Investor drew from the six sources identified in the Commentary to the *ILC Articles* as indicating an act is governmental to demonstrate that Canada Post always acts under governmental authority.⁷⁷⁶ Those six sources are:

- a. Canada's history;
- b. Canada's traditions;
- c. the content of the authority;
- d. the way the authority is conferred on Canada Post;
- e. the purposes for which the authority is conferred on Canada Post; and
- f. the extent to which Canada Post is accountable to Canada for their exercise.

694. None of Canada Post's acts are sufficiently commercial to lose their governmental nature. The example to which Canada cites perfectly illustrates Canada Post's pervasive governmental authority. Canada refers to an example in the Commentary to Article 5 of the *ILC Articles* used to illustrate the distinction between governmental actions that will

⁷⁷⁶ Investor's Memorial at para. 743.

create state responsibility and commercial actions that will not.⁷⁷⁷ The Commentary says “the conduct of a railway company to which certain police powers have been granted will be regarded as an act of state under international law if it concerns the exercise of those powers, but not if it concerns other activities (e.g. the sale of tickets or the purchase of rolling-stock).”⁷⁷⁸

695. In the example, the railway company is granted specific state powers to undertake specific state functions. For example, the company can use the police powers to undertake governmental actions such as fining fare dodgers or arresting miscreants. Selling tickets and purchasing rolling-stock are not in the pursuit of the specific functions for which the railway company was given state powers and, therefore, are not governmental.
696. Contrast the specific governmental authority of this train company with the broad governmental authority of Canada Post. Canada Post has the authority of the old Post Office Department. Its enabling legislation says it is part of the government. Ministers confirm it is part of the government. It is owned by the government, controlled by a board appointed by the government and answers to the government. By Canada’s own admission, its purpose is the fulfillment of the USO and other public functions.
697. Even Canada Post’s more commercial decisions are directed by the government-appointed board, can be controlled by the Minister and are in pursuit of its public purposes. It is for this reason that both Canadian and international tribunals have held that these more commercial decisions are still government actions, attributable to Canada.

⁷⁷⁷ Canada’s Counter-Memorial at para. 813.

⁷⁷⁸ Crawford at page 101, Investor’s Book of Authorities (Tab 3). Cited in Canada’s Counter-Memorial at para. 813.

**2. It Is Irrelevant If Canada Post Has the Authority to Control the
Activities of Others**

698. In its Memorial, the Investor explained that the authority under which Canada Post operates in these three actions is governmental even though it may not give it the authority to control the activities of others.⁷⁷⁹ The Articles do not prefix “governmental” with any words indicating such a limitation. Indeed, such a limitation is inconsistent with the customary international law of state responsibility because it enables a state to avoid responsibility by delegating its state actions that do not control the actions of others. Such a limitation would allow Canada to avoid responsibility under international law for failing to differentiate its postal monopoly operations from its non monopoly operations - the very action harming UPS in breach of international law.

699. Other NAFTA provisions imply that Canada is responsible for its state enterprises’ actions that do not control the activities of others such as procuring, subsidizing and giving grants.⁷⁸⁰ It is nonsense to suggest Canada would be liable for state enterprises’ procurements, subsidies and grants under Chapter 11 but not for failure to prevent those actions under Articles 1502(3)(a) and 1503(2).

⁷⁷⁹ Investor’s Memorial at paras. 750-755.

⁷⁸⁰ 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. 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 ...

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700. Without addressing any of these points, Canada argues that the authority under which Canada Post operates in the three actions relevant to the Chapter 15 claim are not governmental because, Canada argues, they do not give it the authority to control the activities of others. Canada relies on unhelpful interpretative principles, two selective dictionary quotes and a selective citation of WTO jurisprudence.
701. Canada's reliance on the interpretative principles *expressio unius et exclusio alterius*, *noscitur a sociis* and *eiusdem generis* is misplaced.⁷⁸¹ Lord McNair recognized that, through the use of such principles, "a danger exists that a tribunal may be diverted from its true task of ascertaining what the parties meant by the words they used." Lord McNair said he is "amongst those who are sceptical as to the value of these so-called rules and are sympathetic to the process of their gradual devaluation, of which indications exist. The many maxims and phrases which have crystallized out and abound in the text-books and elsewhere are merely prima facie guides to the intention of the parties and must always give way to the contrary evidence of the intention of the parties in a particular case."⁷⁸²
702. Canada draws from *The New Shorter Oxford English Dictionary* to argue "'Authority' refers to power given over someone or something in a manner that affects their rights."⁷⁸³ The dictionary from which Canada quotes gives several definitions of "authority." In addition to the definition used by Canada, the dictionary also gives an alternative definition of 'authority' as "derived or delegated power." It is clear that, by referring to delegated authority, the NAFTA treaty drafters were referring to this meaning of authority. Under this meaning, authority simply means power to do something and does not entail affecting other's rights.

⁷⁸¹ Canada's Counter-Memorial at 820.

⁷⁸² Lord McNair, *Law of Treaties* (Oxford, 1961) at 365-6, *Investor's Book of Authorities* (Tab 167).

⁷⁸³ Canada's Counter-Memorial at para. 811, *Canada's Book of Authorities* (Tab 84).

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703. Canada's reliance on this narrow definition of "authority" is further undermined by the French version of NAFTA, which renders "authority" merely as "pouvoir" or "power". The drafters of NAFTA chose not to use the narrower French word "autorité" which corresponds more closely to Canada's interpretation as the right to command others.
704. Canada also erroneously seeks to draw support for its interpretation from the word "governmental." Canada relies on *Black's Law Dictionary* to argue "Governmental authority is the authority vested in the state to govern the conduct of others."⁷⁸⁴
705. Once again, Canada's quote is selective. In addition to defining governmental in the manner quoted by Canada, the same dictionary defines governmental as "[t]he machinery by which the sovereign power in a state expresses its will and exercises its functions." "Governmental authority" in Articles 1502(3)(a) and 1503(2) simply refers to the authority to exercise the functions of the sovereign power. The sovereign power exercises several functions. Some of those functions exercise control over others. Some, like procurement, subsidizing and giving grants, do not.
706. Canada's reliance on WTO jurisprudence is equally selective and equally misleading. Canada quotes a passage from the Appellate Body's decision in *Canada - Dairy*⁷⁸⁵ but fails to mention the Appellate Body later clarified those comments to mean the precise opposite to the meaning Canada seeks to ascribe to them.
707. In the *Canada - Dairy* decisions, the Appellate Body had to determine the meaning of the phrase, "financed by virtue of governmental action," in Article 9.1(c) of the WTO *Agreement on Agriculture*. In the decision to which Canada refers, the Appellate Body

⁷⁸⁴ Canada's Counter-Memorial at para. 811, Canada's Book of Authorities (Tab 82).

⁷⁸⁵ Canada's Counter-Memorial at para. 816, Canada's Book of Authorities (Tab 41).

said that “governmental action” *includes* action exercising control over others. In a later decision, the Appellate Body clarified that “governmental action” does not, necessarily, require that the action exercises control over others. The Appellate Body said:

As regards “governmental action,” we held in the first Article 21.5 proceedings that “the text of Article 9.1(c) does not place any qualifications on the types of ‘governmental action’ which may be relevant under Article 9.1(c).” Instead, the provision gives but one example of governmental action that is “included” in Article 9.1(c) - however, this example is merely illustrative. Accordingly, we stated that Article 9.1(c) “embraces the full-range” of activities by which governments “‘regulate,’ ‘control’ or ‘supervise’ individuals.” In particular, we said that governmental action “regulating the supply and price of milk in the domestic market” might be relevant “action” under Article 9.1(c). ...

We observe that Article 9.1(c) does not require that payments be financed by virtue of government “mandate”, or other “direction”. Although the word “action” certainly covers situations where government mandates or directs that payments be made, it also covers other situations where no such compulsion is involved.⁷⁸⁶

708. Combined with Canada’s selective quotation of dictionaries and failure to address the points raised by the Investor in the Memorial, Canada’s selective quotation of the *Canada - Dairy* decisions demonstrates that its interpretation of governmental has no foundation. It is irrelevant if Canada Post has the authority to control the activities of others.
709. In any event, even applying Canada’s unfounded definition, Canada Post is exercising control over the activities of others. Its monopoly grants Canada Post control over a valuable resource that no private firm can replicate. Canada Post’s decisions regarding who has access to this network and on what terms are just as much an exercise of governmental authority as the granting of licenses or the approval of commercial transactions.

⁷⁸⁶ *Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, Second Recourse to Article 21.5 of the DSU by New Zealand and the United States, Report of the Appellate Body, 20 December 2002 at paras. 127 - 128 [footnotes omitted, emphasis added], Investor’s Book of Authorities (Tab 168).

D. Canada Delegated That Authority in Connection with the Monopoly Good or Service

710. This element is necessary for a breach of Article 1502(3)(a) but not 1503(2). The Investor set out arguments about this element in its Memorial and that explanation remains unchallenged.⁷⁸⁷

E. Canada Failed to Ensure, Through Regulatory Control, Administrative Supervision or the Application of Other Measures, that Canada Post Acted Inconsistently with Canada's NAFTA Chapter 11 Obligations

711. Canada concedes that this final element is satisfied through the satisfaction of the previous elements of Articles 1502(3)(a) and 1503(2). Canada accepts that, through the Articles, "NAFTA Parties shall make certain that the state enterprise and monopoly respect the obligations that are imposed upon them."⁷⁸⁸ Canada breaches Articles 1502(3)(a) and 1503(2) through the satisfaction of the previous elements of those Articles.

712. Canada overlooks that the final element also imposes a positive obligation on the NAFTA Parties to act to prevent their state-designated monopolies and state enterprises acting inconsistently with the specific NAFTA obligations. If the NAFTA drafters had not intended to impose a positive obligation, then they would simply have said that the NAFTA Parties are responsible for the actions of their state-designated monopolies and state enterprises that are inconsistent with the specified NAFTA obligations. The inclusion of the word "ensure" and the reference to specific measures must mean

⁷⁸⁷ Investor's Memorial at 242-257.

⁷⁸⁸ Canada's Counter-Memorial at para. 844.

something. It can only mean that the NAFTA Parties not only breach Articles 1502(3)(a) and 1503(2) through their state-designated monopolies' and state enterprises' conduct but also through the Parties' failure to take positive steps to prevent that conduct.

713. Canada also breached Articles 1502(3)(a) and 1503(2) through its failure to ensure, through regulatory control, administrative supervision or the application of other measures, that Canada Post acted inconsistently with Canada's NAFTA Chapter 11 obligations. As explained in detail in Chapter VI of Part Two of this Reply, far from ensuring Canada Post did not act inconsistently with Canada's NAFTA Chapter 11 obligations, Canada failed to provide any regulatory control, administrative supervision or other measures to Canada Post. Canada's actions are inconsistent with both international practice and the numerous independent recommendations it implement some regulatory control. Through Canada's failure to respond to international practice and the recommendations, Canada has endorsed Canada Post's actions in an egregious breach of Articles 1502(3)(a) and 1503(2).

VIII. CANADA FAILED TO PROVIDE INTERNATIONAL LAW STANDARDS OF TREATMENT

A. Summary

714. Canada failed to act in a manner consistent with the international law standard of treatment obligations in NAFTA Article 1105 through:
- a. refusing Fritz Starber's bid to provide airfreight in retaliation at this NAFTA claim;
 - b. its prejudicial treatment of UPS Canada in regard to customs; and
 - c. unfairly enabling Canada Post to reduce its costs through denying Canada Post's employees core labour standards.
715. In its Memorial, the Investor explained how each of Canada's actions breaches the customary international law standard of treatment, as that standard has been described by numerous other international tribunals.⁷⁸⁹ The Investor also explained how Canada's actions are also inconsistent with other sources of international law, that Canada is obliged to provide to the Investor under NAFTA Article 1105.
716. Canada spends much of its Counter-Memorial incorrectly confining its responsibility under Article NAFTA 1105. Regardless of the precise content of NAFTA Article 1105, neither party disputes that NAFTA Article 1105 requires, at the least, that Canada must provide the customary international law standard of protection. By failing to provide that

⁷⁸⁹ Investor's Memorial at Part Three, Chapter VI.

level of protection, Canada has failed to act in conformity with its obligations under NAFTA Article 1105.

B. The Investor Receives the Protection of Customary International Law

717. There is no dispute that the NAFTA Article 1105 standard includes, at a minimum, a requirement that Canada follow customary international law governing the treatment of aliens. There is also no dispute that customary international law is state practice performed through an understanding the practice is required by law (“*opinio juris*”).⁷⁹⁰

718. By their acceptance to be bound, at the minimum, by customary international law in NAFTA Article 1105, the NAFTA Parties signaled their acceptance that the accepted content of customary international law displayed the two elements of practice and *opinio juris*. The accepted content of customary international law can be extracted from the international tribunal awards that have identified and applied customary international law.

719. In supporting this approach, the *Mondev* tribunal said:

... 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?⁷⁹¹

720. The *Mondev* tribunal went on to say 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 foreigners.”⁷⁹² The tribunal then drew the content

⁷⁹⁰ Canada’s Counter-Memorial at para. 909.

⁷⁹¹ *Mondev*, Award at para. 113, Investor’s Book of Authorities (Tab 37).

⁷⁹² *Mondev*, Award at para. 120, Investor’s Book of Authorities (Tab 37).

of customary international law from international decisions, including the NAFTA *Azinian* decision.⁷⁹³ The subsequent *ADF* NAFTA tribunal specifically endorsed the *Mondev* tribunal's conclusion that the content of customary international law can be sourced through international tribunal decisions and that it is not necessary to specifically prove the elements of practice and *opinio juris*.⁷⁹⁴

721. In its Memorial, the Investor referred to these passages from the *Mondev* and *ADF* decisions. Canada simply ignored them when it argued in its Counter-Memorial that for every alleged rule of customary international law the Investor must specifically demonstrate the precise existence of the two elements of practice and *opinio juris*.⁷⁹⁵ Canada is incorrect. International tribunal decisions are a legitimate source of the content of customary international law.

1. The Content of the Customary International Law Standard

a. Good Faith

722. In its Memorial, the Investor identified the *S.D. Myers* NAFTA decision and *Tecmed* BIT decision as recognizing that the duty to act in good faith is an independent obligation within the customary international law minimum standard. The *S.D. Myers* tribunal said “Article 1105 imports into the NAFTA the international law requirements of due process,

⁷⁹³ *Mondev*, Award at para. 126 - 127, Investor's Book of Authorities (Tab 37).

⁷⁹⁴ *ADF Group Inc. v. United States of America*, Investor's Book of Authorities (Tab 95) at para. 184: “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.”

⁷⁹⁵ Canada's Counter-Memorial at para. 909.

economic rights, *obligations of good faith* and natural justice.”⁷⁹⁶ Similarly, 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.”⁷⁹⁷

723. Canada simply ignores these decisions when it incorrectly argues good faith is not an independent obligation. Canada also overlooks the NAFTA decisions that have held that an investor need not show the host state’s conduct rises to the level of bad faith to breach Article 1105;⁷⁹⁸ if the investor need not go so far as to show an absence of good faith for the host state to breach Article 1105, then such conduct certainly amounts to a breach.

724. Furthermore, nothing in the *Border and Transborder Armed Actions (Nicaragua v. Honduras)*⁷⁹⁹ or *Land and Maritime Boundary (Cameroon v. Nigeria)*⁸⁰⁰ cases, cited by Canada, supports its claim. In both cases, the International Court of Justice merely said that good faith “is not in itself a source of obligation where none would otherwise exist.”⁸⁰¹ The source of the obligation does exist in this circumstance - the source is the customary international law standard of treatment, which Canada has accepted it is bound by.

⁷⁹⁶ *S.D. Myers Inc. v. Government of Canada*, Partial Award, November 13, 2000, 40 ILM 1408 (2001) at para. 134, Investor’s Book of Authorities (Tab 4) [emphasis added].

⁷⁹⁷ *Tecmed v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003 at para. 153, Investor’s Book of Authorities (Tab 24).

⁷⁹⁸ *Mondev International Ltd*, Award at 116, Investor’s Book of Authorities (Tab 37): “... a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.”

⁷⁹⁹ [1988] ICJ Rep. 69, 105, para. 94 (Decision on Jurisdiction of Dec. 20), cited in Canada’s Counter-Memorial at para. 922, Canada’s Book of Authorities (Tab 42).

⁸⁰⁰ *Case Concerning the Land and Maritime Boundary Between Cameroon and Nigeria (Cameroon v. Nigeria)*, Preliminary Objections, 1998 ICJ 275 at 297, Canada’s Book of Authorities (Tab 46), cited in Canada’s Counter-Memorial at para. 923.

⁸⁰¹ *Border and Transborder Armed Actions (Nicar. V. Hond.)* case, 1988 ICJ Rep. 69, 105, para. 94 (Decision on Jurisdiction of Dec. 20), Canada’s Book of Authorities (Tab 42).

725. A state's obligation to act in good faith is also manifested in a number of specific ways, including the state's obligation:
- a. to protect the investor's legitimate expectations;
 - b. to not act in an arbitrary or discriminatory way;
 - c. to fulfill its commitments; and
 - d. not to abuse its rights.

Contrary to Canada's claim, these are all independent obligations and their expression as part of the customary international law standard by numerous international tribunals demonstrates that Canada has accepted to be bound by them.

b. Legitimate Expectations

726. Numerous tribunals interpreting modern investment treaties have affirmed that a State fails to provide the customary international law standard of treatment when it fails to fulfill the objective legitimate expectations of all investors. These tribunals include *Tecmed v. Mexico*,⁸⁰² the NAFTA Chapter 11 tribunal in *Metalclad v. Mexico*,⁸⁰³ as well

⁸⁰² *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003, 2003 WL 24038436; 43 *I.L.M.* 133 (2004) at para. 154, Investor's Book of Authorities (Tab 24).

⁸⁰³ *Metalclad Corporation and The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, August 30, 2000, 2000 WL 34514285; 40 *I.L.M.* 36 (2001); 16 *ICSID Review – F.I.L.J.* 168 (2001); 119 *I.L.R.* 618 (2002); 5 *ICSID Rep.* 212 (2002) at para. 99, Investor's Book of Authorities (Tab 86).

as other Investor-State tribunals in the *MTD v. Chile*,⁸⁰⁴ *Occidental v. Ecuador*⁸⁰⁵ and *CMS v. Argentina*⁸⁰⁶ cases.

727. These decisions demonstrate the unfounded nature of Canada's claim that the obligation to protect legitimate expectations is only an obligation to protect legitimate expectations arising out of another international obligation⁸⁰⁷. The WTO Appellate Body decision in *European Communities - Customs Classification of Certain Computer Equipment*, to which Canada refers, does not disrupt this conclusion.⁸⁰⁸ That tribunal addressed the distinct question of whether a party's subjective expectations can imply words into a specifically worded provision.⁸⁰⁹ By contrast, modern investment treaty tribunals have simply used objective legitimate expectations to add content to the abstract customary international law standard of treatment.

728. Tribunals applying the customary international law obligation to protect legitimate expectations have also explained what an objective investor legitimately expects from the host state. For example, the *Tecmed* tribunal explained that an investor can legitimately

⁸⁰⁴ *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile*, ICSID Case No. ARB/01/7, Award, May 25, 2004, 2004 WL 3254661 at paras. 114-115, 188, Investor's Book of Authorities (Tab 20).

⁸⁰⁵ *Occidental Exploration and Production Company v. The Republic of Ecuador*, Final Award, July 1, 2004, 2004 WL 3267260 at para. 184, Investor's Book of Authorities (Tab 94).

⁸⁰⁶ *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, May 12, 2005, 2005 WL 1201002 at paras. 278-281, Book of Authorities (Tab 169).

⁸⁰⁷ Canada's Counter-Memorial at para. 945.

⁸⁰⁸ *European Communities - Customs Classification of Certain Computer Equipment*, Report of the Appellate Body, adopted 22 June 1998, Canada's Book of Authorities (Tab 49), referred to in Canada's Counter-Memorial at para. 943.

⁸⁰⁹ The Appellate Body said at para. 82: "... we disagree with the Panel that the maintenance of the security and predictability of tariff concessions allows the interpretation of a concession in the light of the 'legitimate expectations' of exporting Members, i.e., their *subjective* views as to what the agreement reached during tariff negotiations was." The Appellate Body went on at para. 83 to approvingly quote part of an earlier decision in which it dismissed the application of legitimate expectations to "impute [...] into a treaty ... words that are not there ..."

expect the host State to act consistently, free from ambiguity and transparently under customary international law.⁸¹⁰

729. The investor legitimately expects that the host state will enforce its own law in good faith. Contrary to Canada's suggestion, this obligation is distinct from the accepted legal principle that breach of domestic law does not, automatically, give rise to a breach of international law.⁸¹¹ An investor arguing the host state has failed to follow their own law in good faith does not need to show an "outright and unjustified repudiation" of domestic law, as Canada claims.⁸¹² Canada overlooks the following sentence of the *GAMI* decision, from which it takes this phrase, which says "[t]here may be situations where even lesser failures would suffice to trigger Article 1105."⁸¹³

c. Arbitrary and Discriminatory Conduct

730. Both the *Waste Management II* and *GAMI* tribunals recognized the NAFTA Parties' independent obligation under NAFTA Article 1105 to not act in an arbitrary or discriminatory manner. The *GAMI* tribunal quoted the following passage from *Waste Management II*:

Taken together, the *S.D. Myers*, *Mondev*, *ADF* and *Loewen* cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is *arbitrary*, grossly unfair, unjust or idiosyncratic, is *discriminatory* and exposes the claimant to sectional or racial prejudice...⁸¹⁴

⁸¹⁰ *Técnicas Medioambientales Tecmed, S.A.*, Award at para. 154, Investor's Book of Authorities (Tab 24).

⁸¹¹ Canada's Counter-Memorial at para. 944.

⁸¹² Referred to in Canada's Counter-Memorial at para. 969.

⁸¹³ *GAMI* at para. 103, Investor's Book of Authorities (Tab 100).

⁸¹⁴ *Waste Management II* at para. 98, quoted in *GAMI* at para. 89, Canada's Book of Authorities (Tab 71) [emphasis added].

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731. This comprehensive support among NAFTA tribunals for the state's independent obligation not to act arbitrarily or discriminate against investors from other NAFTA parties demonstrates that Canada's claim that it is merely an "overarching principle to be applied to the interpretation and application of a specific rule"⁸¹⁵ is unfounded. Canada's single reference to the distinct law governing state to state relations⁸¹⁶ does not disrupt this conclusion. Neither does Canada's misrepresentation of the *Lauder* decision. Canada quotes from the *Lauder* tribunal as saying that "none of the actions and inactions [...] which have already been examined with respect to the prohibition against arbitrary and discriminatory measures [...] constitutes a violation of the duty to provide fair and equitable treatment [or] to provide full protection and security".⁸¹⁷
732. Canada mistakenly draws from this passage to conclude that, "[a]ccording to the Award, a breach of arbitrary and discriminatory treatment did not amount to a breach of the minimum standard of treatment."⁸¹⁸ The tribunal said no such thing. The tribunal evidently merely believed that the entire customary minimum standard of treatment is not captured in the concepts of fair and equitable treatment and full protection and security. This is obviously the case in NAFTA Article 1105, which refers to "international law, *including* fair and equitable treatment and full protection and security (emphasis added)." The *Lauder* decision, therefore, does not alter the conclusion that a state breaches its customary international law obligations through arbitrary conduct. A state, therefore,

⁸¹⁵ Canada's Counter-Memorial at paras. 924, 925 and 928.

⁸¹⁶ Sir Robert Jennings and Sir Arthur Watts Oppenheim's *International Law*, 9th ed., vol. I, Introduction and Part I (Great Britain: The Bath Press, 1992) at 376-77, Canada's Book of Authorities (Tab 94), referred to in Canada's Counter-Memorial at para. 932.

⁸¹⁷ *Lauder v. Czech Republic*, Final Award, 3 September 2001, 2001 WL 34786000 at paras. 293 and 309, Investor's Book of Authorities (Tab 43).

⁸¹⁸ Canada's Counter-Memorial at para. 938.

breaches its customary international law obligation when it acts on “prejudice or preference rather than on reason or fact”, as the *Lauder* tribunal defined arbitrary conduct.⁸¹⁹

733. Previous NAFTA tribunals evidently also disagree with Canada’s argument that an independent obligation not to discriminate renders NAFTA’s national treatment obligation inutile.⁸²⁰ There are myriad differences between the obligations, not least of which is that national treatment compares the treatment of the foreign investor with treatment of locals, whereas a state can breach its obligation not to discriminate by discriminating among foreign investors.
734. Both the *Metalclad* and *Pope & Talbot* decisions also recognized the NAFTA Parties’ independent obligation under Article 1105 to not act in an arbitrary or discriminatory manner. The *Metalclad* tribunal considered a claim that Mexico breached its Article 1105 obligations through the actions of one of its municipalities. That municipality was legally only allowed to consider construction issues when granting or denying building permits to foreign investors. The municipality exceeded that authority when it refused the investor’s permit on environmental grounds.⁸²¹
735. In finding that this conduct amounted to a breach of Article 1105, the tribunal said:

⁸¹⁹ *Lauder* , Final Award, at para. 232, Investor’s Book of Authorities (Tab 43).

⁸²⁰ Canada’s Counter-Memorial at para. 931.

⁸²¹ The *Metalclad* tribunal said at para. 86, Investor’s Book of Authorities (Tab 86): “Even if Mexico is correct that a municipal construction permit was required, the evidence also shows that, as to hazardous waste evaluations and assessments, the federal authority’s jurisdiction was controlling and the authority of the municipality only extended to appropriate construction considerations. Consequently, the denial of the permit by the Municipality by reference to environmental impact considerations in the case of what was basically a hazardous waste disposal landfill, was improper, as was the municipality’s denial of the permit for any reason other than those related to the physical construction or defects in the site.”

None of the reasons [for refusing the permit] included a reference to any problems associated with the physical construction of the landfill or to any physical defects therein. The Tribunal therefore finds that the construction permit was denied without any consideration of, or specific reference to, construction aspects or flaws of the physical facility.⁸²²

736. The tribunal went on to conclude that “Metalclad was not treated fairly or equitably under the NAFTA and succeeds on its claim under Article 1105.”⁸²³ The tribunal, therefore, found a breach of Article 1105 because Mexico acted on the basis of irrelevant considerations. Simply because the tribunal did not use those exact terms does not mean, as Canada seems to suggest, that it does not stand for that proposition.⁸²⁴ Furthermore, if Canada is right and a state only breaches Article 1105 through a breach of customary international law, then the tribunal’s conclusion that Mexico’s actions breached that Article must mean that Mexico’s actions also breached customary international law. Canada’s objection to this conclusion, simply because the tribunal did not mention the word “custom,”⁸²⁵ is simply obstructionist.
737. Canada’s objections to the Investor’s interpretation of the *Pope & Talbot* decision are equally obstructionist. In *Pope & Talbot*, the tribunal found Canada breached Article 1105 through threatening the investor, denying its “reasonable requests for pertinent information” and requiring the investor “to incur unnecessary expense and disruption in meeting SLD’s request for information.” The Investor drew from this to reach the unremarkable conclusion that the tribunal found Canada breached Article 1105 by acting on “prejudice rather than on reason or fact.”⁸²⁶ Yet, once again, Canada objects that the

⁸²² *Metalclad* at para. 92 - 93 [emphasis added], Investor’s Book of Authorities (Tab 86).

⁸²³ *Metalclad* at para. 101, Investor’s Book of Authorities (Tab 86).

⁸²⁴ Canada’s Counter-Memorial at para. 935.

⁸²⁵ Canada’s Counter-Memorial at para. 935.

⁸²⁶ Canada’s Counter-Memorial at para. 935.

decision “makes no mention of these terms or how they amount to custom.”⁸²⁷ Canada fails to propose an alternate interpretation of the tribunal’s decision because it is impossible to interpret the decision in any other way.

d. Pacta Sunt Servanda

738. *Pacta sunt servanda* requires a state to observe its obligations, including those in international treaties. It can operate as a stand alone obligation and is not merely an “overarching principle to be applied to the interpretation and application of a specific rule” as Canada claims.⁸²⁸ It is simply another expression of the customary international law obligation of good faith contained within NAFTA Article 1105.

e. Protection Against Abuse of Rights

739. In its Memorial, the Investor described Canada’s customary international law obligation not to abuse its rights. The Investor referred to the *Azinian* NAFTA decision⁸²⁹ and the writings of eminent scholars Bin Cheng⁸³⁰ and Sir Hersch Lauterpacht,⁸³¹ which reinforce the rule as a stand alone obligation under customary international law. Canada overlooks all this authority when it incorrectly claims that the prohibition against abuse of right is

⁸²⁷ Canada’s Counter-Memorial at para. 935.

⁸²⁸ Canada’s Counter-Memorial at para. 924.

⁸²⁹ *Azinian v. Mexico*, Award, November 1, 1999, 39 ILM 537 (2000) at para. 103, Investor’s Book of Authorities (Tab 40).

⁸³⁰ Bin Cheng, *General Principles of Law* at 123, Investor’s Book of Authorities (Tab 26): “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.”

⁸³¹ Lauterpacht, *The Function of Law in the International Community* (1933) at 289, Investor’s Book of Authorities (Tab 39).

merely an “overarching principle to be applied to the interpretation and application of a specific rule”.⁸³²

740. Canada also overlooks this authority when it claims the rule is merely confined to “malicious” misapplication of the law.⁸³³ Canada is presumably relying on the passage that the Investor quoted from the *Azinian* decision. However, in that decision, the tribunal qualified their description of a type of denial of justice with this adverb and said that this type of denial of justice “overlaps” with abuse of right.⁸³⁴ Nowhere did the tribunal suggest that only malicious misapplications of the law will rise to a breach of customary international law. NAFTA tribunals have affirmed that states do not need to demonstrate the sort of bad faith that malicious conduct entails to breach the customary international law standard.⁸³⁵

f. Full Protection and Security

741. In its Memorial, the Investor explained how the *CME* decision confirmed that the customary international law obligation to provide full protection and security extends to intangible property. The *CME* tribunal went on to say that under this obligation, “[t]he host state is obligated to 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

⁸³² Canada’s Counter-Memorial at para. 924.

⁸³³ Canada’s Counter-Memorial at para. 925.

⁸³⁴ The *Azinian* tribunal said at para. 103: “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”, Investor’s Book of Authorities (Tab 40).

⁸³⁵ *Mondev International Ltd. v. United States of America*, Award, October 11, 2002, 42 ILM 85 (2003) at 116, Investor’s Book of Authorities (Tab 37) “... a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.”

investor's investment withdrawn or devolved."⁸³⁶ Canada does not challenge the authority of the principle reflected in this passage.

g. Failure to Provide the Customary International Law Standard Is a Breach of International Law

742. Articles 1 and 2 of the *ILC Articles on State Responsibility* confirm that every internationally wrongful act of a state entails the international responsibility of that State.⁸³⁷ Canada repeatedly states in its Counter-Memorial that through Article 1105 it agreed to provide the customary international law standard of treatment.⁸³⁸ Canada has, therefore, breached that Article by failing to treat the Investor in accordance with the standard.

743. There is no foundation to Canada's claim that to prove a breach of Article 1105 the Investor must not only prove Canada failed to provide the international law standard but must also show that Canada's conduct "result[ed] in an outright and unjustified repudiation of [the Investor's] right in a manner that is grossly unfair."⁸³⁹ Canada fails to explain how its theory is consistent with the *ILC Articles* and provides no support in the

⁸³⁶ *CME v. Czech Republic* at para. 613, Investor's Book of Authorities (Tab 34), cited in the Investor's Memorial at para. 627.

⁸³⁷ Article 1 says:

Every internationally wrongful act of a State entails the international responsibility of that State.

Article 2 says:

There is an internationally wrongful act of a State when conduct consisting of an act or omission:

- (a) is attributable to the State under international law; and
- (b) constitutes a breach of an international obligation of the State.

⁸³⁸ Canada's Counter-Memorial at paras. 898, 904, 943, 945, 1012, 1013 and 1014.

⁸³⁹ Canada's Counter-Memorial at para. 991.

text of the NAFTA, its Statement of Implementation, academic writings or tribunal decisions.⁸⁴⁰

C. Canada Breached Article 1105

1. Canada Breached Article 1105 by Retaliating Against Fritz Starber

744. Canada breached Article 1105 through Canada Post's reliance on this arbitration to refuse the bid of Fritz Starber, UPS' subsidiary. Canada Post's decision was based on prejudice, rather than reason, and was, therefore, arbitrary. Canada Post discriminated against Fritz Starber and failed to meet its legitimate expectations that Canada would act for commercial, rather than political reasons. Fritz Starber's legitimate expectations were reinforced by Canada Post's assurances that Fritz Starber's bid was competitive and merited consideration by Canada Post senior officials.

745. Canada says the rejection of Fritz Starber's bid was a commercial decision because there was a more favorable arrangement with the United States Postal Service (USPS).⁸⁴¹

⁸⁴⁰ The few quotes from NAFTA decisions upon which Canada relies do not provide that support. Canada says at para. 988 that "[t]he words used by the Tribunals to capture the concept of the minimum standard include, treatment that is 'grossly unfair', 'wholly arbitrary', 'idiosyncratic or aberrant', a 'clear and malicious application of the law' or a 'pretence of form', 'clearly improper and discreditable' or 'outright and unjustified repudiation'." Canada then discards all but two of these phrase at para. 991 to leap to the conclusion that a state's actions *only* breach Article 1105 when "they result in an outright an unjustified repudiation of an investor's right in a manner that is grossly unfair."

Canada is also incorrect that the tribunals used these words "to capture the concept of the minimum standard." For example, the *GAMI* tribunal used the phrase "outright and unjustified repudiation" within the discrete context of maladministration. The tribunal also went on to say "[t]here may be situations where even lesser failures would suffice to trigger Article 1105" at para. 103, Investor's Book of Authorities (Tab 100).

Finally, Canada ignores many other words used by NAFTA tribunals to describe conduct amounting to a breach of Article 1105, including plain "arbitrary" (*ADF* at para. 188, Investor's Book of Authorities (Tab 95), *Waste Management II* at para. 98, Canada's Book of Authorities (Tab 71)), "unjust" "discriminatory" or "prejudicial" (*Waste Management II* at para. 98).

⁸⁴¹ Canada's Counter-Memorial at paras. 286-291.

Canada has relied on the Affidavits of Don Lavictoire and Barry Craven,⁸⁴² but has been unable to provide any additional and contemporaneous evidence that would support their Affidavits, despite the Investor's requests.⁸⁴³

746. Specifically, Canada offers no documentary evidence that the USPS offered more competitive rates to Canada Post than Fritz Starber. It does admit, however, that Fritz Starber's prices were more attractive than those of the other freight forwarders contacted by Canada Post.⁸⁴⁴
747. Moreover, Canada has failed to explain prior inconsistent statements of Mr. Lavictoire. On December 5, 2001, Mr. Lavictoire clearly expressed Canada Post's improper motives at the time of the bid as follows:

I am not sure to switch [*sic*] gentleman I spoke to, but I mentioned to him that at the time I was not aware that you were affiliated with UPS, a company in legal matters with Canada Post, and that I could not entertain your bid at this time.⁸⁴⁵

748. At the time, Mr. Lavictoire considered Fritz Starber to be engaged in a "bid" that would not be able to proceed given the company's affiliation with UPS. Now, in his June 2005 statement, Mr. Lavictoire states that the December 5, 2001 e-mail referred to unrelated matters regarding a "marine tender".⁸⁴⁶ Canada's own evidence to this effect however shows Mr. Lavictoire was responding to an inquiry regarding an "air-freight bid".⁸⁴⁷

⁸⁴² Canada's Book of Expert Reports and Affidavits (Tabs 24 and 8).

⁸⁴³ Investor's Document Request number 236 stating "A copy of all correspondence, emails, and internal memoranda, and handwritten notes from April 12, 2001 to December 5, 2001 between any employees of Canada Post regarding: ...(4)the reasons the Fritz Starber bid was to be rejected by Canada Post", Investor's Schedule of Documents (Tab 294).

⁸⁴⁴ Canada's Counter-Memorial at para. 289.

⁸⁴⁵ E-mail from D. Lavictoire, Investor's Schedule of Documents (Tab U230).

⁸⁴⁶ Affidavit of Donald Lavictoire at para. 10, Canada's Book of Expert Reports and Affidavits (Tab 24).

⁸⁴⁷ Affidavit of Donald Lavictoire, Exhibit B.

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749. Canada's evidence also discloses that Canada Post's decision to deny Fritz Starber the contract violated its own internal corporate policies. If Canada Post had merely been following an accepted policy of not doing business with parties adverse in interest in litigation, then its decision may have been excusable. However, Canada Post's own evidence is just the opposite.⁸⁴⁸ A decision that departs from Canada Post's own stated policies is the essence of arbitrariness.
750. Canada's breach of Article 1105 is not affected by the Canadian International Trade tribunal's (CITT) decision, on which it relies. That tribunal merely found it had no jurisdiction because there was no executed contract. The tribunal did not decide if Canada Post's refusal of Fritz Starber's bid in retaliation against this NAFTA claim was a breach of Article 1105.
751. There is, therefore, no reliable foundation to Canada's claim that Canada Post's refusal of Fritz Starber's bid was commercially based. Canada Post's refusal was a retaliation against this NAFTA claim and is a breach of Article 1105. Even if Canada's decision was, somehow, commercially motivated, Canada did not convey these reasons to Fritz Starber and, therefore, has failed to protect the Investor's legitimate expectation that Canada will act in a transparent manner.

**2. Canada Breached NAFTA Article 1105 Through Its Prejudicial
Customs System**

752. Canada failed to act consistently with its obligations under NAFTA Article 1105 through its systematic and persistent failure to enforce its customs law in good faith. Canada systematically and persistently:

⁸⁴⁸ Affidavit of Barry Craven at para. 9, Canada's Brief of Affidavits and Expert Reports (Tab 8).

a. failed to require Canada Post to submit postal imports containing goods to Customs, in accordance with the terms of Canadian law and Canada Post's agreement with Customs.⁸⁴⁹ Canada Post has not only failed to fulfil its NAFTA obligation⁸⁵⁰ but it was aware that it was not fulfilling its obligation. Canada has failed to take actions to change Canada Post's practice to ensure that Canada Post complied with that obligation. -----

b. failed to levy fines, penalties or interest on Canada Post for Canada Post's failure to submit goods to customs, in accordance with Canadian law and Canada Post's agreements. Correspondence from Customs demonstrates that Canada failed to levy fines, penalties or interest despite being aware that Canada Post was failing to fulfil its obligations under the *Canada Post Act* to provide postal imports with goods to Customs for inspection.⁸⁵²

⁸⁴⁹ See Part Two, Chapter VII, Section D of the Investor's Reply and Part Two, Chapter V of the Investor's Memorial. See also: *Canada Post Corporation Act*, s.42(1), Investors Schedule of Documents (Tab U218); *Customs Act*, s.12, 13, Investor's Schedule of Documents (Tab U383); *Postal Imports Agreement*, s.4.1, Investor's Schedule of Documents (Tab U66); Paragraph 18 of Customs Memorandum D5-1-1, attached as Appendix H to the Affidavit of Brian Jones, Canada's Brief of Affidavits and Expert Reports and Investor's Schedule of Documents (Tab U253).

⁸⁵⁰ See Part Two, Chapter VII, Section D of the Investor's Reply and Part Two, Chapter V of the Investor's Memorial.

⁸⁵¹ E-mail dated April 7, 2000 re: 'Customs Issues' from Louis Young to Malcolm Tait et al of Canada Customs, Investor's Schedule of Documents (Tab U455). See also Part Two, Chapter VII, Section D of the Investor's Reply and Part Two, Chapter V of the Investor's Memorial.

⁸⁵² See E-mail dated September 18, 2000 from Canada Customs' Brian Gaudette to Richard Bouchard *expressing concerns from Customs head office that Montreal is allowing packages to enter Canada without Customs inspection*, Investor's Schedule of Documents (Tab U455). See also Part Two, Chapter VII, Section D of the

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753. Canada's actions result in a competitive advantage to Canada Post over UPS Canada, which is liable for fines for any failure to submit imported goods to customs and which actually pays those fines imposed upon it. Canada's systematic and persistent failure to enforce its customs law in good faith breaches NAFTA Article 1105 because Canada:
- a. fails to meet the Investor's legitimate expectation that Canada comply with its own laws in good faith;
 - b. fails to provide full protection and security. Applying the words of the *CME* Tribunal, Canada's actions fail to "ensure... by actions of its administrative bodies...[that] the agreed and approved security and protection of the foreign investor's investment [is] withdrawn or devolved;"⁸⁵³
 - c. selectively enforces its laws through prejudice, rather than reason or fact (to apply the language of the *Lauder* tribunal)⁸⁵⁴ and its actions are, therefore, arbitrary and discriminatory; and
 - d. abuses its right to enforce its law.

3. Canada Breached Article 1105 by Denying Canada Post's Workers' Collective Bargaining Rights

754. Canada's actions breach its customary international law obligation to observe its treaty obligations (*pacta sunt servanda*) because Canada committed to provide collective

Investor's Reply and Part Two, Chapter V of the Investor's Memorial.

⁸⁵³ *CME v. Czech Republic* at para. 613, Investor's Book of Authorities (Tab 34), cited in the Investor's Memorial at para. 627.

⁸⁵⁴ *Lauder v. Czech Republic* at para. 232, Investor's Book of Authorities (Tab 43).

bargaining rights to all workers in *ILO Convention No. 87*.⁸⁵⁵ Canada's actions also breach its independent customary international law obligation to provide collective bargaining rights. Such rights are protected in the *Universal Declaration on Human Rights*, whose obligations are now part of customary international law,⁸⁵⁶ and are confirmed in the *International Covenant on Political and Civil Rights* and the *International Covenant on Economic, Social and Cultural Rights*.⁸⁵⁷

755. Canada's breach of Article 1105, by denying Canada Post's workers collective bargaining rights, enables Canada Post to pay lower wages. Canada Post consequently unfairly reduced its costs by lowering core labour standards to give it an unfair competitive advantage over UPS Canada.
756. Contrary to Canada's claim,⁸⁵⁸ the NAFTA Parties did not express their intent to withdraw labour matters entirely from the NAFTA through the North American Agreement on Labour Cooperation. That Agreement does not even address the same obligations as those provided for in the NAFTA. Furthermore, the Investor does have standing to claim for this breach of NAFTA Article 1105 because it has satisfied all the standing requirements in the NAFTA. There is nothing in the NAFTA which limits an investor's right to stand in the way that Canada suggests.⁸⁵⁹

⁸⁵⁵ See Investor's Memorial at paras. 649 - 654. See the Investor's Memorial at paras. 339-346 for a description of the manner in which Canada denies Canada Post's workers collective bargaining rights.

⁸⁵⁶ Investor's Memorial at paras. 655 - 660.

⁸⁵⁷ Investor's Memorial at paras. 661 - 668.

⁸⁵⁸ Canada's Counter-Memorial at para. 977.

⁸⁵⁹ Canada's Counter-Memorial at paras. 951-952 and 970.

IX. MOST FAVORED NATION TREATMENT

757. Canada incorrectly claims that the Investor's NAFTA Article 1103 claim is outside the Tribunal's jurisdiction.⁸⁶⁰ Contrary to Canada's claim, the Investor established each element of Article 1103 in its Memorial.⁸⁶¹
758. NAFTA Article 1103 requires the NAFTA Parties to accord to investors of another Party, and their investments, treatment no less favorable than it accords, in like circumstances, to investors of any other Party or non-Party, and their investments, with respect to the establishment, acquisition, expansion, management, conduct and sale or other disposition of investments.⁸⁶²
759. In its Memorial, the Investor explained that Canada has entered into 16 bilateral investment treaties since the NAFTA came into force where "international law" encompasses all sources of international law.⁸⁶³ The Investor explained that, in the event that this Tribunal determines that the FTC Note of Interpretation restricts the content of

⁸⁶⁰ Canada's Counter-Memorial at paras. 992-993.

⁸⁶¹ Investor's Memorial at paras. 672-718.

⁸⁶² 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 or 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.

⁸⁶³ See the BITs cited at footnote 695 of the Investor's Memorial and the discussion of those treaties at paras. 700 - 706. These treaties do not prefix "international law" with "customary." Furthermore, Canada cannot influence the interpretation of these treaties through a unilateral note on its website posted after the treaties came into force, as Canada incorrectly suggests at paras. 1011 - 1013.

the NAFTA Article 1105 standard to that provided by customary international law, then this Tribunal is required to apply the higher standard available to investments of investors of non-NAFTA Parties under one of these treaties under NAFTA Article 1103's Most Favored Nation obligation.

760. The *Pope & Talbot* tribunal confirmed this conclusion. That tribunal said in *obiter dicta* that NAFTA 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.⁸⁶⁴

While the *Pope & Talbot* tribunal's interpretation of NAFTA Article 1105 has been challenged, its interpretation of NAFTA Article 1103 has not.

761. 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 Most Favored Nation 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 investments. Specifically:
- a. Canada breaches Article 1103 through measures identified in the Investors' NAFTA Article 1105 claim that this Tribunal finds are inconsistent with Canada's obligations under international law but are not inconsistent with Canada's customary international law obligations;

⁸⁶⁴ *Pope & Talbot*, Damages Award, footnote 54 at para. 63, Investor's Book of Authorities (Tab 38).

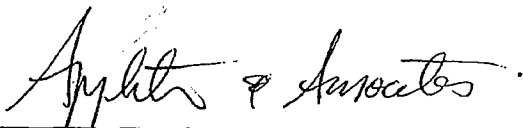
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- b. Canada provides less favorable treatment by adopting these measures against the Investor and its Investments with impunity, but promising not to provide them against the investors and their investments from parties to the specific 16 BITs.
 - c. The Investor and its Investments are in like circumstances with these BIT Party investors and their investments because all are offered protection under investment protection treaties;⁸⁶⁵
 - d. The better protection offered in Canada's BITs is not limited to specific investment activities. That better protection must, therefore, be accorded with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments; and
 - e. The specific harm to the Investor from Canada's breach of NAFTA Article 1103 depends on the specific international law obligation, that is also not a customary international law obligation, that the Tribunal finds Canada has breached. The Investor has described in Part Three, Chapter III, Section D and Part Three, Chapter VIII of this Reply, the specific harm resulting from each of Canada's measures.

⁸⁶⁵ Canada claims at para. 997 of its Counter-Memorial that "like circumstances" in NAFTA Article 1103 includes "all the relevant circumstances surrounding the treatment, including public policy considerations," but fails to explain what public policy considerations could justify treating the Investor and its Investments less favorably than it treats the investors and their investments from all the countries with which Canada has a BIT that came into force after January 1, 1994.

PART FOUR: RELIEF REQUESTED

762. 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, 1105 and 1103;
 - b. A Declaration that Canada has acted in a manner inconsistent with its NAFTA Article 1502 (3)(a) and 1503(2) obligations through Canada Post's actions that are inconsistent with Canada's Chapter 11 obligations and through Canada's failure to ensure Canada Post did not take these actions;
 - c. A Declaration that this arbitration claim should proceed forthwith to the Quantification of Damages Phase; and
 - d. 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



Appleton & Associates International Lawyers

Date: August 15, 2005

